Strategic Management

MBA Second Year
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School of Distance Education
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STRATEGIC MANAGEMENT

SYLLABUS

UNIT I

Corporate strategic planning - Mission - Vision of the firm - Development, maintenance and the role of leader - Hierarchal levels of planning - strategic planning process. Strategic management Practice in India, Family run corporates.

UNIT II

Environmental Analysis & Internal Analysis of Firm: General environment scanning, competitive & environmental analysis - to identify opportunities & threat - Assessing internal environment through functional approach and value chain - identifying critical success factors - to identify the strength & weakness - SWOT audit - core competence -Stakeholders' expectations, Scenario-planning - industry analysis.

UNIT III

Strategy Formulation: Generic strategies - Grand strategies - Strategies of leading Indian companies - The role of diversification -limit - means and forms. Strategic management for small organisations, non- profit organizations and large multi product and multiple market organisations.

UNIT IV

Tools of Strategy Planning and Evaluation: Competitive cost dynamics - experience curve-BCG approach - cash flow implication. IA -BS matrix - A.D Littles Life -cycle approach to strategic planning - Business portfolio balancing - Assessment of economic contribution of strategy - Strategic funds programming.

UNIT V

Strategy Implement & Control: Various approach to implementation of strategy - Matching organization structure with strategy - 7Smodel - Strategic control process - Du Pont's control model and other Quantitative and Qualitative tools - Balanced score card - M.Porter's approach for Globalization - Future of Strategic Management.

UNIT I

LESSON

1

CORPORATE STRATEGIC PLANNING

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1.0 AIMS AND OBJECTIVES

After studying this lesson, you will be able to:

- Understand corporate strategic planning
- Know about mission and vision of the firm
- Learn about development, maintenance and the role of leader
- Understand hierarchical levels of planning

1.1 INTRODUCTION

Strategic Management is necessary for organizations facing major strategic decisions that involve high task complexity, change, uncertainty, and inefficient markets. These characteristics are summarized below:

1. High complexity of the task means that there is a greater need for explicit plans to ensure that the various bits and pieces fit together.
2. Large changes create a need for Strategic Management because organizations are designed to deal primarily with repetitive situations. These changes could come from the environment, from competitors, or from the firm itself. For large changes, the standard bureaucratic responses would be less useful. Large changes call for planning rather than merely reacting.
3. Uncertainty can lead to a waste of resources and in today's environment of change, uncertainty is high for most large businesses. As uncertainty increases, the need for planning increases. Strategic Management can address "what if" questions so that the firm can develop ways to respond to these uncertainties.
4. Inefficient markets call for Strategic Management because the price system does not dictate the organization's actions. The organization has much flexibility in how it acts. An efficient market would inform stakeholders and would help to ensure that their needs are met, no matter what an individual company does. If they plan poorly, another company will replace them.

Strategic Management is most relevant when all four of these conditions hold, e.g., if a utility decided to build an atomic reactor. It has a complex task, large changes are involved, uncertainty is high as there is a resistance to generation of nuclear power by a number of action groups, and the market is inefficient as subsidies are paid by the government on the cost of generation and in addition the government bears the costs of disasters.

An investment in formal Strategic Management might be considered like an insurance policy against these risks: It might be needed. But in situations where the risk is small, the investment in strategic management may not be necessary.

In this lesson, we will first look at Strategy and explore the concept. We will also discuss how starting from 1960s, Business Strategy evolved with the different Schools of thought. In particular we will examine the Resource Based Theory, New Positioning Approach and Prahalad and Hamel's concept of Stretch. Strategic Thinking is an approach to problem solving; we will relate it to the strategic management Process. We will also try to explain, discuss and explore different aspects of Strategic Planning and Strategic Management.

1.2 WHAT IS STRATEGY?

'Strategy', narrowly defined, means "the art of the general" (from the Greek StratAgos). The term first gained currency at the end of the 18th century, and had to do with stratagems by which a general sought to deceive an enemy, with plans the general made for a campaign, and with the way the general moved and disposed his forces in war.

Clausewitz (1780-1831), a Prussian, was the first great student of strategy and the father of modern study of strategy. The contributions of Clausewitz to strategic thought are many and diverse. He was the first to explain the role of war both as an instrument of social development and as a political act. Clausewitz's definition of strategy was "the art of the employment of battles as a means to gain the object of war." He also was the first to focus on the fact that strategy of war was a means to enforce policy and not an end in itself.

The term ‘strategy’ has expanded far beyond its original military meaning. Strategy is now used in all areas where the horizon is long term, there is a competition for the use of resources, and the objective is to realize some goals. With the evolving importance of strategy as a theoretical discipline, scholars have tried to identify the principles of strategy that have traditionally guided military strategists in war. These studies found, though there is no complete agreement on the number of principles, that most lists include the following:

- the objective
- the offensive
- co-operation (unity of command)
- mass (concentration)
- economy of force
- manoeuvre
- surprise
- security
- simplicity

Strategy is a set of key decisions made to meet objectives. It refers to a complex web of thoughts, ideas, insights, experiences, goals, expertise, memories, perceptions and expectations that provides general guidance for specific actions in pursuit of particular ends. Nations have, in the management of their national policies, found it necessary to evolve strategies that adjust and correlate political, economic, technological, and psychological factors, along with military elements. Be it management of national policies, international relations, or even of a game on the playfield, it provides us with the preferred path that we should take for the journey that we actually make.

Every firm competing in an industry has a strategy, because strategy refers to how a given objective will be achieved. 'Strategy' defines what it is we want to achieve and charts our course in the marketplace; it is the basis for the establishment of a business firm; and it is a basic requirement for a firm to survive and to sustain itself in today's changing environment.

An organization cannot operate effectively without a strategy. The strategy may have been developed explicitly through a planning process or it may have evolved implicitly through the operations of the various functional departments - but in order to function effectively in the marketplace, the organization must have answers to these questions:

- What business are we in? What products and services will we offer?
- To whom?
- At what prices? On what terms?
- Who are the competitors?
- On what basis will we compete?

If the organization asks any of these key questions and it has the answers, then there is a strategy in place.

The definitions given in Box 1.1 provide an insight into the diversity of thinking and changing perceptions on the nature of strategy.

Box 1.1: Definitions of Strategy

Chandler: Strategy is the determinator of the basic long-term goals of an enterprise, and the adoption of courses of action and the allocation of resources necessary for carrying out these goals; 1962

Learned: Strategy is the pattern of objectives, purposes or goals and major policies or plans for achieving these goals, stated in such a way as to define what business the company is in or is to be in and the kind of business it is or is to be; 1969

Andrews: Corporate strategy is the pattern of decisions in a company that determines and reveals its objectives, purposes, or goals, produces the principal policies and plans for achieving those goals, and defines the range of business the company is to pursue, the kind of economic and human organization it intends to be, and the nature of economic and non-economic contribution it intends to make to its shareholders, customers and communities; 1971

Mintzberg: Strategy is a mediating force between the organization and its environment: consistent patterns in streams of organizational decisions to deal with the environment; 1979

Quinn: A strategy is the pattern or plan that integrates an organization's major goals, policies, and action sequences into a cohesive whole. A well-formulated strategy helps to marshal and allocate an organization's resources into a unique and viable posture based upon its relative internal competencies and shortcomings, anticipated changes in the environment, and contingent moves by intelligent opponents; 1980

Contd....

Wernerfelt: Strategy is to create a situation where a resource position makes it more difficult for others to catch up; 1984

Grant: Strategy is the overall plan for deploying resources to establish a favorable position; it is less a predetermined program of investment plans and more a positioning of the firm to permit it to take advantage of opportunities as they arise; 1990

Normann: Strategy is the art of creating value; 1993

Prahalad: Strategy is more than just fit and allocation of resources. It is stretch and leveraging of resources; 1993

Teece: The essence of strategy is the search for rents. Strategic Management is – or can and should be – the study of rent-seeking by the enterprise; 1994

Mahoney: Strategy is a search for balance; 1994

Porter: Strategy is about being different. It means deliberately choosing a different set of activities to deliver a unique mix of value; 1996

1.2.1 Strategy and Tactics

Strategy and tactics are both concerned with formulating and then carrying out courses of action intended to attain particular objectives. The language of strategic manoeuvre is also largely the language of tactics. 'Tactics' follow and facilitate strategy and is defined as techniques or a science of dispensing and manoeuvering forces to accomplish a limited objective or an immediate end.

Strategy and tactics are distinct in terms of their dimensions. Strategy, for the most part, is concerned with deploying resources, and tactics is concerned with employing them. Strategy deals with wide spaces, long periods of time, and large movements of forces; tactics deal with the opposite. Strategy is the prelude to action, and tactics the action itself. Table 1.1 attempts to summarize the difference between the two, as there often is confusion about the distinction between strategy and tactics.

Despite distinctions in theory, strategy and tactics cannot always be separated in practice. Strategy gives tactics its mission and resources and seeks to reap the results. Tactics, then become an important conditioning factor of strategy, and as the tactics change, so does strategy. Strategy triggers a movement; a movement begets an action; and the action results in new movement. This inter-connectedness between the movement and the action often merges one into the other.

Table 1.1: Strategy versus Tactics

Aspects	Strategy	Tactics
Scale of the Objective	Grand	Limited
Scope of the Action	Broad and General	Narrowly Focused
Guidance Provided	General and Ongoing	Specific and Situational
Degree of Flexibility	Adaptable, but not hastily changed	Fluid, quick to adjust and adapt in minor or major ways
Timing in Relation to Action	Before Action	During Action
Focus of Resource Utilization	Deployment	Employment

There is a unique relationship between strategy and tactics. Every tactic can be a significant strategic opportunity. It is necessary to understand the difference between strategy and tactics, as this can be a strategic edge to the organization. It gives us the ability to have the ultimate position of the organization and the particular strategy in mind while executing any tactic. This competency can enhance the organization's effectiveness without any investment.

For example, assume the strategic position of the company is: "To be the best known, most trusted and respected company in the target market." If that is our overall goal, then we have to ask what our tactics do to achieve this important goal. If our salesperson is simply trying to make a sale, then he is operating only tactically.

If he can think strategically, he must ask "What should I do to sell the product and make the customer believe my company is the best in the market?" If he can accomplish this objective in his sale, he is improving the effectiveness of the organization at no cost to the organization. If not, he is just chasing the sale of the day, and not building anything sustainable for the organization. This is difficult as most business executives, even from the biggest firms in the world, are so tactical that they often find it difficult to differentiate between strategy and tactics.

Fred Nickols, a prolific writer on strategy in his article 'Strategy is Execution' has tried to capture the essence of what strategy is. An excerpt from his article is presented in Box 1.2.

Box 1.2: Strategy Is ...

Strategy is many things: plan, pattern, position, ploy and perspective. As plan, strategy relates how we intend realizing our goals. As pattern, strategy is the "rhyme and reason" that emerges in the course of making the endless decisions that reconcile the reality we encounter with the aims we hold dear. As position, strategy is the stance we take: take the high ground, be the low-cost provider, compete on the basis of value, price to what the market will bear, match or beat the price offered by any competitor, let no threat go unmet. As ploy, strategy is a ruse; it relies on secrecy and deception: "Let not thy left hand know what thy right hand doeth." As perspective, strategy is part vantage point and part the view from that vantage point, particularly the way this view shapes and guides decisions and actions.

Strategy is ubiquitous. It can be found at the highest levels of corporate, governmental, military and organizational endeavor and in small, medium and large units. It is used to define the basis for competition and it can give rise to collaboration and cooperation. It can even be found guiding and explaining individual initiative. It is everywhere.

Strategy is an abstraction, a construct. It has no concrete form or substance. At best it can be communicated in words and diagrams. But, just as "the map is not the territory," the words and diagrams used to communicate strategy are not the strategy they convey.

Strategy is the art of the general. It is broad, long range and far reaching. In part, it is about the preparations made before battle, before the enemy is engaged. But it is also about avoiding battle and making combat unnecessary. It is as much about destroying the enemy's will to fight as it is about destroying the enemy in a fight. If that sounds too militaristic, consider the business parallel: a firm that raises such formidable barriers to entry that would-be competitors throw up their hands and walk away. In short, destroying the will to compete differs little from destroying the will to fight.

Strategy is a general plan of attack, an approach to a problem, the first step in linking the means or resources at our disposal with the ends or results we hold in view. Tactics, of course, is the second step. Strategy is concerned with deploying resources and tactics is concerned with employing them. Without some goal, some end in view, there can be no strategy and tactics will consist of aimless flailing about-action for the sake of action. Strategy, then, is relative, which is to say that it exists only in relation to some goal, end or objective. If someone asks us, "What is your strategy?" be sure to reply, "In relation to what?"

Strategy is direction and destination. At one and the same time strategy says, "We are headed there - by this path." Yet, as noted earlier, it is also ruse and deception; that is, our strategy takes us down a path with many branches and only we know our destination and the choices we will make as we are confronted with them. In short, strategy is a way of confounding our enemies or, in less warlike terms, our competitors.

Contd....

Strategy is a set of decisions made. What business are we in? What products and services will we offer? To whom? At what prices? On what terms? Against which competitors? On what basis will we compete?

Extracted from: Strategy is Execution by Fred Nickols, © Fred Nickols 2003

1.2.2 Characteristics of Strategy

What are the characteristics of strategy and what constitutes decisions that are 'strategic?' How do we recognize 'strategic decisions?' By going through the case of Dorsey Corporation, which has been given as an illustration in Box 1.3, we will try to understand the characteristics of strategy and identify the dimensions of decisions that are strategic.

Box 1.3: Case - Dorsey Corporation

Dorsey Corporation was a medium sized company. The Chairman of the Board, John T. Pollock, and President of Sewell Plastics, Charles Sewell, were the principal officers of the company. In 1975, Dorsey Corporation consisted of three divisions - Chattanooga Glass, Sewell Plastics and Dorsey Trailers. Chattanooga Glass made green Coca-Cola bottles for its Southern region; Sewell Plastics made plastic containers and Dorsey Trailers produced cargo trailers for bulk transportation. Chattanooga Glass accounted for 60 percent of total sales and dominated Dorsey's business.

Du Pont had invented a new technology in plastics, called PET (polyethylene terephthalate). In an attempt to find applications for this new material, Du Pont found the beverage market had good potential. They made a 2-litre container out of PET and submitted it to the FDA for approval. In 1977, Du Pont received FDA approval to use PET bottles as beverage containers. They worked with a machine tool company, Cincinnati Milacron, who built a line to mass-produce the PET bottle.

In 1977, most glass companies had been ignoring the potential of new plastic technology in bottles. Dorsey recognized that a plastic bottle made of PET was not only lighter than glass bottles but could hold carbonated beverages as well as glass. This would result in lower freight costs and less breakage. Also, glass manufacturing had come under the purview of environmentalists and required large investments to meet the new emerging pollution standards.

Charles Sewell saw this as a unique opportunity and immediately took the board's approval and invested $ 4 million in new plant and machinery. Sewell knew he was competing against giant companies like Owen-Illinois, Continental, Amoco, etc. He saw the introduction of PET beverage bottles as an opportunity for a smaller company with older technology - yet receptive to technological change, to challenge his competition.

He invested further in plastic bottles. He not only used PET containers for beverages; he also introduced them for milk and chemicals. By 1982, Sewell Plastics was the market leader in beverage bottles and had a sales volume of nearly $ 800 million.

The PET bottle innovation by Dorsey made obsolete both the product and production process of glass beverage bottles for larger sized containers.

Dorsey Corporation took a decision to adopt the PET bottle innovation. The innovation had major impacts on the product, process, organization and competitive standing of Dorsey - transforming a small company to a market leader.

This was a strategic decision. Let us examine the characteristics of ‘strategy’ on the basis of the experience of Dorsey Corporation. The decisions are expected to be strategic if the decisions incorporate one or more of the elements given below:

- The decisions are concerned with or effect the long term direction of an organization.

  Dorsey Corporation was basically dominated by Chatanooga Glass that accounted for 60 per cent of its revenues. By considering the opportunity afforded by PET

technology, the whole thrust of its strategy had to move from its traditional business. The resource and managerial commitments were such that it would be difficult to reverse the decision.

- Strategic decisions are normally about trying to achieve some advantage for the organization.

  Dorsey Corporation became successful because it could provide an advantage to the customers, in providing cheaper bottles, an advantage to the distributors and transporters in that the losses due to breakage, etc., were minimized. Similarly, strategic advantage can be thought of as providing higher quality, value for money, better designs, etc. This type of strategic decision develops out of a 'positioning strategy.' The idea is to give the organization an advantage with the consumer or in relation to other suppliers.

- The decision is likely to be concerned with the scope of an organization's activities and may involve major changes in the business of the organization, such as the products or services it offers.

  Dorsey Corporation had defined its scope in terms of the businesses it was in. It was in the business of manufacturing glass bottles, equipment for moving goods for bulk transportation and manufacture of plastic containers. Its decision changed the boundaries of its business in terms of the type of product and the manufacturing processes that it used.

  The scope of activities is fundamental to strategic decisions because it impacts the perceptions of management on the boundaries within which they operate.

- The decisions can be seen as a matching of the activities of an organization to the environment in which it operates.

  Glass manufacturing had come under the purview of environmentalists and Dorsey Corporation required large investments to meet the new emerging pollution standards. Dorsey Corporation knew that remaining in the glass business meant that they would have to put in a large investment without any increase in their revenues. The investment would be required just to qualify them to remain in the same business.

  The Corporation, therefore, decided that as they were already manufacturing glass bottles for Coca-Cola, for the southern region, they would continue to use their existing distribution network to deliver a substitutable product and yet meet the changing legal environment, due to the emerging pollution standards.

- The decision has major financial or other resource implications – for example, on staffing or equipment.

  In 1977, 4 million dollars was a lot of money. The strategic decision to use the PET bottle innovation, committed them to major financial and other resource implications. They had to re-train their workers and technical manpower as the processes of glass-making and manufacture of PET bottles were distinctly dissimilar.

  Strategies need to be considered not only in terms of the extent to which the existing resource capabilities of the organization are suited to the opportunities, but also in terms of the extent to which the existing resources can be controlled or modified to meet the opportunity. Alternatively, these resources can be obtained to develop a strategy for the future.

- The decision will involve building on or stretching an organization's resources and competencies. It will result in a significant amount of change in the organization or will affect the whole organization or a large part of it.

An innovation generally requires building of new competencies or stretching existing competencies within the organization. It also requires building of new physical, managerial and technological resources in the organization. When Dorsey Corporation took the strategic decision, the management was aware of the implications of the decision.

- The decision will have a major impact outside the organization – for example, on customers or other bodies.

  Dorsey's decision had a major impact on the developments of the beverage market. Du Pont became a major player. Customers also had to decide whether or not they would use PET bottles in place of glass bottles. Dorsey Corporation's decision not only impacted the beverage market, it also permitted Dorsey to introduce them for milk and chemicals, further extending the impact of the innovation.

- The decision entails significant risks to the business.

  Dorsey Corporation took a significant risk in entering a market where the consumer had the final choice in accepting the product. A similar concept, in the case of the beer industry, of bottling beer in plastic containers was not accepted by consumers. It resulted in significant losses to the companies that had invested in the new technology. The risk that Dorsey Corporation took paid off - a small company emerged as the market leader.

- Strategic decisions are likely to affect operational decisions.

  For example, Dorsey Corporation disposed of its trailer manufacturing unit and closed down the glass manufacturing unit. The innovation required a large number of other operational decisions, e.g., reduction of staff in a number of areas, recruitment of new staff, re-training of its work force, etc.

- The decision is related to other important decision areas, and raises issues of complexity and 'cross-cutting' interactions.

  The adoption of the PET innovation, transformed Dorsey Corporation. It grew into the market leader for PET bottles. The corporation sold off its trailer manufacturing unit, closed down the glass manufacturing unit, and extended the market for its bottles from the south of U.S.A. to the entire country. The outcome created complex issues, cross-cutting the existing activities of Dorsey.

- The strategy of an organization will be affected by the values and expectations of persons with power in and around the organization.

  Charles Sewell saw this as a unique opportunity and took the board's approval but the Chairman of the Board was John T. Pollock. The success of the innovation in the marketplace changed the organization. The organization got more influenced by the values and thoughts of Charles Sewell. The power within the organization gradually moved from John Pollock to Charles Sewell.

Strategic decisions demand an integrated approach to the management of the organization. Unlike functional problems, there is no one area of expertise, or one perspective that can define or resolve the decision making. The management has to cut across functional and operational boundaries to make strategic decisions. Very often, there is a conflict of interest and perhaps priorities, between management involved in different functional or operational areas.

Strategic decisions may also involve major changes in organization as well as in relation with the task environment, as was the case with Dorsey. These are difficult decisions,

both in terms of planning as well as in implementation. Especially so, as most 'going businesses' develop their own style of operating, which is not necessarily in line with their future strategy. Therefore, strategic decisions may require major changes including a change in the operational style of the organization.

1.2.3 Strategic Thinking

As 'change' becomes increasingly frequent, it makes it more and more difficult to define a strategic direction for an organization. Because the future is progressively uncertain and does not follow any predictable path, increasing competition, forces of globalization, the regulatory environment, customer choices, innovations and technological changes make it essential to continuously evaluate and update strategies.

Corporations in the 21st century have to look for a more flexible and dynamic system to meet the demands of the changing external environment. Strategic thinking is a process of developing or examining the assumptions about the future upon which the organization's mission, goals, and strategy are based, to evaluate whether they still reflect the realities the organization faces.

Strategic thinking looks at the vision for the organization and then works backwards by focusing on how the business will be able to reach this vision. In doing so, it improves the ability of the organization to make its business vision a reality.

'Vision' is a long term perspective of what is the final destination of the organization. Vision is what keeps the organization moving forward. Vision is the motivator in an organization. It needs to be meaningful with a long term perspective so that it can motivate people even when the organization is facing discouraging odds.

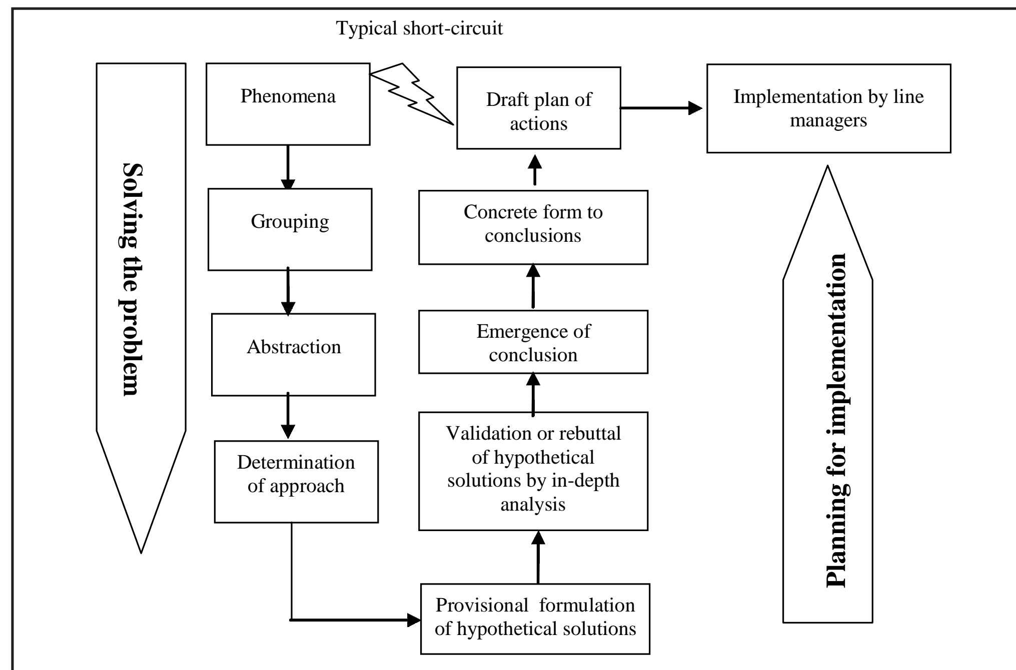

Figure 1.1: Stages of Strategic Thinking

These are times of change and paradigm shift, where management no longer has the luxury of resting upon past successes or ways of doing business. The future is unknown and the world is continually changing, all business plans and strategies eventually become obsolete and the assumptions on which they are based must be re-examined and updated. Therefore, it is not surprising that strategic thinking has become a critical requirement of the business process and is a necessary requirement for the modern organization.

In strategic thinking, we first seek a clear understanding of the particular character of each element of a situation. Then we make the fullest possible use our brainpower to restructure the elements in the most advantageous way. Phenomena and events in the real world do not always fit a linear model. Hence the most reliable means to analyze a situation is to break it up into its constituent parts and reassemble the constituent parts in the desired pattern. This is not a step-by-step methodology such as systems analysis. Rather, it uses the ultimate nonlinear thinking tool, the human brain. True strategic thinking thus contrasts sharply with the conventional mechanical systems' approach based on linear thinking. However, it reaches its conclusions with a real breakdown or analysis.

Key Elements: Strategic thinking requires a definition of the problem. We need to itemize the respects in which the organization requires to change to have a competitive advantage. Identify the phenomena that share a common denominator. Combine them into groups. Having done this, look once again at each group as a unit and ask, 'What crucial issue does each unit pose? ' The source of the problem must be understood before any real solution can be found, and the process of abstraction should bring the crucial issues to light without the risk of overlooking anything important.

Given in Figure 1.1 are the different stages of the strategic thinking process. The first stage in strategic thinking is to identify the critical issue in the situation. In problem solving, it is vital at the start to formulate the question in a way that will provide a solution. For example, overtime has become chronic in a company, dragging down profitability. If we frame the question as: ‘What should be done to reduce overtime?’ many answers will suggest themselves:

- Work harder during the regular working hours
- Shorten the lunch period and coffee breaks
- Forbid long private telephone conversations

Such questioning is characteristic of organizations using techniques that involve the participation of all employees. Ideas are gathered, screened, and later incorporated in the improvement program. But this approach has an intrinsic limitation. The questions are not framed to point toward a solution; rather, they are directed toward finding remedies to symptoms.

We could frame the question in a more solution-oriented way: ‘Is this company's work force large enough to do all the work required?’

There can be only one of two answers: 'yes' or 'no'. To arrive at the answer 'yes', we have to compare with other companies in the same industry, find the historical trend of workload per employee, and the degree of automation and computerization and their economic effectiveness. On the other hand, after careful perusal of the sales record, profit per employee, ratio between direct and indirect labor, comparison with other companies, etc., if the answer should turn out to be 'no', this in itself would be tantamount to a solution of the original problem. The solution is an increase in personnel.

That is not the only way the question could have been formulated. We might have asked it this way: ‘Do the capabilities of the employees match the nature of the work?’

This formulation, like the previous one, is oriented toward finding a possible solution. Here too, a negative answer would imply a shortage of suitable personnel, which would in turn suggest that the solution is either in staff training or in recruiting capable staff. On the other hand, if the answer is 'yes', it indicates chronic overtime lies in the amount of the workload. Thus, not training but adding to the work force would then be the crucial factor in the solution.

If the right questions are asked in a solution-oriented manner, and if the proper analyses are carried out, the final answer is likely to be the same, even though it may have started from a differently phrased question and may have been arrived at by a different route. In either case, a question concerning the nature and amount of work brings the real issue into focus and makes it easy to arrive at a clear-cut verdict.

Solution-oriented questions can be formulated only if the critical issue is localized and grasped accurately. When problems are poorly defined, the creative mind does not work well. Isolating the crucial points of the problem and determining the critical issue is most important to the discovery of a solution.

No matter how difficult or unprecedented the problem, a breakthrough to the best possible solution can come only from a combination or rational analysis, based on the real nature of things, and imaginative reintegration of all the different items into a new pattern, using non-linear brainpower. This is always the most effective approach to devising strategies for dealing successfully with challenges and opportunities, in the market arena as on the battlefield.

There are four key requirements to strategic thinking:

- a definite purpose in mind
- an understanding of the firm's environment, particularly of the forces that affect or impede the fulfilment of that purpose, the environmental view; the marketplace view; the project view; and the measurement view
- the organization, the people, the organizational structure, and the resources necessary to make it all work
- creativity in developing effective responses to all the above forces.

1.2.4 Attributes of Strategic Thinking

Drucker defines strategic thinking as examining the "Theory of the Business". According to Drucker, in the dynamic conditions of change today, strategic thinking provides the insights to answer the questions, ‘What business are we in today?’ and ‘What business should we be in tomorrow?’

Strategic thinking is a creative, mind expanding process which visualizes the future environment and formulates strategy that will bring success. To succeed, the key participants involved in the process must be active, involved, connected, committed, alert, and stimulated. They have to create an environment of calculated chaos, which drives their thinking, enabling them to build reflection on action as an interactive process.

According to Jeanne Liedtka (1998), of The Batten Institute-the major attributes of strategic thinking are: "A systems or holistic view. Strategic thinking is built on the foundation of a systems perspective." It includes "a mental model of the complete end-to-end system of value creation … and an understanding of the interdependencies it contains." It involves looking at each part "not as a sum of its specific tasks, but as a contribution to a larger system that produces outcomes of value…"; “Strategic thinking is intent-driven. … it allows individuals within an organization to leverage their energy, to focus attention, to resist distraction, and to concentrate for as long as it takes to achieve a goal." ; “Strategic thinkers link past, present, and future. … The gap between today's reality and intent for the future … is critical."; “Strategic thinking … deals with hypothesis generating and testing as central activities… and avoids the analytic-intuitive dichotomy; … it is both creative and critical in nature.” As such, strategic thinking allows us to, "pose ever-improving hypotheses without forfeiting the ability to explore new ideas" and be "intelligently opportunistic."

“The dilemma involved in using a well-articulated strategy to channel organizational efforts effectively and efficiently must always be balanced against the risks of losing sight of alternative strategies better suited to a changing environment. … There must be room for intelligent opportunism that not only furthers intended strategy but that also leaves open the possibility of new strategies emerging."

Relevance of Strategic Thinking

Strategic thinking is aimed at putting us into the most favourable position to engage the opposition, and compelling the opposition to engage at a disadvantage. It evolves ways and means of developing capabilities in team work, problem solving, and critical thinking in the organization. It provides clarity of purpose, common understanding and a framework for detailed planning; it gives the organization a focus on the strategic developments it should be pursuing and a view of the future towards which it is moving.

The characteristics of strategic thinking can be summarized as:

- ***An ability to see the 'whole picture':*** looking across all parts of the organization and its business, and its relationships with others; understanding the connections between them, both now and in various possible futures
- ***Creativity:*** thinking outside existing boundaries and constraints; identifying and questioning the assumptions upon which the existing business organization and operations are based
- ***Scenario generation and evaluation:*** consideration of many possible futures for the organization, through formulation and responses to 'What if ?' questions
- ability to deal with ambiguity and uncertainty
- ***Identification of strategic issues:*** the strategy will be driven by our perception of the issues, and the strategic themes.

Strategic thinking finally leads the organization to gain insight into the driving forces behind the new competitive paradigm; systematically develop a sustainable competitive advantage based on its core competencies; create an infrastructure for the continuous review and redefinition of strategic direction to maximize results, while minimizing the time spent on this process; and recognize and capitalize on new developments and opportunities in the market.

1.2.5 Early Writings on Business Strategy

Some of the earliest academic writings about strategy were produced by eminent economists. John Commons in his 1934 book wrote about business firms' focus on strategic or limiting factors. Ronald Coase published a provocative article in 1937 that asked why firms exist - an article that continues to be relevant today, and it earned him a Nobel Prize. Joseph Schumpeter discussed the idea that business strategy encompassed much more than the price-setting contemplated in orthodox microeconomics in his 1942 book. A book published in 1959 by Edith Penrose explicitly related the growth of business firms to the resources under their control and the administrative framework used to coordinate their use.

In a classic 1960 article over a firm's "willingness to gamble" on its distinctive competence, titled "Marketing Myopia", Theodore Levitt focused on serving the customer. When companies fail, "it usually means that the product fails to adapt to the constantly changing patterns of consumer needs and tastes, to new and modified marketing institutions and practices, or to product developments in complementary industries." Another leading strategist, Igor Ansoff, defined the organization's "mission" or its commitment to exploit an existing need in the market as a whole. Ansoff suggested a model for defining business/ corporate strategy.

In the 1970s, diversification and technological changes increased the complexity of the strategic situations that many organizations faced, and they needed more sophisticated measures that could be used to evaluate and compare many different types of businesses. That created a demand for renewed thinking on strategy. The last three decades have seen an explosive growth in scholarship, and a deepening understanding of the part strategy plays in the 'organizations' competitive advantage, sustainability and growth.

While strategic management has its roots in business policy, the current field of strategic management is strongly theory based, with substantial empirical research that is eclectic in nature. Different schools of thought see strategy in a different perspective. For example, Mintzberg has identified the 5 Ps of strategy. Strategy could be: a plan, a pattern, a position, a ploy, or a perspective.

1. A plan, a "How do I get there?"
2. A pattern, as emerging out of actions consistent over time.
3. A position, that is, it reflects the decision of the firm to offer particular products or services in particular markets.
4. A ploy, a manoeuvre intended to outwit a competitor.
5. A perspective, that is, a vision and direction, a view of what the company or organization is to become.

What, then, is strategy? Management literature provides many different theories of 'strategy.' In their article, "Reflecting on the Strategy Process" in the Sloan Management Review, Mintzberg and Lampel identify ten different schools of Strategy formation. A brief discussion of these different schools of thought on strategy follows:

Design School

The origins of 'The Design School,' are associated with the writings of P. Selznick (1957), followed by Alfred Chandler in 1962. This school provided the first formal framework on business strategy. It considered strategy to be an essential fit between internal strengths and weaknesses and external threats and opportunities. Based on this analysis, management formulated clear and simple strategies for implementation.

Planning School

The Planning School grew in parallel with the Design School. H. Igor Ansoff's book appeared in 1965, as did the initial text by E.P. Learned, C.R. Christensen, Kenneth Andrews, and W.D. Guth. It reflected most of the design school's assumptions except that it introduced a formal discipline into the process. The thinking was that business strategy not only could, but it should come about through highly systemized forms of planning. It should define the contribution of the firm to the business, its contribution to the stakeholders, customers and community. The interdependence of purposes, policies and organized action is crucial to the strategy in order to give the firm a competitive advantage. The planning department was the key player in the process, and the process was called 'Strategic Planning.'

Positioning School

The third of the prescriptive schools, commonly labeled ‘Positioning’, was born out of the PIMS project in General Electric, started in 1960, followed by the writings of Hatten and Schendel, Henderson, and S. Schoeffler, R.D. Buzzell, and D.F. Heany, etc., in the mid-nineteen seventies. The positioning concept was revitalized by management thinkers like Michael Porter and became the dominant view of strategy formation in the 1980s.

The 'positioning school' treats strategy as an analytical process - it is a search to 'position' the firm so as to establish and maintain a difference with other firms in the marketplace. The view is that the heart of strategy is 'being different' so as to create a unique and valuable position for the firm. Strategy reduces to generic positions selected through formalized analysis of industry situations.

This literature has grown to include strategic groups, value chains, game theories, and other ideas.

Entrepreneurial School

Like the Design School, the Entrepreneurial School centered the process on the chief executive; but unlike the Design School and differently from the Planning School, it rooted that process in the mysteries of intuition. Strategy formulation was a visionary process with broad perspectives rather than precise designs, plans, or positions. This school focused on the process on particular contexts, e.g., start-up, niche, or private ownership, as well as "turnaround" by a forceful and creative leader. It ignored the interdependence of activities within an organization. In this view, the leader maintains close control over implementing his or her formulated vision. This approach to strategy formation may be considered within the perspective approach but the dominance of the leader creates a distinction with the other three prescriptive schools.

Cognitive School

The Cognitive School considers strategy formulation as a mental process. Strategies are developed in people's minds as frames, models, maps, concepts, or schemes. A newer branch of this school adopted a more subjective constructionist view of the strategy process: that cognition is used to construct strategies as creative interpretations, rather than simply to map reality. On the academic front, the origin of strategies has generated considerable interest. Research has grown steadily on cognitive biases in strategy making and on cognition as information processing, knowledge structure mapping, and concept attainment.

Learning School

The Learning School has its basis in Lindblom's early work on disjointed incrementalism. This was further reinforced by Quinn's logical incrementalism, Bower's and Burgelman's notions of venturing. Mintzberg et al's ideas about emergent strategy, and Weick's notion of retrospective sense-making further added to the theoretical basis of this school. This model differs from the earlier schools in its view that strategies are an emergent process. Strategists can be found throughout the organization, and therefore formulation and implementation of strategy are linked. Of all the descriptive schools, the Learning School has provided the greatest challenge to the theories of the dominant prescriptive schools.

Power School

A process of negotiation between groups in power is the basis of strategy making, according to the Power School. Two separate orientations exist. In the micro power view, the development of strategies within the organization are essentially political - a process that involves bargaining, persuasion, and confrontation among actors who share the power. In the other view-the macro power view, the organization is an entity that uses its power over others and among its partners in alliances, joint ventures, and other network relationships to negotiate "collective" strategies in its interest.

Cultural School

Interesting research developed in Sweden in the 1970s with culture as a central theme, stimulated by the early work of Rhenman and Normann, and Hedberg and Jonsson, and

others. The Cultural School gained impact when the concepts of Japanese management were fully realized in the 1980s. The Cultural School considers the formulation of strategy as a social process. The literature focuses particularly on the influence of culture in discouraging significant strategic change. Strategy formation remains a social process rooted in culture, permitting and encouraging change that is incremental. Power and culture are reverse images in a mirror - one focuses on self-interest and fragmentation, the other on common interest and integration.

Environmental School

Strategic management is a reactive process, if one defines the term as being concerned with how organizations use degrees of freedom to manoeuvre through their environments. The Environmental School focuses on the demands of environment. In this category, there are a number of theories; "contingency theory" that considers which responses are expected of organizations facing particular environmental conditions; "population ecology" writings that claim severe limits to strategic choice; and "Institutional theory," which is concerned with the institutional pressures faced by organizations, etc. This school is perhaps a hybrid of the Power and Cognitive schools.

Configuration School

This school sees the organization as a configuration - coherent clusters of characteristics and behaviors - each configuration, in effect, in its own place. For example, in manufacturing organizations, where work is repetitive, and under conditions of relative stability 'planning' prevails, while entrepreneurship can be found under more dynamic configurations of start-up and turnaround. Change is a process of transformation and takes place by the organization moving from one state to another.

In brief, some of the basic characteristics of each of the schools of strategy formation are given below:

- The Cognitive School is located in the mind of the strategist with the strategist located at the center.
- The Positioning School looks at established data on the external environment and strategy-making is a subsequent analytical process based on doing things differently.
- The Design School looks with a fixation to a strategic perspective of the organization, while the Planning School looks ahead at the strategic perspective, and on methods, procedures and rituals to program the strategies created.
- The Entrepreneurial School looks beyond, to a unique vision of the future, based on the vision of its leader.
- The Learning and Power Schools look inside themselves for strategy formulation. Learning looks into the grass roots, whereas power looks to places that organizations may not want to expose.
- The Cultural School looks inwards at the beliefs, stories, routines and rituals and symbols of the organization for strategy.
- Above the Cultural School, the Environmental School looks on at conformity and degrees of freedom to manoeuver through their environments.
- The Configuration School, looks at the process in contrast to the Cognitive School that tries to look inside the process.

Mintzberg and Lampel consider that these schools fall into two categories based on their approaches to strategy: (a) the prescriptive approach, and (b) the descriptive or emergent approach.

The prescriptive approach is adopted by the Design, Planning, Positioning, and (partly perhaps) Entrepreneurial Schools. These Schools are relatively well defined - they take the view that the core area of strategic management and planning (analysis, strategy development, and implementation) is a rational and linear process. Prescriptive strategy is one whose objective has been defined in advance and whose main elements have been developed before the strategy begins.

The descriptive or emergent approach is used by the Cultural, Learning, Cognitive, Power, and Environmental schools. These Schools argue that strategy emerges, adapting to human need, and evolves over time. They de-emphasise planning and stress on the importance of learning and adaptability allowing for more experimentation and innovation.

These Schools may have grown as relatively distinct and coherent, but they have also become inter-twined. There is a general blurring of the boundaries, and they stray into each other's space, over time increasingly borrowing from each other. This is seen in recent approaches to strategy formation that combine the concepts and thoughts of these different schools in interesting ways. For example, research on stakeholder analysis links the Planning and Positioning Schools, whereas the work of Porter and others on strategic manoeuvering connect the Positioning to the Power School. Chaos theory, as applied to strategic management, can be seen as a hybrid of the Learning and Environmental Schools.

"Resource-based theory," a dominant theory in business strategy today, is a hybrid of the Learning and Cultural Schools. These two new views differ in orientation, if not content- the former more prescriptive and practitioner-focused, the latter more descriptive and research-focused. Leadership is not a central concern to resource-based theorists. Instead they focus on competencies rooted in the essence or culture of an organization. Prahalad and Hamel, in the "dynamic capabilities" approach, have introduced notions of core competence, strategic intent, and stretch that are a hybrid of the Learning and Design Schools.

Table 1.2: Blending of the Strategy Formation Schools

Approach	Schools
Dynamic capabilities	Design, Learning
Resource-based theory	Cultural, Learning
Soft techniques (e.g., scenario analysis and stakeholder analysis)	Planning, Learning or Power
Constructionism	Cognitive, Cultural
Chaos and evolutionary theory	Learning, Environmental
Institutional theory	Environmental, Power or Cognitive
Intrapreneurship (venturing)	Environmental, Entrepreneurial
Revolutionary change	Configuration, Entrepreneurial
Negotiated strategy	Power, Positioning
Strategic maneuvering	Positioning, Power

Considering the diasporas of business organizations, the attributes of the different schools have relevance in different types of organizations and at different times. The attributes of the Entrepreneurial School are important during start-up or when there is the need for a dramatic turnaround; the attributes of the Learning School are relevant under dynamic conditions when prediction is impracticable.

Sometimes the process of strategy formulation has to be more individually cognitive than socially interactive e.g. in small businesses. Some strategies need to be more rationally

deliberate, especially in mature mass-production, industries and government. The environment can sometimes be highly demanding, yet at other times entrepreneurial leaders are able to maneuver through it with ease. As long as strategic management is applied to highly dissimilar entities and the theoretical base is empirical, it will remain eclectic in nature.

1.3 PHASES IN THE DEVELOPMENT OF STRATEGIC MANAGEMENT

Strategic Management is a development of the concepts embodied in Strategic Planning. Strategic Planning in an organization appears to evolve through four sequential phases according to Gluck, Kaufman, and Walleck, which starts with the annual budgeting process. The four phases of evolution are shown in Figure 1.2.

1.3.1 Phase I - Annual Budgeting

Companies in Phase I often have sound business strategies, but the business strategy is reflected in its budgeting procedure. The annual budgeting process reduces the functioning of the organization to a financial problem. Procedures are developed to forecast revenue, costs, and capital needs. This is a budget that identifies limits for expenses on an annual basis. Information systems' reportage on functional performance is compared with budgetary targets to establish control and feedback. These may be reflected in the projected sales/earnings growth rate, occasionally qualified by certain debt/equity target or other explicit financial objectives.

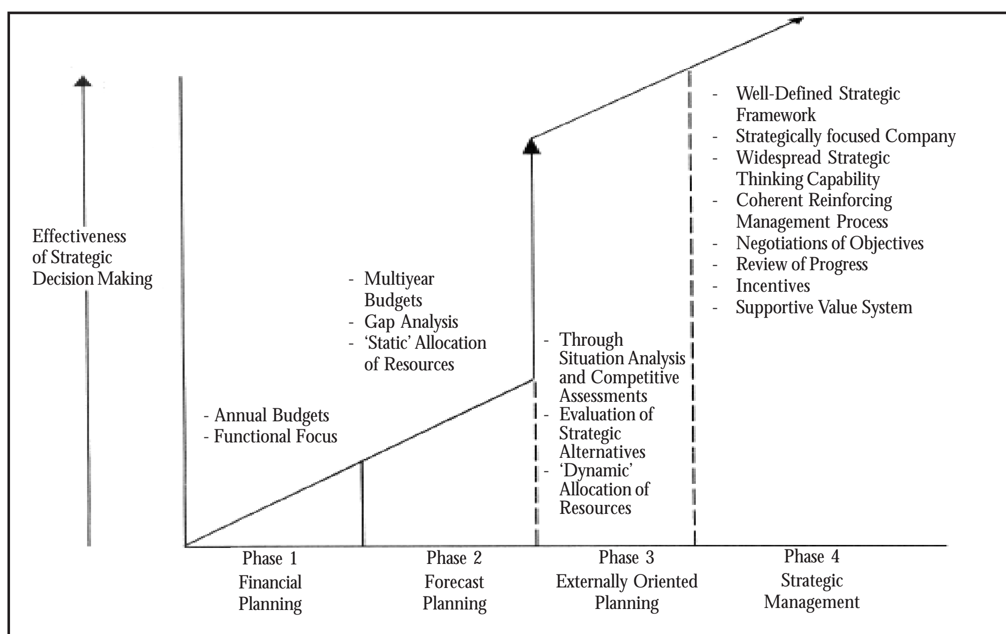

Figure 1.2: Phases in the Development of Strategic Management

The CEO and his top team plan the future based on their knowledge of their company's products and markets. They try to sense what major competitors are doing and are expected to do. Based on this framework and their own cost structure, they can estimate what the impact of a product or marketing change will be on their plants, their distribution system, or their sales force. With this knowledge, and if they are not planning for the business to grow beyond reasonable limits, the need to set up an expensive planning system may not be there.

Complexities increase when companies become large—the number of products and markets served, the degree of technological sophistication required, and the complex economic systems involved far exceed the intellectual grasp of any one manager or a small group of managers. Explicit documentation in place of implicit knowledge is required to chart the strategy of the organization.

The financial planning system is extended to estimate the capital needs and the trade off between alternative financing plans. This requires extrapolation of past trends and an attempt to predict the future impact of political, economic, and social forces. This is the basis of the second phase: forecast-based planning. Many Indian companies use a Phase II planning system-long-range planning-today.

1.3.2 Phase II - Long Range Planning

Phase II is the traditional long-range planning system. The objective of the long-range planning activities is to provide the organization with answers to the questions:

(1) Where is the organization now?

(2) Where is it going?

(3) Where does it want to go?

(4) What does it have to do to get to where it wants to go?

In its most elementary form, traditional long-range planning identifies four key activities on which the concept of planning is based - monitoring, forecasting, goal setting, and implementing policies and actions to facilitate the goals. Long-range plans are produced by performing these key activities as a continuing process.

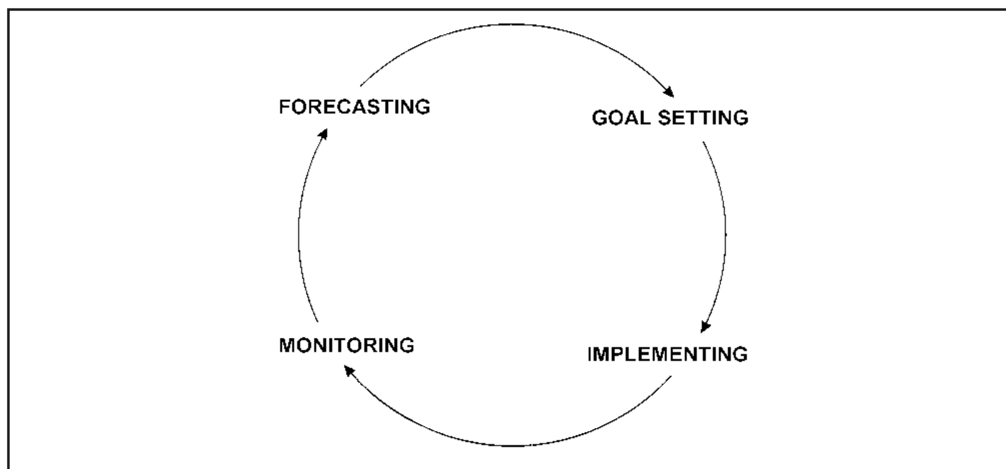

Figure 1.3: Traditional Long Range Planning Model

The inter-relationship between these activities is shown in Figure 1.3. The cycle begins by:

(a) monitoring selected trends of interest to the organization

(b) forecasting the expected future of those trends

(c) defining the desired future by setting organizational goals in the context of the expected future

(d) developing and implementing specific policies and actions designed to reduce the difference between the expected future and the desired future

(e) monitoring the effects of these actions and policies on the selected trends

The major limitation of the long-range planning model is that information about the changing external environment is usually not taken into account systematically or comprehensively. It is assumed that there is continuity in the environment. This assumption is valid only under very special circumstances, e.g., mature industries, or to basic industries like mining, etc. Hence, the usefulness of this type of model under dynamic conditions is limited.

Differences between Phase I and Phase II

Usually this phase starts like the annual budget with a time frame of around 3-5 years as compared to a year for Phase I. However, as the organization develops its capabilities, the models become more sophisticated. In the early models, there is generally significant variance between the real world and the forecasts. The simple extended budgeting models often fail to signal major environmental shifts. As these models become more sophisticated, they protect the negative impact on corporate fortunes of the limited accuracy of the earlier models.

Nevertheless, Phase II improves the effectiveness of strategic decision-making. It forces management to confront the long-term implications of decisions and to give thought to the potential business impact of discernible current trends. One of the greatest impacts of Phase II is on resource allocation. Under the pressure of long-term resource constraints, planners learn how to look at the flow of capital and other resources among business units with a longer time frame.

However, owing to the limited view of the horizon, Phase II companies tend to be focused on current capabilities, rather than on the search for longer term options. Moreover, the model is deterministic, that is, the current position of a business is used to determine the appropriate strategy, according to a generalized formula. And Phase II companies typically regard positioning as the end product of strategic planning, rather than as a starting point.

Phase II systems are also beneficial in analyzing medium-term trends and setting operational objectives (for example, productivity improvement or better fund utilization), but the key business issues are often ignored as the focus is on short or medium-term operating performance at the expense of long-term goals.

1.3.3 Phase III - Environmental Scanning

As businesses become more competitive, planners typically reach for more advanced forecasting tools to handle the complexities of the marketplace. This may include trend analysis and regression models and, eventually, computer simulation models. These models are an improvement. They add information from the external environment to the long-range planning process. Environment scanning is used to:

- Identify new and potentially crucial information that should be added to those identified and tracked during monitoring.
- Identify possible developments that must be used to adjust the forecasts of the internal issues derived from forecasting.

1.3.4 Phase IV - Strategic Planning Phase

By merging the two models of planning, long-range planning and environmental scanning to form an inter-related model - the Strategic Planning Model was formed. The Strategic Planning model is a tool that helps an organization in setting up goals or objectives; the analysis of the environment and the resources of the organization; the generation of strategic options and their evaluation; and the planning, design and implementation of control systems or monitoring mechanisms.

This model consists of six identifiable stages that fulfil the requirements of the management thinkers:

- environmental scanning
- evaluation of issues
- forecasting
- goal setting
- implementation
- monitoring

Check Your Progress 1

Define Strategy.

....

....

1.4 CORPORATE STRATEGIC PLANNING

Corporate Planning departments, equipped with tools and techniques to formalize the strategic planning system, are extremely effective when internal changes prevail in the business environment. However, when changes in the external environment become predominant, they bring out the limitations of a formal planning system. In order to survive, corporate planning departments must plan ahead comprehensively, controlling an array of critical functions in every detail. They specify policies and procedures in meticulous detail, spelling out for practically everyone what can and what cannot be done in particular circumstances. They establish hurdle rates, analyze risks, and anticipate contingencies. As strategic planning processes proliferate in these companies, strategic thinking gradually withers away.

Data analysis and decision-making tools of strategic planning do not make the organization work - they can only support the intuition, reasoning skills, and judgment that people bring to their organization. The success of Strategic Planning has to do with the acceptability of the plan and dynamics of the organization. The success of Strategic Management will be the topic for the remaining part of this book.

According to Mintzberg, the problem is that strategic planners often believe that strategic planning, strategic thinking, and strategy making are synonymous. When managers comprehend the difference between planning and strategic thinking, it is possible to return to what the strategy-making process should be:

"…….capturing what the manager learns from all sources (both the soft insights from his or her personal experiences and the experiences of others throughout the organization and the hard data from market research and the like) and then synthesizing that learning into a vision of the direction that the business should pursue."

Henry Mintzberg (1994), in an article appearing in the Harvard Business Review titled "The Fall and Rise of Strategic Planning," sees strategic planning as practiced as strategic programming - articulating and elaborating strategies that already exist. According to Mintzberg, strategic planning is about analysis (i.e., breaking down a goal into steps, designing how the steps may be implemented, and estimating the anticipated consequences of each step) while strategic thinking is about synthesis, about using intuition and creativity to formulate an integrated perspective, a vision, of where the organization should be heading.

1.5 MISSION-VISION OF THE FIRM

The first task of Strategic Management is formulating the organization's vision, mission, and value statements. These statements are primarily based on internal processes within the organization. They have the greatest impact on the identity and the future of the organization and reflect the strategic intent of the organization. Vision, mission, and values have their distinct characteristics and play distinct roles in the subsistence of the organization:

- VISION is what keeps the organization moving forward. Vision is the motivator in an organization. It needs to be meaningful with a long term perspective so that it can motivate people even when the organization is facing discouraging odds.
- MISSION is the founders' intentions at the outset of the organization - what they wanted to achieve. In the dynamic environment of today, it must be re-examined and refreshed periodically.
- VALUES manifest in what the organization does as a group and how it operates. An explicit depiction of values is a guide to ways of choosing among competing priorities and about how to work together.

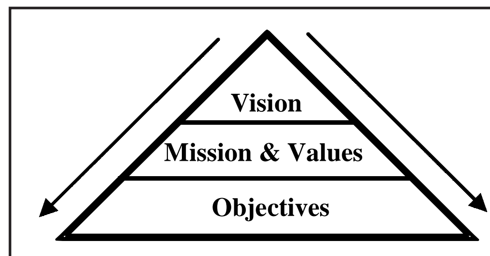

Figure 1.4: Hierarchy of Vision, Mission and Objectives

Vision, values and mission are the three components of focus and context of the organization. They form a hierarchy. The vision of the organization leads to its Mission and its values. The Mission in turn leads to the Objectives of the firm. This relationship is shown graphically in Figure 1.4.

The time to articulate vision, mission, and values is at the outset of an organization's life, if possible and at the first opportunity if the organization is already under way.

1.5.1 Vision Statement

When you begin the process of corporate strategic planning, visioning comes first. Martin Luther King, Jr. said, "I have a dream," and what followed was a vision that changed a nation. That famous speech is a dramatic example of the power that can be generated by a compelling vision of the future. A vision is a guide to implementing strategy. Visions are about feelings, beliefs, emotions, and pictures.

A vision statement answers the question, "What will success look like?" The pursuit of this image of success is what motivates people to work together. It is an important requirement for building a strong foundation. When all the employees are committed to the firm's visions and goals, optimum choices on business decisions are more likely.

When visioning the change, ask yourself, "What is our preferred future?" Your vision must be encompassed by your beliefs.

- Your beliefs must meet your organizational goals as well as community goals.
- Your beliefs are a statement of your values.

- Your beliefs are a public/visible declaration of your expected outcomes.
- Your beliefs must be precise and practical.
- Your beliefs will guide the actions of all involved.
- Your beliefs reflect the knowledge, philosophy, and actions of all.
- Your beliefs are a key component of strategic planning.

The process and outcomes of visioning is to develop an effective basis for business strategy. The foresight of the organization is to fit the strengths of the organization with the market demands, to make the organization highly competitive with growth and profits as the rewards. The long-term benefits are substantial, because Visioning:

- Breaks you out of boundary thinking.
- Provides continuity and avoids the stutter effect of planning fits and starts.
- Identifies direction and purpose.
- Alerts stakeholders to needed change.
- Promotes interest and commitment.
- Promotes laser-like focus.
- Encourages openness to unique and creative solutions.
- Encourages and builds confidence.
- Builds loyalty through involvement (ownership).
- Results in efficiency and productivity.

Whatever the eventual architecture of the organization, the vision statement encompasses the organization in all its forms. The vision statement identifies activities the organization intends to pursue, sets forth long term direction and provides a big perspective of:

- Who are we?
- What are we trying to do?
- How do we want to go about it?
- Where are we headed?

Successful organizations have a vision that is executable - not a pie-in-the-sky blanket statement but a realistic goal, according to Sunil Alagh, former Managing Director and CEO of Britannia Industries. "It's all about how you define the market, or how you redefine it for yourself. We can always raise the bar, but the vision stays with the company." When he was the CEO of Britannia, he decided to come up with a one-line vision for the company. He came up with the following vision statement:

'Every third Indian must be a Britannia consumer by 2004.'

It is this vision of the organization that has made Britannia a leading manufacturer of bakery and dairy products.

Jack Welch redefined GE's approach to its business when he announced to all GE managers, "To me, quality and excellence means being better than the best ……if we aren't better than the best, we should ask ourselves 'What will it take?', then quantify the energy and resources to get there."

Y.C. Deveshwar, Chairman of ITC, had a vision of ITC reminiscent of Jack Welch. He said that in a mature economy, with developed market institutions, ITC was unlikely to be successful unless it was focused on a one theme vision:

'Either we become world-class or we leave the business.'

It is this quality of vision that makes organizations excel. Therefore, it is not surprising that this vision statement comes from ITC which has remained, over the last five decades, one of the leading consumer products conglomerates in the country, with its annual revenues reaching $2 billion in 2002.

The vision statement of Ford Foundation is an illustration of a well crafted vision statement. It identifies who they are and who they are not, what they are trying to do, how they are going about it, and where they are headed.

1.5.2 A Basis for Performance

A vision is a description in words that conjures up a similar picture for each member of the organizations of the path and the destination. A clear vision of the desired future is an essential component for the high performance of the organization.

Take an example from the story based on Italian folk lore. The story goes like this:

A man was cutting stones in a stone quarry. A traveller was passing the stone quarry, and seeing the man cutting stones, asked him, "What are you doing?" The man was irritated at being disturbed and said, "Can't you see, I am cutting stones." When the traveller had gone some additional distance, he saw a second man doing similar work and he again asked, "What are you doing?" The man looked up, smiled at him and replied, "I am earning a living." Further on, the traveller came across another man cutting stone. When he was asked, "What are you doing?" The man straightened up and proudly replied, "I am building a cathedral."

The person building the cathedral had a vision that would make his performance outstanding in comparison to his compatriots. Building this type of motivation is what an organization looks at in its Vision Statement.

1.5.3 Reflects Core Values

The vision statement should be built around the core values of the organization and the people within it. The statement should be designed to orient the group's energies towards the core values and serve as a guide to action.

- Draw on the beliefs, mission, and environment of the organization.
- Describe what you want to see in the future.
- Be specific to each organization.
- Be positive and inspiring.
- Do not assume that the system will have the same framework as it does today.
- Be open to dramatic modifications to current organization, methodology, teaching techniques, facilities, etc.

The vision statement is meant to inspire challenge and motivate the work force, arouse a strong sense of organizational purpose, build pride and strike a responsive chord to their value system.

1.5.4 Way to Communicate

A vision statement is an exercise in communication. A well communicated vision statement will bring the workforce together and galvanise people to act. It will cause people to live in the business rather than live with the business. The 'dream' of Martin Luther King Jr. was communicated so effectively, that it changed the course of the American nation. A well crafted Vision Statement should be:

- realistic and credible
- well articulated and easily understood
- appropriate, ambitious, and responsive to change

Given below are vision statements of Tata Iron & Steel Co. Ltd., Hindustan Lever Ltd., DuPont, Burger King and Reliance Industries. These are a representative cross-section of vision statements.

Tata Iron and Steel Co. Ltd.

To seize the opportunities of tomorrow and create a future that will make us an Economic Value Added positive company.

To continue to improve the quality of life of our employees and the communities we serve.

Revitalize the core business for a sustainable future.

Venture into new businesses that will own a share of our future.

Uphold the spirit and values of TATAs towards nation building.

Hindustan Lever Ltd.

Our vision is to meet the everyday needs of people everywhere.

DuPont

We, the people of DuPont, dedicate ourselves daily to the work of improving life on our planet.

We have the curiosity to go farther … the imagination to think bigger … the determination to try harder … and the conscience to care more.

Our solutions will be bold. We will answer the fundamental needs of the people we live with to ensure harmony, health and prosperity in the world.

Our methods will be our obsession. Our singular focus will be to serve humanity with the power of all the sciences available to us.

Our tools are our minds. We will encourage unconventional ideas, be daring in our thinking, and courageous in our actions. By sharing our knowledge and learning from each other and the markets we serve, we will solve problems in surprising and magnificent ways.

Our success will be ensured. We will be demanding of ourselves and work relentlessly to complete our tasks. Our achievements will create superior profit for our shareholders and ourselves.

Our principles are sacred. We will respect nature and living things, work safely, be gracious to one another and our partners, and each day we will leave for home with consciences clear and spirits soaring.

Burger King

We take Pride in serving our Guests the Best Burgers and a variety of other Great Tasting, Healthy Foods Cooked over an Open Fire. That's what we're all about.

The ultimate success of the vision statement is the extent to which leadership and key stakeholders actually begin living the vision day-to-day. Sometimes, there is an unwritten vision statement, understood by the stakeholders and the leadership.

Reliance Industries

Reliance believes that any business conduct can be ethical only when it rests on the nine core values of Honesty, Integrity, Respect, Fairness, Purposefulness, Trust, Responsibility, Citizenship and Caring.

We are committed to an ethical treatment of all our stakeholders - our employees, our customers, our environment, our shareholders, our lenders and other investors, our suppliers and the Government. A firm belief that every Reliance team member holds is that the other persons' interests count as much as their own.

The essence of these commitments is that each employee conducts the company's business with integrity, in compliance with applicable laws, and in a manner that excludes considerations of personal advantage.

We do not lose sight of these values under any circumstances, regardless of the goals we have to achieve. To us, the means are as important as the ends.

In the 1980s, Reliance grew a staggering 1110 percent with sales moving from Rs. 200 crores to Rs. 1840 crores. It has continued to maintain its growth projectory. Today, Reliance Industries Limited is India's largest private sector company with total revenues of over Rs 99,000 crore ($ 22.6 billion), and cash profit of Rs 12,500 crore. Reliance Industries' activities span exploration and production of oil and gas, refining and marketing, petrochemicals, textiles, financial services and insurance, power, telecom and infocom initiatives. This is due to the vision and ambition of its founder, Dhirubhai Ambani.

Though the vision statement does not reflect the staggering ambition of Dhirubhai Ambani, this phenomenon is reflected in the unwritten philosophy of Reliance Industries. According to one of its employees, "Defying conventional thinking. That is what Reliance stands for". Another employee says that its vision can be summed up as, “Dikhaana hai!”

To get Reliance to do something is to say that it is impossible - Reliance then goes on to prove that the impossible is possible.

This vision is an unwritten rallying cry of Reliance.

The visioning process is meant to encourage initiative and enthusiasm at all levels in the organization. Therefore, be alert to the following vision killers:

- Tradition
- Fear of ridicule
- Stereotypes of people, conditions, roles and governing councils
- Complacency of some stakeholders
- Fatigued leaders
- Short-term thinking
- "Naysayers"

1.5.5 Mission Statements

Vision is the critical focal point and beginning to high performance. But obviously a vision alone won't make it happen. Even the most exciting vision will remain only a dream unless it is followed up with striving, building, and improving.

Why does the organization exist? What is its value addition? What's its function? How does it want to be positioned in the market and minds of customers? What business is it in? These are all questions of purpose. They deal with the deeper motivations and assumptions underlying the values and purpose that form the context and focus of the organization. Your mission statement is a statement of purpose and function.

- Your mission statement draws on your belief statements.
- Your mission statement must be future oriented and portray your organization as it will be, as if it already exists.
- Your mission statement must focus on one common purpose.
- Your mission statement must be specific to the organization, not generic.

The mission statements set the organization apart from others. They give meaning to the reason for being, value-add, and define the business of the organization. As with vision and values, the mission should have clear answers to the above questions. It should arouse a strong sense of organizational identity and business purpose.

Though some of these questions often seem deceptively simple, they are not so simple. We need to answer them to prepare a mission statement. For example the question, "What business are we in?" The implications of making a definitive identification means that the organization has put boundaries around to give guidance to the strategic direction in which it will move.

The mission statement has direct implications on the diversification strategy of the organization. It provides directions on the strategic choice in diversification strategies. If the areas are to be related it puts limits on the options. The diversification options may be related in a number of different ways; the new products and services may have similar technologies, or may be serving similar markets, or may have similar competencies.

Signal to Management's Intents

Specifically speaking of Mission statements, a well crafted mission statement must be narrow enough to specify the real area of interest; and it should serve as a signal on where the top management intends to take the firm. Overly broad mission statements provide no guidance in strategy making. However, diversified companies will have a broader mission definition than single business enterprises. In either case, the statement should lead to the direction the organization plans to take.

Ranbaxy Laboratories Ltd. - Mission Statement

Our mission is to become a research-based international pharmaceutical company.

McDonald's - Mission Statement

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.

In the examples given above, the mission statement of Ranbaxy gives a clear signal of the management's intent. As a matter of fact, Ranbaxy rejected a lucrative offer to expand by setting up business in the USSR. It was the management's view that this would deter it from its mission to become an international pharmaceutical company. Similarly, McDonald's mission statement which is given above, gives a clear signal of its management's intent. It indicates that it will look at domestic and international markets, and it intends to remain in the reasonably priced, high quality fast food industry.

Business Horizon

Many industries have faded away because of the lack of vision in identifying their business horizon in the mission statement. A railway company can be in the 'business of running railways' or 'it can be in the business of moving people and goods.' Similarly, a cosmetics company can be in the business of 'making cosmetics' or in the business of 'enhancing beauty.' An oil company can 'supply oil products' or it can be in the 'energy business.' For example, J. Helene Curtis says that is in the 'enriching beauty business'. Oil & Natural Gas Commission (ONGC) presents its mission statement as, "To stimulate, continue and accelerate efforts to develop and maximize the contribution of the energy sector to the economy of the country."

Many companies define their business too narrowly. That means they often miss new market opportunities. Or they don't provide a broader level of service support to their basic products or services. So customers start looking elsewhere. At the other extreme, some companies define their business too broadly. That often takes them beyond their core competencies into businesses they don't understand. The results are often very expensive and sometimes fatal learning experiences.

The perception of what business we are in will, to a large extent, determine our strategy. It will determine who we consider your competition is, and this focus can very often be the basis for the survival of the firm. Management philosophers believe that if the carriage makers of yesterday had realized that they were in the business of 'providing personal transportation to people' and not in the 'carriage making business', many of them would have survived the introduction of the motorcar. Similarly, gas light manufacturers would have survived the electric bulb. An inadequate vision of the business horizon is often called, 'organizational myopia.'

Some examples of the mission statements are given below. These are the mission statements of Ford Foundation, and Otis Elevators:

Ford Foundation - Mission Statement

Our dream is a world free of poverty:

To fight poverty with passion and professionalism for lasting results.

To help people help themselves and their environment by providing resources, sharing knowledge, building capacity, and forging partnerships in the public and private sectors.

To be an excellent institution able to attract, excite, and nurture diverse and committed staff with exceptional skills who know how to listen and learn.

Our Principles: Client centered, working in partnership, accountable for quality results, dedicated to financial integrity and cost-effectiveness, inspired and innovative.

Otis Elevators

To provide any customer a means of moving people and things up, down and sideways, over short distances with higher reliability than any other enterprise in the world.

Setting a Direction

If we study the Mission Statements carefully, we will notice that these statements have three distinct and identifiable components. These are:

- The key market
- Contribution
- Distinction

The Ford Foundation Mission Statement identifies "the world living in poverty" as its key market, Otis Elevator identifies the key market as, "any customer" and McDonald's mission statement, that was given earlier, identifies the key market as "fast food customers."

The distinctions are specified in the last part of the statements. The distinction of Ford Foundation is, "To be an excellent institution able to attract, excite, and nurture diverse and committed staff with exceptional skills who know how to listen and learn." In the case of Otis Elevator it is, "with higher reliability than any other enterprise in the world," and in the case of McDonald's it is, "delivered in a consistent low key décor and friendly manner."

The contributions are identified in the body of the statements.

Mission statement can set the direction of the business organization by identifying the key market, the contribution the organization plans to make to the key market, and the 'distinctive competencies' or 'value' the organization will provide in its focus on to serve the key market. This provides clarity and focus to the strategy that the organization employs.

Outward Looking Statements: There are different ways to define in a mission statement; Customer needs - what is being satisfied; and Customer Groups - Who is being satisfied. Looking outwards at customer needs makes the organization a market driven organization and customer driven firm. An example is the mission statement of Hindustan Lever Ltd.

Hindustan Lever Ltd. - Mission Statement

Our purpose in Unilever is to meet the 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.

Inward Looking Statements: A mission statement can also be defined by technologies used and functions performed - How customer needs are satisfied. Looking inwards at how customer needs are satisfied makes the organization a specialized, fully integrated or partially integrated organization. An example is the mission statement of TISCO.

Tata Iron & Steel Co. Ltd. - Mission Statement

Consistent with the vision and values of the founder Jamshedji Tata, Tata Steel strives to strengthen India's industrial base through the effective utilization of staff and materials. The means envisaged to achieve this are high technology and productivity, consistent with modern management practices.

Tata Steel recognizes that while honesty and integrity are the essential ingredients of a strong and stable enterprise, profitability provides the main spark for economic activity.

Overall, the Company seeks to scale the heights of excellence in all that it does in an atmosphere free from fear, and thereby reaffirms its faith in democratic values.

Mission Statements by Functional Areas: Though mission statements are generally considered to be in the domain of the corporate entity, sometimes, these are made by functional areas in an organization also. They may be used to focus on the department's contribution to the overall mission of the company; the department's role and scope within the company; and direction in which the department needs to move. This is more common in highly diversified firms or firms that have a high level of specialization.

Organizational Values and their Impact on Strategy

The value statements give a common cause and a common sense of purpose across the organization. Just like the mission statement, it provides the direction to the strategy of the organization. It provides an explicit depiction of values to guide the organization in choosing among competing priorities, thereby setting the organization apart from others. Organizational Values can set the direction of the business organization by identifying the contribution the organization plans to make to the key market, and the 'distinctive competencies' or 'value' the organization will provide in its focus on to serve the key market. The statements should speak loudly and clearly for themselves, elicit personal effort and dedication and generate enthusiasm for the firm's future - the strategy of the organization.

The value statement of the Ford Foundation provides guidelines to the moral conduct of the organization in achieving its mission and objectives. The statements reflect that the Ford Foundation do not believe in a 'no holds barred' strategy. The strategies that it will adopt will be limited by the ethical values of the organization. The value statement is given below, as an example:

Ford Foundation - Our Values

Personal honesty, integrity, commitment; working together in teams - with openness and trust; empowering others and respecting differences; encouraging risk-taking and responsibility; enjoying our work and our families.

As with vision and its mission, the organizational values provided should be clear, to provide answers to what strategic options are acceptable to the organization. It should add to the sense of organizational identity and business purpose and identify the areas of value-addition of the organization in its business. The Values of an organization are often built with associations. You create a simple and consistent message of who you are, what you're looking for, and your uniqueness as differentiated from others.

For example, what does Pillsbury mean? Pillsbury perhaps means a lot because it is identified with high quality dough products. Two of the biggest names that have emerged in the past decade are Amazon and Starbucks. Does Starbucks mean coffee? Absolutely not. But we get to know a company and that starts to create an image. It is linked in customers' minds with attributes or benefits.

Identity is the answer to the question, "Who are we?" The Tatas have been advertising, "Tata, a century of trust". This corporate identity reflects the personalities and values of the founders and its management. It envelops the whole group of industries operating in different areas of business and the economy.

The value statement of Wipro Technologies provides a direction on the purpose and identifies the areas of value-addition of the organization. Wipro identifies as its values providing innovative, value-for-money solutions to its customers and to keep innovating and thinking about innovative solutions on a daily basis. The value statement of Wipro is given below.

Wipro Technologies - Values

With utmost respect to human values, we promise to serve our customers with integrity through innovative, value-for-money solutions, by applying thought day after day.

Though Mission and Value Statements are generally separate, organizations sometimes combine the two together. Therefore, very often, we will find a Value Statement of the organization but no Mission Statement, or it may be the other way round. In such cases

the mission statement should also define the values of the organization or, the value statement should provide the mission of the organization.

Many Indian organizations compromise on their values. Simulated by an environment where corruption is accepted, they have developed values where they cut corners, and 'manage the environment'. In order to meet the future face on, organizations should be bound together by their 'values' and be governed by them. Organizations find it difficult to establish a sense of purpose if they compromise on their values, irrespective of how exciting and well crafted their vision might be.

Jack Welch of GE fame says, "Objectives and strategies don't get you there, values and people do. We defined a set of values and those values then determined who would be in the management team. Anyone who could not conform to those values … had to go".

1.5.6 Preparation of Vision and Mission Statements

In a competitive economy driven by the cruel logic of markets, a company with a determined management can transform an organization much more quickly and much more effectively than in the past. Clearly articulating your strategic intent is the key. Vision, mission, and values hold an organization together.

Unfortunately, they don't come neatly packaged in separate mental compartments. Instead, they are linked in people's hearts and minds. Most people can relate to a personal vision, their personal values, and their mission in life, but they often find it difficult to arrive at a consensus on issues concerning mission, values, and vision of the group.

It's important to recognize and respect diverse approaches to questions of ultimate purpose in a group. Ideally, the senior management team defines the broad parameters of what business we're in and which direction we're heading. They can prepare a rough vision for input and refinement or leave things wide open for the rest of the organization to fill in. Group members then exchange ideas and make decisions to articulate the vision, mission, and values.

Different ways of defining a group's vision, mission and values may seem foolish or even alarming; but organizations are strongest when many aptitudes, interests, and points-of-view can be worked out together. Teams or organizations need a shared vision, not something that only a few people own. Everyone should be a "stakeholder" in spirit. That's usually a cascading process, but it can start in any part of an organization.

The vision and mission statements should provide clarity to the issues of governance. However, often there are conflicts in perceptions. What organizations describe as "personality conflicts", after a little exploration often reveals real differences on issues about governance, finances, purpose and program of the organization.

For example; Gaurav is a compulsive organizer; he's worried about taking risks, especially financial risks. Gayatri is spontaneous and improvisatory; she's worried that the organization will lose its soul by pinning everything down. Each has collected a little camp of supporters, and every issue that comes up is seen as a challenge to the way they view the organization. This is ammunition in their competition. What looks like a "personality conflict" obscures the deeper questions of this competition: what they want to accomplish as an organization, and what measure of risk-taking and improvisation are appropriate to that mission and their values.

There are many ways in which the Vision Statement can be prepared. It depends on the nature and type of organization as well as the philosophy and management style of the top management. One popular method, to prepare the vision statement, is given here.

We may brainstorm with our staff or our board what we would like to accomplish in the future, using the "guided fantasy" method. We bring the participants together and ask them to imagine and create a vision of what the group's activities will be five or ten years down the line. We can begin by leading the group with our vision of how the world will change as the result of the group's work, the array of things we like it to do - our vision. And others will find themselves thinking first about how the organization should evolve and how they can work with each other within the public elements of the organization's values. People can spur each other on to more daring and valuable dreams and visions—dreams of changing the world that they are willing to work hard for. For some people, it will be most comfortable to focus on the purpose of the organization itself—its mission. This should be consistent with the organization's values.

An exercise like this encourages people to develop their visions and missions, loosening their imaginative powers. Keep the process as open as possible. Avoid symbolic or theoretical disputes and try not to be diverted by details. Then discuss the ideas this has brought up. Create a consensus and welcome all the contributions.

Then have a working group prepare a draft after the meeting, summarizing the results and harvest what is needed to formulate mission and vision statements.

1.5.7 Revision of Mission Statements

Unlike a vision statement, the mission statement may undergo changes from time to time. The entrepreneurial challenge is to know when the mission requires modifying or changing so that the organization does not get trapped in a stagnant core business or allow new growth opportunities slip away.

In order to keep doing so and keeping the organization on the right course, management has to keep track of changes in the environment. This means tracking a number of variables that include shifting customer wants and needs, emerging technological capabilities, changing international trade conditions and signs of growing or shrinking opportunities.

Take the example of Zee Telefilms, which in the mid nineties, was growing at an amazing pace. However, below the impressive growth figures, its profitability was dropping and investment requirements were going up. In 1996 profits had dropped to around Rs. 24 crores, and seemed to be on their way further down. Zee needed to invest in more software and hardware; suppliers were putting pressure on them; and at the same time, Rupert Murdoch's Star TV was eating into their business. Zee's mission statement in 1994 had been:

To be the leading TV and communications group providing the people of South Asia, wherever they live, with the finest entertainment, information and communications network and to provide a strong medium through which marketing organizations can enhance their business. Through these services we intend to be worthy citizens of this global village. We will be a profitable, dynamic, forward looking and financially strong organization which cares for the welfare of its people while providing an enjoyable and rewarding work experience.

The changing environment made the management introspect its mission. They realized that their currency of importance was airtime; this was their bread and butter. The mission statement needed to reflect the new reality, in order that they might build a new business model that reflected that they were in the media business and their stakeholders

obtained value through the creation of media assets. The new mission statement read as follows:

To be the leading round-the-clock airtime properties provider, delighting the viewers, on the one hand, and providing value to advertisers for their time and money on the other. To establish the company as the creator of entertainment and infotainment products and services to feast the viewers and the advertisers. Through these services, we intend to become an integral part of the global market. As a corporation, we will be profitable, productive, creative, trendsetting and financially rugged with care and concern for all stakeholders.

Revamping the mission statement and following it up with radical changes served Zee extraordinarily well. By 1999, Zee had once again started to regain its profitability. It ended the financial year with a profit of Rs. 61.1 crores on revenue of 231 crores.

Value to Managers

The mission statement is not only meant to direct the strategy makers in their decision making or enthuse and motivate the employees, it also assists managers at different levels in the organization to function more effectively. The value of well crafted mission and value statements for managers in the exercise of their duties rests on the following factors:

- Enables management to identify the boundary between what to do and what not to do
- Crystallizes top management's views of the firm's long term direction
- Helps managers take decisions to keep the organization on the right track
- Conveys organizational purpose as motivation to employees to do their very best
- Helps keep direction related actions at all levels in the organization on a common path
- Gives a yardstick to measure our present performance and plans, against our aspirations

The new mission statement of Zee Telefilms created a renewal at all levels. The management was able to better identify the boundary of what to do and what not to do. There was a new business model for the organization. Zee rationalized its channels; they set out benchmarks on programming revenues; they changed their relationship with the producers of programs and became the owners of software; their advertising policy became more transparent, and advertisers were provided with attractive packages.

1.6 HIERARCHICAL LEVELS OF PLANNING

Strategic choice has to consider options about resources, capabilities, and competencies as well as those for markets and products. It may well be, therefore, that the strategic assessment has identified strengths and weaknesses in existing resources and capabilities in comparison with competitors. This may lead to identifying capabilities of the organization. The time-scales for developing resources and capabilities often determine strategic options. The organizational thinking should be about capability options first and market options second, so that it can build on unique competencies and seek markets and products to demonstrate them. This is generally the basis for setting objectives of the organization.

Planning of an organization form a hierarchy on a similar basis as that for strategic choice, discussed earlier. This is shown in Figure 1.5. The hierarchy ranges from the broad aim to specific individual objectives. The long-term intentions of the organization provide a focus for setting the objectives. They are expressed qualitatively in the form of

a mission statement. The zenith of the hierarchy is the mission of the organization. This produces the Strategic Objectives.

At the second level are the operations of the Strategic Business Units (SBUs) in a diversified organization, or critical processes in a single unit organization. For example, in a single unit organization manufacturing commercial vehicles, these could be Marketing, Manufacturing, or Quality Control. In a diversified organization, this would imply each major commercially oriented activity of the firm, or each of its units. These are the Business Process Objectives.

At a lower level, that reflects the operations of a department, the objectives are more specific. These are generally the Key Result Areas (KRAs). The objectives are translated further down the line to the individual managers and down to the lowest level of the organization. It may be necessary to sub-divide the objectives into functional work-tasks so accountability can be assigned to a single individual.

Objectives must typically be specific, quantifiable, challenging but 'doable,' and tied directly to a reward system. In addition, a method must be established to communicate each level's goals to the next level down (flow down) and also send feedback (roll-up) to the next level up.

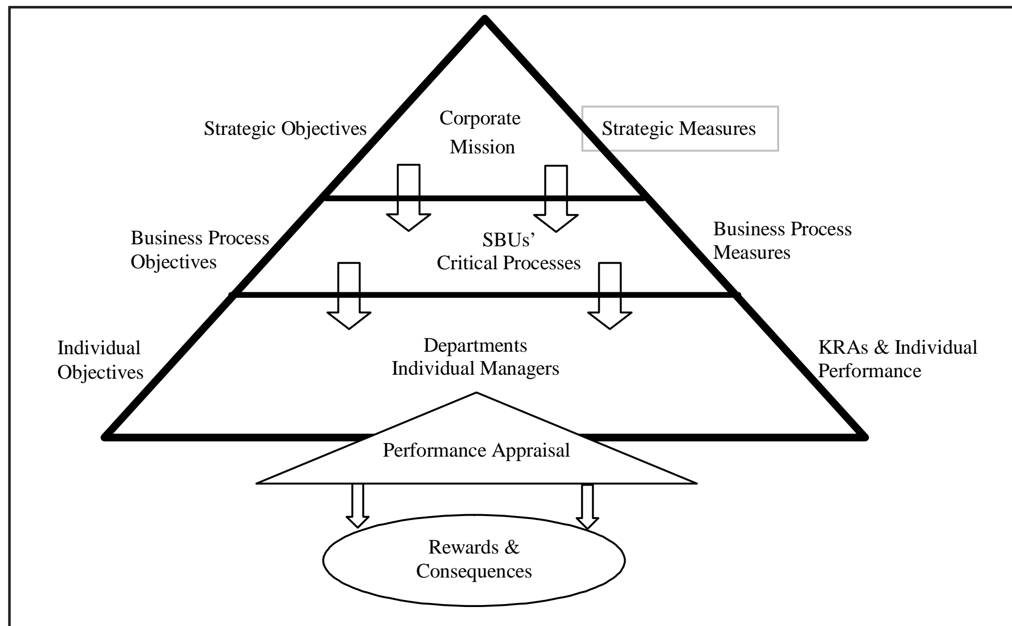

Figure 1.5: Objectives at Different Levels

Much of management literature talks of long-run and short-run objectives. Long-run objectives focus on long term performance and short-run objectives focus on short term performance. Generally, the span of a short-run objective is 1–2 years, while the span of a long-run objective is 3–5 years. Corporate Objectives or Strategic Objectives are normally long-term objectives, but often incorporate short-run objectives. Short-run objectives play a significant part in assessing and determining whether the speed and level of performance being aimed for is being achieved. These also provide a stepping stone towards attaining the long term performance.

1.6.1 Setting Objectives

All managers need objectives. A very important consideration in setting objectives is to convert the organization into integrated networks. The process should be such that the shared values and identity of the organization is reflected in the process.

Top down objectives: Objective setting is generally a top-down process. This achieves unity and cohesion throughout the organization. Managers at different levels in the organizational hierarchy are concerned with different kinds of objectives. The Board of Directors and top managers are involved in determining the Vision, the Mission and the Strategic Objectives of the firm. They are also involved in deciding upon the specific overall financial objectives in the Key Result Areas.

The middle management is involved in setting up objectives for the Key Result Areas, objectives at the divisional levels, at the departmental and individual levels. Lower level managers set objectives of units as well as their subordinates.

Bottom-up approach: Though in most manufacturing and service organizations, the objective are set top-down, there is an argument for a bottom-up approach. This is especially true for knowledge based companies, where the argument is that objective setting should be bottom-up that it should be part of a learning process and not a part of the reward and punishment system.

Proponents of the bottom-up approach argue that top management needs to have information from lower levels and this will make objectives more realistic and acceptable. They also argue that subordinates are more likely to be highly motivated by, and committed to goals that they initiate, than to objectives thrust upon them. In spite of the strength of the arguments, the bottom-up approach is highly under-utilized.

Is the top down or the bottom up approach suggested? For example, Wipro Corporation's has been a remarkably successful organization in spite of the fact that its activities are extremely diversified. Its activities span vanaspati, toilet soaps, toiletries, hydraulic cylinders, computer hardware and software, lighting, financial services, medical systems, diagnostic systems, and leather exports.

Wipro was organized around five distinct business activities and into eight companies. These were Wipro Consumer Products, Wipro Lighting, Wipro Fluid Power, Wipro Financial Services, Wipro Infotech, Wipro Systems, Wipro GE, and Wipro Biomed. Mr. J. Shankar, corporate treasurer of Wipro, describes the performance of the group in the following words, "….. historically during the last 54-55 years, our annual growth in profit would be about 23 percent annually. Our market capitalization growth would also be somewhere in the region of 20 percent plus. …..This we have been able to achieve by reinventing ourselves through various businesses".

The annual planning exercise of Wipro is the basis for integrating the different businesses into the operational management process. Each business prepares its own business plans for the year with its key result objectives. The objectives are examined on the basis of six variables. Four of these are defined by the corporate office and the other two are selected by the individual businesses. The variables defined by the corporate office are (i) Speed; (ii) Customer Satisfaction; (iii) Financial Parameters; and (iv) Employee Morale. 'Speed' was based on a reduction of cycle time; 'Customer Satisfaction' was based on the percentage increase of customers who rated Wipro a '4' or a '5' on a 1-5 scale; 'Financials' were rated on the following: sales, sales growth and market share; profit before tax; profit after tax; cash flow; return on average equity; and return on capital employed. Finally, 'Employee Morale' was rated on the annual Employee Perception Survey; attrition rates and internal growth.

The annual plans of the different businesses are then approved by the Corporate Executive Council (CEC) headed by Mr. Premji, the business heads and the corporate functional heads. The CEC meets every quarter to comprehensively assess the performance. It also identifies 'strategic thrusts' and other corporate-wide thrusts.

Wipro's experience shows that neither top-down or bottom-up approaches are exclusive. Based on the structure of the organization, a combination of 'bottom-up' and 'top-down' objective setting is often the way to integrate businesses to translate the vision, values and goals of the organization into a workable plan.

Setting objectives is a critical exercise in an organization. Not only does it direct the organization towards its goals but also, it is the basis for the reward system. Therefore, this activity affects almost everyone in the firm. Some care needs to be taken while setting objectives. Some of the issues that need to be kept in mind while setting business objectives have been discussed below:

1.6.2 Balance your Objectives

Objectives should be balanced. They should incorporate requirements that will involve all members of the organization. If our objectives focus on only profit and sales, people outside of the executive planning group may wonder, "What's in it for us?" If they ask that question out loud, we've got a problem. If they ask it silently to themselves, we've got an even more serious problem.

Its simply a fact of life that after a couple of levels down from the top of the organization, we find a lot less interest in the financial and marketing objectives, and a lot more interest in operations and in people. In order to successfully accomplish our objectives, we'll need the help of all the people in the organization. So we should balance our list of objectives. Consider including objectives in each of the six categories mentioned earlier.

Set goals for routine work as well as one-off items (such as training programs, strengths to exploit, or weaknesses to eliminate). The idea is that to successfully implement any objective, we have to gain the commitment of employees.

1.6.3 Multiplicity of Objectives

We should not set too many objectives. If we do, we'll lose focus. We won't be able to use our objectives in managing day to day. Keep the objective lists short. The importance of the objectives is that we should enthuse and motivate the employees. In order to do so, employees should be able to remember and keep the objectives in mind.

At every level in the hierarchy there are likely to be a number of objectives. Some people think that a manager can handle a limited span of objectives effectively. Too many objectives have a number of problems:

- They tend to dilute the drive needed for their accomplishment
- They may unduly highlight minor objectives to the detriment of major ones

There is no agreement to the number of objectives that a manager can handle. However, if there are so many that none receives adequate attention and the execution of the objectives is ineffective, there is a need to be cautious. However, it will be wise to identify the relative importance of each objective, in case the list is not manageable.

1.6.4 Themes for Objectives

For an objective to be useful, it has to meet certain criteria. It must carry a single theme. It should tell us to do one thing only, not two or more. When there is more than one theme in the objective there is a problem in evaluating the performance, both for the management as well as for us. If we fulfill one of the two themes, have we met our objectives? A lack of clarity can make the objective redundant.

Multiple themes also create conflict. It is unlikely that the themes will result in the same outcomes. Were this so, there would be no need to have multiple themes. An example given by Bill Birnbaum in his article, 'Developing Your Strategic Objectives' is given below:

"If we decided to increase sales by 15% next year, we might write an objective that said exactly that. But let's imagine we'd also like to increase net profit by 1%. Couldn't we write one objective that said "do both." Let's suppose we do. Suppose we write an objective that said, "We will increase sales by 15% next year and, at the same time, improve net profit by 1%." If, by the end of the year, we achieved the 15% increase in sales, but missed the 1% increase in profit, have we made or missed the objective? We could argue it either way. At best, it's ambiguous.

Worse, however, is that the objective does not provide us with guidance in operating our business. Here's why ... imagine that six months after we write our objective calling for 15% increase in sales and 1% increase in net profit, our sales manager comes running in with the "golden opportunity of the month."

"Here's the deal," he says. "We have a grand opportunity to land a really sizable order. And if we get it, this order should be enough to put us over the top -- to give us the 15% increase in sales we're shooting for." "Oh yeah," continues our sales manager. "There's some bad news. Since the market is so fiercely competitive, and since our competitors know about this large potential order, we're really going to have to sharpen the pencil to get it. We'll have to shave our price just as far as we can."

So while the "golden opportunity" will go a long way toward achieving the 15% increase in sales volume, it will actually detract from the 1% increase in profit. Should we go after the big order, or not? Notice our objective statement hasn't provided us any guidance in this decision. Why? Because in the same statement, we've bundled together the sales revenue increase and the profitability increase. The objective leaves us to debate which of the two (sales or profit) is the more important.

Wouldn't it be better to pull the objective statement apart? Then we have one statement that addresses the increase in sales revenue; another, the increase in profit. And then be sure to do one more thing -- give a different priority to each of the two potentially conflicting objectives. During our planning sessions, we can argue all we like about whether sales volume or profit is more important. But when our sales manager appears with his "golden opportunity," we'll know how to respond."

1.6.5 Use Result Oriented Objectives

There are two orientations in describing activities. Based on this, there are two types of objectives that we can develop:

- Result oriented
- Activity oriented.

In a result oriented objective, we focus on the outcome from the activities of the individual or function. We could require the function to increase its production of certain products, say by 10 per cent. This is a result oriented objective. We could also require the workers to put in 10 per cent extra hours in production. This is now an activity oriented objective. In this case, the increase in hours put in by the worker does not ensure that there is an increase in the production by 10 per cent.

Obviously, the first is a stronger statement. It motivates the workers to work harder and even improve their productivity so as to provide the result. We should establish results-oriented objectives whenever possible. Results-oriented objectives are stronger. Whenever possible, we write our objectives in terms of a result, rather than an activity. Activity oriented objectives should be used when it is extremely difficult to write a results-oriented objective. It should be an exception.

"Install the new press on the shop floor by the end of the year, 'O' Preventive maintenance must be completed by June 30."

These are activity-oriented objectives. Each is used because no result (other than the completion of the activity) can be measured. However, these types of objectives, i.e., activity oriented objectives, should be an exception rather than a rule.

1.6.6 Quantify your Objectives

Objectives must be quantified. Everyone in the organization has to know how much effort we need to put in to accomplish the objectives and we've got to be able to measure it to figure out whether or not we've succeeded.

Some objectives are easy to measure, some are not. Financial objectives are the easiest to quantify. Marketing objectives, e.g., sales volume and market share, are also usually easy enough to turn into numbers if we can agree on a measurement for industry sales.

Quantities like 'customer satisfaction' are more difficult to measure. We can count complaints. We can measure defective product. We can count referrals to new accounts. Or repeat business. Or warranty costs. In the case of a measure of 'customer satisfaction', we assume that it is difficult to measure directly, and so we use proxy variables. Something we believe parallels the issue of customer satisfaction. We quantify our objectives even if we have to "force" our measurement. So when warranty cost gets below 1.5%; or when the reorder ratio goes over 75%; or when referrals to new accounts reach 25% of total billings – then we'll believe that customer satisfaction is where we want it to be.

Though it seems some objectives are measurable, on analyzing the measure more carefully, the measure may not be so good. For example, it is normally accepted that market share is a measurable objective. But is this true? It's difficult to get agreement on the total market size used in calculating market share. And even if we can agree on total market size, there is a lag between the periods when the objectives have to be met and when market data will be available. This lack of timely information means we can't use the market share objective to manage our business on a day-to-day basis.

Perhaps, if market share is important to our organization, it may be better to write our objective in terms of sales volume, after we estimate the total market size. That way, we'll have an objective that can be measured by the people who have to meet the objectives and can be used as a day-to-day tool in managing our business.

Can you state which goals are based on assumptions such as performance of the economy, market, industry trends and identity these factors? Remember, the greater the number of assumptions, the weaker the position of the objectives.

If at all possible, specify ways of measuring the success of each of the objectives (also known as 'metrics'). These allow the success of the project to be assessed. With metrics still an area of ongoing research, we will need to spend some time to determine the best measures to use. In order for metrics to be effective, measure them before the project starts. This provides a baseline, and gives something to compare against.

Long term objectives that have only long-run objectives prompt action now, that will permit reaching long range performance later. These types of objectives are sometimes difficult to assess as we have to weigh the impact of today's decision on future performance. Unfortunately, in the dynamic business environment of today, a large number of Corporate Objectives have this characteristic.

1.6.7 Network Objectives

Objectives are never linear. When one objective is accomplished, it is not neatly followed by another, and so on. Objectives form an interlocking network. One objective is very often dependent on another. The implementation of one may impact the implementation of the other. It's one thing to write down an objective and say "Yes, that's fine. I think we can do it. Let's commit to it." Then go on to the next one and do it again and again.

There is the aspect of 'fitting'. When we have a number of objectives we should take a long, hard look at them. And ask, "Can we do this whole bunch of objectives all at the same time?" Very often, an examination like that will indicate the type of problems we may face, as typified below:

"Assume we have a situation where the manufacturing department has to cut the cost of the product by say 5 per cent. It can do so by taking long production runs. The marketing department, in order to meet its objectives desires to have all the products in the line readily available for dispatch. The finance department has the objective of maintaining investment in inventories at a certain low level.

We wrote a set of objectives calling for growth in the sales volume, and reduction in the cost of manufacture, at the same time. But the two are conflicting objectives. Because reduction in cost requires high productivity and sales growth requires that it should be able to ship the products promptly to the customers so that they do not go to other sources. The solution could have been an increase in inventory. But this is in conflict with the objectives of the finance department, who have to ensure that inventories are maintained at a low level."

Look at our objectives all together to make sure they're in concert. If they are not, make a choice and eliminate or modify one or the other. There is another aspect to this also.

Make sure objectives not only fit but also reinforce each other. The requirement is that everyone on your planning team should believe that we can accomplish all the objectives we have put down, at the same time.

1.6.8 Make them Challenging but Attainable

There was a lot of literature that came out in the nineteen sixties on 'Achievement Motivation'. The main proponent of this concept, Atkinson, proposed that if the task put before a person was too easy or too difficult, the likelihood was that there would be failure in executing the task efficiently, as the motivation to succeed was related to the person's perception of the probability of success or failure. In order to prove his hypothesis, he used expert marksmen and gave them an extremely easy target range to shoot at. He found that the marksmen did not perform as well as they should have - according to him this was a result of poor motivation.

The objective should be challenging but, at the same time, attainable. In other words, an objective should be achievable. People in your organization should understand that accomplishment of the objective requires effort and given that effort, they should expect they can accomplish the objective.

For example, DuPont has defined a set of goals; immortal polymers; zero waste processes; elastic coatings as hard as diamonds; elastomers as strong as steel; materials that repair themselves; chemical plants that run by a single chip; and coatings that change color on demand.

Thank God, this is the vision of the company. Were these the objectives of the company, we would be so overwhelmed that we would put our hands up even before we started trying to play the game. Even if the objective were "maintain our performance at last year's level," (there could be good reasons for such an objective) most people would relax assuming that it was too easy to require them to put in additional effort. Chances are they would not be able to maintain last year's performance.

We must make each of our objectives both challenging and attainable. Finally, in writing objectives, eliminate the "why". Do not be tempted to explain 'why', in order to enthuse or motivate employees. The 'why' may replace the objective in the mind of the employee and the focus of the objective will be lost. Also, don't write 'how' in the objective. Not only will it cause confusion, it will also cause conflict. Is the 'how' more important than the objective itself? We must also understand that the answer to "how" is really a strategy.

1.6.9 Other Considerations

In addition to what has been said before, the following issues are important too:

- At all costs avoid goals that are incompatible with the current resources of the company. These will only serve to drain the resources of the firm.
- Allow for game playing. Be ready to lose battles if we want to win the war.
- Always try to have a fall-back position. For critical activities, duplicate efforts, if possible. It may cost us, but can be very important.
- Be flexible, if objectives become obsolete due to unexpected changes in the business environment, drop them in favour of more current ones.

1.6.10 SMART Formula

The SMART Formula is a useful method of examining objectives. Many business schools use this model to illustrate how to build up and create proper business objectives. Each letter in SMART stands for a characteristic associated with business objectives. That is:

- ***Specific:*** Clearly state what it is we want to do/achieve by way of a factual description.
- ***Measurable:*** Ensure that the success of your business objective can be measured against concrete criteria.
- ***Achievable:*** Is the objective achievable given your current operational resources and/or competence/capacity?
- ***Realistic:*** Is the scope of the objective within the bounds of what is recognizable as a proper 'business fit'?
- ***Timely:*** Include a time scale within which the objectives should be achieved.

The SMART method is a very nice way to reassess the objectives, once they are made. It is a good evaluation method.

1.6.11 Role of Planning

Business planning provide the overall direction to help us and our staff, focus on the rationale and its expected results. In setting a business objective we need to consider what it is we want to achieve - in other words, starting at the end point. Objectives help

to provide a definition of the end point that can be used to monitor progress and to identify when success has been achieved. Good objectives are those that are clear, measurable and quantifiable. If they are not clear, it is difficult to assess whether the objective has been met.

Properly defined objectives play a major role in the operation of a business organization. Some of the important aspects of their role in the organization is given below:

1. Objectives define the entire purpose of your business in a couple of sentences. They provide legitimacy to the existence and continuance of the organization.
2. They provide a direction in which the organization moves and the guidelines for organizational effort. The objectives that we set will finally determine the quality of the strategy or tactics that we will adopt.
3. Well framed objectives co-ordinate the activities of the organization. They assist management to network and fit the activities of the organization into an effective instrument to meet its mission.
4. Objectives serve as standards for evaluating the performance of the organization. They provide a benchmark for assessment of the performance.
5. Objectives are motivators. They give a purpose and direction to the day-to-day working of the members of the organization.

Check Your Progress 2

State whether the following statements are true or false:

1. Business strategy is not a senior and top management responsibility.
2. Strategic planning is about fundamental decisions and actions on choices that must be made but it does not attempt to make future decisions.
3. Strategic thinking is a process of developing or examining the assumptions about the future upon which the organisation’s mission, goals and strategy are based.
4. A vision is a description in words that conjures up a similar picture for each member of the organisation of the path and destination.
5. The vision statement should be built around the core values of the organization and the people within it.

1.7 STRATEGIC PLANNING PROCESS

A modified Strategic Planning Process is summarized in Figure 1.6. This figure differs in that 'scanning' and 'forecasting' are together used to 'generate strategies', and 'goal setting' and 'implementation' are also clubbed together as 'specify objectives'. The arrows suggest the best order in which to proceed.

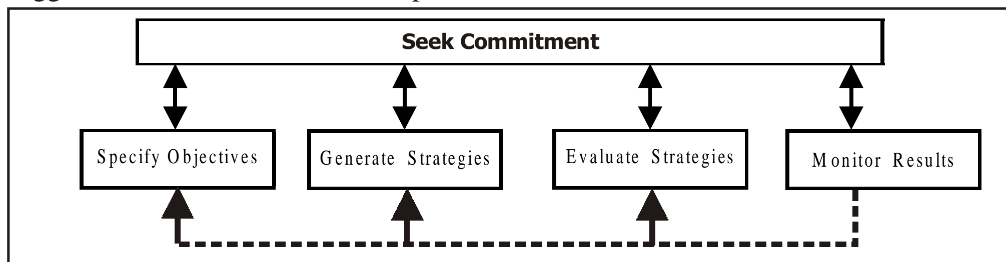

Figure 1.6: Strategic Planning Process

Strategic Planning is a formal exercise, with planners drawing up objectives, budgets, programs, and operating plans. This was done with the process broken up into distinct steps, defined by checklists, and supported by techniques. As the process is formal, the need for commitment is relevant for all phases. The specification of objectives should be done before the generation of strategies which, in turn, should be completed before the evaluation. The monitoring step is last. The dotted line indicates that, to some extent, the process is iterative. For example, the evaluation may call for going back to the generation of new strategies, or monitoring may require a new evaluation of strategies.

The Planning School from which strategic planning evolved in the 1970s, called for an explicit written process for determining the firm's long-range objectives, the generation of alternative strategies for achieving these objectives, the evaluation of these strategies, and a systematic procedure for monitoring results. Each of these steps of the planning process was accompanied by an explicit procedure for gaining commitment. This gave birth to Corporate Planning Departments which were setup in order to implement Strategic Planning. The planning was carried out by corporate planners, who were the think tanks of the organization.

Organizations find strategic planning useful because it is a highly systemized form of planning and therefore it is easy to grasp the methods, procedures and rituals programmed to execute the strategies. In addition, its other advantages are:

(a) It provides a structured means of analysis and thinking about complex strategic problems, requiring management to question and challenge what they take for granted.

(b) It can be used to involve people in strategy development.

(c) It is also a way to communicate the intent of management to members of the organization.

(d) It can be used as a means of control by regularly reviewing performance and progress against agreed objectives.

The different phases in the development of strategic management practices in an organization are shown in Table 1.3. These differences also reflect the changing concepts of strategic management taking place over a period of time. Strategic Management as we know it now is what has been given in the table in the last two columns of Table 1.3. It is this change that has widened the gap between how strategy was envisioned in 'strategic planning' and now in 'strategic management'.

Table 1.3: Evolution of Strategic Management

PERIOD	1950s	1960s	1970s	1980s	1990s	Now
Dominant Theme	Budgetary Planning & Control	Long term Planning & Environmental Scanning	Environment Scanning & Strategic Planning	Strategic Planning - Systems Approach	The quest for Competitive Advantage	Strategic Innovation
Main Issues	Financial Control through annual budgets	Financial Control through medium term projections	Portfolio Planning	Positioning Approach with focus on Value Chain Analysis	Competitive Advantage, Benchmark-ing & Resource Based Approach	Concept of stretching Strategic & Organiza-tional Advantage
Principal Concepts & Techniques	Budgeting, Investment Planning & Project Appraisal	Forecasting Investment Planning Models	Portfolio Planning, Experience Curves	Organizational Synergy, Industry Structure & Competitor Analysis	Resource Analysis & Analysis of Core Competenc-ies	Dynamic Sources of Competitive Advantage, Knowledge & Learning

Contd....

Organiza-tional Implications	Strategic Planning Structures, Functional Designs	Strategic Planning Structures, Multi-divisional Organization	Financial Control Organizations, e.g. SBUs, Portfolio, Restructur-ing	Strategic Control Organizational Structures, e.g., Matrix, Horizontal	Structures, Structures, IT controls	Virtual Organization Alliances and Networks & Knowledge Based Firms

1.8 LET US SUM UP

The strategic intent of the organization offers unique insights into ways in which organizations work and think. The aspirations of the organization, as reflected in the vision and mission documents, should lead to an end. The vision of an organization consists of two major components, the ideology and the envisioned future of the organization. The core ideology characterizes the enduring nature of an organization and remains unchangeable over a long period of time. The envisaged future provides a description of goals.

However, the most important function of building a vision is to provide a dream to the organization to live for- a basic motivation. Going back to the story of the stonecutter given as an example earlier, the Vision Statement should be such that each person in the organization should see his or her job as part of building a cathedral. It is this type of vision that provides a sense of purpose and common cause to people in the organization.

The mission statement has a different perspective from the vision statement. The mission statement lists out a particular set of tasks that the organization has to carry out in order to fulfill the vision of the organization. It sets out priorities of how the purpose of the organization can be fulfilled and identifies the particular need of society the organization will satisfy.

This particular need of society, for example, could be the need for personal transportation. This need could be satisfied equally by a manufacturer of motorcycles and scooters, as it would by a bicycle manufacturer, or a manufacturer of automobiles. Though they all meet the same need of society, they will necessarily have different objectives.

Just the vision and the mission are not sufficient to create a sense of purpose in the organization. To create purpose, it is equally important to embed the vision and mission of the organization with a set of shared values and beliefs - a description of what type of organization it wants to be. To quote Azim Premji, "Beliefs and values give a common cause and a sense of purpose across the businesses making Wipro in essence one company. They define the spirit of Wipro…"

Objectives define the organization's relationship with the environment and help the organization to pursue its mission. They also provide the standards by which the performance of the organization can be judged. But most important, as strategies consist of a set of objectives, the objectives determine the strategies of the organization.

Firms choose their objectives to reflect the demands of their many stakeholders. (Chandler, 1962).

The extent to which the vision, mission and objectives really help organizations to survive, and equips them to devise and carry out winning strategies, remains an open question. This is not because the future is often uncertain but because managements often believe that they do not have to change when everything seems to be going well. In today's world you cannot build your vision, mission, strategies, and systems on the old assumption of continuity.

It is worth remembering that you cannot manage from the past to the future - to manage well, you have to stand in the future and look at the present. From that vantage point it is possible, with a high degree of consistency, to come up with winning strategies.

The primary objective of management is to enable the organization to cope with the turbulence of the modern world, where priorities change suddenly, uncertainty about the future is the norm, and the pace of change is ever-accelerating. That is what management effort is about - it is worth the effort even though chance events can sometimes lead to results that are very different from what you envisaged.

Strategies surface at different tiers in the organization hierarchy depending on the architecture of the organization. The first task of Strategic Management is formulating the organization's vision, mission, and value statements. Whatever the eventual architecture of the organization, the vision statement encompasses the organization in all its forms. The vision of the organization leads to its Mission and its values. The Mission in turn leads to the Objectives of the firm.

The vision statement should: Resolve Conflicts in Perceptions; be a basis for identification; be a basis for performance; be a Way to Communicate and Reflect Core Values. It should answer the questions: Why does the organization exist? What is its value addition? What's its function? How does it want to be positioned in the market and minds of customers? What business is it in? These are all questions of purpose and the mission and value statements set the organization apart from others.

The Mission and Value Statements should speak loudly and clearly for themselves, generate enthusiasm for the firm's future, and elicit personal effort and dedication. They should Signal the Management's Intents, Business Horizon, and Set a Direction. Looking outwards at customer needs makes the organization a market driven organization and customer driven firm. Looking inwards at how customer needs are satisfied makes the organization a specialized, fully integrated or partially integrated organization. Unlike a vision statement, the mission statement may undergo changes from time to time.

Corporate Objectives evolve directly from the mission statement of the firm. The corporate objectives of the organization form the basis of Business Process Objectives. Business Process Objectives are specific, measurable Objectives that are developed at all levels of the enterprise or company.

Key result areas of a business are generally subservient to the Strategic Objectives and often to the Business Process Objectives.

Objectives of an organization form a hierarchy on a basis similar to that for strategic choice. Objective setting is a top-down process. Some of the issues that need to be kept in mind while setting business objectives are: Balance your Objectives; Avoid Multiplicity of Objectives; One Theme for one Objective; Use Result Oriented Objectives; Quantify Objectives; Network Objectives; and Make them Challenging but Attainable.

1.9 LESSON END ACTIVITY

Read the annual report of a company, you are familiar with as a customer (e.g. an FMCG company like Hindustan Lever Limited). Identify the main characteristics of the strategy, as you perceive it as a customer.

1.10 KEYWORDS

Vission: 'Vision' is a long term perspective of what is the final destination of the organization.

Mission: 'Mission' is the founders' intentions at the outset of the organization- what they wanted to achieve.

Values: 'Values' manifest in what the organization does as a group and how it operates. It is a guide to ways of choosing among competing priorities and about how to work together.

Strategic Analysis: 'Strategic analysis' is the technique of analysis required to form a view on the key factors that will have an effect on the future well being of the organization.

Strategic Choice: 'Strategic Choice' is a management function of making choices and decisions that will affect the future of the organization.

Strategy Implementation: 'Strategy implementation' is concerned with the translation of strategy into action.

1.11 QUESTIONS FOR DISCUSSION

1. Use your insight and critical abilities to analyze the Vision and Mission Statements for any three organizations given in this lesson. What would be the impact of these statements on the functioning of those organizations? And, Why?
2. This question requires students to demonstrate an understanding of the importance and relevance of the vision and mission statements of an organization. The student is also expected to understand how these statements are arrived at, and under what circumstances they need to be changed or revised.

Check Your Progress: Model Answers

CYP 1

Strategy and tactics are both concerned with formulating and then carrying out courses of action intended to attain particular objectives. The language of strategic manoeuvre is also largely the language of tactics. Strategy, for the most part, is concerned with deploying resources, and tactics is concerned with employing them. Strategy deals with wide spaces, long periods of time, and large movements of forces; tactics deal with the opposite.

CYP 2

1. False
2. True
3. True
4. True
5. True

1.12 SUGGESTED READINGS

Pearce & Robinson, *Strategic Management*, All Indian Travellers N.D.

A.C. Hax and NS., *Strategic Management: An Integrative Perspective*, Majifu, Prentice Hall.

Micheal Porter, *Competitive Strategies*.

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Samul C. Certo and J.Paul Peter, *Strategic Management: Concept and Application* (Second Edition), McGraw Hill.

Georgy G. Dess and Alex Miller, *Strategic Management*, McGraw Hill.

Gerry Jhonson & Keven Scholes, *Exploring Corparate Strategy: Text and Cases*.

Jaunch L Rajive Gupta & William F Glueck, *Business Policy and Strategic Management*, Frank Bros & Co, 2003

Fred R.David, *Strategic Management: Concept and Cases*, Pearson, 2003.

LESSON

2

STRATEGIC MANAGEMENT PRACTICE IN INDIA

CONTENTS

2.0 Aims and Objectives

2.1 Introduction

2.2 Strategic Management Practice in India

2.3 Family Run Corporates

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2.5 Lesson End Activity

2.6 Keywords

2.7 Questions for Discussion

2.8 Suggested Readings

2.0 AIMS AND OBJECTIVES

After studying this lesson, you will be able to:

- Learn about dynamics development and the role of a leader
- Understand the strategic management practice in Indian organisation
- Have a knowledge about the family run corporates in India

2.1 INTRODUCTION

In words of C. K. Prahalad, " As Indian firms emerge into the global scene, they bring with them their unique brand of innovative practice. Some of these are radically new ways of organizing and leveraging resources globally, while others are breaking new grounds in offering products and services at price points and quality never envisaged before. Simultaneously, Indian firms are facing hurdles in their rapid growth, as they transition from domestic to global players".

"The rise of India poses opportunities as well as fundamental challenges both to academics and strategists. While access to potentially one billion customers poses large untapped opportunities, the very unique milieu in India is requiring a re-thinking of strategic tenets."

2.2 STRATEGIC MANAGEMENT PRACTICE IN INDIA

In keeping with the strategic imperatives of contemporary global business, the India should focus on the opportunities and challenges associated with enhancing innovation in a world, which is becoming increasingly flatter. Businesses in India, both domestic and foreign, are redefining global industries through innovations in product, process and business models. Importantly, the emergence of innovations that are being targeted to the bottom of the pyramid, are heralding a significant shift to a more inclusive form of capitalism.

As India shakes off the shackles of its past and emerges on the world stage as a rapidly modernizing and progressive nation, it poses a number of challenges and opportunities to strategic thinkers, industry leaders, and policy makers around the world. From the perspective of Indian firms, the challenge revolves around developing platforms for innovation and growth that will sustain their meteoric rise onto the world stage as 'emerging multinationals.' From the perspective of Western firms, the rise of India poses opportunities as well as fundamental challenges. While access to a potential one billion customers poses large untapped opportunities, the very unique milieu in India and the competition from resurgent and ambitious Indian firms poses learning challenges. From this platform, a set of intriguing questions arises:

How can Indian companies put innovation at the heart of their business strategy and organizational culture? How can they harness their entrepreneurial skills to build world-class businesses? What's next for India as it further integrates into the world economy? How are India's leading retailers, banks, pharmaceutical companies and other service providers turning the country into a center for innovation? How should India Inc. help bolster the relatively weak innovation eco-system and infrastructure in the country? How can Indian firms manage overseas growth and integrate Western businesses into their fold? How can Indian firms innovate to face the challenges from challengers such as China and other emerging markets? Similarly, how can Western companies learn to compete in the new world? How can they tap into the disruptive power of innovations that are finding expression at the bottom of the pyramid and scale that into their existing markets? How can they morph themselves so that they are proactive participants in the new age? More broadly, what are the opportunities for creating new insights for strategic management by focusing on the business activities in emerging markets such as India?

Many trans-national businesses have been eyeing India keenly. They either want to cater to the Indian market, source products from India or outsource businesses processes here. The country has a highly skilled manpower pool fluent in English. This, along with state-of-the-art telecom infrastructure makes it a favorable destination for offshore outsourcing of business processes. Further, the country's technology savvy talent base gives it an advantage in low-cost manufacturing of engineered products. But on the flip side, India is a complex market with diverse economic strata, differential economic growth across regions, dynamically changing government policies, diverse cultures, geographically dispersed markets and a huge low-cost unorganized distribution structure.

Therefore, to understand these diversities is extremely important before product portfolios and investment phases for the Indian market are designed. Decisions on partners, acquisition targets and manufacturing locations can also be critical for the success of a business in India.

TSMG of Tata group has developed a unique consulting model for addressing the issues faced by companies leveraging India in its global strategy for growth or cost optimization. Our experience across sectors, knowledge of the Indian markets and consumers, and understanding of government regulations and policies has stood us in good stead while

assisting a number of companies from the US, Europe and Asia prepare and implement India entry strategies. Further, we have helped clients looking to harness India's low-cost manufacturing, through strategic sourcing initiatives and vendor identification. Our numerous service industry clients have been benefited by way of outsourcing their customer facing and back-office processes and setting up of BPO outfits. Often, we have partnered them from identifying processes through to transitioning and stabilising the BPO.

TSMG helps companies understand the contradictions of the Indian market and industry. We develop a detailed strategy for entering India on the lines of phasing of products, markets, investments and customer access plans. As manufacturing capacities are disintegrated and geographically diverse, it is no easy task to identify the most appropriate supplier of a product. We assist companies in identifying the products that can have factor advantages when manufactured in India. We also identify and qualify suitable suppliers with the appropriate technology for production at desired price points, their financial capability to sustain supplies and credibility in business dealings. We also assist in identification of strategic alliance partners and acquisition targets, due diligence and location studies.

In the case of outsourcing of processes, it is critical to identify a suitable vendor as a large number of third-party BPOs, focusing on different industry verticals and business processes, have mushroomed in different geographical hubs. We assist our clients identify the processes to outsource by mapping their criticality to business and costs. The processes can either be out-located to a subsidiary in India or outsourced to a suitable vendor. In the case of out-location, we assist the client set up a subsidiary in India. In the latter case, we help them identify suitable Indian suppliers. We also map the transitioning of the processes to India. We could also run a program management office to stabilize the process in the Indian outfit.

Our India entry practice has assisted several global corporations including some Fortune 500 companies in businesses as diverse as media, retail, telecom and auto components explore and/or set up operations in the Indian sub-continent.

The major objectives of Strategic Management in India include:

Innovation as Strategy and Strategy as Innovation

Understanding 'game-changing' disruptive innovations. How are Indian companies approaching the innovation challenge as they emerge as new multinationals? Do Indian companies approach the innovation challenge differently from their Western counterparts? What are the implications of the 'frugal innovation' model on global value chains?

Globalization of Indian Firms - Challenges and Opportunities

Another major objectives of Strategic Management in India is to run with the race of globalization, and to keep a vigil at : What is new and innovative about the internationalization moves of these Indian firms? How do they overcome the liability of foreignness? What are the challenges facing Indian companies as they internationalize? What are some implications for established models of strategic management?

India as Innovation Source - MNE Perspectives

Yet another purpose of strategic management in India remains to mark out: What are some lessons learned from the successes and challenges of multinationals that have opened up new markets in India? How is the competition from India-based companies different? What has been the experience of multinationals that have set up R&D labs in India? What is the nature of the R&D mandate from Indian subsidiaries?

2.3 FAMILY RUN CORPORATES

A silent revolution is sweeping through India Inc. Leading family-run business groups such as the Birlas, the Ruias, the Goenkas and the Jindals are making efforts to centralise functions such as IT and payroll processing under a single entity, that mirror the large BPO and IT captives currently being run by multinationals such as Citi and HSBC.

Some groups like Essar and the Jindals have already put in one to two years into these efforts and have recruited senior management consultants to head the ventures or put key group executives in charge of them. Other groups, like the Kolkata-based RPG group, are in the process of short-listing consultants to help them come up with a blueprint for the new venture.

"Ours is a large diversified group and it makes sense to have a separate company to handle all IT and related activities. Especially as we have been expanding internationally, the need to have unified company for these services is vital," said Prashant Ruia, director, Essar group.

"This is what has happened globally. We are following the same trend," said Milan Sheth, partner, Ernst & Young. According to him, as these large family-run businesses go global through acquisitions, having a single entity that handles all the IT and support functions also makes integration easier. "In future, these companies can be listed or valued as a commercial business," he added.

Most promoters ET spoke to said the goal was to run the companies as shared service centres, facilities that cater to customers even outside the group fold, making it easier to monetise them. The immediate driver, however, is to build economies of scale and higher efficiency across the group firms.

"We could see three options emerge. One is that the company continues to service all the group companies. The other is, they take the concept to market and take on third party business. The third is, eventually sell it out to a specialised provider like what happened in the Philips-Infosys BPO deal," said Vikash Jain, engagements director, Everest Group.

The Essar group hired Vijay Mehra, a former McKinsey executive with international experience and designated him as group CIO to outline the unified IT and BPO strategy. One of Mr Mehra's first tasks was to come out with a 160-page vision document setting out the blueprint for the delivery of IT solutions across the group, as well for processes such as payroll, human resources, accounting and procurement.

Today, Essar Information Technology Holdings (EITL) is being built to serve all the common IT needs of the group and some functions such as payroll are being handled by its BPO, Aegis BPO. "There will be three legs to it, BPO, IT applications and data centres. To start with, we will service the six Essar business under various holding companies and later, also take on external clients," said Mr Mehra.

Similarly, Aditya Birla group firm, PSI Data Systems, is now being repositioned to handle the IT requirements of all the group companies. "It will be more inward looking now," group chairman Kumar Mangalam Birla had told ET in a recent interview.

The appointment of Dev Bhattacharya, a key member of the Birla group think-tank as group executive president, IT & ITES also reflects this focus, Birla group officials said. In the JSW group, the common IT functions are being centralised under a new firm, JSoft Solutions, formed for this purpose.

"Accounting, payroll, procurement, HR and other common functions will be run as shared services. In another six months we will also extend the operation to outside the group," said JSW group finance director, MVS Seshagiri Rao. Others like the RPG group are in the process of short listing a consultant to guide it on this exercise.

In family run companies, there was a time when the value system of the organization was simply the value system of the patriarch and his wife. Back then, those who invested in company shares were usually businessmen from the same community as the promoter, which meant they had implicit trust in the family management. There were no rules of conduct written down, no formal norms of governance, and the patriarch's sons, sons in-law and nephews were groomed to carry on the business, hopefully inculcated with the same set of values.

It's a wonderful structure in theory, relying as it does on goodness of family values, but alas, history shows that very few have been able to carry it off in practice. MV Subbiah is one of the few who has managed to avoid an acrimonious split in the family, though he's candid about the tensions inherent between the idea of family and the idea of business. Speaking at the third CII Corporate Governance Summit in Mumbai, the former chairman of the Murugappa group said: "A business needs meritocracy, but families want equality among members, so they practice nepotism. Further, families look for high profit, high dividends , safety and security, while a business needs growth and risk-taking ability."

Arun Bharat Ram, chairman of SRF, is from a prominent business family that splintered famously in the late 80s. He believes attitudes have changed since then and business families now actively seek to bring the aspirations of their members in line with what's good for the company. "Family businesses have adapted," he says. "They realize that what is good for the common shareholders in good for them."

With 42% of the companies listed on the Bombay Stock exchange having family shareholdings exceeding 50%, India Inc's fortunes are closely linked to the way family businesses conduct themselves. Then there are a new set of family businesses that are currently establishing themselves in these times of rapid growth. Many of them fall in the small and medium enterprise (SME) category and are not yet listed, but they will eventually set the pace.

ICICI Bank has made it its business to lend to the SME sector and CEO KV Kamath is confident that the new-gen family businesses will measure up. "They are adopting good corporate governance practices of their own volition," he says. "They understand that the best way to increase their wealth is through the valuation of their companies."

Not everyone is convinced. Ajay Bagga, CEO of Lotus India Asset Management, says that family managements continue to be arrogant and at the CII Summit, he presents a series of examples of families that have enriched themselves at the expense of common shareholders. Some give themselves preferential allotments at reduced prices ahead of an IPO and others merge their group companies in a way that the swap ratio favors the company with the higher promoter stake. "It gets hushed up because everyone is making 40% returns on the market," he says. "Shareholder activism doesn't yet exist in India, but if the returns fall, there could be trouble."

What do family-run businesses need to do to earn a reputation for good corporate governance? Ernst &Young , in conjunction with CII, has recently released a discussion paper titled Corporate Governance: Value for whom and how, where it suggests they install a succession planning mechanism, appoint independent directors who are not too close to the family and empower them to help resolve conflicts of interest between the business and the family.

Farokh Balsara, "A huge chunk of Indian companies are family managed and their corporate governance will determine whether people will invest in them and the premium they will pay. For example, in Tata group companies, corporate governance has added significant value to the brand."

One of the most sensitive areas in family run corporates is succession planning. Indian corporates are still a long way from the American model of separation of ownership from management, which means a place needs to be made for succeeding generations of the family. Promoters try to mitigate this problem by ensuring their children have impeccable educational credentials, often followed by a stint in another organization where they might earn their spurs. But still, the nagging question remains - is the family member the best person to take charge? Or should professionals within and outside of the organization be considered?

Rama Bijapurkar is an independent director on the boards of Infosys, Godrej Consumer Products and Mahindra Resorts among others and she candidly admits that it's a difficult call: "Given our Indian culture, if the family owns 60%, can you really contest it if a well educated new family member is brought into the company? As an independent director, I've struggled with that question."

Worse still are the sibling rivalries that crop up in the second generation, when independent directors are usually called upon to mediate. The Murugappa group's MV Subbiah says such rivalries are usually unavoidable and need to be managed. At the CII Summit he had this piece of practical advice to give to family business patriarchs: "Build schools, hospitals, engage your family in social work. Not only does it build a sense of values, it acts as a glue when it comes to a question of a split."

2.3.1 Tata and Ballarpur Industries

Founded in 1868, Tata Industries is the classic Indian example of a family-run business that has built a reputation for philanthropy alongside that of business success. Now one of the largest corporations in India, with over 80 companies operating across seven sectors, the company funds a vast number of charitable Trusts that are involved in a range of community development works. Anant Nadkarni is the general manager of Group CSR for the Tata Council for Community Initiatives, a network of over 30 Tata companies charged with coherently driving projects across 200,000 employees and nearly 100 facilities. He talks proudly of projects run by TCCI, which include the Functional Adult Literacy Programme, which aims to make a substantial contribution to the fight against illiteracy in India.

Tata does appear to be an example of pure corporate philanthropy. As Ratan Tata, chairman of Tata Sons, says, "We are not doing this for propaganda or visibility. We are doing it for the satisfaction of knowing that we have really achieved and given something to the community in which we are working." The Indian philanthropic tradition of Tata and thousands of other family businesses has evolved for many reasons: partly because to live in India is to live in the midst of grotesque inequality, partly because families tend to be rooted in communities and partly because good schools and hospitals produce an educated and healthy workforce.

Perception Problems for Western Multinationals

Foreign multinationals operating in India are finding it difficult to exist alongside this tradition. While the majority have attempted to engage with local communities in a socially and environmentally responsible way, their motives are frequently questioned. "Multinationals often lack direct local knowledge and tend to frame their initiatives in

terms of 'making business sense'," points out Nadkarni. "Too often a genuine desire to build in commercial sustainability is misunderstood and people become suspicious." So Coca-Cola has been accused of polluting water in Kerala, Unilever and Monsanto have both been accused of using large-scale child labour in their Indian cottonseed operations and western multinationals have, as a rule, struggled to convey western notions of what it means to be a socially responsible corporate.

New breed of Indian Corporation

However, the liberalisation of the Indian economy that occurred throughout the 1990s has led to an increased interest in European and North American business ideas. Guatam Thapar is the new and innovative MD of traditional paper manufacturer, Ballarpur Industries (BILT). His CR manager, Yashshree Gurjar, describes how new policies have evolved over the last three years: "Our company is beginning to understand that community is only one of many stakeholders and so we are developing policies with regard to groups like employees, the environment and our suppliers. We are also shifting away from notions of philanthropy and instead are trying to enable people to take charge of their own lives." 2002 saw the company produce its first CR report. "BILT Cares" is an employee-volunteering programme that seeks to involve every employee in the issue of social responsibility. BILT is proving that it is possible to embed CR successfully in a traditional Indian company.

BILT faces many obstacles, not least its own government. Gurjar complains that the Indian government sees CR initiatives as unwelcome competition: "India has for a long time had the problem that government welfare programmes do not reach the poorest in society. Companies can play a key role in facilitating the programmes, especially in remote areas. However, government tends to believe that business is taking over its role and so is reluctant to engage in constructive partnerships."

Many Indian businesspeople want less government and more governance. Corruption remains a crippling problem in India and is for technology giant, Infosys, the first issue of corporate responsibility to be tackled. "If you want to be a responsible company you must first operate legally. You must pay your tax on time and follow the laws of the land," argues Senepathy Gopalakrishnan, COO of Infosys. Although the Infosys Foundation receives one percent of the company's net profit, around US$1 million per quarter to spend on education and health care, it is the standards of corporate governance at the company that have attracted the most favourable attention. It has won a raft of international awards including first place in CG Watch, a survey of corporate governance standards at companies in emerging markets.

Enduring Importance of Philanthropy

Companies like BILT and Infosys remain very much the exception. Although there is a shift from philanthropy to CR, two factors are combining to slow progress in that direction. Firstly, Indian companies face little pressure from NGOs, government and consumers to do more than conform to the tradition of charitable giving. Bimal Arora, director of Partners in Change, an organization that promotes the role of business in Indian development, argues that lack of awareness is limiting progress on the issue: "Unlike in Europe and North America, most consumers have never heard of corporate responsibility. More than anything we need politicians to stand up and promote the issue."

However, the second and perhaps more powerful factor is that India actually remains in need of community development and charitable giving. While the Indian economy has grown by around six percent a year since 1990, 25 percent of the population still lives below the poverty line, 45 percent is illiterate and many lack access to basic sanitation and health care. While in the developed world companies need to consider broader issues, such as supplier relations, employee satisfaction, environmental impact and

corporate governance, for many Indian businesses these would simply be distractions from the critically important work of community development and charitable giving. Mohan Kaul, director general of the Commonwealth Business Council, emphasizes the importance of this work: "It is unlikely that development goals will be reached unless business is involved in some way. This means continuing to fund education and health care as many businesses already do to their great credit. It is no exaggeration to say that without these charitable works many parts of India would be in desperate trouble."

In time, foreign multinationals in India may need to recognize that, while broader issues of social responsibility are important in the developed world, profitable ventures in the developing world are still expected to engage in old-fashioned philanthropy. In time, multi-stakeholder partnerships will become more important. But in the immediate future Jamsetji Tata's emphasis on community development will remain as relevant as it was over one hundred years ago.

Check Your Progress

State whether the following statements are True or False:

1. The corporate sector in India very often blames the government for poor governance and lack of farsightedness.
2. Businesses today are realizing that the world is not made up of strangers.
3. In India, most of the corporate do not have a clear policy on social responsibility.
4. While developed countries like England have separate ministries to look after the issue of corporate social responsibility, in India, the government does not have a clear policy on the issue.
5. Many Indian businesspeople want less government and more governance.

2.4 LET US SUM UP

A Statement of Intent Generating wealth in a manner that is socially and environmentally sustainable must be the common goal of domestic and international business. In this age of open world economy, brand reputation, repositioning of government activities and privatisation, it is increasingly important to do business ethically, morally and with concern for the society. Businesses today are realizing that the world is not made up of strangers. There is bondage- human bondage. There are customers, employees, shareholders and the neighbours. The business class should render their support to the general people. If they will be uplifted socially and economically, the productivity of the corporate is also bound to increase.

The corporate sector in India very often blames the government for poor governance and lack of farsightedness. The question that comes every time into mind is, do the corporate sector performs its duty to contribute to the overall growth of the country? Does it have right to blame the government for poor governance? Does it contribute to nation building?

In India, most of the corporate do not have a clear policy on social responsibility. While developed countries like England have separate ministries to look after the issue of corporate social responsibility, in India, the government does not have a clear policy on the issue. Out of very few companies who contribute to the social development, the basic intention was not to ensure the good of the nation, rather a business policy to stay away from the tax net.

The corporate and the government should try to build up a relationship between the business and the society. The concept of corporate social responsibility (CSR) has so far failed to take deep root in India because the nomenclature is not properly defined.

2.5 LESSON END ACTIVITY

Prepare a note on the strategic management practice adopted by the Reliance Industries, in the last five years.

2.6 KEYWORDS

Strategy Objectives: 'Strategic Objectives' are the goals of the whole enterprise and reflect the firm's aims. This set of objectives is a commitment of the organization to direct efforts and energy on what needs to be accomplished. They also provide a benchmark for judging organizational performance.

Business Process Objectives: 'Business Process Objectives' are specific, measurable Objectives that are developed at all levels of the enterprise or company. The Objectives represent managerial commitment to achieve specific and measurable performance targets in a measurable time frame.

Key Result Areas: 'Key Result Areas (KRAs),' are areas where performance is essential for the ongoing success of the enterprise.

2.7 QUESTIONS FOR DISCUSSION

1. Comment on the strategic management practice prevalent in India.
2. Write a note on various ways in which different Indian organizations have set up their vision, mission and values.
3. What do you understand is the importance and relevance of the vision and mission statement of various Indian organizations?
4. Write a note on the family run corporates, The Tata, and the Ballarpur Industries.

Check Your Progress: Model Answers

1. T, 2. T, 3. T, 4. T, 5. T.

2.8 SUGGESTED READINGS

Pearce & Robinson, *Strategic Management*, All Indian Travellers N.D.

A.C. Hax and NS., *Strategic Management: An Integrative Perspective*, Majifu, Prentice Hall.

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UNIT II

LESSON

3

ENVIRONMENTAL ANALYSIS OF A FIRM

CONTENTS

3.0 Aims and Objectives

3.1 Introduction

3.2 Competitive and Environment Analysis - to Identify Opportunities and Threat

3.2.1 Competitive and Environment Analysis

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3.4 Identifying Critical Success Factors

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3.5 Let us Sum up

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3.7 Keywords

3.8 Questions for Discussion

3.9 Suggested Readings

3.0 AIMS AND OBJECTIVES

After studying this lesson, you will be able to:

- Understand environment analysis and internal analysis of a firm
- Know about the general environment scanning
- Understand the competitive environment analysis to identify opportunities and threat

3.1 INTRODUCTION

The limitations of the traditional long-term planning model lead to the development of the environmental scanning model.

The environmental scanning model was also designed with 4 activities as shown in Figure 3.1.

- Scanning the external environment for threats or opportunities to the organization.

- Each potential issue or trend is then analyzed (evaluation/ranking) as to the likelihood that it will emerge and the nature and degree of its impact on the organization if it should actually materialize. This stage produces a rank ordering of the issues and trends according to their importance to current or planned operations.
- Forecasting focuses on developing an understanding of the expected future for the most important issues and trends, using forecasting techniques.
- Monitoring is used to track the continued relevance of each issue and identify areas for additional and continued scanning.

For example, monitoring may suggest that an original forecast of the prices of the raw materials that go into the product are no longer credible, which would imply the need for more focused scanning, forecasting, and analysis to develop a more credible projection on the cost of inputs and understand the forces that are moving the prices of the raw materials. Similarly, there could be changes in other factors, e.g., competitor's activities, market preferences, new technology etc.

In an environment of rapid change, an unforeseen event can render market forecasts obsolete almost overnight. The understanding provided on the basic marketplace results in a new grasp of the key determinants of business success and improved planning effectiveness.

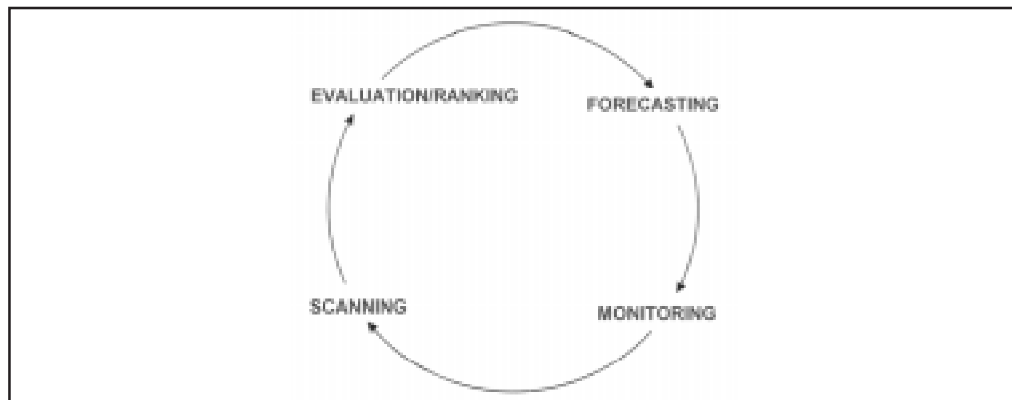


Figure 3.1: Environment Scanning Model

3.2 COMPETITIVE AND ENVIRONMENT ANALYSIS - TO IDENTIFY OPPORTUNITIES AND THREAT

3.2.1 Competitive and Environment Analysis

Coping with change is one of the most persistent problems facing a firm. The firm's survival depends on its capacity to exploit evolving technical and market transformations. Forecasting provides the firm with the information necessary to identify the opportunities and threats it may face in pursuing its corporate goals. As Peter Drucker says, business forecasting is concerned not with the future itself, but by the futurity of the present decisions taken by management today.

Inherent with the notion of strategy is the search to identify bases of advantage. There is a need to identify if there are factors which influence the capability of the organization to position itself advantageously. Specific models provide an insight at the level of the organization, the product group, or the Strategic Business Unit. These are given below:

- Competitiveness Profiling
- Strategic Group Analysis
- The "Five Forces Model"

We will also discuss a Scenario Planning, which is used in the case of situations with a high degree of uncertainty.

Competitiveness Profiling

A powerful tool for strategic analysis involves creating a simple profile of how our product matches up to what the market wants and our best competitors can offer. The step-by-step process is well-suited to discussion in groups and provides a powerful way of building a shared awareness of the strategic challenges facing the firm.

The first step is to identify the market requirements for performance of the product being examined. The concept of 'order qualifiers' and 'order winners' is helpful here. This involves defining the factors that have to be present simply to be able to remain in the market (such as price, quality, etc.) and those required winning customers (such as levels of customisation, design, delivery, etc.) in each product category.

To assist the group in arriving at its view, additional information can be provided from market research mapping techniques, based upon consumer responses. Advanced techniques like 'perceptual mapping' and 'joint space analysis' have been developed to assist the firm understand the market and the competition it faces. They are also used to determine the importance of various attributes. A basic analysis of consumers is made to determine what brands they purchase, why they purchase them, what are they looking for, and how can they be described in enduring characteristics or psychographic variables? The customer analysis can be used in this technique to identify the product or service features, price and market performance expectations.

Perceptual Mapping

Perceptual Mapping has been a popular way to represent what people believe about choice objects. All Perceptual Mapping methods produce a spatial representation of how individuals perceive the various brands. In a perceptual space, brands that are perceived to be similar are located close to each other and brands that are perceived to be dissimilar are further apart.

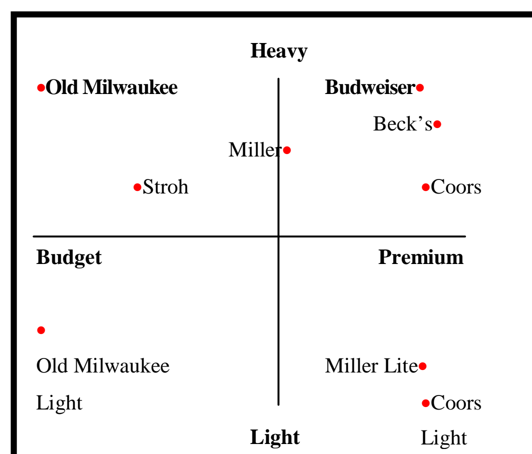


Figure 3.2: Perceptual Map of the Beer Market

The related procedures are based on a number of assumptions:

- The product is a bundle of attribute levels - the product can be decomposed into various utilities for which utilities can be calculated
- The utility of the product is some simple function of the product's attribute levels
- The product that has the highest utility will be selected by the consumer.

We have taken the case of the brewing industry to illustrate the technique. The brands are shown as points on the map. The map has two dimensions, the horizontal axis is labelled 'Premium - Budget' and the vertical axis is labelled 'Heavy - Light'. The distance between the points is inversely proportional to the similarity between the brands.

The location of a brand relative to each axis indicates whether it is perceived to be more of a premium or budget beer and whether it is perceived to be heavier or lighter than average. For example, Miller Lite and Old Milwaukee Light are perceived to be more like each other than either is to Budweiser. However, Miller Lite is a premium beer and Old Milwaukee Light is a budget beer. A typical map has been shown as Figure 3.2.

After the group has discussed and analyzed the results that have been obtained, it tries to answer the question "What level of performance does the market want on each of these criteria"? Using a scoring scale of 1 to 10 where '1' is not important and '10' is very important, score each important attribute that has been short listed. Essentially this stage involves building up a map of what the market requires.

Perceptual Mapping can be constructed using any set of attributes that are selected. Sometimes, a larger number attributes need examining. In this case a similar exercise is carried out again using a different set of attributes in the perceptual map.

The next stage is to analyze how we meet these criteria in our product. We rate the factors in the case of own product. We will also like to identify the best competitor in the market and make a similar analysis on his product. For all but the smallest firm, there may be a number of different product/market combinations with widely-differing strategic characteristics. Where one business might involve a relatively standard product and compete in a market based on price, another may involve producing to customer specifications, where competition is based on fast delivery, high quality and the ability to meet customer needs as closely as possible. We need to choose the alternatives that most closely match our market profile.

Joint Space Analysis

The starting point of the Joint Space Analysis is the Perceptual map. Joint Spaces are constructed from Perceptual maps by including some measure of preference or likelihood to purchase in the space. Using ideal points or preference vectors does this. In Figure 3.4, ideal points have been used. The ideal points could have been replaced by any other measurement criteria. In this case, an ideal point represents a consumer's most preferred combination of the attributes defining the space.

People are assumed to prefer brands that are located closer to their ideal points to those that are located further. The people in the first segment judge a heavier fairly premium beer to be ideal. One would expect them to prefer Budweiser or Beck's. The people in the second segment prefer a light fairly premium beer, such as Miller Lite and Coors Light.

Figure 3.3 shows that there are 4 product categories in the beer market. It gives a ranking of the various brands in the consumer's mind. Therefore, in the heavy premium category, Budweiser is the preferred brand; in the light premium brand Miller Lite, Old Milwaukee Light in the light budget category are the preferred brands. The joint space analysis also provides the relative ranking of the various brands in each segment. This provides the insight to the products, the perception of the market and the working of the firm. The results of this exercise should be a clear picture of what direction changes are needed, and the range of possible options that the firm should consider.

At this stage, using the information provided by the joint space analysis and the consensus within the group, it is useful to review the internal capability of the firm to meet the performance targets of the market requirement. This can be a review of strengths and

weaknesses of individual elements in the product or process. If the competitor is better able to meet the market demands, we have a problem. Either we close the gap or find some alternative means of reducing the advantage of competition. Explore the range of innovations possible for effecting improvements in the identified areas. We might even stretch the model a little and ask questions like: "If I had a product that met or exceeded market expectations, what would it be like?" or "How much advantage would I get if I had a process which was faster/higher quality/etc."? We would also examine the potential choices and select options based upon some set of priorities.

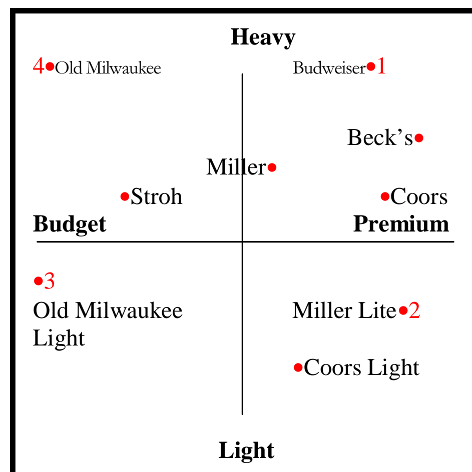


Figure 3.3: Joint Space of the Beer Market

Competitive Profiling

Competitive profiling involves creating a simple profile of how products and processes match up to what the market wants and what competitors can offer. It provides a focus to the business and identifies order winners and the market requirements to be an order winner. It also identifies our internal performance and benchmarks our product with the best competitor. It tells us what needs to be done to match up to competition. It acts both as a check list as well as a forum to brainstorm on our product and process.

As with all tools of this kind its main purpose is to focus thinking and discussion—to help firms 'look before they leap'. Therefore, we need not use market research data for brain storming; we can also do without it.

Strategic Group Analysis

Sometimes, the problem with the analysis of competition is that defining 'industry' does not always identify our competition. In a specific industry many companies have different interests and different bases of competition. Some may be competing with us directly, some may not. Strategic Group Analysis has as its objective, identification of groupings within the industry that have similar strategic characteristics, following similar strategies or are competing on similar bases.

Table 3.1: Strategy versus Tactics

Characteristics
Extent of Product or Service Diversity
Extent of Geographic Coverage
Number of Market Segments Served
Distribution Channels used

Contd....

Extent of Branding
Marketing Mix
Extent of Vertical Integration
Product or Service Quality
Technological Leadership
R&D Capability
Utilization of Capacity
Pricing Policy
Ownership Structure
Relationship to Influence Groups
Size of Organization

It is possible to identify these grouping by using 2 or 3 sets of key characteristics that distinguish between the organizations.

The basis for deciding the relevance of the characteristics is of utmost importance. Our direct competitors can perhaps be determined based on the history and development of the industry, strategies of the organization, and identification of the forces at work in the environment, etc. The idea is to determine those parameters that differentiate and provide logic for the groupings.

Such groupings can be plotted on a matrix or shown graphically using mapping techniques as shown in Figure 3.4. There are a number of research methodologies that can be used to collect data and analyse it in terms of the requirements of the firm.

These types of analysis are useful in many different ways, as is shown below:

- It helps identify the most direct competitors, and the basis on which competitive rivalry is expected to take place within strategic groups
- It indicates the degree of ease how easy it is for an organization (and its likelihood) to move from one strategic group to another
- It often results in identifying strategic opportunities
- Some significant strategic problems are also brought up by such an analysis.

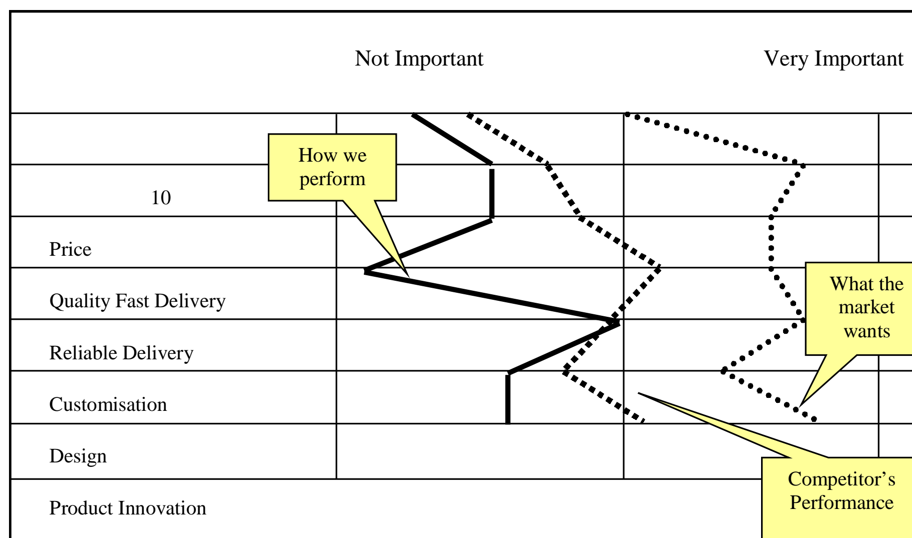


Figure 3.4: Competitor Profiling

Five Forces Model

The 'Five Forces Model', developed by Michael Porter, provides the groundwork for strategic action. Competitive forces determine profitability and are therefore of foremost importance to the firm. Competition is not manifested only in the other players. Competition is rooted in the underlying economic structure. Customers, suppliers, potential entrants and substitute products, all have the potential to impact the market depending on the industry. The model is shown in Figure 3.5.

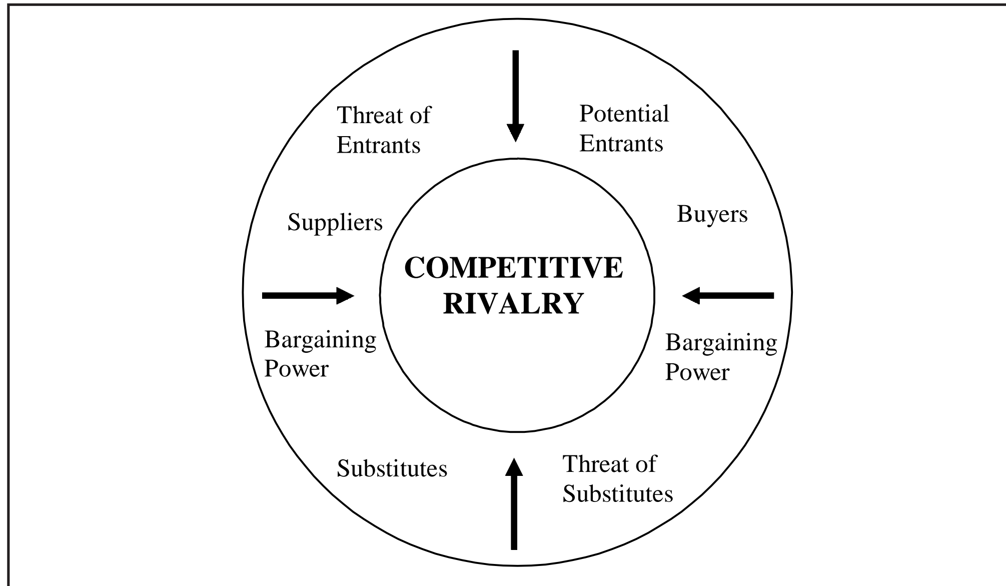


Figure 3.5: The Five Forces Model

It represents the competitive universe of the firm. Its main purpose of this analysis is to provide a structure for discussion and debate around the theme of strategy. It is a powerful and simple tool for analysis. At a generalized level, the variety of influences will be so great that it will reduce the value of the analysis. This model is found to be very effective at the level of the Strategic Business Unit (SBU). The unit under analysis or the products that are being examined should be such that there is no great difference between the five forces. If there is a large difference, the unit or the product group should be broken down to a more congruent configuration for the greatest effectiveness of the model.

There has been some criticism that because of its simplification of complex relationships, it is linear in structure. In response, Porter has increased the complexity of the model, which is beyond the scope of this discussion. However, even in its simplest form, the 'Five Forces Model' can be extremely helpful in most cases. The five forces considered in this model are:

Threat of New Entrants

New entrants bring in new capacity, the desire to gain market share and often substantial resources. They may offer products or services at lower prices or with some advantage. The extent to which there are high 'entry barriers' is an indication of strategic strength. Entry barriers come in the form of economies of scale - the new entrant may have to come in on a large scale or accept a cost disadvantage. Cost disadvantages to the new entrants are sometimes there when there is an established operator who knows the market well and has good relationships with the suppliers and the buyers. Examples of economies of scale are relevant in the production of electrical components, or fast moving consumer goods.

Requirement of large financial resources can also deter competition from entering the product market. This could be the case in industries like chemicals, power or mining. Brand identification may require very high entry expenditures in the form of advertising and promotion. Entrenched companies may have price advantages that are not available to potential competitors. These advantages may stem from proprietary technologies, lower asset costs, effects of the learning curve etc. It may also not be very cost effective to set-up new distribution network to compete with the entrenched players. Sometimes there may be Governmental restrictions in terms of licensing requirements. All these factors can act as barriers to the entry to the market.

Bargaining Power of Suppliers

Suppliers can exert bargaining power in an industry by raising prices or by change in the quality of their goods and services. Powerful supplier groups can squeeze the profitability of the company or industry. The supplier group is strong when it is large and dominated by a few companies; for example, a major steel producer selling to a small metal fabricator. In this case, the client firm has a weak position and its ability to compete will to a large extent depend on the steel producer. If, for example the supplier decided to raise prices, the firm would have little option but to carry the cost. When its product is unique or differentiated; it does not have sufficient competition; it has the ability to integrate forward into the industry; or the industry is not an important customer the supplier is strong.

A significant outcome of analysing suppliers is that strategies can be developed that can enhance the power of the organization or create a situation of mutual interest. An example of enhancing the power of the organization was seen when the Government of India, in the early nineteen fifties floated an organization, "Directorate General of Supplies and Disposals (DGS&D)". This organization had, as one of its objectives, to consolidate the buying power of Government purchases so as to maximise the negotiating power of the Government.

Bargaining Power of Buyers

Customers can lower the profitability of the firm by forcing down prices, playing competitors against each other, or demand better quality, service and design. The bargaining power of the buyers is high if it purchases in large quantities; there is little switching costs associated with purchase decision; there are lower cost substitute products available to the buyer; the price, quality and brand identity of the product is not critical to the purchase decision. The buyer will pose a threat to the industry if they decide to integrate backwards to make the industry's product. Depending upon the configuration of factors, the buyers can have a profound affect on the market of the product.

Here also, the organization can develop strategies that can enhance the power of the organization, create a situation of mutual interest or develop mutually beneficial links.

Existence of Substitute Products

Substitute products limit the potential of an industry by placing a ceiling on the prices it can charge. The more attractive the price performance trade-off offered by such products, the greater are the limitations of the industry to improve profitability. Substitute products that have the potential to improving their price performance trade-off with the industry are potential threats. For example, a new technology could simultaneously open the doors to substitutes and lower entry barriers to other players. Equally, a firm that has a product that cannot be easily substituted, either because it is unique or because it has some form of protection (e.g. a patent), is in a strong position.

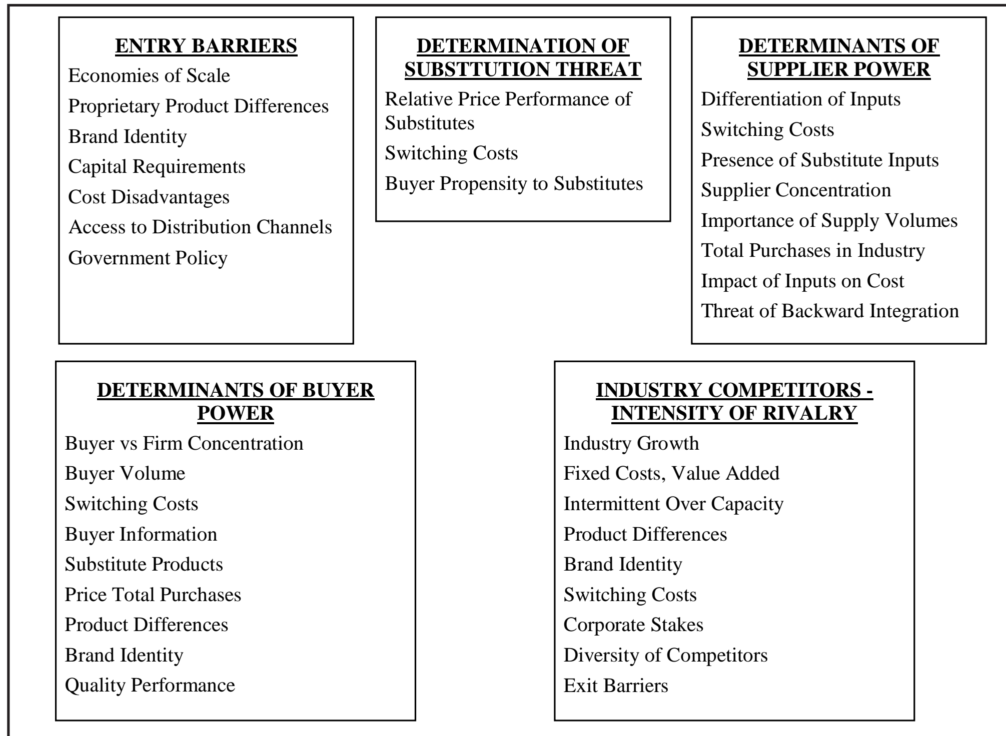
The key question for this analysis is whether or not the substitute poses a threat to the organization's product or service or provides a higher perceived value or benefit. Another issue is: what is the ease with which buyers can switch to substitutes. Can the organization reduce the risk of substitution by building in switching costs?

Intensity of Rivalry

There is competitive rivalry between firms on a continuing basis, the various players in a particular sector or niche try to constantly jockey for position and try new product and process innovations in order to develop a strategic edge and hence a stronger position in the competitive space. Intense rivalry is related to a number of factors; competitors are large in number and of comparable sizes; industry growth is slow; the product or service has low switching costs; fixed costs are high; the product is perishable; exit barriers are high; etc.

In strategic terms, the most competitive conditions will be those in which entry is likely, substitutes threaten, and buyer and suppliers exercise control.

Box 3.1: Porter's Five Forces Model



Very often, the power of buyers and suppliers is taken together. This is because the acquisition of resources and delivery of goods and services is known as the 'Supply Chain' or the 'Value Chain" of an organization. The Value Chain is an important 'competence' of an organization.

The position of the various players in a particular sector, which is competing with the Industry, i.e. whether the structural factors enable a good chance of earning a reasonable return on investment, can be judged in terms of size, growth, current profitability, ability to maintain prices during downturns, base technology and rate of technological change. As the industry matures, its growth rate falls, resulting in a profit squeeze. This is the time that threatens the survival of the weaker firms. Factors like technological change, acquisitions and mergers etc., can change the personality of an industry.

The first step is to identify and categorize a list of observations on every factor that defines the company's competition, entry barriers, supplier and buyer power, and substitutes. These factors are shown, for each of the 5 forces, in Box 3.1. Then determine which of the "issues" are important and focus on these items. These are the factors we have identified that will impact the problem.

The objective of the exercise is to identify: What factors are affecting the competitiveness of the organization? Which of these are important? This could be followed with a SWOT analysis to determine the competitive strategy. However, this approach can only be used for extremely simple problems. A number of complex computer models have also been developed to assist in the analysis.

Porter's analysis underscores the firm's opportunity to decide its strategy freely. The market maintains its importance but firms seem to be given higher levels of freedom. According to the Harvard School, strategy is the result of a one-way interaction between industry and firms, from external to internal environment, consistent with a strong pattern of structure-conduct-performance. Porter makes the model less rigid, giving the firm the opportunity to move in the market freely.

The value of this model is that it is a thought provoking aid to help understand the threats and opportunities facing the firm. The Five Forces Model has created new thinking on supplier relations and in some cases promoted the change of adversarial relationships to developing co-operative relationships. It is a very important tool for developing the firm's strategy.

Getting Information

All Competitive Environment Analysis models require a large amount of information on competition and customers. Porter's Five Forces Model requires information on the suppliers and buyers also, to be effectively used. The nature, type and the details of the information required will depend on the analysis technique that is to be used as well as the required depth of analysis by our organization.

There are a number of institutions and consultants that can provide a Competitive Environment Analysis. However, it will be an advantage if the organization has the capability to make such an analysis internally. A large part of the information required for the model can come from secondary sources. Secondary sources include information developed for a specific purpose but subsequently made available for public access and thus alternative uses. With the ever increasing speed of document identification and retrieval through electronic means, secondary sources are not only an inexpensive source of information but are readily available soon after publication.

Some sources have been identified in the paragraphs that follow. It should be remembered that these sources of information are indicative and not comprehensive. These include:

- ***Advertising:*** Not only does advertising copy tell us a competitor's price and other product information, it provides an indication of our competitor's entire promotional program and budget. It's also important to notice the design and tone of our competitor's advertisements. What kind of image do they convey? How does our own image compare?
- ***Sales Brochures:*** Sales brochures provide a wealth of product information. We can learn how our competitors are positioning their products and companies and what features and benefits they're using to sell their products.
- ***Newspaper and Magazine Articles:*** Articles in newspapers and magazines are a source of information we can use to get an idea of what our competitor is planning for the future, how their organization is run, and what new product information or innovations they have. Be on the lookout for product reviews in magazines; they will usually discuss a competing product's strengths and weaknesses.
- ***Reference Books and Databases:*** The publications listed in this section are available at most public libraries that have business resources. Government sources that we should examine include:
    - Census Bureau sources of statistics on our business

- State agency publications such as industry directory's, and statistics on local industry employment, production, and equipment
- United Nations, Statistical Year Book
- Current 5 Year Plan, Planning Commission, Government of India
- Guidelines to Industry, Ministry of Industries, Government of India
- RBI Annual Companies Report

- ***Commercial data sources include:***
  - International directories e.g. Dun & Bradstreet Database
  - Competitive data and Analysis from the Chambers of Commerce.
  - Indian Databases provided by CRISIL, India Infoline etc.
  - Data from Centre for Monitoring Indian Economy
  - ICICI Portfolio Studies
  - Financial Analysis of companies is published by a number of organizations including financial institutions like ICICI, IDBI etc.
  - BSE Official Directory
  - Clipping Services
  - Security Analysts & RBI Bulletins
  - Analyst's Reports
  - Patent Records
  - Court Records

On-line versions of these products not only make their pertinent statistics easy to find, they often permit downloading of data, so we can combine it with other data to produce our own statistical analyses.

- ***Annual Reports:*** If our competitor is a publicly-held or a privately held company, many of its reports are available with the Registrar of Companies.
- ***Your Sales Force:*** Our sales staff probably has more access to competitive information than anyone else in our organization. Customers often show salespeople sales literature, contracts, price quotes, and other information from competitors.
- ***Other Employees:*** Our employees working in other areas of the company also become exposed to competitive information. They interact with others in their industry area and often learn what your rival is doing or hear gossip and rumours.
- ***Trade Associations:*** Most professional trade associations compile and publish industry statistics and report on industry news and leaders through trade association magazines and newsletters.
- ***Your Competitors:*** We can garner a great deal of information through a simple, friendly conversation. People like to talk about themselves and share their success stories and concerns with business associates.
- ***Your Business Network:*** Make it a point to interview the customers, suppliers, bankers, government employees, and industry experts about your competition's product and service.

Compiling of Data

Compiling data for a sophisticated competitor analysis requires an organized mechanism. Many large companies have a Marketing Services Department, or a similar set-up, that can be used to ensure that the process is efficient. The details of information gathering and analysis will vary depending on the firm's need, the sophistication of the analyses, the industry as well as the capability of the firm.

Analysis of Data

The data that has been collected should be ranked according to the reliability of the source. It has to be compiled in a form that can be used by management. This can be done by cataloging the data based on competitors, and creating the abstracts. Gathering data is a useless effort unless it is used to formulate strategy, and concise and creative ways must be devised to put the data in a form that is usable by top management. This could include periodic comparative financial analysis of key competitors, relative product line analysis, estimations of competitor's cost curves and relative costs, and finally this could also include pro forma financial statements on competitors under different scenarios about the economy, prices, and competitive conditions. This information can be computerized, providing both the catalog as well as the abstract, which should be made available to the company strategists and top management.

Check Your Progress 1

Define Perceptual Mapping.

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3.3 ASSESSING INTERNAL ENVIRONMENT THROUGH FUNCTIONAL APPROACH AND VALUE CHAIN

3.3.1 Value Chain

Value analysis was originally an accounting method used to analyze complex manufacturing systems. It was designed to find out and examine how to bring in cost improvements or improve value creation in the system. Accountants, instead of using conventional costing for expenses for a specific function, broke them into the activities of the function.

A simple example is given below. The traditional method of representing expenses of the Materials Management function is as follows:

Salaries & Wages	Rs. 500,000.00
Staff Welfare	Rs. 75,000.00
Supplies	Rs. 10,000.00
Travel	Rs. 25,000.00
Other Fixed Charges	Rs. 100,000.00
Depreciation	Rs. 50,000.00
Miscellaneous	Rs. 25,000.00
TOTAL	**Rs. 785,000.00**

By breaking up the function into activities and restructuring the way in which the expenses were allocated, accountants were able to identify the expenses and effectively identify areas where value was added and from that they were able to identify areas where cost

savings could be possible. They were able to compare and evaluate expenses across different product lines. Using the Value analysis concepts, accountants rewrote these figures as follows:

Process Purchase Orders	Rs. 150,000.00
Delivery & Follow-up	Rs. 70,000.00
Warehousing Costs	Rs. 150,000.00
Receipts Checking	Rs. 150,000.00
Vendor Assistance	Rs. 85,000.00
Administration	Rs. 180,000.00
TOTAL	**Rs. 785,000.00**

Porter, in his book Competitive Advantage: Creating and Sustaining Superior Performance (1985) used the concepts of separate activities and value added and linked them for analysing the organization's competitive advantage. In Porter's analysis, he considered 'strategic fit', as the way various components of a strategy interlink, and this could be facilitated by, "creating a value chain that is as strong as its strongest link, and is a more potent, and central, strategic concept."

According to Porter, the processes and linkages between activities can be better examined and understood through a Value Chain Analysis. The value chain analysis describes the activities the organization performs and links them to the organization's competitive position. Therefore, it evaluates which value each particular activity adds to the organization's products or services.

This idea of the value chain recognises that organizations are much more than a random compilation of machinery, equipment, people and money. If these assets are deployed into activities or are arranged into systems effectively so as to maximize the benefits to the organization, it will become possible to produce something of value for which customers are willing to pay a price. In other words, it is the ability to perform particular activities efficiently and the ability to manage the linkages between these activities which are the source of competitive advantage.

3.3.2 Primary Activities

Porter distinguishes between primary activities and support activities. Primary activities are directly concerned with the creation or delivery of a product or service. They can be grouped into five main areas:

Inbound logistics: These are inputs required and disseminated by the organization in order to produce the goods and services that it offers. These could be activities concerned with receiving goods, stores functions, inventory control, etc.

Operations: These are the primary activities involved in converting the inputs into outputs. For example, in an automotive company, these could be foundry operations, forging operations, machining, assembly, painting, etc.

Outbound logistics: Once the output reaches its final form, the activities that are involved in taking the service or product to the end user or bring the end user to the product of service. For example, in the case of tangible products it could mean warehousing, transportation, material handling, etc.

Marketing and Sales: These are activities linked to bring the product to the attention of the consumer and induce them to consume the product or service. It also includes those activities that would enable and facilitate purchase of the product or service. This would include sales administration, marketing services, advertising and promotion, etc.

Service: These are activities designed to enhance or maintain a product or service's value. Examples are installation of the product, spare parts support, warranty administration, maintenance, etc.

Each of these primary activities is linked to support activities which help to improve their effectiveness or efficiency. There are four main areas of support activities:

Procurement: This refers to the activities involved in acquiring the various resource inputs needed to produce the product or the service. This could be procurement of capital goods, consumables, production parts, raw materials, etc. Procurement occurs in many parts of the organization.

Technology Development: All 'value' activities have a technology, even if it is certain rules and procedures. The key technology may be directly concerned with the product or service, e.g., Research & Development, Design, etc., or with the process, for example design of dies and fixtures, or methods to improve productivity, etc., or with a particular resource, e.g., raw material improvements etc.

Human Resource Management: This is concerned with all activities involved in recruiting, training, developing and rewarding people in the organization. This is a particularly important function as it is the basis for creating, rewarding and enhancing those competencies that are related to the people in the organization.

Infrastructure: The systems for planning, finance, legal, quality, information management, etc., are included under this head. These activities are crucially important in the organization's performance of its primary activities. Through its infrastructure, the organization tries to effectively and consistently identify external opportunities and threats, identify resources and capabilities, and support core competencies. Infrastructure also includes the structures and routines of the organization that sustain its culture.

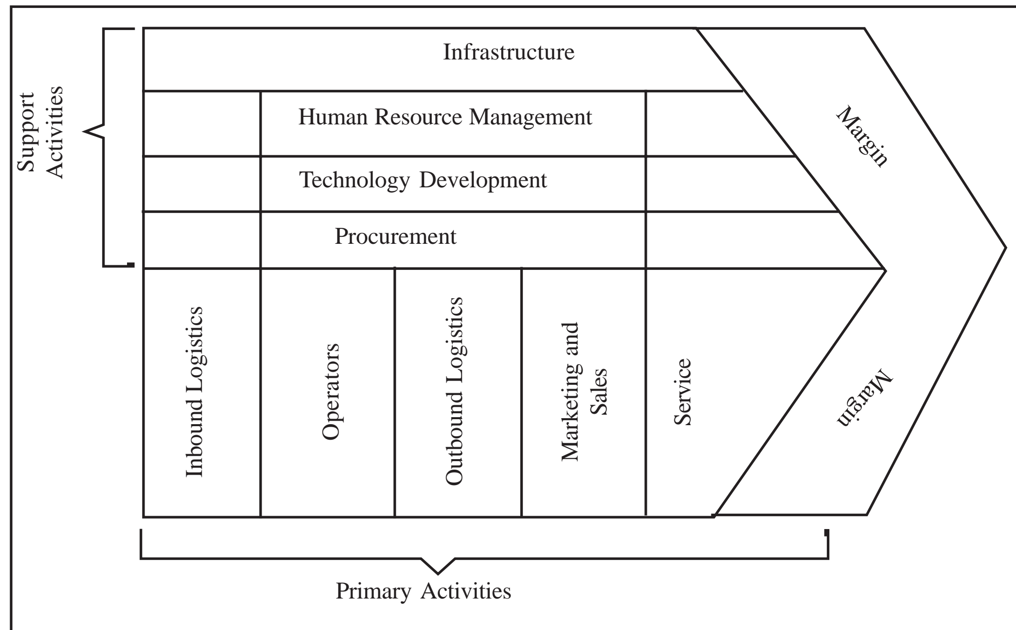

Figure 3.6: The Value Chain

In Figure 3.6, the primary activities as well as the support activities are bordered with a 'margin'. The term, 'margin' implies that organizations realize a profit margin that depends on their ability to manage the linkages between all activities in the value chain. In other words, the objective of the organization is to deliver a product/ service for which the customer is willing to pay more than the sum of the costs of all activities in the value chain.

These linkages shown in the model are crucial for corporate success. The linkages are flows of information, goods and services, as well as systems and processes for regulating activities. In the result, the linkages are about seamless cooperation and information flow between the value chain activities. Their importance is illustrated with a simple example:

In an organization producing a tangible product, the Marketing & Sales function is supposed to deliver the sales forecasts for the next period to all other departments in time and with reliable accuracy. Based on this forecast, procurement will be able to order the necessary material for the correct date. And if the materials and inputs are properly provided by procurement and it forwards order information to inbound logistics, only then will operations be able to schedule production in a way that guarantees the delivery of products in a timely and effective manner - as pre-determined by marketing.

One of the key features of modern industrial systems is that organizations use specialist services, incorporate proprietary items into products, and develop ancillaries to support their product and services. Very rarely does a single company perform all activities from product design, production of components, and final assembly to delivery to the final user by itself. Therefore, all the organizations connected with delivering the product or services to the final consumer are elements of a value system or supply chain. There is usually specialization of role and a number of organizations are involved in the creation of the final product.

In looking at the strategic capability of an organization, it is not sufficient to look inside the organization. We must look into the interconnections. Much of the value creation will occur in the supply and distribution chain. Any analysis of the strategic capability has to be viewed from a holistic viewpoint that includes the entire value chain. For example, an analysis into the value chain may show that some of these interconnections will be critical to the competitive advantage of the organization; some can perhaps have substitutes; others can be eliminated. Hence, value chain analysis should cover the whole value system in which the organization operates. This concept is illustrated in Figure 3.7.

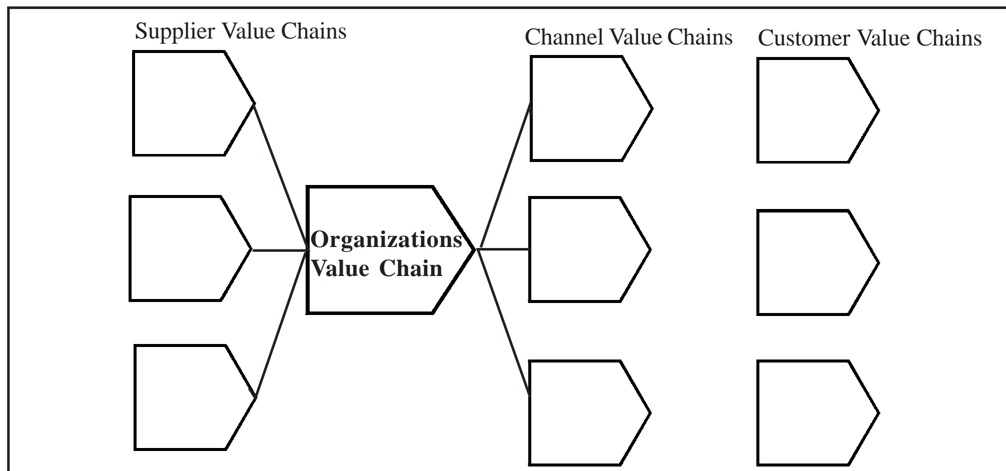

Figure 3.7: The Value System

Within the whole value system, there is only a certain value of profit margin available. This is the difference of the final price the customer pays and the sum of all costs incurred with the production and delivery of the product/service (e.g., raw material, energy etc.). The structure of the value system will determine, to a large extent, how this margin is distributed between the various elements of the value system, e.g., suppliers, producers, distributors, customers, and others.

Each member of the value chain will use its standing in the value chain, market position and negotiating power to get a higher proportion of this margin. A successful value chain is developed when each member of the value chain believes that it obtains value from the relationship. The ability of an organization to influence the performance of other organizations in the value chain is often a core capability and a source of competitive advantage. Many organizations have special functions that are involved in ancillary development, dealer and distributor training, etc.

A value chain is one of the most common sources of increasing the technological competence of organizations. Knowledge is spread between members in the value chain through the process of diffusion. This results in adding competencies both to the provider and receiver of the knowledge. The traditional structure of the Japanese industry is illustrative of this. Units attached to the mother unit cooperate with each other to improve their efficiency, teach each other and learn from each other new and better ways of accomplishing their tasks, and help each other to reduce their costs. In doing so, they are able to achieve a higher total margin to the benefit of all of the members in the system.

A strong and supportive value chain works like the traditional Japanese system, where members of the chain look at the benefits that accrue to the entire value chain. Such cooperation is possible and often seen in such value chains, e.g., increasing productivity, reducing stocks at different levels, or process improvements, etc., are undertaken by members of the value chain and the advantages that accrue benefit all members of the value chain.

Value chain analysis is not a very difficult exercise conceptually. However, depending on the nature of the product, the linkages, the primary processes involved, etc., it is often an exercise that can be quite complex and requires a large amount of information and data processing capacity for the analysis. However, many of the concepts of breaking up functions into activities and attributing costs to them are now a standard cost accounting practice which makes the process easier. Once the basic information has been collected and the linkages established, it becomes a routine exercise. A typical value chain analysis can be performed in the following steps:

1. Analysis of own value chain - identify the primary and support activities. Each of these activity categories needs to be broken up into its basic components and costs are allocated to every single activity component.
2. Analysis of customers value chains - examine how does our product fit into the value chain of the customer
3. Identify activities that differentiate the firm and the potential cost advantages in comparison with competitors
4. Identify potential value added for the customer - how can our product add value to the customer's value chain (e.g., lower costs or higher performance) - where does the customer see such potential?
5. The final step is to identify those activities that provide a differential advantage compared to competitors. These are the competencies or the core competencies of the organization.

3.3.3 How to Use the Value Chain Analysis?

The value chain is useful in defining the areas where it can benefit from: (a) cost reduction, and /or (b) product differentiation.

Cost Reduction

Rahul Bajaj, in the face of competition and limited by the capacity to grow due to Government restrictions, focused on standardizing and refining the operational processes of Bajaj Auto. He was able to bring Bajaj Auto to the position where it became the lowest cost two-wheeler producer in the world. The idea was on giving customers 'the best value for money'. Historically, about 60 percent of the value of the Bajaj vehicle was outsourced. Outsourcing was increased, and the value chain was rationalized. Costs were tightly controlled, and a major initiative was launched to develop a highly efficient value chain for supply, production and distribution system. As a result the labour time to manufacture a scooter came down from 1.9 days to 1.3 man-days. Bajaj Auto successfully regained its position as the market leader in the two-wheeler industry based on cost leadership.

A strategy based on seeking cost leadership requires reduction in the costs associated with the value chain activities, or reduction in the total amount of resources used. The basic approach of value chain analysis is to look at the value and cost of each activity and determine whether it is delivering value for money. The priority between various activities is determined by a Value Index:

Value Index (VI) = Value/Cost = Utility/Cost = Function/Cost

If the Value index is less than 1, it is not worth the cost incurred; if Value index is greater than 1, it provides value to the organization. The organization has to identify those activities that add value and those where the value added does not justify their cost. The value is generally based upon a comparison with a similar activity within the organization or on the basis of benchmarking the activity with the best practices in the industry.

Cost reduction can be either by reducing individual value chain activities or by reconfiguring the value chain. Reconfiguring the value chain involves structural changes such as new production processes, new distribution channels, new sources of supply, etc. In general, Porter has identified ten drivers for cost reduction:

- Economies of Scale
- Learning
- Capacity utilization
- Linkages between activities
- Interrelationships with suppliers and buyers
- Degree of Vertical Integration
- Timing of market entry
- Generic Strategy
- Geographical location
- Institutional factors

Value chain activities are often linked. For example, if a product is redesigned to reduce cost, it is possible that the cost of servicing the product may go up. Inversely, it may result in a concomitant reduction in service costs due to an improvement in reliability or a design simplification. In the first case the value benefit would be less than was anticipated. On the other hand, in the second case, the value benefit would be greater and has a potential to become a source of competitive advantage.

Product Differentiation

Jet Airways started with 4 aircraft in 1993. Since May 1993 the airline has flown close to 33 million passengers. Its fleet of 31 Boeing B737s and 8 ATR aircraft operate daily

over 245 flights to 41 destinations in India. Jet Airways differentiated itself from its main rival, Indian Airlines, by its focus from the very beginning - to emerge as the "Businessman's Preferred Airline". It did this by providing high standards of service and reliability of operations. It earned a reputation for punctuality, quality of catering, in-flight service and the attention paid to security. Today, Jet Airways accounts for a domestic market share of around 45 per cent.

Differentiation stems from uniqueness. This uniqueness can be achieved either by changing the value chain activities to provide uniqueness to the product, or by reconfiguring the value chain. Porter has identified several drivers for uniqueness.

- Policies and decisions
- Linkages between activities
- Timing
- Location
- Interrelationships
- Learning
- Integration
- Scale
- Institutional factors

Once identified, we have to decide how we can enhance these competencies that have a Value index greater than 1, to provide us with greater differentiation and competitive advantage. For example, a business which wishes to outperform its competitors through differentiating itself, through higher quality, will have to perform its value chain activities related to quality better than the opposition. Changes in technology can also be a factor in reconfiguring the value chain or changing the activities, to provide competitive advantage.

However, there will be activities that add value to the business though they may not directly justify their costs. These are activities that have to be accepted as apart of doing business and cannot be eliminated. It should be recognized that Value Chain Analysis has its origins in accounting practices. Its effectiveness is based on the ability of the organization to identify costs and associating it to each activity and attributing a value to each activity.

An example of the results of a Value Chain Analysis carried out by IBM is given in Box 3.2.

Box 3.2: The IBM story

Results from Value Chain Analysis

Business units across IBM have moved toward systematic assessment and optimization of their application portfolios. The benefits are tangible:

Retire—IBM reduced its portfolio from a high of 15,000 applications in 1998 to 6,800 in 2000.

Reprioritise—IBM now classifies all of its applications by business value, and restricts or targets maintenance of these applications accordingly.

Rustproof—IBM proactively reengineers applications to reduce the possibility of maintenance problems. As such, the company's applications' defect rates have declined by 58 percent, and maintenance costs for these applications have been reduced by 20 percent.

Relocate-IBM currently sources 40 percent of its maintenance work to lower-cost regions and sees savings of 60 to 70 percent.

Outsourcing

For those activities that have a Value index less than 1, the disadvantage can be mitigated using one of these two strategies or a combination of both; (a) what are the resources we have to put in to improve our performance in these areas such that the Value index comes within the acceptable range; or (b) how can we possibly extend or redesign the value chain so that we include in our value chain the required competence from outside the organization.

Simply put, these are candidates for outsourcing. The objective is to identify those activities that can be eliminated or moved that do not have a Value index of more than 1, and focus on those activities that can be used for competitive advantage and have a Value index greater than 1.

3.3.4 Value Chain Analysis

Since the value chain is composed of the set of activities performed by the business unit, it provides a very effective way to analyze the position of the business against its major competitors. The way in which the value system of the organization is configured, the linkages between value activities and the competence in separate activities, provide the key to sustainable success. This type of analysis has already been shown in the last section. The manner in which the value chain will improve the competitive position has also been shown in the use of the Life Cycle - Portfolio matrix.

Another way to use the value chain is to determine the degree to which the strategy provides synergy. This will show how much extra benefit can be created by reconfiguring the value chain.

Table 3.2: The Value Chain and Synergy

Degree of Synergy with present Activities	Weightage	Strategy 1	Strategy 2	Strategy 3

Table 3.2 is an analytical tool designed to show the relationship between synergy and the value chain. The first column should identify all the activities in the organization that are impacted by the strategic options. The second column represents the importance of the activity in the scheme of the organization. The total of the weightage in the second column should add up to 100. The third column onwards represents the different strategies. The objective is to identify the impact of each strategy on the identified activity. The degree of synergy can be scored on a scale of 1 to 5. The degree of synergy should be multiplied with the weightage factor of the activity and the total put in column for the particular strategy. Then each column is added. The total of the column represents the level of synergy of the strategy.

Synergy can arise through many different types of links or interrelationships. For example, in marketing it could arise from exploiting the brand name, sharing distribution channels, advertising and promotion, etc. Synergy is often used as a justification in many areas of the company's strategy that includes new products, new markets and diversification. Many decisions on mergers and acquisitions are based on the synergy the organization derives from such a strategy.

Check Your Progress 2

State whether the following statements are True or False:

1. Strategic analysis is concerned with understanding the relationship between the forces of change and its impact on the choice of strategies of the organisation.
2. Environment scanning is used to identify new and potentially crucial information that should be added to those identified and tracked during monitoring.
3. Strategic planning model is a tool that helps an organisation in setting up goals or objectives.
4. Strategic planning is a formal exercise, with planners drawing up objectives, budgets, programme and operating plans.
5. The SMART formula is a useful method of examining objectives.

3.4 IDENTIFYING CRITICAL SUCCESS FACTORS

Critical Success Factors (CSFs) is defined as a feature of an organisation that becomes critical to success. These may be generated as a result of the environment, politics, human resource issues, and cost drivers. A critical success factor analysis is generally used as a basis for preparing resource plans. This process of developing a resource plan forms a closed-loop system. It operates in a continuous cycle, with neither a beginning nor an end incorporating strategic control.

The resource plan translates the strategic choice for implementation. A resource plan is an actionable set of activities that determine what and how the utilization of the existing resources and competencies of the organization have to be used and the need to create new resources and competencies. The resource plan is sometimes, also, called the strategic plan. This is different from Strategic Planning or Strategic Management.

The starting point for the resource plan is the business and policy objectives. From these are derived the Critical Success Factors (CSFs). Critical success factors are those components of strategy where the organization must excel to outperform competition. These are translated into implementation options based upon the prioritized change initiatives required. This forms the basis for the programs and corresponding projects and should result in benefits in the policies and operations of the organization. The flowchart of a resource plan is shown as Figure 3.8. The resource plan is expressed as a sequence of actions or a timetable of priorities, and is supported by programs, projects and budgets. It identifies in detail the requirements of specific strategic developments.

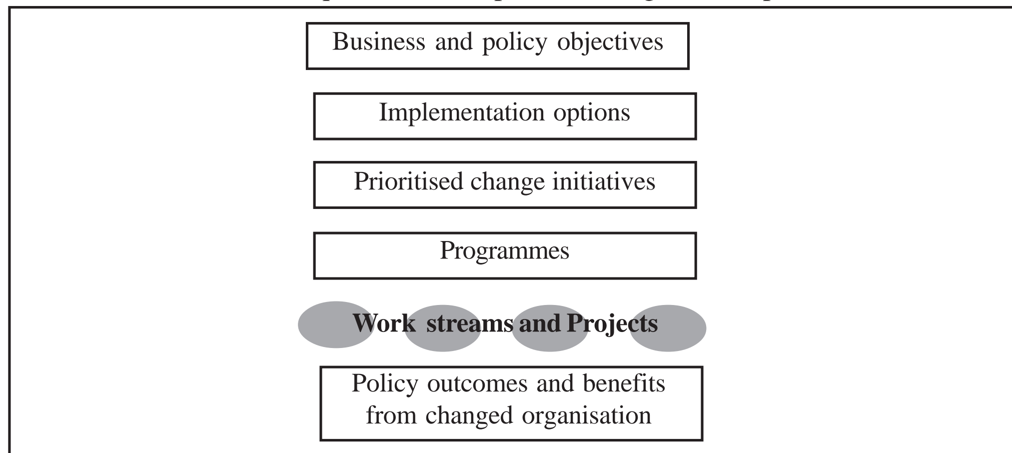

Figure 3.8: The Resource Plan

3.4.1 Critical Success Factors

A major shortcoming of strategy implementation is a failure to translate statements of strategic purpose, such as gaining market share, into an identification of those factors which are critical to achieving these objectives and also identifying the resources and competencies which will ensure success. A Critical Success Factor is defined as a feature of an organisation or its environment which, by its nature, has such an impact on the success that its tracking, measurement, achievement, or avoidance, becomes critical to success. Critical Success Factors (CSFs) may be generated as a result of the environment, politics, human resource issues, and cost drivers.

Critical Success Factors (CSFs) are the information needs for effective management control. The validity of CSFs is to a large degree dependent upon deciding what is important to business success; that is, translating management information requirements into the critical areas underpinned by competencies which ensure this success.

A critical success factor analysis is generally used as a basis for preparing resource plans. The three stages of CSF analysis are:

- ***Identification:*** Identify the critical success factors for the specific strategy. The list should be manageable (preferably fewer than six). For example, these may be factors such as developing a global network, supply chain management and 'agile' production.
- ***Key decisions:*** Sense critical decisions that need to be made. Identify the underpinning competencies which are essential to gaining competitive advantage through each of these CSFs, though they may be related to separate activities, support activities or the management of linkages between activities.

  Scrutinize the list to ensure that it is sufficient to give competitive advantage. Assess the extent to which competitors can imitate each underpinning determining the core competencies of an organization.

  Decide on the impact of potential competitive moves and how that might need to be counteracted.
- ***Information requirements:*** Identifying the information needed to support the decisions. Identify performance standards which need to be achieved to outperform competition. It is important to remember that competitors are likely to attempt to match or beat these standards and erode competitive advantage. Therefore, ensure continual review of performance standards.

It is important to maintain the link between what must be done and why it is needed. For example, a review of a major project carried out by Price Waterhouse in 1998 on behalf of a client found that only twenty-three CSFs out of a total of thirty-nine were achieved. The main reasons cited for this failure was poor communication. The mechanisms that had been established at the beginning of the project lapsed and became ineffective and the project management team lost sight of what was important. There are a number of ways in which these risks can be reduced.

- Overall direction and leadership responsibility should rest with one individual
- Ensure active stakeholder management
- Have a clear idea of the required change and the metrics to measure success
- There should be full coordination of the program's components, the relationship with other programs and the interface to business strategy

- Clearly assign responsibility for the delivery of business benefits
- The organization should have appropriate personnel available with relevant skills and experience to set up, manage and deliver the program
- The organization should be capable of achieving the change required by the program.
- Check and recheck that the program management and support processes are in place.

It is important when implementing strategies that the responsibility for each of the activities of the CSF is properly identified. Although responsibility may be assigned for the delivery of business benefits, the linkages are crucial in ensuring accurate information and action.

3.5 LET US SUM UP

The business environment is a complex mix of different influences. Competitive advantage flows from the organization's abilities to create a framework to enhance the organization's knowledge of the market forces and their complex influences. It is necessary to make sense of this diversity in a way that will contribute to the strategic decision making. Formal learning about specific jobs is only a part of the knowledge acquisition process. The more difficult part is to design and use information flows so that it can be used to analyze the changes taking place in the external environment that will facilitate the organization to reshape work methods, management processes and contribute to strategic decision making.

Institutions decline when they lose their ability to keep track of changes taking place around them. This has been one of the lessons of history. Companies have found themselves losing their markets and their ability to provide value to the customer. It is not only the competitive, macroeconomic or technological that lies behind the need for change. The closing years of the twentieth century have also triggered a fundamental shift in social.

Organizations have to keep track of the economic, social, legal, competitive and technological changes. To track changes requires discipline and effort. Organizations need to accord the same priority to the collective task of building the ability to collect and analyze information as they do to the task of enhancing the organization's economic performance.

Even when the analysis is in a form to contribute to strategic decision making, there are a number of difficulties in doing so. Most people cope with complexity by simplifying the situation. The business manager is no different. One way to simplify the complexity is by focusing on aspects that have been historically important, or confirm prior views. This is often done and in the process, the contribution of the analysis is diluted.

3.6 LESSON END ACTIVITY

Demonstrate an understanding of the potentially compelling impact on the competitive environment by the forces of technological change, and how they can respond to its challenges.

3.7 KEYWORDS

Strategic Analysis: 'Strategic Analysis' is concerned with understanding the relationship between the forces of change and its impact on the choice of strategies by the organization.

Uncertainty: 'Uncertainty' is a situation where the occurrence of the event cannot be represented by a probability. The nature of uncertainty is dependent on the degree to which the environment is stable or dynamic, simple or complex.

Trade Liberalization: 'Trade Liberalization' is aimed at furthering world trade by the abolition of quotas and the reduction of tariff duties among the nations of the world.

Globalization: 'Globalization' is a concept that encapsulates the growth of connections between people on a planetary scale. Globalization involves the reduction of barriers to trans-world contacts.

Demography: 'Demography' (Greek demos, "people"), is the study of human populations, primarily with respect to their size, structure, and development.

Regulatory Frameworks: 'Regulatory frameworks' are the various facilitating rules, laws, procedures, norms, and institutions that play an enabling role for the actions of society.

Sovereign or Political Risks: 'Sovereign or Political Risks' are the risks assumed by a firm on the likelihood a nation will default on its payments to creditors.

Order qualifying factors: 'Order qualifying factors' are those that are essential to maintain your presence in the market.

Order winners: 'Order winners' are those factors that can distinguish your offering from competition.

3.8 QUESTIONS FOR DISCUSSION

1. "Location and co-ordination have become the critical strategic issues for corporations facing the challenges of globalization."
2. Outline and assess the factors affecting the decisions corporations might take about the location and management of key activities, such as research and development, manufacturing, sales and marketing, in the light of the statement above. How might such corporations respond to these challenges? Illustrate your answer with examples with which we are familiar.
3. Demonstrate an understanding of the potentially competing requirements of globalization to be both global and local, and how they can respond to its challenges.

Check Your Progress: Model Answers

CYP 1

Perceptual Mapping has been a popular way to represent what people believe about choice objects. All Perceptual Mapping methods produce a spatial representation of how individuals perceive the various brands. In a perceptual space, brands that are perceived to be similar are located close to each other and brands that are perceived to be dissimilar are further apart.

CYP 2

1. True
2. True
3. True
4. True
5. True

3.9 SUGGESTED READINGS

Pearce & Robinson, *Strategic Management*, All Indian Travellers N.D.

A.C. Hax and NS., *Strategic Management: An Integrative Perspective*, Majifu, Prentice Hall.

Micheal Porter, *Competitive Strategies*.

Micheal Porter, *Competitive Advantage of Nations*.

Samul C. Certo and J.Paul Peter, *Strategic Management: Concept and Application* (Second Edition), McGraw Hill.

Georgy G. Dess and Alex Miller, *Strategic Management*, McGraw Hill.

Gerry Jhonson & Keven Scholes, *Exploring Corparate Strategy: Text and Cases*.

Jaunch L Rajive Gupta & William F Glueck, *Business Policy and Strategic Management*, Frank Bros & Co, 2003

Fred R.David, *Strategic Management: Concept and Cases*, Pearson, 2003.

LESSON

4

INTERNAL ANALYSIS OF FIRM

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4.8 Lesson End Activity

4.9 Keywords

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4.11 Suggested Readings

4.0 AIMS AND OBJECTIVES

After studying this lesson, you will be able to:

- Understand the generic tools of analysis
- Learn about the popular tool for audit and analysis–SWOT audit

- Understand the concept of 'Core Competencies'
- Know about the stakeholders' expectations
- Analyse the concept of scenario-planning
- Understand the concept of industry analysis

4.1 INTRODUCTION

A number of simple models are used for analysis of the organization. Some of them are: Issue Trees; Profit Trees; Hypothesis Trees; SWOT Analysis and PESTLE Model.

Issue trees help to structure the conclusions or identify the key issues or questions that a problem should address, and break it down into its smaller component parts. A hypothesis tree and a profit tree are extensions of an issue tree.

4.2 SWOT AUDIT

It is a popular tool for audit and analysis of the overall strategic position of a business and its environment. The acronym "SWOT" represents "Strengths", "Weaknesses", "Opportunities", and "Threats". The environmental factors internal to the firm usually can be classified as strengths (S) or weaknesses (W), and those external to the firm can be classified as opportunities (O) or threats (T). The process diagram for a SWOT analysis is shown in Figure 4.1.

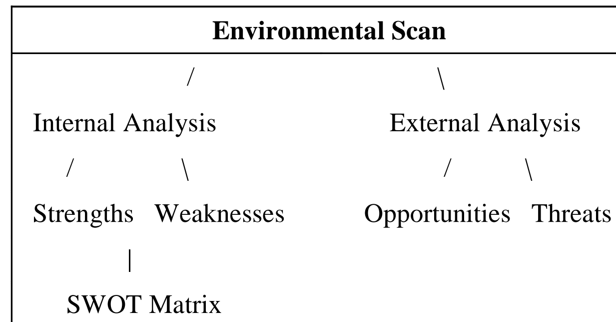

Figure 4.1: SWOT Analysis Framework

The SWOT analysis provides information that is helpful in matching the firm's resources and capabilities to the competitive environment in which it operates. As such, it is instrumental in strategy formulation and selection. Successful businesses build on their strengths, correct their weaknesses and protect against internal vulnerabilities and external threats. They also keep an eye on their overall business environment and spot and exploit new opportunities faster than competitors. The technique is simple and effective. It requires an analytical frame of mind. Due to its simplicity, all firms have the capacity to use this tool to advantage.

Analysis of our Firm against Competition

The first step is to identify our competition. Every business has competitors. Our competitors are those who could provide our customers a product or service that fills the same need as ours does. Even if our product or service is truly innovative, we need to look at what else our customers would purchase to accomplish this task.

Begin by looking at our primary competitors. These are the market leaders, the companies who currently dominate our market. Next, look for our secondary competitors. These are the businesses who may not go head-to-head with us, but who are targeting the same general market. Finally, look at potential competitors. These are companies who might be moving into our market and who we need to prepare to compete against.

The second step is to analyze strengths and weaknesses of our competitors. Determine their strengths and find out what their vulnerabilities are. Why do customers buy from them? Is it price? Value? Service? Convenience? Reputation? Focus as much on "perceived" strengths and weaknesses as we do on actual ones. This is because customer perception may actually be more important than reality.

The strengths/weaknesses analysis is more easily done in table form. Write down the names of each of the competitors. Then set up columns listing every important category for our line of business. It may be price, value, service, location, reputation, expertise, convenience, personnel, or advertising/marketing. Rate the competitors on each of the identified parameters, and put in comments as to why we've given them that rating.

The third step is to look at opportunities and threats. Strengths and weaknesses are often factors that are under a company's control. But when we're looking at our competition, we also need to examine how well prepared we are to deal with factors outside our control. Opportunities and threats fall into a wide range of categories. It might be technological developments, regulatory or legal action, economic factors, or even a possible new competitor. An effective way to do this is to create a table listing our competitors and the outside factors that will impact our industry. We will then be able to tell how we can deal with opportunities and threats.

The fourth step is to determine our position. Once we figure out what our competitors' strengths and weaknesses are, we need to determine where to position our company with respect to competition. Rank our company in the same categories that we ranked our competitors. This will give us a clear picture of where our business fits in the competitive environment. It will also help us determine what areas we need to improve, and what characteristics of our business we should take advantage of to gain more customers.

The bottom line: look for ways to leverage our strengths and take advantage of our competitors' weaknesses.

SWOT Matrix

The relationships in a SWOT analysis are generally represented by a 2×2 matrix. The "Strengths" and "Opportunities" are both positive considerations. "Weaknesses" and "Threats" are both negative considerations. The final results of an analysis could be listed in the matrix given in Figure 4.2. The matrix identifies the Strengths, Weaknesses, Opportunities and Threats of a firm.

This information can be used by the company in many ways in evolving its options for the future. In general, the company should attempt to:

- Build its strength
- Reverse its weakness
- Maximize its response to opportunities
- Overcome its threat

A firm should develop a competitive advantage by identifying a fit between the firm's strengths and upcoming opportunities. In some cases, the firm can overcome a weakness

in order to prepare itself to pursue a compelling opportunity. SWOT analysis is often used to develop strategies The SWOT strategy matrix is shown in Figure 4.2.

	Positive	Negative
Internal Factors	**Strengths** Patents Strong brand names Good reputation among customers Cost advantages from proprietary know-how Exclusive access to high grade natural resources Favorable access to distribution networks	**Weaknesses** Lack of patent protection A weak brand name Poor reputation among customers High cost structure Lack of access to the best natural resources Lack of access to key distribution channels
External Factors	**Opportunities** An unfulfilled customer need Arrival of new technologies Loosening of regulations Removal of international trade barriers	**Threats** Shifts in consumer tastes away from the firm's products Emergence of substitute products New regulations Increased trade barriers

Figure 4.2: SWOT Matrix

S-O strategies pursue opportunities that are a good fit to the company's strengths.

W-O strategies overcome weaknesses to pursue opportunities.

S-T strategies identify ways that the firm can use its strengths to reduce its vulnerability to external threats.

W-T strategies establish a defensive plan to prevent the firm's weaknesses from making it highly susceptible to external threats.

The SWOT analysis is a powerful tool, but involves a large subjective component. Therefore, it is best when used as a guide and not a prescription. Used in conjunction with other established strategic management tools, for example the PEST or PESTLE analysis, the SWOT Analysis can provide information that is helpful to the firm in strategy formulation and selection.

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

Figure 4.3: SWOT Strategies

4.2.1 PESTLE Analysis

An in-depth investigation and analysis of our competition is one of the most important components of environmental scanning. PESTLE analysis, like the PEST analysis involves identifying the political, economic, socio-cultural and technological influences on an organization - and providing a way of auditing the environmental influences that have impacted on an organization or policy in the past and how they might do so in future.

Increasingly when carrying out analysis of environmental or external influences, legal factors have been separated out from political factors. The increasing acknowledgement of the significance of environmental factors has also led to Environment becoming a

further general category, hence 'PESTLE analysis' becoming an increasingly used and recognized term, replacing the traditional' PEST analyses:

PESTLE is an acronym for:

- P - political
- E - economic
- S - socio-cultural
- T - technological
- L - legal
- E - environmental

Like the SWOT analysis, the PESTLE analysis is simple, quick, and uses four key perspectives. The advantage of this tool is that it encourages management into proactive and structured thinking in its decision making.

When analyzing the competition, we must first identify competition. Any business marketing a product similar to, or as a substitute for, our own product in the same geographic area is a direct competitor. There are several markets where it is relatively easy to name every competitor. These are concentrated markets where only a handful of competitors exist. If this is the scenario for your product or service, develop an analysis for each competitor. The steel industry and automobile industry are examples of these types of markets.

If we are selling in a market with many competitors, the job of analyzing the competition becomes more difficult. In fragmented markets with many competitors, use the old 80/20 rule; it is most probable that 80% of the total market revenues are accounted for by 20% of the competition. It's the 20% we should examine most closely.

Firms offering dissimilar or substitute products in relation to our product or service are considered indirect competitors. Indirect competition would exist between the manufacturer of butter and a manufacturer of margarine selling to the same customers or a manufacturer of eyeglasses who competes indirectly with contact lens manufacturers. Indirect competition will satisfy the customer's need with a particular product or service, although the product or service used may be different from ours.

If a firm has similar products and distribution channels, but has chosen to operate in different market segments, they are not at this time our direct competitor. However, it's important to monitor the marketing activities of such firms because they may decide to move into our market segment, just as we may decide to move into theirs.

PESTLE Matrix

The construction of the PESTLE matrix is similar to that of the SWOT analysis. The PESTLE matrix is shown in Figure 4.4.

The first step is to identify the issue. Remember, focus is very important. Make up your own PESTLE questions and prompts to suit the issue being analyzed and the situation. Shortlist those that are important.

On the basis of these, it should be possible to identify a number of key environmental influences, which are in effect, the drivers of change. These are the factors that require to be considered in the matrix. Then transpose the final items that we have identified from your list to a PESTLE matrix.

Political	Economic
• Ecological/environmental issues • Current legislation • Future legislation • Regulatory bodies and processes • Government policies • Government term and change • Trading policies	• Economy situation & trends • Taxation specific to products • Market and trade cycles • Specific industry factors • Customer/end-user drivers • Interest and exchange rates
Social • Lifestyle trends • Demographics • Consumer attitudes and opinions • Brand, company, technology image • Consumer buying patterns • Ethnic/religious factors	**Technological** • Replacement technology/solutions • Maturity of technology • Manufacturing maturity and capacity • Innovation potential • Technology access, licensing, patents
Legal • International Law • Employment Law • Competition Law • Health & Safety Law • Regional legislation	**Environmental** • Environmental impact • Environmental legislation • Energy consumption • Waste disposal

Figure 4.4: PESTLE Matrix

Making it more Scientific

The PESTLE analysis can be converted into a more specific instrument of measurement by giving a weightage and a score to the items in each of the sections for each of the identified options that the firm has to consider. For each of the items in each segment of the PESTLE chart, we can give a score on a scale of 1 to 100. Some factors will be more important than the others. Make sure the total weights add up to 100. In case we are looking at options, the next step is to list all the options that we are considering. Give marks to each specific option. Multiply the marks with the weightage factor and then add the total score for each option.

Figure 4.5 gives weightings for one option in an environmental project. Each option will have a score. The higher the score is, the more attractive the option. The final results will give an indication of the attractiveness of the various options and should be the basis for short listing viable options.

Scoring and giving weightage is particularly beneficial if more than one option is being considered, e.g., two markets are being analyzed for the purpose of comparing which market or opportunity holds most potential and/or obstacles. Other examples are when considering business development and investment options, i.e., whether to develop market A or B; whether to concentrate on local distribution or export; whether to acquire company X or company Y., etc. The weights should be given according to the more or less significant factors.

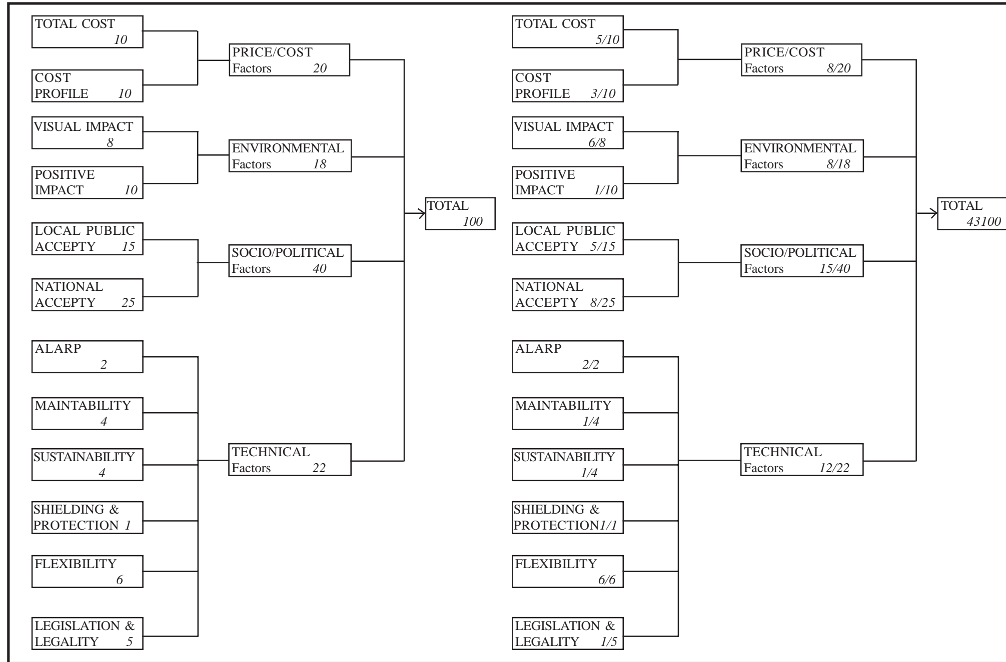

Figure 4.5: Weighted PESTLE Analysis

PESTLE assesses a market, including competitors, from the standpoint of a particular proposition or a business and is more useful and relevant the larger and more complex the business or proposition, but even for very small local businesses, a PESTLE analysis can still throw up one or two very significant issues that might otherwise be missed. The PESTLE analysis is a useful business measurement tool for understanding the competitive environment of the firm.

On completion of the PESTLE analysis, the short listed options can be examined using a SWOT analysis. The SWOT analysis further aids the process which leads to the conclusions and recommendations. PESTLE is useful before SWOT - not generally the other way round. PESTLE helps to identify SWOT factors.

4.2.2 Case Analysis

Strictly speaking, case analysis is not a management tool but a management learning tool. Case analysis has been used in Management Studies from 1908, when the Harvard Business School was set up. Case analysis requires us to apply the concepts taught in different areas of business study and use the concepts to analyze the organization or the problem.

A case study presents an account of what happened to a business or industry over a number of years. It chronicles the events that managers had to deal with and provides a detailed insight into various aspects of business life, such as changes in the competitive environment, and charts the managers' response, which usually involved changing the business—or corporate-level strategy. It is normally written from the point of view of the decision maker. Each case is different because each organization is different.

The case writer reports the relevant facts of the situation and the student is expected to provide arguments and an independent opinion on the problem, and present alternatives or possible solutions. There is no right answer to a problem. The importance of this method is that it provides an opportunity to think and an ability to understand the complexities of the real world. The underlying thread in all cases, however, is the use of Strategic Management techniques to solve business problems.

Cases prove valuable in a Strategic Management course for several reasons:

- Cases provide the student with experience of organizational problems. In a relatively short period of time, students have the chance to appreciate and analyze the problems faced by many different companies and to understand how managers tried to deal with them.
- The theory and concepts of Strategic Management illustrated in case analysis help reveal what is going on in the companies studied and allow us to evaluate the solutions that specific companies adopted to deal with their problems.
- Case studies provide us with the opportunity to participate in class and to gain experience in presenting our ideas to others. Instructors and our classmates may have analyzed the issues differently from us. We will have to organize our views and conclusions so that they will accept our conclusions. This mode of discussion is an example of the dialectical approach to decision making. This is how decisions are made in the actual business world.

Cases are commonly assigned to a group, to analyze before the whole class. The presentation must cover the issues posed, the problems facing the company, and a series of recommendations for resolving the problems. The discussion is then thrown open to the class, and we will have to defend our ideas. Through such discussions and presentations, we will experience how to convey our ideas effectively to others. In real situations, a great deal of a manager’s time is spent in these kinds of situations: presenting their ideas and engaging in discussion with other managers who have their own views about what is going on. Thus, case analysis will provide us with the experience in the classroom in the actual process of Strategic Management.

Analyzing a Case

The purpose of a case study is to help us apply the concepts of Strategic Management to a real life-like situation. We are expected to analyze the issues facing a specific organization. Therefore to analyze a case, we must closely examine the issues confronting the organization. Most often we will need to read the case several times. The first reading is to grasp the overall picture of what is happening to the organization. We should read the case several times more till we are certain we have discovered and grasped the specific problems of the organization.

The steps we can take to analyze case material is given below to help in formulating a scientific approach to case analysis. There are a number of steps that are given below in three parts, as described below:

- Historical and SWOT analysis
- Analysis of Strategies
- Recommendations and Discussions

Historical and SWOT analysis

The first part is to familiarize ourselves with the history of the organization. This will normally provide the information that will be the basis for the complete analysis. This is followed by the SWOT analysis. The SWOT analysis provides a brief summary of the organization's condition; a good SWOT analysis is the key to all the analyses that follow:

1. ***Analyze the organization's history:*** Analyze the organization's history, development, and growth. Identify events that were the most unusual or the most essential for its development into the organization it is today. This should help us understand how an organization's past strategy and structure affect it in the present.

Some of the events that we will identify will have to do with its founding, and its initial products. Understand how it makes new-product market decisions, and how it developed and chose functional competencies to pursue. Important milestones are entry into new businesses and shifts in its main lines of business.

2. ***Examine the internal environment:*** The historical profile is best followed up with an analysis to identify the company's internal strengths and weaknesses. As we have already identified the milestones in the historical investigation, the critical incidents should provide an insight of the organization's strengths and weaknesses.

   Examine each of the functions of the organization, and identify the functions in which the organization is currently strong and currently weak, e.g., the organization may be strong in marketing or in research and development; it may be weak in production functions, etc. Make lists of these strengths and weaknesses.

3. ***Examine the external environment:*** After having analyzed the internal environment, the external environment has to be examined to identify environmental opportunities and threats. Identify which factors in the macro environment, for instance, economic or environmental factors, are relevant for the organization in question. We must apply our mind to determine how these factors affect the competitive environment.

Having done this, we have completed a SWOT analysis. We will have generated both a description of the organization's internal environment and a list of opportunities and threats. The SWOT analysis is especially important for industry analysis. What are the threats to the organization from the environment? Can the organization deal with these threats? How should it change its business-level strategy to counter them? If our SWOT analysis has captured the essence of the problems, this should not be difficult. We now have a full picture of the way the organization is operating and be in a position to evaluate the potential of its strategy. Thus, we will be able to make recommendations concerning the pattern of its future actions.

As we have identified the organization's external opportunities and threats as well as its internal strengths and weaknesses, we require relating our findings to the problem on hand. Consider what our findings mean. We need to balance strengths and weaknesses against opportunities and threats.

The SWOT Checklist (Table 4.1) gives examples of some common environmental opportunities and threats that we may look for.

Table 4.1: A SWOT Checklist

Potential Internal Strengths	Potential Internal Weaknesses
Many product lines?	Obsolete, narrow product lines?
Broad market coverage?	Rising manufacturing costs?
Manufacturing competence?	Decline in R&D innovations?
Good marketing skills?	Poor marketing plan?
Good materials management systems?	Poor material management systems?
R&D skills and leadership?	Loss of customer goodwill?
Information system competencies?	Inadequate human resources?
Human resource competencies?	Inadequate information systems?
Brand name reputation?	Loss of brand name capital?
Portfolio management skills?	Growth without direction?
Cost of differentiation advantage?	Bad portfolio management?
New-venture management expertise?	Loss of corporate direction?
Appropriate management style?	Infighting among divisions?

Contd....

Appropriate organizational structure? Appropriate control systems? Ability to manage strategic change? Well-developed corporate strategy? Good financial management? Others?	Loss of corporate control? Inappropriate organizational structure and control systems? High conflict and politics? Poor financial management? Others?
Potential Environmental Opportunities	**Potential Environmental Threats**
Expand core business (es)? Exploit new market segments? Widen product range? Extend cost or differentiation advantage? Diversify into new growth businesses? Expand into foreign markets? Apply R&D skills in new areas? Enter new related businesses? Vertically integrate forward? Vertically integrate backward? Enlarge corporate portfolio? Overcome barriers to entry? Reduce rivalry among competitors? Make profitable new acquisitions? Apply brand name capital in new areas? Seek fast market growth? Others?	Attacks on core business(es)? Increases in domestic competition? Increase in foreign competition? Change in consumer tastes? Fall in barriers to entry? Rise in new or substitute products? Increase in industry rivalry? New forms of industry competition? Potential for takeover? Existence of corporate raiders? Increase in regional competition? Changes in demographic factors? Changes in economic factors? Downturn in economy? Rising labour costs? Slower market growth? Others?

Analysis of Strategies

The SWOT analysis will bring up some questions that we may like to examine: Is the organization in an overall strong competitive position? Can it continue to pursue its current strategies profitably? What can the organization do to turn weaknesses into strengths and threats into opportunities? Can it develop new strategies to accomplish this change?

1. ***Analyze corporate-level strategy:*** We have to start by defining the organization's mission and objectives. We may have to infer them from available information. This information includes such factors as the organization's business, the nature of its subsidiaries and acquisitions. If it has more than one business, it is important to analyze the relationship among the company's businesses. For example, we know that Escorts Limited operates in more than one business. The questions we need answers to are: How do its businesses connect? Do they trade or exchange resources? Are there gains to be achieved from synergy? Is the company just running a portfolio of investments?

   This analysis should enable us to define the corporate strategy that the organization is pursuing and to conclude whether the company operates in just one core business. Sometimes the mission and objectives are stated explicitly. In that case, it becomes easier.

2. ***Debate the merits:*** Using SWOT analysis, debate the merits of the strategies that we have identified. Are the strategies appropriate in the given environment of the organization? Could a change in strategies provide new opportunities or transform a weakness into strength? For example, should the company focus on improving its production capability or on Research & Development; should it diversify from its core business into new businesses? We should also consider how and why have the organization's strategies changed over time? What was the rationale for these changes, if any?

The organization's businesses or products should be assessed. We should identify the areas that contribute the most to or detract from its competitive advantage. Find out how the organization has built its portfolio over time. Did it acquire new businesses, or did it internally venture its own? All of these factors provide clues about the organization and indicate ways of improving its future performance.

3. ***Analyze business-level strategy:*** If the organization has a single business, its business-level strategy is identical to its corporate-level strategy. If the organization is in many businesses, each business will have its own business-level strategy. The next step is to identify the company's business-level strategy. In order to do so, we will need to identify the company's generic competitive strategy-differentiation, low cost, or focus. We will also have to determine its relative competitive position and the stage of the life cycle of the products - this should give us an insight into the investment strategy of the organization. The organization may market different products using different business-level strategies. For example, Maruti Udyog offers a low-cost product – the Maruti 800 – and a line of differentiated products catering to different economic segments. Give a full account of a company's business-level strategy to show how it competes.

   Identifying how the functional strategies build competitive advantage is very important. Does the organization do it through superior efficiency, quality, innovation, and customer responsiveness? We should relate the functional competencies from the SWOT analysis to investigate its production, marketing, or research and development strategy further. This will give us a picture of where the company is going. For example, pursuing a low-cost or a differentiation strategy successfully, as is being followed by Maruti, requires very different sets of competencies. Has the company developed the right ones? If it has, how can it exploit them further?

4. ***Analyze structure and control systems:*** Identify what structure and control systems the organization is using to implement its strategy and to evaluate whether that structure is the appropriate one for the organization. Different corporate and business strategies require different structures. For example, does the organization have the appropriate number of levels in the hierarchy or does it have a decentralized control? Does it use a functional structure when it should be using a product structure? Similarly, is the company using the right integration or control systems to manage its operations? Are managers being appropriately rewarded? Are the right rewards in place for encouraging cooperation among divisions? These are all issues to consider.

In the last part, we make our recommendations. We need to examine the strengths and weaknesses of the organization.

Recommendations and Discussions

We also need to consider the corporate strategy and the business level strategy and see how they fit into the strengths and weaknesses we have identified. We also need to see the efficacy of strategy implementation, or the way the organization tries to achieve its strategy.

1. ***Make recommendations:*** The thoroughness with which we prepared the case analysis will reflect in the quality of our recommendations. Our recommendations should be in line with our analysis and should follow logically from the analysis we have prepared. Recommendations are directed at solving whatever strategic problem the organization is facing and increasing the organization's future profitability.

The recommendations should centre on the specific ways of changing functional, business, and corporate strategies and organizational structure and control to improve business performance. The recommendations should be mutually consistent and written in the form of an action plan. The plan may require a sequence of actions that may change the organization's strategy and we should add a description of how changes at the corporate level will necessitate changes at the business level and functional levels.

2. ***Class discussion:*** The emphasis of the process of the case study is that we must be involved in the case to the maximum extent possible and we should feel the responsibility of decision making. The professor assumes the role of the facilitator. Therefore, the final action in a case analysis is a class discussion or a presentation of our ideas to the class. Both these formats are used depending on our professor's decision. Remember that we must tailor our analysis to suit the specific issue discussed in our case.

Conclude the Analysis

Different cases give different types of information about the situation and circumstances. Depending on the case study and what is required of us, we might completely omit one or more of the steps in the analysis, as it may not be relevant to the situation we are considering. We must be sensitive to the needs of the case and not apply the framework blindly. The framework is meant only as a guide, not as an outline. In some cases, there will be little information on many issues, whereas in others there will be a lot. In analyzing each case, focus on information on salient issues only.

The information given may include facts about the industry, the competitive conditions, the nature of products and their markets, the physical facilities, the work climate and organizational culture, the organizational structure, financial and other economic data, etc. Keeping in view the information available, be systematic and logical.

In cases relating to organizational analysis, begin with the identification of operating and financial strengths and weaknesses and environmental opportunities and threats. Only when we are fully conversant with the SWOT analysis can we assess the organization's strategies. Do the organization's current strategies make sense given its SWOT analysis? If they do not, we need to determine what changes need to be made, linking any strategic recommendations we may make to the SWOT analysis. We should explicitly explain how the strategies we identify take advantage of the organization's strengths to exploit environmental opportunities, how they rectify the organization's weaknesses, and how they counter environmental threats. Outline what needs to be done to implement our recommendations. A number of conceptual tools are required for case analysis. These tools will be provided as we go through the rest of the book.

It is important to remember that no one knows what the right answer is in a case analysis. All that managers can do is to make the best guess. In fact, it is believed that if we are right only half the time in solving strategic problems, we are pretty good.

4.3 CORE COMPETENCE

Prahalad and Hamel through a series of articles in the Harvard Business Review followed by a best-selling book, 'Competing for the Future', developed the concept of 'Core Competencies'.

'In the 1990s managers will be judged on their ability to identify, cultivate, and exploit the core competencies that make growth possible - indeed, they'll have to rethink the concept of the corporation itself.'

C K Prahalad and G Hamel (1990).

Their central idea is that a corporation should be built around a core of shared competencies. Over time, companies develop key areas of expertise which are distinctive to that company and critical to the company's long term growth. These are areas of strength of the company and provide maximum value to the competitive edge of the organization adding to its capability. It is by exploiting these strengths that the growth of the organization is made possible. Core competence can be seen as any combination of specific, inherent, integrated and applied knowledge, skills and attitudes.

Core competencies are those capabilities that are critical to a business achieving competitive advantage. In order to qualify as a core competence, the competency should differentiate the business from any other similar businesses. Core competencies are a set of unique internal skills, processes and systems. Resources that are standardized or easily available that will not enable a business to achieve a competitive advantage over rivals, even though they may be central to the business's operations, are not considered core competencies.

For example, a process which uses a lathe to manufacture components and is staffed by people with only basic training cannot be regarded as a core competence. Such a process is highly unlikely to generate a differentiated advantage over rival businesses. However it is possible to develop such a process into a core competence with suitable investment in tooling and training.

For a manufacturer of electronic equipment, key areas of expertise could be in the design of the electronic components and circuits. In the case of a software company, the key skills may be in the overall simplicity and utility of the program they create or it may be in the high quality of software code writing they have achieved or a combination of the two.

Core Competencies are not fixed. Competencies are developed internally by the firm in its day-by-day activity and by the use of acquired resources. Therefore, competencies are accumulated following firm-specific knowledge patterns. Once developed, they affect the resources from which they have been generated, transforming the same resources into something different from what the firm bought originally. The result is that core competencies change in response to changes in the company's environment. As a business evolves and adapts to new circumstances and opportunities, so do its Core Competencies adapt and change.

Competencies are difficult to assess and require some basis of comparison. There are a number of tools that are used to assess competencies. These will be discussed later on in this chapter. However, after assessing the competencies, management has to focus attention on competencies that really affect competitive advantage. These areas of expertise may be in any area but are most likely to develop in the critical, central areas of the company where the most value is added to its products. The organization requires analyzing how resources are being deployed to create competencies. It needs to prioritize every activity or function, and also to assign a value or cost to each activity. This step allows the organization to evaluate the cost of creating competencies and to focus on those competencies that are critical to the organization, for example lowering of costs so as to bring the most value to the business.

The organization also has to develop a Strategic Architecture which includes development of competencies needed based upon core product. The corporate centre should not be just another layer of accounting, but must add value by enunciating the strategic architecture that guides the competence acquisition process. It should internalize resources from strategic alliances and integrate competencies across Strategic Business Units and also across the organization.

It must identify the projects and the people closely connected with the core competence. Corporate auditors should direct an audit of the location, number, and quality of the people, processes and systems that embody the core competence. Core competence carriers should be brought together frequently to trade notes and ideas so that the core competency is further strengthened. It must develop communication, increasing involvement, demanding commitment, and provide rewards for performance.

Core competencies can be identified by examining what it achieves. Prahalad and Hamel suggest three criteria to help identify core competencies in any business. Core competencies are those that:

- Provide potential access to a wide variety of markets: The key core competencies may be those that enable the creation of new products and services; extend the distribution and service network; enhance the brand recognition; etc.
- Make a significant contribution to the perceived customer benefits of the end product: Core competencies are the skills that enable a business to deliver a fundamental customer benefit - in other words: What is it that causes customers to choose one product over another? To identify core competencies in a particular market, ask questions such as "Why is the customer willing to pay more or less for one product or service than another?" "What is a customer actually paying for?
- Difficult for competitors to imitate: A core competence should be "competitively unique": In many industries, most skills can be considered a prerequisite for participation and do not provide any significant competitor differentiation. To qualify as "core", a competence should be something that other competitors wish they had within their own business.

The more unique and the better the organization's performance is on its core competencies the larger will be the economic value for the organization and for the customer. The reverse is also important, that is, the more similar the organization competencies are to its direct competitors the lower the economic value for the organization. The more distinctiveness and uniqueness can be built into the company core competencies, the more market leverage and margin performance the company can anticipate. And, in addition, more customer loyalty will also develop.

While the core competencies vary by industry and by company, following is a selected list of skills, processes or systems that might be considered as core competencies:

- Product Development - Marketing
- Supply Chain - Speed To Market
- Sales Force - Customer Service
- Technology - Strategic Alliances
- Manufacturing Practices - Engineering
- Service Levels - Design
- Efficient Systems - Product Innovation.

Core Competency Analysis creates a realistic view of the skill sets, processes and systems the company is uniquely good at performing. It helps to generate focus on the value adding activities and provides a review format useful in identifying the need for improvement in key strategic activities, practices and systems. And, finally it helps in the decision process used to determine which activities are candidates for outsourcing.

For example, Reliance Industries has grown to be the largest private enterprise in India in the last twenty five years. The secret of its phenomenal success are its competencies. Its competencies are its project management skills, perhaps among the best in the world, its competence to mobilize large quantities of low cost finance, manage the regulatory environment and speed. These competencies allowed Reliance to set-up world scale plants at the lowest capital costs of any company in India and extend its activities to span exploration and production (E&P) of oil and gas, refining and marketing, petrochemicals (polyester, polymers, and intermediates), textiles, financial services and insurance, power, telecom and infocom initiatives.

In each company or industry there are different sets of core competencies that are important to the success of the business. In most instances the list of important competencies is relatively short. However, this short list, when well selected and developed, provides the opportunity to leverage the strategy of the company. Porter has identified some competencies that determine competitive strategy. These are given in Table 4.2.

Table 4.2: Identification of Core Competencies

AREA	COMPETENCE REQUIREMENTS
Products	Standing of products from the user's point of view, in each market segment Breadth and depth of the product line
Dealer /Distribution	Channel coverage and quality Strength of channel relationships Ability to service the channels
Marketing & Selling	Skills in each aspect of the marketing mix Skills in market research and new product development Training and skills of the Sales force
Operations	Manufacturing cost position - economies of scale, learning curve, age of equipment etc. Technological sophistication of facilities and equipment Flexibility of facilities and equipment, Proprietary know-how and unique patent or cost advantage, Skills in capacity addition, quality control, tooling etc., Location, including labour and transportation costs Labour force climate, unionization situation Access to and cost of raw materials, Degree of vertical integration
Research & Engineering	Patent and copyrights In-house capability, in the research and development process (product research, process research, basic research, development, imitation etc.), R&D staff skills in terms of creativity, simplicity, quality, reliability etc., Access to outside sources of research and engineering (e.g. suppliers, customers, contractors, consultants etc.)
Overall Costs	Overall relative costs, Shared costs or activities with other business units Scale and other factors that are key to our cost position

Competency need not be contained within the firm. It is also possible to build up on competencies held elsewhere. The requirement in such a case is to develop the relationships necessary to access the necessary complementary knowledge, equipment, resources, etc. We should not only be able to borrow but also to internalize the skills through various alliances.

Strategic advantage comes when the firm can mobilize a set of internal and external competencies that make it difficult for others to copy or enter the market.

4.3.1 Organizational Competencies - Fit Concept

Identification of organizational competencies is essential in determining how to use them. Organizational competencies are those competencies that result in the long-term competitive success of the organization.

The first step in determining the organizational competencies begins by defining market boundaries; this enables us to identify the boundaries of our competitive arena. Closely linked to that is to understand where the potential markets may arise.

The next step is an analysis to identify and classify the core competencies of the organization. This tells us where we have the necessary skills, processes or knowledge for sustainable competitive advantage. This will improve our chances of success and reduce risks in executing our strategy.

The analysis involves four stages:

1. Making a list of the organizational competencies needed to provide the products/ services to the users.
2. Listing the organizational competencies in which we must excel to provide the quality and service demanded by the users of our products/services.
3. Listing the organizational competencies that enable our organization to provide the product characteristics or service attributes that cause the customer to decide to purchase our product rather than a competitor's (These are core competencies if they are unique to us or we perform them significantly better than others).
4. Listing any other competencies our organization possesses that create customer value throughout our product line or give us a significant cost advantage over our competitors. These are also core competencies.

After the identification has been completed, examine the basis of the assumptions used in identifying the competencies. This is central to this stage. Each assumption should complete the phrase, "We assumed that …" Identifying assumptions can be difficult. An approach that could make this simpler is to ask for each skill set, "What must be true for us to be successful?" Evaluate these assumptions against the current realities we face to determine if they are valid and what is their impact on our operations. There is an implicit assumption that competencies not in our lists are not relevant to our business expectations and decisions.

A good way to think of organizational capability analysis is to list the values of both product and services from the point of manufacturer or distribution to consumption. The framework will be able to provide us the answers as they relate to the organizational capability:

- What are the capabilities in each of the functional areas? What are we best at? What are we worst at?
- How do we measure up to the tests of consistency in strategy?
- Are there any changes in these capabilities? Will they increase or diminish with time?
- In what activities or skills do we add value better than competitors? Are we better at research? Distribution? Marketing or Selling? Or perhaps manufacturing?
- In what functional disciplines do we add value for the customer?

Organizational Competencies Analysis provides a framework in which the core competencies of the organization can be integrated and used as critical success factors in our competitive strategy. It provides an insight into the skills, processes, knowledge and systems of the organization. It is a way to assess the value of the core competencies to the organization.

4.3.2 Core Competencies - Stretch Concept

Where the Value Chain analysis is based on an outside-in approach and places the market, the competition and the customer at the starting point of the strategy process, the core competence model does the exact opposite. The core competencies model of Hamel and Prahalad is an inside-out corporate strategy model that starts the strategy

process by thinking about the core strengths of an organization. Its approach to the 'stretch' concept can be summarized as follows:

1. The building blocks of corporate strategy are not products and markets but business processes. Products and markets are a result of business processes.
2. Competitive success depends on transforming a company's key processes into strategic capabilities that consistently provide superior value to the customer.
3. Companies create these capabilities by making strategic investments in a support infrastructure that links together and transcends traditional Strategic Business Units and functions. The portfolio perspective is not a viable approach to corporate strategy and the primacy of the Strategic Business Unit is an anachronism.
4. Because capabilities necessarily cross functions, there needs to be a champion of a capability-based strategy at the top.
5. Traditional cost-benefit analysis should not be the basis for leveraging capabilities. This requires strategic investments across Strategic Business Units and functions.

According to the stretch concept, the essence of strategy is not the structure of a company's products and markets but the dynamics of its behaviour. Management can leverage its resources, both financial and non-financial in five different ways.

a. ***Concentrating Resources (Convergence and focus):*** Management concentrates its resources on key strategic goals. This strategy is called strategic intent. The efforts of individuals, functions, and business converge over time to a strategic focal point. An example is the manner in which Komatsu encircled Caterpillar.

b. ***Accumulating Resources (Extracting and borrowing):*** Resources are accumulated more efficiently by complementing one type of resource with another to create a higher order value. In order to do so, an organization must be capable of accumulating knowledge or learning more efficiently than its competitors. It should be able to tap into technologies and not only borrow the skills but also internalize them. For example, NEC involved itself in hundreds of alliances, licensing agreements and joint ventures to multiply its own internal resources.

c. ***Complementing Resources (Blending and balancing):*** The ability to blend resources involves several skills including technological integration, functional integration and new product imagination. Balancing involves three capacities; product development capability; production capability (at competitive cost and quality); and distribution, marketing and service infrastructure. For example, EMI invented the CAT scanner in the early 1970s. Though EMI had a ground breaking product, it did not have complementary manufacturing and international sales and service network. Companies like GE and Siemens, with stronger distribution and manufacturing capabilities, imitated the product and made the profits. As for EMI, it had to abandon the business.

d. ***Conserving Resources (Recycling, co-opting and shielding):*** Recycling means using our resources in as many ways as possible. Technology and brands can be recycled. Co-option requires us to join hands with a potential competitor to fight a common enemy, while shielding resources means to reduce exposure to unnecessary risks and use our competitor's strength to our own advantage.

e. ***Recovering Resources (Expediting success):*** The time between the expenditure of resources and recovery is a source of leverage; the more rapid the recovery, the greater the leverage. An example is the fast paced product development programs of many Japanese companies. This strategy allowed them quicker recovery of investments and also gave them more up-to-date products so that they could compete more effectively.

Creating 'stretch' requires the organization to create a misfit between aspirations and resources. Using the core competency framework, it means creating competencies that permit us to 'stretch' our resources. The objective is to organize around the chosen capability and make sure employees have the necessary skills and resources to achieve it-keep motivating our managers, to encourage their willingness to keep challenging their frames of reference. This is the best way for providing a relative competitive advantage.

To take up the example given earlier, Reliance Industries had high levels of competencies but also the staggering ambition of the Ambanis. Starting as a public limited company in the mid-seventies with a turnover of Rs. 120 crores, the Reliance Group is today India's largest business house with total revenues of over Rs 99,000 crore (US$ 22.6 billion), cash profit of Rs 12,500 crore (US$ 2.8 billion), net profit of Rs 6,200 crore (US$ 1.4 billion) and exports of Rs 15,900 crore (US$ 3.6 billion). The success of Reliance is anchored on the dreams of Dhirubhai Ambani. Dhirubhai's vision was of Reliance as a $ 10 billion company by the end of the twentieth century.

Hamel and Prahalad illustrate the concept of stretch by giving examples from the international community: "Companies like NEC, CNN, Sony, Glaxo and Honda are united more by the unreasonableness of their ambitions and their creativity in getting the most from the least than by any cultural or institutional heritage." Corporate ambitions do not necessarily mean greater risk because risk recedes as knowledge grows; and as knowledge grows, so does the organization's capacity to advance.

4.3.3 Organizational Capabilities

The starting point for analyzing capabilities and competencies is recognizing that market position and market power is a result of the mastery of competencies and capabilities of competing firms. Differences in resource base rarely explain the differences in performance of organizations in the same industry. Organizations that perform better do so because of the manner in which they deploy their resources. The effective employment of resources allows the firm to develop a sum of knowledge and operative capabilities, resulting in greater competencies. Thus, competencies and capabilities result from the way the organization uses its resources to create knowledge and skills. When these competencies and capabilities are linked together effectively, they sustain excellent performance and give the organization market position and market power.

Traditionally, the capabilities of the organization have been described under the following heads:

- Financial capabilities
- Marketing capabilities
- Technological capability
- Strategic Business Alignment Capability or Management Capability

Check Your Progress 1

Define Core Competencies.

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4.4 STAKEHOLDER'S EXPECTATIONS

Although analyzing financial statements can be quite complex, a good idea of a company's financial position can be determined through the use of ratio analysis. Financial performance ratios can be calculated from the balance sheet and income statement.

Since different *stakeholders* in the organization will have a difference in their views of the financial performance of the organization, the analysis requires to be geared to the requirements of each of the groups. There are different financial ratios that satisfy the requirements of each of the groups. Based on this logic, the financial ratios have been arranged on this basis.

4.4.1 Quality of Investments

The stakeholder's expectations are given by the goal of maximizing stockholders' wealth and providing shareholders with an adequate rate of return. Shareholders are primarily interested in different measures of earnings on their capital that measure the quality of their investments.

Total Shareholder Returns: Total shareholder expectations or returns measure the returns earned by time (t + 1) on an investment in a company's stock made at time t. (Time t is the time at which the initial investment is made.) Total shareholder returns include both dividend payments and appreciation in the value of the stock (adjusted for stock splits) and are defined as follows:

Total shareholder returns = (Stock price (t + 1) – stock price (t) + sum of annual dividends per share) /Stock price (t)

If a shareholder invests Rs. 100 at time t and at time t + 1 the share is worth Rs. 150, while the sum of annual dividends for the period 't' to 't + 1' has amounted to Rs. 10, total shareholder returns are equal to (150 - 100) + 10)/100 = 0.6, which is a 60 percent return on an initial investment of Rs. 100 made at time 't'.

Return on Equity (ROE): This ratio measures the percentage of profit earned on common stockholders' investment in the company. It is defined as follows:

Return on stockholders' equity = Net profit /Stockholders' equity

It is a basic measure of the efficiency with which the firm employs the owners' capital and estimates the earnings per Rs.100 of invested equity capital. ROE is a powerful tool for analyzing the operations of the organization, as the ratio can be decomposed into 3 elements:

$$ROE = [Profit/Sales] \times [Sales/Assets] \times [Assets/Equity]$$

Each of the three elements provides information on different aspects of the operation of the organization.

Price-Earnings Ratio: The price-earnings ratio measures the amount investors are willing to pay per dollar of profit. It is defined as follows:

Price-earnings ratio = Market price per share/Earnings per share

Earnings before Interest and Taxes (EBIT), is an earning ratio. It is the income earned by the company without regard to how it is financed; so EBIT (1 - Tax rate) is income after tax, excluding any effects of debt financing. The earning per share can be calculated before tax as well as after tax.

Capital Asset Pricing Model [CAPM]: In addition, stockholders can also use modeling to determine the quality of their investment. One such model is the Capital Asset Pricing Model [CAPM]. This models the risk expected and expected return trade-off in the capital market. CAPM Model looks at the company in the market.

CAPM = Return on stock (Rs) = Risk Free Rate + ß. (Expected Market Profitability Rate - Risk Free Rate)

ß (bêta): is the measure of risk used for a single share. In other words, it shows the sensitivity or reaction of a share compared to the variation of total portfolio of market shares.

The Risk free rate is the rate that is offered for example, by Treasury Bills or Bonds, National Bonds, etc. The expected market profitability rate is the average rate attracted by similar portfolios in the market. For example, Standard & Poor's Index of 500 stocks had an average annual profitability rate from 1926 to 1994 of 12.2 %. The Beta is given by the market and published by various investment advisory services. It is the Bêta of a levered firm (with debts). That means that the Bêta takes in account the Business risk and the Financial risk.

There are a number of other financial ratios that are of particular interest to the shareholders. Shareholder-return ratios measure the return that shareholders earn from holding stock in the company.

It can be helpful to compare a company's *shareholder returns* against those of similar companies. This is a yardstick for determining how well the company is satisfying the demands of this particularly important group of organizational constituents and is a measure of its core competence in attracting shareholders to invest in the organization.

The basic principle in determining the quality of an investment is the Economic Value Added (EVA). The EVA of a company should always exceed the cost of capital employed, or the ratio 'EVA/Assets' > Cost of Capital.

Organizational Risk

Bankers and other providers of funds to the organization are primarily interested with the risk attached to the borrowings and the competence with which the borrowings are managed. This information can be gathered from the capital structure of the organization, using what is commonly called as 'Leverage ratios.'

Debt-to-Equity Ratio: The debt-to-equity ratio indicates the balance between debt and equity in a company's capital structure. This is perhaps the most widely used measure of a company's leverage. It is defined as follows:

Debt-to-equity ratio = Total debt/Total equity

Financial Leverage: The financial leverage of the firm is given by the relationship:

Financial Leverage = [ROA - interest] × Debt/Equity

The "Financial Leverage" factor is dependent upon 2 elements: ROA - Interest rate, and D/E (gearing ratio)

The balance between debt and equity is called the capital structure. A company is said to be highly leveraged if it uses more debt than equity, including stock and retained earnings. The optimal capital structure is determined by the individual company. Debt has a lower cost because creditors take less risk; they know they will get their interest and principal. However, debt can be risky to the firm because if enough profit is not made to cover the interest and principal payments, bankruptcy can result. As can be seen from Figure 4.6 there is an optimal debt equity ratio, beyond which the Return on Equity gets impacted.

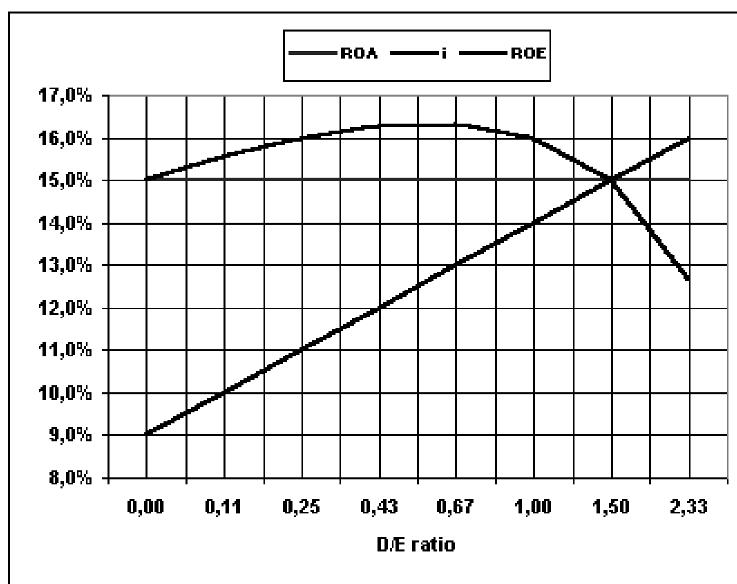

Figure 4.6: Financial Leverage

Return on Assets (ROA) is a fundamental measure of the efficiency with which a firm manages its assets. This ratio measures the profit earned on the employment of assets. It is defined as follows:

Return on total assets = Net profit/Total assets

ROA is an Economic profitability. It answers the following question: How much profit is the firm generating from the use of its assets?

- ROA does not depend upon the way the firm finances its assets
- Usually define ROA on a pre-tax basis to make international comparisons
- and to compare profitability across firms having different financing strategies

Ideally, the Return on Assets (ROA) should be such as to maximize the Self-Sustainable Growth (SSG) of the organization. This is the rate of growth that a company can maintain (can sustain) internally without changing its financial structure (D/E). A good track record and a good SSG of the organization can be considered as areas of core competence by Bankers. This would provide an incentive for them to invest further in the organization.

Profitability

Management will generally be interested in the profit ratios. These measure the efficiency with which the company uses its resources. The more efficient the company, the greater is its profitability. It is useful to compare a company's profitability against that of its major competitors in its industry to determine whether the company is operating more or less efficiently than its rivals. In addition, the change in a company's profit ratios over time tells whether its performance is improving or declining.

A number of different profit ratios can be used, and each of them measures a different aspect of a company's performance. The ROE and the ROA have been discussed in earlier sections. Here, we look at the other commonly used profit ratios.

Return on Invested Capital: This ratio measures the profit earned on the capital invested in the company. It is defined as follows:

Return on Invested Capital (ROIC) = Net profit / Invested capital

Net profit is calculated by subtracting the total costs of operating the company away from its total revenues (total revenues - total costs). Total costs are the (1) costs of goods sold, (2) sales, general, and administrative expenses, (3) R&D expenses, and (4) other expenses. Net profit can be calculated before or after taxes, although many financial analysts prefer the before-tax figure.

Invested capital is the amount that is invested in the operations of a company, that is, in property, plant, equipment, inventories, and other assets. Invested capital comes from two main sources: interest bearing debt and shareholders' equity. Interest-bearing debt is money the company borrows from banks and from those who purchase its bonds. Shareholders' equity is the money raised from selling shares to the public, plus earnings that have been retained by the company in prior years and are available to fund current investments.

ROIC measures the effectiveness with which a company is using the capital funds that it has available for investment. As such, it is recognized to be an excellent measure of the value a company is creating.

Cash Flow

The Operating cash flow (Cash flow provided by operations) is a central and crucial concept for financial management. It measures the ability of the firm to generate, through its day-to-day operations, a flow of cash, and therefore evaluates its capacity for survival and for long term growth. The operating cash flow is the long term engine of the company.

A strong positive cash flow enables a company to fund future investments without having to borrow money from bankers or investors. The higher it is, the better it is, the more freedom and flexibility it gives to the firm to build its long term strategy without constraint and interference from finance as the company avoids paying out interest. A good track record of liquidity ratios could be a core competence. It could result in improved suppliers relationships as well as discounts or improved credit. This could also impact the perception of the Bankers. They would also look at loans to the organization as having low risk profile and offer funds at attractive rates to the organization.

A weak or negative cash flow shows the inability of the company to meet its financial obligations and to make the necessary Capital expenditures required to operate efficiently and produce funds for future periods. A company has to turn to external sources to fund future investments. Generally, companies in strong-growth industries often find themselves in a poor cash flow position (because their investment needs are substantial), whereas successful companies based in mature industries generally find themselves in a strong cash flow position.

Cash flow position is cash received minus cash distributed. The net cash flow can be taken from a company's statement of cash flows. A company's internally generated cash flow is calculated by adding back its depreciation provision to profits after interest, taxes, and dividend payments. Cash flow is important for what it reveals about a company's financing needs. If this figure is insufficient to cover proposed new investments, the company has little choice but to borrow funds to make up the shortfall, or to curtail investments. If this figure exceeds proposed new investments, the company can use the excess to build up its liquidity (that is, through investments in financial assets) or repay existing loans ahead of schedule.

A company's liquidity is a measure of its ability to meet short-term obligations. An asset is deemed liquid if it can be readily converted into cash. Liquid assets are current assets

such as cash, marketable securities, accounts receivable, and so on. Some ratios that are commonly used to measure liquidity are given below.

Current Ratio: The current ratio measures the extent to which the claims of short-term creditors are covered by assets that can be quickly converted into cash. Most companies should have a ratio of at least 1, because failure to meet these commitments can lead to bankruptcy. The ratio is defined as follows:

Current ratio = Current assets / Current liabilities

Inventory Turnover: This measures the number of times inventory is turned over. It is useful in determining whether a firm is carrying excess stock in inventory. It is defined as follows:

Inventory turnover = Cost of goods sold / Inventory

Cost of goods sold is a better measure of turnover than sales because it is the cost of the inventory items. Inventory is taken at the balance sheet date. Some companies choose to compute an average inventory, beginning inventory, and ending inventory, but for simplicity, use the inventory at the balance sheet date.

Days Sales Outstanding (DSO) or Average Collection Period: This ratio is the average time a company has to wait to receive its cash after making a sale. It measures how effective the company's credit, billing, and collection procedures are. It is defined as follows:

DSO = Accounts receivable/(Total sales/360)

It can also be helpful to conduct historical analysis, looking at the deployment of resources of the organization by comparison with previous years. This can help identify any significant changes and reveal trends which might not otherwise be apparent. Comparison with other similar organizations can also help put the organization into perspective.

Social Costs

A major concern about traditional financial analysis from a strategic perspective is that it generally has tended to exclude the impact of the operations of the organization on the community. This is also a facet of business ethics. The community is largely concerned with the social costs of an organization's activities. However, traditional accounting practices do not have any method to reflect this in the balance sheets.

There is a growing awareness of issues that relate to the community; for example, there was a major movement to oppose the use of child labour in the carpet weaving and match-box industry in India. There was opposition from foreign buyers on the use of azo-dyes in the textile and carpet industry. These issues need to be taken into account. Failure to pay proper attention to these issues could be a source of strategic weakness.

4.4.2 Marketing Capability

Traditional Sources of Competitive Advantage are the economic / financial capability: able to produce goods or services at lower cost than competitors, and the Strategic / marketing capability: products or goods that differentiate a firm from its competitors, typically by "adding-value" or "product-portfolio mix."

Marketing and sales provide the means whereby consumers and users are made aware of the product or service offered by the organization. Marketing and Sales also provide the customer the ability to procure the product or service in a manner that they perceive a fair exchange of value.

Marketing is the foundation of a good business. It is the anticipation and fulfillment of customers' needs taking account of an organization's core competencies. As customers become more demanding, their needs change, new technologies emerge and competition increases, many organizations find that they need to build or enhance their own marketing capability. Marketing capability pertains to building the right products, establishing a close relationship with the customer, and effectively marketing products and services.

Traditional Requirements

The organization should have the ability of selecting its target markets, and developing and maintaining a marketing mix that will produce mutually satisfying exchanges with target markets. This requires the ability to identify to which part of the population it wants to sell its product or service, its Market Segment. The market segment is a homogeneous group of people that can be identified according to a well defined criteria such as: Age, Frequency of Product Use or Lifestyle.

The organization must have the capability to reach the target market. Target Market is the market segment of consumers whose wants or needs a firm will attempt to satisfy. Management must have an understanding of why customers make purchases and why non-customers do not. The marketing program should lead to a more efficient allocation of the available marketing resources.

The organization must have the capability for Implementation, Evaluation, and Control of the marketing plan itself. Implementation is the process that turns marketing plans into action assignments, and ensures that these assignments are executed in a way that accomplishes the plan's objectives. Evaluation is the method of gauging the extent to which marketing objectives have been achieved during the specified time period. Control provides the mechanisms for evaluating marketing results in light of the plan's goals and for corrective actions that will help them reach those goals.

New Concepts in Marketing Capability

Marketing capability is becoming more complex. Marketing competence has changed from the traditional functional view. Today's products and services offer simultaneous improvements on multiple dimensions:

- greater benefits
- improved quality
- greater customisation
- more focused marketing communications
- lower prices

One area where specialized skills are becoming increasingly critical is in the tailoring of marketing programs to consumer segments and even individual consumers. Sophisticated, demanding, and micro-segmented consumers are no longer willing automatically to place their confidence in premium-priced brands; consumers increasingly trust only their own ability to seek value. This means that marketers will have to deliver sharply articulated value to their set of consumers.

This fragmentation in demographics and user needs has impacted even the most homogenous of product categories. There are now a range of market segments within these product categories. This has already happened in developing countries and will soon become necessary in India. The best companies in these countries are now using specialists to develop, interpret, and communicate the results of models that predict likely consumer behaviour on the basis of past purchases.

A few organizations are using parallel computer processing systems to gain competitive advantage in target marketing. For example, Wal-Mart has developed an advanced information system that enables it to tailor merchandise store by store. It has introduced a "traiting" system. This system indexes each store on about 3,000 traits. Using this data, store managers can select products that reflect the unique features of their stores. (A store near fresh water, for instance, will receive different fishing rods and reels from one near salt water.)

Kraft, for example, has designed an approach to the micro-market planning called Geo-targeting. Geo-targeting allows Kraft to predict the potential sales of each of its products by store (on the basis of the size of each demographic/lifestyle segment in the neighbourhood).

For retailing and other industries, some organizations are already using consumer sales data to model, from as few as three or four transactions, the expected lifetime value of a loyal customer. This approach, which was initially developed for targeted business-to-business marketers, when combined with customized research data can be used in consumer marketing. This tells the organization the way they need to go to focus on their consumer populations.

Rapid responses to changing customer demand enable Sainsbury, the UK grocer to change the prices on 25,000 items in each of its stores every day, and 7-Eleven, the convenience retailer in Japan, changes its prices hourly. This is now spreading to the USA; several US packaged goods firms are equipping their account managers with predictive models that help them estimate the likely profitability of a promotion by modelling its specific attributes against historical results for comparable programs. As a result, promotions decisions no longer rely purely on "gut feel," but are both account specific and statistically sound.

Sophisticated direct marketing programs are already enhancing the ability of marketers to communicate efficiently with smaller and smaller segments of the population. As information processing costs continue to fall and new decision-support systems become available, this ability will grow - but at the cost of increasingly complicated decision-making processes.

Marketing Capabilities Revisited

The number of available channels for providers of packaged goods, apparel, durables, and financial services are increasing. Many of these channels are dominated by large, powerful, and professionally managed organizations, adding a new dimension to the complexity of the marketing task. Not only are the consumers demanding more, the distribution channels are now becoming capable of influencing and determining the role of the supplier.

Increasingly powerful, sophisticated, and fragmented distribution channels are demanding unique products, marketing strategies, and selling techniques. For example, a family-run store and a departmental store or supermarket sells its wares in different ways. They make completely different demands on the functions of a packaged goods manufacturer.

All these changes have made the marketing capability significantly different from its historical avatar. Marketing capability that was effective when high growth, unsophisticated consumer demands, and weak distribution channels meant that each function could make real progress by itself toward improved consumer satisfaction and greater profitability. On its own, manufacturing could cut costs and boost quality; marketing could develop better ads; and sales could improve call patterns and enhance customer presentations.

This may no longer be good enough. Marketing capability, in the future, requires that the organization will:

- Understand the real drivers of profitability throughout an industry's chain in order to identify which market segments to compete in and which economic levers to use to maximize a organization's share of scarce industry profits.
- Work across the value chain to develop genuinely consumer-focused strategies.
- Lead cross-functional teams responsible for executing these strategies day by day.

New tools are needed, and new challenges have to be faced. The biggest challenge may be instilling a new marketing culture, in making the transition from a relatively simple structure to one in which the organization develops skills to deliver value to the new breed of consumers and customers.

As marketers try to anticipate consumer needs, the capability required exceeds those required by transaction-based models that merely extrapolate from the past to ones that forecast potential demand. These new marketing capabilities will provide a fairly accurate assessment of the firm's competitive strengths and weaknesses. The goal is flexibility - and focus.

4.4.3 Technological Capability of the Firm

In developing countries and the less developed countries, economic growth is based on industrial development. The focus in these countries is on the secondary sector of the economy (manufacturing sector). Therefore, the most critical competence concern is the current technological base of the organization - its distinctive technological capability and competence. It is important to try to get a good fit between what the organization currently knows about, and the proposed changes it wants to make. One of the important considerations to determine this is an understanding of the technological capabilities of the organization.

The organization has to recognise there are different types of technological capabilities and the role of these capabilities in the various functions of the organization. By this is meant the types of knowledge and skills it requires in terms of the product or service and how it is produced or delivered effectively. This knowledge may be embedded in particular products or equipment, but is also present in the people and systems needed to make the processes work.

Generally, technological capability of an organization is a measure of its innovativeness. As the level of innovative capability of a firm goes up, the organization's capacity to face challenges also undergoes significant change. A major component of technological capability is learning from others. The process of diffusion is an important source of technological capability. An organization that is a member of a value chain, where the product or service can be broken-up into its individual components, passes on its knowledge to another through the process of 'diffusion'. For example, the software industry has this attribute; this is also the case in most mechanical industries. When components of the product or service are outsourced, it leads to an improvement in the technological capability of the sub-contractors.

There are a number of models of technological capability. The technological capability models of an organization, as adapted from the World Bank and Ramanathan's Eclectic models are described below.

World Bank Model

According to this model, technological capability is the ability to make effective use of technological knowledge. Accepting the complexity of technology, the model identifies

distinct technological capabilities, and classifies the technological capabilities by distinguishing between the different aspects of technological knowledge and its applications.

A. ***Production Capability***

1. Production management to oversee the operation of established facilities; production engineering to provide the information required to optimise the operation of established facilities that include the following: (a) Raw Material Control, to sort and grade inputs, and seek improved inputs; (b) Production Scheduling, to co-ordinate production processes across products and facilities; (c) Quality Control, to monitor conformable with product standards and to monitor them; (d) Trouble-shooting, to overcome problems encountered in the course of operation; and (e) Adaptation of Processes and Products, to respond to changing circumstances and to increase productivity;

2. Repair and maintenance of physical capital according to regular schedule or when needed;

3. Marketing to find and develop uses for possible outputs and to channel outputs to markets;

B. ***Investment Capability***

1. Manpower training to impart skills and abilities of all kinds;

2. Pre-investment feasibility studies to identify possible projects and to ascertain prospects for viability under alternative design concepts;

3. Project execution to establish or expand facilities, that includes: (a) Project Management, to organise and oversee the activities involved in project execution; (b) Project Engineering, to provide the information needed to make technology operational in particular settings, including: detailed studies to make tentative choices among design alternatives; basic engineering to supply the core technology in terms of process flows, material and energy balances, specifications of principal equipment, plant layout; and detailed engineering to supply the peripheral technology in terms of complete specifications for all physical capital, architectural and engineering plans, construction and equipment installation specifications,; (c) Procurement, to choose, co-ordinate, and supervise hardware suppliers and construction contractors; (d) Embodiment of Physical Capital, to accomplish site preparation, construction, plant erection, manufacture of machinery and equipment; and (e) Start-up of Operations to attain predetermined norms.

C. ***Innovation Capability:*** Included are all the activities spanning invention to innovation that are involved in technological changes that range from radical new departures to incremental improvements in existing technology.

Ramanathan's Eclectic Model

In this classification, six levels of technological capabilities are identified. The level of technological capability of the firm increases as it goes down the ladder formed by these technology types.

1. ***Reverse Engineering:*** Ability to imitate an existing product. For example, Sharp Corp. imported a crystal radio set from USA in 1925; reverse engineered it and made Japan's first radio, the Sharp - Dyne.

2. ***Product Innovation:*** Innovations that lead to improvements of existing products or development of new products. The innovations could be incremental, architectural, modular or radical.
3. ***Process Innovation:*** Improvements in the manufacturing process, or integration of steps in the manufacturing process leading to reductions in cycle time or reductions in the number of process types, improving the manufacturing process yields, etc.
4. ***Application Innovation:*** Utilisation of an existing idea or concept for a new application, or a new design, method or measurement technique. It can sometimes dramatically improve existing products and processes. For example, the development of Nylon into material for use as tyre cords.
5. ***Systems Innovation:*** Innovations involving integration of sub-subsystems and several innovations. This may be through linking or integration of a variety sub-systems, and involving product, process and application innovations. For example, application of fuzzy logic to improve continuous cold rolling mills in steel manufacturing to washing machines, to eccentricise the wash/rinse operation, enabling it to simulate a hand wash.
6. ***Core Competency Leveraging innovations:*** Ability to leverage and enhance innovative activity from its areas of core competence. A firm's capability to innovate in all phases of the innovation process, such as design, engineering, testing and manufacturing, forms its core competence:
   a. Expansion of innovation in the different phases of innovation
   b. Extension of core competence horizontally into a new field
   c. Fusing core competence in different areas

For example, Thermax, under the leadership of Rohintan Aga, used its technological capability in small boilers to leverage innovations into both the inlet and out let sides of the product. On the inlet side, Thermax expanded into water treatment and as it developed capability in water chemistry, it further expanded into polymer resins. It used this knowledge in the recovery of precious metals, and in nuclear and pharmaceutical business. On the outlet side, as Thermax built up its capabilities in heat transfer, it expanded into new businesses of both energy generation and energy conservation.

Another example is Hitachi's ability to design and produce 1MB DRAM in 1985, which it extended to 16 MB by 1990. Hitachi then developed the world's largest Ga-AsP (Gallium Arsenide Phosphide) single crystal and used this technology in satellite broadcasting; and thermostatic ceramic textiles. Thereby it created a fusion of core competencies in textiles, space and chemical technologies.

The classification of technological capability is important because it permits the firm to evaluate its position on the technological capability continuum from time to time. This enables it to take the decisions necessary to continue raising its capabilities. As the technological capability increases, so does the innovative capability. With an increase in the innovative capability of the firm, more skills and knowledge are added to the firm.

Competence needs to be nourished and grown and developed over time, it cannot be got off the shelf. This is why firms are constrained to follow particular pathways or trajectories based on their past history. Moving into new areas has higher risk and a good principle of management is, "to be successful, learn and absorb competence before deploying it". Firms that have the competency to leverage their core competencies display the highest level of technological capability.

Technology Auditing

Organizations often need directions in which they should focus their innovative efforts in order to gain competitive advantage. There is a significant body of knowledge that confirms that innovations have a better possibility of succeeding if they fit with the competence base of the firm. There is also the problem of lack of communication among different corporate functions. A collaborative divisional interaction is vital and will make it easier for the organization to find ways and means to identify, upgrade and improve their technological competencies. Technology auditing is one of the methods to carry out the exercise. It calls for the participation of both top management and staff related to technology.

The process begins with an introduction of mechanisms for the identification of technology needs. This is followed by the participants completing a questionnaire that is designed to find answers to some of the questions below:

- What is the technological competence of our organization?
- Do we have the resources to increase our technological competencies?
- Does the organization require options to acquire additional technological competencies?

Next, groups of 5 or 6 discuss individual results and identify strengths and weaknesses. The final product of technological auditing is recommendations, along with a snapshot of the current situation of the firm related to its technological potential as an instrument in achieving its objectives.

The effective use of technological auditing depends on top management support and participation. It is effective if it is carried out by a task force - comprising personnel from the various company areas - to coordinate the process. There should be a coordinator to apply the methodology, with assistance from a trained consultant.

The process is strengthened if there is some type of commitment from top management on the implementation of audit recommendations and that the audits are repeated at regular intervals.

4.4.4 Strategic Business Alignment Capability

Conventional requirements of management are being challenged by the developments in the complexity of organizational structures. As organizations become more complex, they achieve focus through the creation of business units, as strategic business units, virtual structures, and strategic enterprises, etc., each with its own internal value chain. In spite of their complexity, organizations have to be increasingly more competitive and enhance their capability to respond rapidly by to events.

Strategic business alignment represents the capability of an organization to coordinate the activities of all of its components for the purpose of achieving its strategic objectives. It is grounded in a shared vision and common understanding—as well as ownership by all stakeholders—of what the organization wants to achieve and why. It replaces the concepts of management and IT capability in the modern organization.

Strategic Business Alignment Capability provides the modern organization the capability to rethink the conventional wisdom about consistency, conflict, and leadership. Strategic alignment of the different business units has become a crucial aspect in exercising managerial capability.

Strategic Business Alignment (SBA) represents the organization's capability to coordinate the Activities of all its components for the purpose of achieving its strategic objectives.

SBA is grounded in a shared vision and common understanding-as well as ownership by all stakeholders-of what the organization wants to achieve and why. Though the driving factors for SBA are organizational control, performance metrics, and short-term accountability the focus is on achieving and sustaining a corporate climate that serves as the basis for collaborating effectively.

Given the goal of maximizing stockholders' wealth, providing shareholders with an adequate rate of return is a primary objective of most business organizations. Bankers and other providers of funds to the organization are also interested with the risk attached to the borrowings and the competence with which the borrowings are managed. Therefore, managing risks becomes an important aspect of the acceptability of the organization's strategy.

Stakeholder value in the organization is the collective output of its interacting processes such as product development, customer acquisition, production, procurement, and human resources management. These form a hierarchy of value creating activities. The processes also drive the various targeted stakeholder requirements. Resource allocation determines how an organization can allocate adequate resources to each of these processes and businesses in a manner that is balanced.

Resource configuration is concerned with creating capabilities for the future by identifying the broad mix of resources and competencies – and the unique resources and core competencies on which competitive advantage will be built. In doing so, it exploits the experience of the organization and protects its unique resources. In particular, it configures the resources, competencies for the future that will need to be created by fitting together separate resources and activities of the organization and by managing linkages with customers, etc.

Strategy will determine the relative importance of resources and competencies in the implementation of the strategy. Established distribution networks can be a unique resource. In many knowledge-based organizations, such as software houses and biomedical companies, the capability of the organization is found in personal competence and is not formally owned by the organization.

The organization must be able to bring together an appropriate mix of resources to create competencies. The opportunity to sustain competitive advantage is determined by the synergistic combination and integration of sets of resources. Exploiting experience is extremely important to maintain a competitive advantage, as other organizations are likely to imitate the leaders and catch up through their own learning.

4.5 SCENARIO PLANNING

Scenario planning looks at what's going to happen tomorrow. The purpose of scenario planning is not to pinpoint future events but to highlight large-scale forces that push the future in different directions. It's about making these forces visible, so that if they do happen, the planner will at least recognize them. It's about helping make better decisions today.

Scenarios can play a critical role in environmental analysis systems. The Shell method helped the Anglo-Dutch firm to become an oil giant. It makes 20-year-scenario plans, which are updated every three years. Shell uses a two-year global scenario structure. Shell's most recent efforts are to chart energy markets out to 2050, and features two distinct scenarios: one in which renewable energy sources gain popularity very slowly over time and another in which new fuel technologies, such as hydrogen fuel cells, quickly rise to acceptance.

The term 'scenario,' taken from the world of theatre and film, refers to a brief synopsis of the plot of a play or movie. In the Strategic Management context, scenarios can be described as "stories of possible futures that might be encountered." Scenarios are graphic and dynamic, revealing an evolving future. They are holistic, combining Social, Technological, Economic, Environmental, and Political (STEEP) trends and events, the qualitative as well as the quantitative. They focus attention on potential contingencies and discontinuities, thereby stimulating us to think more creatively and productively about the future.

It is possible to create scenarios in-house. The methodology involves a relatively straightforward six-step process with two important elements. The first is the decision focus of the scenarios. The starting point for the process is the very specific decision(s) that confront the organization. Scenarios should be designed specifically to help make those decisions. The other key element is the scenario logic. This gives scenarios a kind of organizing principle or logical structure. The logic of a scenario comes from a theory, assumption, or belief about change. Each distinct scenario logic is an argument about the future, a different interpretation of the uncertainties in the underlying forces that lead to a different view of the future. The steps are:

Step 1: Identify and Analyze the Organizational Issues that will Provide the Decision Focus

Clarifying the decision focus of the whole process is the first task. The decisions that form the scenario focus tend to be strategic rather tactical in nature. Virtually any decision or area of strategic concern in which external factors are complex, changing, and uncertain can be appropriate for treatment by scenarios. As a general rule, the narrower the scope of the decision or strategy, the easier scenario construction-and interpretation-will be. Developing scenarios for broader strategic concerns-the long-range positioning is substantially more difficult than for a straightforward investment decision.

Step 2: Specify the Key Decision Factors

Having thought through the strategic decision(s), we then need to examine the key decision factors. In simple language, these are the key factors we would like to know about the future in order to make a decision. We cannot actually know the future; it would still be helpful to have some "fix" on the future course and "value" (or range of values) for these factors. Decision factors for an anticipated major expansion of manufacturing facilities, for example, might include market size, growth, and volatility; competing products or substitutes resulting from new technology; long-range economic conditions and price trends; future government regulations; capital availability and cost; technology availability and capacity.

Step 3: Identify and Analyze the Key Environmental Forces

The next step is to identify the external forces that determine the future course and value of our key decision factors. Here an environmental scanning/monitoring system can be used to scan for signals of change in the task, industry, and macro environment. The objective is to start building a good conceptual model of the relevant environment, one that is as complete as possible, including all the critical trends and forces, and that which maps out the key cause-and-effect relationships among these forces.

Our assessment should be to try to differentiate between trends and developments that we believe to be relatively predictable and those about which we have some feeling of uncertainty. An impact/uncertainty matrix, with a simple high-medium-low scoring system, can position each of these forces on the matrix in terms of (1) the level of its impact on

the key decision factors (obviously, all the forces are presumed to have some impact, but some are more important than others) and (2) the degree of uncertainty we feel about the direction, pace, or fact of its future course.

Step 4: Establish the Scenario Logics

This step is the heart of the scenario development process: establishing a logical rationale and structure for the scenarios we select to develop. The central challenge in this step is to develop a structure that will produce a manageable number of scenarios-and do so logically. For example, economic growth will be "driven by expanding trade" or "hobbled by increasing protectionism"; competition in our markets will be "marked by growing consolidation" or "restructured by the entry of new players."

Step 5: Select and Elaborate the Scenarios

The objective is not to cover the whole envelope of our uncertainty with a multiplicity of slightly varying futures, but rather to push the boundaries of plausibility using a limited number of starkly different scenarios.

1. The selected scenarios must be plausible, that is, they must fall within the limits of what logic says might happen regardless of our judgement as to probability.
2. They should be structurally different, that is, not so close to one another that they become simply variations of a base case.
3. They must be internally consistent, that is, the combination of logics in a scenario must not have any built-in inconsistency that would undermine the credibility of the scenario.
4. They should have "decision-making utility," that is, each scenario, and all the scenarios as a set should contribute specific insights into the future that bear on the decision focus we have selected.
5. The scenarios should challenge the organization's conventional wisdom about the future.

Once the scenarios have been selected, they then have to be elaborated. There are many ways to elaborate the description of scenarios, but there are three important features:

1. A highly descriptive title: short enough to be memorable but descriptive enough to convey the essence of what is happening in the scenario. After people have had the scenarios described to them, they should find each title to be a memorable encapsulation of the scenario.
2. Compelling "story lines." Remember: a scenario should tell a story; that story should be dramatic, compelling, logical, and plausible.
3. A table of comparative descriptions. This provides planners and decision makers with details along specific dimensions. These three features can always be embellished with charts, graphs, and other visual material to help to bring the scenarios to life. The guiding principle in determining the extent of this elaboration is, as always, the requirement of the decision focus: provide as much detail as is needed to help executives make the decision, and no more.

Step 6: Interpret the Scenarios for their Decision Implications

This final step in the scenario process can develop some initial and valuable strategic insights. Then two questions suggest themselves. First, which opportunities and threats

are common to all (or nearly all) the scenarios? These are the ones on which presumably our strategic thinking should be focused. The second question is: how well prepared are we to seize those opportunities and obviate (or minimize) the threats? The answers to these questions provide an initial assessment of the core competencies that the organization needs if it is to succeed in the conditions portrayed in the scenarios. Bringing together the answers to these two questions suggests some discrete strategy options (though not yet an integrated strategy) that deserve more disciplined analysis.

Scenario planning is especially useful in circumstances where it is important to take a long term view of strategy; where there are limited numbers of key factors influencing the success of that strategy; but where there is a high level of uncertainty about such influences. There are two main benefits of such an exercise. First, management can examine strategic options against the scenarios and test the sensitivity of possible strategies. The second is that the scenarios can be used to challenge the assumptions about the environment in which the organization operates. This is particularly important where change is unpredictable and the future is uncertain.

In Scenario Planning technique, options are matched to different future scenarios. This technique has great importance in conditions of high uncertainty.

The purpose of scenario planning is not to pinpoint future events but to highlight large-scale forces that push the future in different directions. It makes these forces visible, so that if they do happen, the analyst will at least recognize them. Scenarios are a way of understanding the dynamics shaping the future. By doing so, it helps organizations make better decisions today.

The primary "driving forces" at work in the present fall roughly into four categories:

1. ***Social dynamics - Quantitative and Demographic Issues:*** For example, how influential will youth be in 10 years; softer issues of Values or Lifestyle.

2. ***Economic issues - Macroeconomic Trends, forces shaping the economy as a whole:*** For example, how will the development of the oil and gas reserves in Siberia and changes in the exchange rates of the dollar affect the price of crude?; Microeconomic Dynamics: For example, how might the very structure of the industry change with outsourcing?; and Forces at Work, on or within the company itself, etc.

3. ***Political issues - Electoral:*** legislative for example, if the NDA cannot form the government in the Centre, will tax policies be changed? Regulatory: will there be lifting of the ban on drugs in India?

4. ***Technological issues - Direct:*** For example, how will high-bandwidth wireless affect land-line telephony; Enabling: For example, will the development of smaller and faster chips result in changes in the modes and systems of communication; and Indirect: For example, will biotech allow easy "body hacking" and thus compete with more traditional forms of entertainment?

Real issues entail a bit of all four forces. After we identify the predetermined elements from the list of driving forces, we should be left with a number of uncertainties. At first, all uncertainties seem unique. But by stepping back, we can reduce bundles of uncertainties that have some commonality to a single spectrum, an axis of uncertainty. If we can simplify our entire list of related uncertainties into two orthogonal axes, then we can define a matrix that allows us to define four very different, but plausible, quadrants of uncertainty. Each of these far corners is, in essence, a logical future that we can explore.

The output would be number of options under different possible future scenarios. The organization will have to keep scanning the environment and identify which of the scenarios is relevant at any one time to its strategic options. The thinking process in scenario planning cannot be combined with a strong rationalist approach to strategic decision making. It fits in a different thinking paradigm, which defines strategy making not as a one-time decision, but as an ongoing process.

Check Your Progress 2

State whether the following statements are True or False:

1. SWOT analysis is a popular tool for audit and analysis of the overall strategic position of a business and its environment.
2. Scenario planning looks at what is going to happen tomorrow.
3. The purpose of scenario planning is not to pinpoint future events but to highlight large-scale forces that push the future in different directions.
4. Scenario planning does not play any role in environment analysis system.
5. Scenario planning is especially useful in circumstances where it is important to take a long term view of strategy.

4.6 INDUSTRY ANALYSIS

An organization's strategic capability is ultimately assessed in comparative terms. Traditional methods are based on historical data and industry norms. Though financial information and analysis and comparisons with industry norms are ways in which the assessment of organizational competencies can be made, nowadays, benchmarking is used as a basis for comparison, which includes comparison of competencies with best practices including comparisons beyond the industry.

Industry analysis looks at the deployment of resources and performance measures by comparison with previous years in order to identify any significant changes. For example, a strategy that requires significant investment in new products, distribution channels, production capacity and working capital will place great strain on the business finances. Such a strategy needs to be very carefully managed from a finance point of view.

The financial analysis will become more meaningful by the additional comparison with similar factors analyzed for the industry as a whole. This helps to put the organization's resources and performance into a relative perspective to its competition. However, in order to improve the value of the comparison, the analysis needs to be a detailed cover of the separate activities of the organization.

Though desirable, this is often not very practical. As this comparison has to be made from the data made public by the competitor, very often in multidivisional set-ups or in the case of diversified companies, it may not be possible to get comparable data on the basis of separate products or product classes. This limits the type of comparisons that can be made. Some of the other common limitations of this type of comparison are as follows:

- Data from balance sheets of different companies may reflect values of assets that may not be comparable.
- Corrections may have to be made for differences in accounting practices.

- In organizations that have international operations and we might end up adding apples and oranges.
- Where the industry as a whole is making losses or performing badly, such analysis is not particularly useful.
- Competitive comparisons are based on the stage-wise value added by different activities. This requires access to accounts in great detail. This is not possible with industry comparisons.

The shortcomings of *industry* norm *analysis* have encouraged organizations to develop other approaches to make assessments of the relative strategic capabilities of the organization. Rather than trying to establish norms, business organizations are trying to search for best practices and thereby establish benchmarks of performance related to the best practice.

4.7 LET US SUM UP

SWOT is a popular tool for audit and analysis of the overall strategic position of a business and its environment. The acronym "SWOT" represents "Strengths", "Weaknesses", "Opportunities", and "Threats". Used in conjunction with other established strategic management tools, for example the PESTLE analysis, the SWOT Analysis can provide information that is helpful to the firm in strategy formulation and selection.

Like the SWOT analysis, the PESTLE analysis is simple, quick, and uses four key perspectives, the political environment, the economic environment, and social and technological factors. The stages of the PESTLE analysis are carried out in the same way as the SWOT analysis. Weightages can also be used; the weightage factor provides a more objective analysis of the problem.

Any complex problem will find a solution by the combined use of analysis and intuition. Constant access to accurate market information is the key to any analysis. No effective business strategy can be built on fragmentary knowledge or analysis. In order to conduct a good analysis, it takes a strategic and inquisitive mind to come up with the right questions and phrase them as solution oriented issues.

The resource analysis becomes useful to the organization and can be effectively used when the key issues are identified. This provides the basis for judging the future course of action. A number of tools are available to assist the organization in making an assessment of the major strengths and weaknesses and their strategic importance. SWOT analysis, is one such tool. However, strengths and weaknesses can be assessed only in relation to the strategies the organization is pursuing or plans to pursue. This requirement relates to the natural connection between strategic analysis and strategic choice.

'Critical success factors' can be used to map the core competencies needed to support specific strategies. Critical success factors are those aspects of strategy in which the organization must excel to outperform competition, and they are strengthened by core competencies in specific activities or in the management of linkages between activities.

Formal planning and evaluation can be valuable tools for strategic managers, but they should not be regarded as an exclusive process through which the strategies are selected. The critical issue for strategic managers is to ensure that the organization's formal planning and evaluation activities assist whichever is the dominant approach to strategy selection the organization takes. We need to examine how the formal planning process can influence the decisions taken by management, whatsoever be the criteria.

Formal planning and evaluation are useful means of raising the level of debate among the decision-makers during the selection process. For example, sensitivity analysis is a useful technique for allowing decision-makers to understand the risks and uncertainties surrounding specific strategies, but it does not select strategies for the decision makers.

Competencies result from the way the organization uses its resources to create knowledge and skills. Core competencies are those capabilities that are critical to a business achieving competitive advantage. Core competencies are a set of unique internal skills processes and systems. The organization requires analyzing how resources are being deployed to create competencies. This allows the organization to evaluate the cost of creating competencies and focus on those competencies that are critical to the organization.

Organizational capabilities are those competencies that result in the long-term competitive success of the organization. It is a way to assess the value of the core competencies to the organization.

Creating 'stretch' requires the organization to create a misfit between aspirations and resources. It means creating competencies that permit us to 'stretch' our resources. "Stretch" is leveraging. Management can leverage its resources, both financial and non-financial in five different ways; Concentrating Resources (Convergence and focus): Accumulating Resources (Extracting and borrowing): Complementing Resources (Blending and balancing): Conserving Resources (Recycling, co-opting and shielding): and Recovering Resources (Expediting success).

A critical competence concern is the current technological base of the organization - its distinctive technological competence. By this is meant what the organization knows in terms of the product or service and how it is produced or delivered effectively. Technological capabilities can be classified in six levels. The level of technological capability of the firm increases as is goes up the ladder formed by these technology types: Reverse Engineering: Product Innovation: Process Innovation: Application Innovation: Systems Innovation: and Core Competency Leveraging innovations Ability.

Industry Analysis thus helps a firm to find answers to two questions basically: “What characteristics of Industry are important?” and “how can a manager enhance performance given those characteristics?” An answer to the first question traces industry characteristics that affect incumbent firms and, thus contribute to average profitability. When managers are able to pursue a strategy that exploits the opportunities that industry characteristics pose and reduce the negative impacts, the firm performs better than its rivals in the industry. Thus the basic purpose of industry analysis is to assess the relative strengths and weaknesses of an organisation relative to other players in the industry.

4.8 LESSON END ACTIVITY

Outline and assess the factors affecting the decisions corporations might take about the location and management of key activities, such as research and development, manufacturing, sales and marketing. How might such corporations respond to these challenges? Illustrate your answer with examples.

4.9 KEYWORDS

Stretch Concept: The 'stretch' concept is the ability of the organization to leverage resources so as to extend the capabilities of the organization and its competitiveness.

Competitive Advantage: Competitive advantage is the result of a strategy capable of helping a firm to maintain and sustain a favourable market position. This position is translated into higher profits compared to those obtained by competitors operating in the same industry.

Key Success Factors: Key Success Factors are those functions, activities or business practices, defined by the market and as viewed by the customers, which are critical to the vendor/customer relationship. Key Success Factors are defined by the market and by the customer, not by the company. They revolve around skills, processes and systems.

Resource Analysis: Resource Analysis is a methodology that assesses the inherent strength of the organization based on its resources. This includes the quantity of resources available, the nature of these resources, and the extent to which these resources are unique and difficult to imitate.

Value Chain Analysis: Value chain analysis describes the activities the organization performs and links them to the organization's competitive position. Therefore, it evaluates which value each particular activity adds to the organization's products or services.

Core Competencies: Core competencies are those capabilities that are critical to a business achieving competitive advantage. In order to qualify as a core competence, the competency should differentiate the business from any other similar businesses.

Strategic Business Units: Strategic Business Units are units within the overall organization for which there is an external market for goods or services distinct form other Strategic Business Units.

Organizational Capabilities: Organizational capabilities are those competencies that result in the long-term competitive success of the organization.

Technological Capability: Technological Capability is the ability to make effective use of technological knowledge.

4.10 QUESTIONS FOR DISCUSSION

1. Select a firm and make its internal environment analysis using SWOT analysis.
2. What conditions would prompt a firm to retaliate aggressively against a new entrant to the industry?
3. Many firms neglect industry analysis. When does it hurt them? When does it not?
4. Define Industry analysis. Explain its important uses. In your opinion, who in a firm should be responsible for Industry Analysis? Which methods be should use for analysis?
5. Write a note on the importance of SWOT audit. Core competency, stakeholder’s expectations and scenario planning in the internal analysis of a firm.

Check Your Progress: Model Answers

CYP 1

Core competencies are those capabilities that are critical to a business achieving competitive advantage. In order to qualify as a core competence, the competency should differentiate the business from any other similar businesses. Core competencies are a set of unique internal skills, processes and systems.

CYP 2

1. True
2. True

Contd....

3. True
4. False
5. True

4.11 SUGGESTED READINGS

Pearce & Robinson, *Strategic Management*, All Indian Travellers N.D.

A.C. Hax and N.S., *Strategic Management: An Integrative Perspective*, Majifu, Prentice Hall.

Micheal Porter, *Competitive Strategies*.

Micheal Porter, *Competitive Advantage of Nations*.

Samul C. Certo and J. Paul Peter, *Strategic Management: Concept and Application* (Second Edition), McGraw Hill.

Georgy G. Dess and Alex Miller, *Strategic Management*, McGraw Hill.

Gerry Jhonson & Keven Scholes, *Exploring Corparate Strategy: Text and Cases*.

Jaunch L Rajive Gupta & William F Glueck, *Business Policy and Strategic Management*, Frank Bros & Co, 2003

Fred R.David, *Strategic Management: Concept and Cases*, Pearson, 2003.

UNIT III

LESSON

5

STRATEGY FORMULATION

CONTENTS

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5.0 AIMS AND OBJECTIVES

After studying this lesson, you will be able to:

- Understand the generic strategies
- Learn about grand strategies
- Know about strategies of different Indian Companies

5.1 INTRODUCTION

Formulating competitive strategy involves the consideration of four key factors. These are shown in Figure 5.1. These factors determine what a company can successfully accomplish. The factors that are internal to the organization are its strengths and weaknesses and the values of its key personnel; the factors that are external to the organization are the industry opportunities and threats and societal expectations. These factors combine to provide the basis and limits to the competitive strategy a company can successfully adopt. The appropriateness of the competitive strategy can be determined by testing the proposed objectives and policies for consistency.

These broad considerations in an effective competitive strategy can be extended into a generalized approach to the formulation of strategy. In order to do this, the organization must be in a position to answer the following questions:

- What is the current strategy, implicit or explicit?
- What assumptions have to hold for the current strategy to be viable?
- What is happening in the industry, with our competitors, and in general?
- What are our growth, size, and profitability goals?
- What products and services will we offer?
- To what customers or users?
- How will the selling/buying decisions be made?
- How will we distribute our products and services?
- What technologies will we employ?
- What capabilities and capacities will we require?
- Which ones are core?
- What will we make, what will we buy, and what will we acquire through alliance?
- What are our options?
- On what basis will we compete?

Although the process may seem intuitively clear, answering these questions involves a great deal of penetrating analysis. It is in answering these questions that the organization finds its competitive strategy.

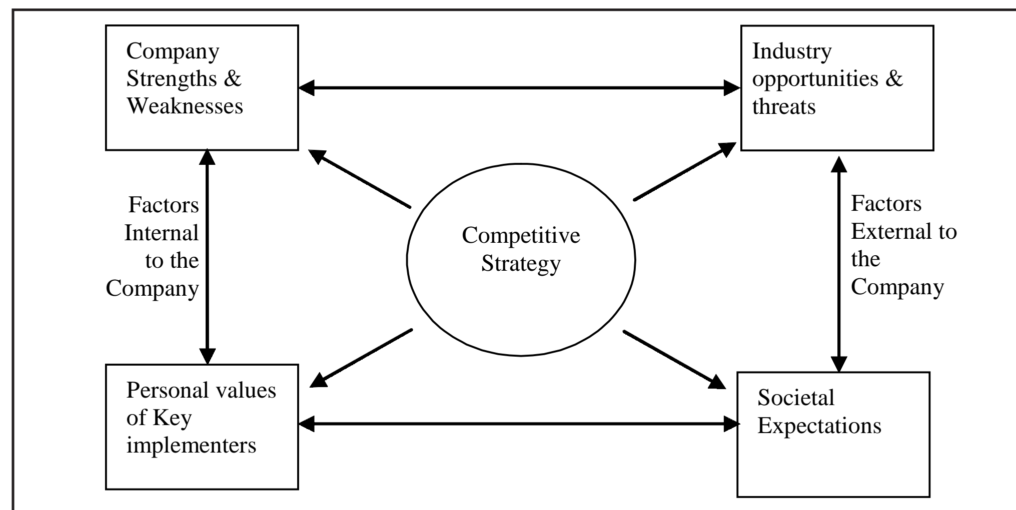

Figure 5.1: Formulation of Strategy

5.2 STRATEGY FORMULATION

In a tidy logical world, any process of choice could be rational. Identifying and choosing options would be done purely analytically. This is not necessarily true. Identifying and evaluating options and then exercising it for strategy formation is a complex process. Actually, it may be difficult to identify all possible options with equal clarity, or at the same time.

The future may evolve differently from any of the options. Unexpected events can create new opportunities, destroy foreseen opportunities, or alter the balance of advantage between opportunities. The results may eventually depend as much on chance and opportunity as on the deliberate choice. Good fortune and inspiration play a large role in organization success and failure, too. No one yet knows enough about effective strategic management to model it fully (Mintzberg, 1994), making it more art than science.

The evolution of strategic choice is driven by many different forces. Ideas and practices emerge from collaborative contacts between organizations. Firms cannot avoid learning and borrowing when they trade and work together. The evolution of strategy is also pushed along by competition and confrontation. New ideas and practices arise when managers try to outwit or beat back powerful rivals. New strategies are often a recasting of the old. In a sense, old strategic ideas never disappear entirely; they infiltrate new practices covertly, like the blending of old and new malt whiskies. Finally, strategy is pushed along by the sheer creativity of managers, because they explore new ways of doing things.

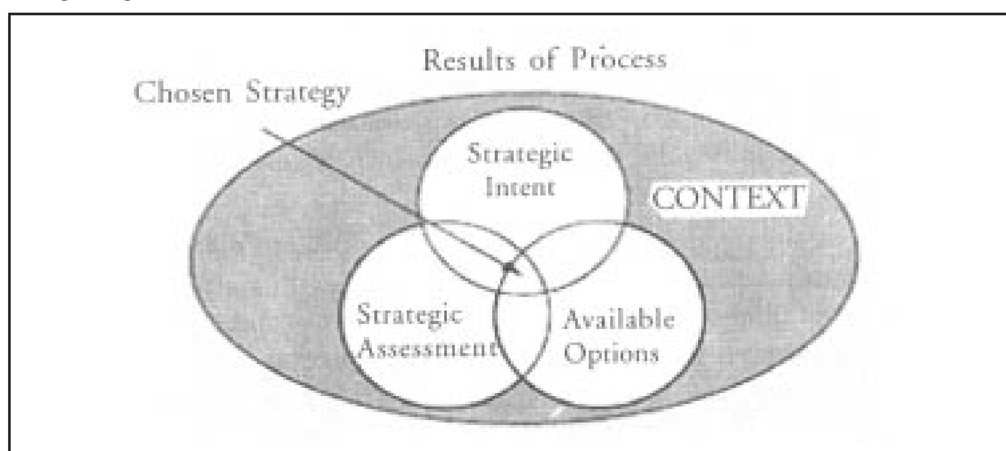

Figure 5.2: The Strategic Choice Process

The nuts and bolts of strategy start with the selection process. Strategy selection is based on the vision of the organization. It blends into the missions and goals of the organization. Through strategies, organizations align their internal resources with environmental demands to ensure long-term effectiveness. A workable strategy is built on these outputs.

The relationship of strategy selection with the strategic intent and the strategic assessment process is shown in Figure 5.2. In the figure, strategic intent, strategic assessment and available options are shown as three circles. To some extent, strategic choice shapes and even limits the goals a company can reasonably pursue. The logically viable strategy emerges where the three logical elements overlap. Where all three circles overlap, the differing requirements of intent and assessment are most fully met.

The common ground between any two circles is of some interest. This is explained in Figure 5.3. Where any two circles overlap are areas where feasible options may exist which are not aligned to strategic intent. This may raise the question of whether the strategic intent should be changed. Options that are not feasible may seem highly attractive and may have powerful supporters, so the reasons why they are not feasible may need to be carefully argued with clear evidence in support.

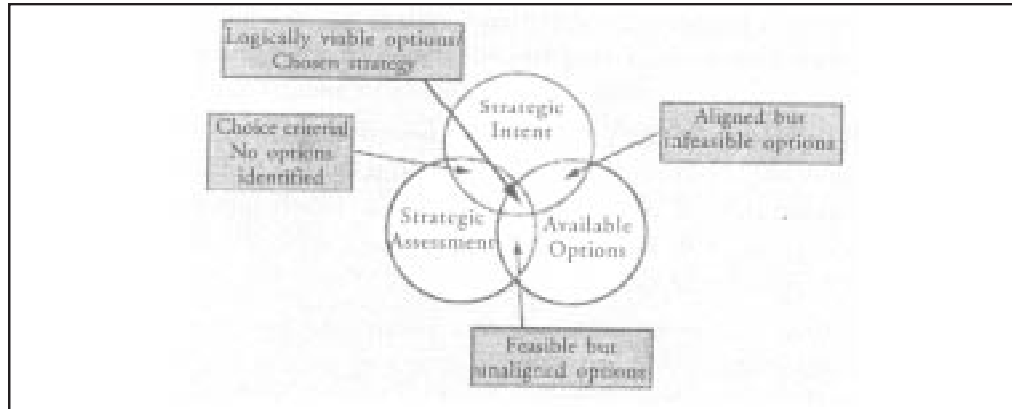

Figure 5.3: The Strategic Choice Process Explained

Another case may be that they are aligned but have not been found feasible. In this case also, it will be necessary to faithfully document all the assumptions and analysis of why the option was found not to be feasible. Choices of what not to do may sometimes be as important as choosing what to do.

5.3 GENERIC STRATEGIES

The objective of the organization is to yield a superior rate of return on the investment for the organization. The principle to meet this objective is that organizations achieve competitive advantage by providing their customers with what they want, or need, better or more effectively than competitors and in ways the competitors find difficult to imitate. The best strategy for the organization, therefore, is ultimately unique, reflecting the particular circumstances it faces.

In order to succeed in this, organizations have found many offensive and defensive actions to defend their position in the industry and cope with the five competitive forces. A firm's relative position within its industry determines whether a firm's profitability is above or below the industry average. The fundamental basis of above average profitability in the long run is sustainable competitive advantage. There are two basic types of competitive advantage a firm can possess: low cost or differentiation. The two basic types of competitive advantage combined with the scope of activities by which a firm seeks to achieve them, lead to three internally consistent generic competitive strategies that can be used by the organization to outperform competition and defend its position in the industry. These strategies are:

- Cost Leadership
- Differentiation, and
- Focus and Niche Strategies.

		Competitive Advantage	
		Lower Cost	**Differentiation**
Competitive Scope	**Broad Target**	1. Cost Leadership	2. Differentiation
	Narrow Target	3. Cost Focus	4. Differentiation Focus

Figure 5.4: Generic Strategies

The focus strategy has two variants, cost focus and differentiation focus. This is shown in Figure 5.4.

These strategies are explained below. Effectively implementing any of the generic competitive strategies usually requires total commitment and determined organizational support. This happens when there is compatibility between corporate level strategy and the strategy at the business level.

5.3.1 Cost Leadership Strategy

A firm pursuing a cost-leadership strategy attempts to gain a competitive advantage primarily by reducing its economic costs below its competitors. This policy once achieved provides high margins and a superior return on investments.

The skills and resources required to be successful in this strategy are sustained capital investment and access to capital; superior process engineering skills; good supervision and motivation of its labour force; product designed for ease in manufacturing; low-cost distribution system. The organization attempts to exploit economies of scale by aggressive construction of efficient economies of scale through:

- Volume of production and specialized machines
- Volume of production and cost of plant and equipment
- Volume of production and employees’ specialization
- Volume of production and minimised overhead costs

This strategy requires tight cost control. This is often done by using a full costing method or activity based costing with frequent and detailed control reports. The structure of the organization should be clear-cut and responsibilities clearly laid out. Organizations often provide incentives based on meeting strict quantitative targets, etc.

In order to remain a cost leader, the firm attempts to avoid those factors that can cause the economies of scale to be affected. It has to work within the physical limits to efficient size; worker motivation; and focus on markets and suppliers, sometimes, in restricted geographical areas. Firms that are known to have successfully used this strategy in a number of their businesses include Black and Decker, Texas Instruments, and DuPont.

The low-cost producer strategy works best when buyers are large and have significant bargaining power; price competition among rival sellers is a dominant competitive force; the industry's product is a standard item readily available from a variety of sellers; there are not many ways to achieve product differentiation that have value to the buyer; buyers incur low switching costs in changing from one seller to another and are prone to shop for the best price.

A low-cost leader is in the strongest position to set the floor on market price and this strategy provides attractive defences against competitive forces. Its cost position gives it a defence from competitors because its lower costs mean that it can still earn returns after its competitors have competed away their profits through rivalry. It is protected from powerful buyers because buyers can exert power only to lower prices, and this will be possible only with next most efficient competitor. Lower cost provides protection against suppliers because there is more flexibility in the organization to cope with input cost increases. Any new entrant will find it difficult to overcome entry barriers because of required economies of scale, and also because the activities taken to achieve low costs are both rare and costly to imitate.

Finally, it places the organization in a favourable position when pitted against substitutes compared to competitors in the industry.

Cost leadership is valuable if:

- Buyers do not value differentiation very much
- Buyers are price-sensitive
- Competitors will not immediately match lower prices
- there are no changes in:
    - consumer tastes
    - technology
    - exogenous prices/costs

There are a number of risks in using this strategy. These risks relate to the fast changing business environment. The most serious risk to cost leadership is technological change that nullifies past investment or learning of the organization. Sometimes the inability of the management to see or anticipate the changes required in the product or market change, is a grave handicap. The organization's advantage can also be neutralized if there is low cost learning by industry newcomers or inflation in costs of supplies or processes that provide the organization a competitive advantage.

5.3.2 Differentiation Strategy

In a differentiation strategy, a firm seeks to be unique in its industry along some dimensions that are widely valued by buyers. It selects one or more attributes that many buyers in an industry perceive as important, and uniquely positions itself to meet those needs. Differentiation will cause buyers to prefer the company's product/service over the brands of rivals. An organization pursuing such a strategy can expect higher revenues/margins and enhanced economic performance.

The challenge is finding ways to differentiate that create value for buyers and that are not easily copied or matched by rivals. Anything a company can do to create value for buyers represents a potential basis for differentiation. Ways to differentiate products / services include:

- Product features
- Linkage between functions
- Timing
- Location/convenience
- Product mix
- Links with other firms
- Customisation
- Product complexity/sophistication
- Marketing (image, etc)
- Service and support

Successful differentiation creates lines of defense against the five competitive forces. It provides insulation against competitive rivalry because of brand loyalty of customers and hence lower sensitivity to price. The customer loyalty also provides a disincentive for new entrants who will have to overcome the uniqueness of the product or service. Competitors are not likely to follow a similar approach if buyers value the differentiated

products and services. If they do, this will lead to a lose - lose situation for them. The higher returns of the strategy, provides a higher margin to deal with supplier power. Buyer power is mitigated as there are no comparable alternatives. Finally a company that has differentiated itself to achieve customer loyalty should be better placed to compete with substitutes than its competitors. Some successful examples of this strategy are DaimlerChrysler in Automobiles, Bose in Audio Systems, and Caterpillar in construction equipment.

Competitive advantage through differentiation is sustainable if the activities taken to achieve differentiation are rare and costly to imitate. The most appealing types of differentiation strategies are those least subject to quick or inexpensive imitation. Differentiation is most likely to produce an attractive, long-lasting competitive edge when it is based on technical superiority, quality, giving customers more support services, and on the core competencies of the organization.

Differentiation requires the organization to have some of these skills and resources:

- Strong marketing abilities
- Product engineering
- Creative flair
- Corporate reputation for quality or technological leadership
- Strong cooperation from channels
- Strong coordination among functions
- Amenities to attract highly skilled labor, scientists, or creative people

Differentiation strategy works best when there are many ways to differentiate the product/ service and these differences are perceived by buyers to have value or when buyer needs and uses of the item are diverse. The strategy is more effective when not many rivals are following a similar type of differentiation approach. There are risks in this strategy when the cost of differentiation becomes too great or when buyers become more sophisticated and need for differentiation falls.

Check Your Progress 1

Fill in the blanks:

1. .... emerge from collaborative contacts between organizations.
2. The objective of the organization is to yield a superior .... on the investment for the organization.
3. The low-cost producer strategy works best when buyers are .... and have significant bargaining power.

5.3.3 Focus and Niche Strategies

The generic strategy of focus rests on the choice of a narrow competitive scope within an industry. The focuser selects a segment or group of segments in the industry, or buyer groups, or a geographical market and tailors its strategy to serving them to the exclusion of others. The attention of the organization is concentrated on a narrow section of the total market with an objective to do a better job serving buyers in the target market niche than the rivals. Each functional policy of the organization is built with this in mind.

There are two aspects to this strategy, the cost focus and the differentiation focus. In cost focus a firm seeks a cost advantage in its target market. The objective is to achieve lower costs than competitors in serving the market - this is a low cost producer strategy focused on the target market only. This requires the organization to identify buyer segments with needs/preferences that are less costly to satisfy as compared to the rest of the market. Differentiation focus offers niche buyers something different from other competitors. The firm seeks product differentiation in its target market.

Both variants of the focus strategy rest on differences between a focuser's target market and other markets in the industry. The target markets must either have buyers with unusual needs or else the production and delivery system that best serves the target market must differ from that of other industry segments. Cost focus exploits differences in cost behaviour in some markets, while differentiation focus exploits the special needs of buyers in certain markets. A focuser may do both to earn a sustainable competitive advantage though this is difficult. Examples of focus strategies are Rolls-Royce in luxury automobiles; Apple Computer in Desktop publishing.

Focus strategy is successful if the organization can choose a market niche where buyers have distinctive preferences, special requirements, or unique needs and then developing a unique ability to serve the needs of the target buyer segment. Even though the focus strategy does not achieve low cost or differentiation from the perspective of the market as a whole, it does achieve this in its narrow target. However, the market segment has to be big enough to be profitable and it has growth potential. The organization has to identify a buyer group or segment of a product line that demands unique product attributes. Alternatively, it has to identify a geographical region where it can make such offerings.

Focusing organizations develop the skills and resources to serve the market effectively. They defend themselves against challengers via the customer goodwill they have built up and their superior ability to serve buyers in the market. The competitive power of a focus strategy is greatest when the industry has fast-growing segments that are big enough to be profitable but small enough to be of secondary interest to large competitors and no other rivals are concentrating on the segment. Their position is strengthened as the buyers in the segment require specialized expertise or customized product attributes

A focuser's specialized ability to serve the target market niche builds a defence against competitive forces. Its focus means that either the organization has a low cost position as its strategic target, high differentiation, or both! The logic that has been laid out earlier for cost leadership and differentiation also is applicable here.

Some of the situations and conditions where a focus strategy works best are:

- When it is costly or difficult for multi-segment rivals to serve the specialized needs of the target market niche;
- When no other rivals are concentrating on the same target segment;
- When a firm's resources do not permit it to go after a wider portion of the market;
- When the industry has many different segments, creating more focusing opportunities and allowing a focuser to pick out an attractive segment suited to its strengths and capabilities.

A focus strategist must beware of events that could impact the target market. This can happen when broad-line, multi-segment competitors may find effective ways to match the focused firm in serving the narrow target market, or the segment may become so appealing that it is soon crowded with eager, aggressive rivals, causing segment profits to be split. Often the niche buyer's preferences and needs drift more and more towards

the product attributes desired by the market as a whole; this could be threatening. The focus strategy always implies some limitation on the overall market share achievable. The strategy involves a trade-off between profitability and sales volume.

Some Aspects of Generic Strategies

The three generic strategies differ on many dimensions. Implementing them successfully requires different resources and skills. These have been summarized in Table 5.1. Organizations pursuing different strategies will find that they attract different sorts of people. This should result in different styles of leadership that can translate into different corporate cultures and atmospheres.

If the organization is in a position where it is between the three strategic options, it usually takes time and sustained effort to come out of this position. In spite of the fact that successfully executing each generic strategy involves different resources, strengths, organizational arrangements, and managerial style, some organizations try to flip back and forth among the generic strategies. In addition, the organization would be amenable to a blurring of the corporate culture and conflicting motivation system. Obviously, this happens when organizations do not exercise their options based on their capabilities and limitations.

An organization must take a fundamental strategic decision to select one of the three generic strategies. Failing to develop a strategy in any of the three directions will result in low profitability. It will either lose the high volume customers who demand low prices or operate with reduced profits to get this business away from low cost competition. It will also lose high margin businesses to competition that have achieved differentiation overall.

Table 5.1: Summary of Generic Strategies

Generic Strategy	Required Skills and Resources	Organizational Requirements
Cost Leadership	▪ Sustained Capital Investment capability and access to Capital ▪ Process Engineering Skills ▪ Intense supervision of labour ▪ Product designed for ease in manufacture	▪ Tight cost control ▪ Frequent, detailed control reports ▪ Structured organization and responsibilities ▪ Incentives based on meeting strict quantitative targets
Differentiation	▪ Strong marketing abilities ▪ Product engineering ▪ Creative flair ▪ Strong capability in basic research ▪ Reputation for quality or technological leadership ▪ Long tradition in the industry or unique combination of skills from other areas ▪ Strong cooperation from channels	▪ Strong coordination among functions in R&D, product development and marketing ▪ Subjective measurement and incentives instead of quantitative measures ▪ Amenities to attract highly skilled labour, scientists or creative people
Focus	▪ Combination of the above, directed at the particular strategic target	▪ Combination of the above, directed at the particular strategic target

This seems to indicate that in many industries there is a U-shaped relationship between profitability and market share. The profitability is high with low market share using a differentiation strategy and a high market share using a cost leader strategy. For example, in the automobile industry the profit leaders are General Motors that has a price leadership strategy and DaimlerChrysler which has a differentiation strategy.

The three strategies are based on competing differently in the marketplace. They construct different types of defenses against competitive forces. The types of risks they face are also different. However, there are two types of risks that are common to all of them:

- Failing to attain or sustain the strategy, and
- Erosion in the value of the strategic advantage with industry evolution.

Cost leadership imposes severe burden on the organization to keep up its position. It means the organization has to reinvest in modern equipment so as to keep reaping all economies of scale. In addition, it must keep honing its process engineering core capability. Similarly, differentiation requires investments in a strong R&D on a continuous basis and the ability to attract the right type of people into the company. A summary of the risks for the different strategic options is given in the Table 5.2 below:

Table 5.2: Risks of the Generic Strategies

Generic Strategy	Risks
Cost Leadership	• Technological change that nullifies past investments or learning • Low cost learning by industry newcomers or followers through imitation or their ability to invest in state-of-art facilities • Inability to see required product or marketing change because of attention placed on cost • Inflation in costs that curtail the firm’s ability to maintain enough of a price differential to offset competitor’s brand image or differentiation
Differentiation	• The cost differential between low cost competitors and the differentiated firm becomes too great to hold brand loyalty • Buyer’s need for the differentiating factor falls. This can happen when the buyers become more sophisticated • Imitation narrows perceived differentiation, a common occurrence as industries mature
Focus	• The cost difference between broad range competitors and the focused firm widens to eliminate the cost advantages or differentiation achieved by the focus • The differences in desired product or services between the strategic target and the market as a whole narrows • Competitors find submarkets within the strategic target and out focus the focuser.

Check Your Progress 2

State whether the following statements are True or False:

1. Generic Strategies are those competitive strategies which can be used by the organisation to outperform competition and defend its position in the industry.
2. Formulating competitive strategy involves the consideration of the four key factors; strengths and weaknesses; the values of its key personnel; industry opportunities; threats and societal expectations.
3. Game theory examines situations in which a player in a game in affected by what others do.
4. A firm pursuing a cost-leadership strategy attempts to gain a competitive advantage primarily by reducing its economic costs below its competitors.
5. A simultaneous game is a game where both players make moves without knowing the move of the other player.

5.4 GRAND STRATEGIES

Corporate level strategies are also known as Grand strategies. Corporate strategy, therefore, is critical as it forms the framework that enables the organization to cope with the external and internal environments. It resolves the basic objectives and focuses the organization's activities with the objective to optimize the use of the organization's resources.

Strategies surface at different tiers in the organization hierarchy depending on the architecture of the organization. They form a hierarchy, with the corporate strategies being the basis for the business strategies. Corporate strategy is the highest, in the sense that it is the broadest, applying to all parts of the organization. Corporate strategies are concerned with the broad and long-term questions of what business(es) the organization is in or wants to be in, and what it wants to do with those businesses. In addition to providing the vision for the organization, corporate strategy gives direction to corporate values, corporate culture, corporate goals, and corporate missions.

Down one step is business-level strategy. The business strategies are basically competitive strategies. The objectives of these strategies are about how to compete successfully in particular markets, and how the business units can acquire competitive advantage and position itself among its competitors.

In an integrated operating company, decision making of the broad corporate strategy may be prepared at the corporate headquarters and may be reinforced by more detailed functional strategies. Functional strategies include marketing strategies, new product development strategies, human resource strategies, financial strategies, legal strategies, and information technology management strategies. The strategies made by the functional entities generally emphasize on short and medium term plans and limit their domain to the department's functional responsibility. Each functional department attempts to do its part in meeting overall corporate objectives, and hence to some extent their strategies are derived from broader corporate strategies.

The other traditional architecture is that of a broadly diversified holding company. Diversified companies are organized as Strategic Business Units (SBUs), a semi-autonomous unit within an organization. SBUs are distinct business units that have an external market for their products and services distinct from another SBU. It is usually responsible for its own budgeting, new product decisions, hiring decisions, and price setting. An SBU is treated as an internal profit centre by corporate headquarters and made responsible for developing its business strategies. These strategies must be in tune with broader corporate or grand strategies.

The "lowest" level of strategy is operational strategy. It has a very narrow focus and deals with day-to-day operational activities such as scheduling, production, and dispatch, etc. It must operate within a budget but is not at liberty to adjust or create that budget. Operational level strategies are informed by business level strategies which, in turn, are informed by corporate level strategies.

Strategic Choice is generally limited to the study of corporate and business level strategies, i.e., growth strategies and competitive strategies. Strategies at the functional level and operational strategies form the subject of the specific functions that are being studied and will not be a part of our discussions.

But before we go into the selection of strategies, we should be aware of the different strategic options that are available to the organization. These are the bases for strategic choice.

Corporate strategies can be growth (directional), portfolio based or parenting. Growth strategies can be long-term or short-term. Long term strategies include strategic options like product development, market development, diversification and concentration strategies, while short-term strategies are focused on either stability or renewal. Parenting is a special case limited to conglomerates and relates to the relationship between the parent and its business units.

The organization has to have a grand strategy. The corporate level strategies or Grand strategies are the general plan by which the organization intends to achieve its purpose and long-term objectives.

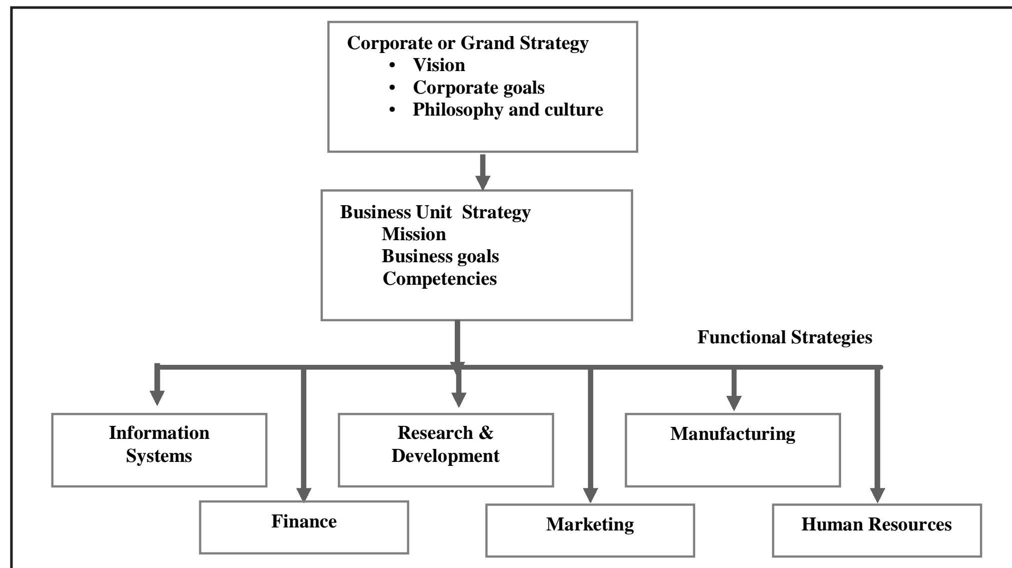

Figure 5.5: Structure of Strategies

Grand strategies are concerned with the type of business the organization is in, it overall competitive position and how the resources of the organization have to be deployed. They set the overall direction the organization will follow. This can be clearly seen in Figure 5.5 that graphically represents the structure of strategies.

At the corporate level, the firm faces several strategic questions: What businesses should we compete in, given our strengths and weakness? Which new product markets should we enter? Which should we exit? This is the "domain choice" question. It delineates the product-market domain of the firm and describes the firm's scope of operations.

Depending on the nature and purpose of the organization, there are three approaches to strategy formulation. The organization can adopt any of the approaches described below or it can combine the approaches in the options it exercises. We will study all three broad approaches to corporate strategies:

Growth Strategies:	Long-Term Strategies
Corporate Parenting:	Resource Allocation and Centralized Management of Business Units.
Portfolio Analysis:	Products and Business Units.
Corporate Revival:	Short-Term Strategies

The strategic intent gives a broad direction to strategic choice. Within this broad direction, depending on the approach that is taken by the organization, there are a number of specific options concerning the direction of developing the organization's strategies. We will start by looking at growth strategies.

5.5 LET US SUM UP

Formulating competitive strategy involves the consideration of four key factors: strengths and weaknesses; the values of its key personnel; industry opportunities and threats and societal expectations.

The strength of competitive forces in an industry determines the degree to which this inflow of investment occurs and the ability of organizations to sustain above average returns. The five competitive forces - threat of new entrants; threat of substitute products or services; bargaining power of suppliers; bargaining power of buyers; and rivalry among existing firms, reflects the fact that competition in an industry goes well beyond the established players.

There are two basic types of competitive advantage a firm can possess: low cost or differentiation. A firm pursuing a cost-leadership strategy attempts to gain a competitive advantage primarily by reducing its economic costs below its competitors. In a differentiation strategy a firm seeks to be unique in its industry along some dimensions that are widely valued by buyers. An organization pursuing such a strategy can expect higher revenues/margins and enhanced economic performance. Competitive advantage through differentiation is sustainable if the activities taken to achieve differentiation are rare and costly to imitate.

Another approach to business strategy is the Resource-Based View. It is based on four key components:

1. ***Unique Competencies:*** Competitive advantage is created when resources and capabilities owned exclusively by the organization can generate unique core competencies.
2. ***Sustainability:*** The advantage that results from generating core competencies can be sustained due to the lack of substitution and imitation capacities by the organization's competitors.
3. ***Appropriability:*** As the core competencies are unique, the benefits derived from these advantages are retained inside the organization: they are not appropriated by others
4. ***Opportunism and Timing:*** The timing of the acquisition of the necessary resources and capabilities is so opportune that their cost will not offset the resulting benefits.

If all these conditions are met, then the competitive advantage that is created will generate economic value for the organization. Competitive advantage arises from an ability of an organization to build, less expensively and more rapidly than competitors, the core competencies that generate unanticipated products. The link between identified core competencies and end products are the core products. Strategic architecture is a necessary requirement for building and enhancing the core competencies of the organization.

5.6 LESSON END ACTIVITY

Provide a description of the different possible type of strategic alliance-from joint ventures to network organisations to informal agreements. Provide some context to the growing number of alliances in many industries.

5.7 KEYWORDS

Competitive Strategy: Competitive strategy provides the framework that guides competitive positioning decisions. It examines the way in which an organization can compete more effectively to strengthen its market position and build a sustainable competitive advantage.

Generic Competitive Strategies: Generic competitive strategies are those competitive strategies that can be used by the organization to outperform competition and defend its position in the industry.

Cost-leadership Strategy: A firm pursuing a cost-leadership strategy attempts to gain a competitive advantage primarily by reducing its economic costs below its competitors.

Different Strategy: In a differentiation strategy a firm seeks to be unique in its industry along some dimensions that are widely valued by buyers. It selects one or more attributes that many buyers in an industry perceive as important, and uniquely positions it to meet those needs.

Generic Strategy: The generic strategy of focus rests on the choice of a narrow competitive scope within an industry. The focuser selects a segment or group of segments in the industry, or buyer groups, or a geographical market and tailors its strategy to serving them to the exclusion of others.

Cost Focus: Cost focus exploits differences in cost behaviour in some markets. In cost focus, a firm seeks a cost advantage in its target market. The objective is to achieve lower costs than competitors in serving the market - this is a low cost producer strategy focused on the target market only.

Differentiation Focus: Differentiation focus offers niche buyers something different from other competitors. The firm seeks product differentiation in its target market.

5.8 QUESTIONS FOR DISCUSSION

1. Take an organization with which you are familiar, and use relevant tools and frameworks to identify and assess the potential sources of competitive advantage. To what extent will the sustainability of this competitive advantage depend upon the organization's strategic capabilities or its position within the industry?
2. "Location and co-ordination have become the critical strategic issues for corporations facing the challenges of globalization."

   Outline and assess the factors affecting the decisions corporations might take about the location and management of key activities, such as research and development, manufacturing, sales and marketing, in the light of the statement above. How might such corporations respond to these challenges? Illustrate your answer with examples with which you are familiar.
3. How do corporate strategies relate to the other organizational strategies (i.e., competitive and functional)? What is the difference between single and multi-business organizations? Provide examples.

Check Your Progress: Model Answers

CYP 1

1. Ideas and practices
2. rate of return
3. large

CYP 2

1. True
2. True
3. True
4. True
5. True

5.9 SUGGESTED READINGS

Pearce & Robinson, *Strategic Management*, All Indian Travellers N.D.

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LESSON

6

STRATEGIES OF LEADING INDIAN COMPANIES

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6.8 Let us Sum up

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6.0 AIMS AND OBJECTIVES

After studying this lesson, you will be able to:

- Know about the role of diversification
- Understand the strategics of leading Indian Companies.
- Learn about the limit, means and forms of diversification
- Understand strategic management for small organizations.
- Know about non-profit organizations and large multi-project and multi-market organizations

6.1 INTRODUCTION

Strategy plays a vital role in companies for its sustainability and growth. Major issues of strategy are being discussed at national and global levels and research being undertaken to understand what makes some companies outperform their industry peers. It is argued that companies need tools and techniques to excel in an industry but more important is how to formulate and implement strategies as also what kind of management practices to be followed. A large body of literature is available throwing light on various strategic issues for companies to excel in an industry.

- Organizational Excellence and Dynamics Challenges
- Innovation and Corporate sustainability
- Competition and Competitiveness
- Strategy Formulation and Implementation
- Balanced Scorecard
- Change Management

Some of the Indian companies entered the global market and become major player. They are either cost leader or producer of differentiated products. They accept the challenges of global competition by innovation and strategic dynamics. They capture global market through joint ventures, mergers and acquisitions. They try to make their present felt in the global market. However they have to struggle hard to compete with other global players.

6.2 STRATEGIES OF INDIAN IT COMPANIES

Many IT companies are growing in terms of sales, man power, and skills. Indian companies are becoming part of the world reputed IT projects. What are the growth strategies of successful Indian IT companies?

Indian IT companies' revenues are increasing every year after the US economic slowdown in 2000. Every year Indian IT industry is reaching the software export targets projected by the NASSCOM. Many IT companies are growing in terms of sales, man power, and skills. Indian companies are becoming part of the world reputed IT projects. What are the growth strategies of successful Indian IT companies? How are they getting more business every year in spite of the tough competition from China? How are they becoming profitable? How are they able to retain their employees for long term? How they are able to deliver good quality turn key solutions?

I think people are first assets to any company. It is the human capital which is giving maximum returns to any company. The skilled man power and the education system India is having are the greatest assets. The young engineers in India are very flexible in learning new technologies and they are hunger for technology and technical developments. Indian software engineers welcome new technologies and they accept change, which is an advantage to IT companies. Indian IT companies are heavily investing in training young engineers. As we know technologies change fast. To catch the new technical projects, these companies should be ready with the latest skilled technical man power. Quick learning capabilities of these engineers is also an advantage to these software services firms. Once you have the man power available in the latest technologies, it is easy to bid the projects in those technologies.

One of the growth strategies of Indian IT services firms is acquisitions. In the recent past many Indian IT companies acquired companies in US and Europe which are having the good customer base so that they can get more business from US and Europe. For example, US based NerveWire was acquired by Wipro Technologies. If you look at the global player Cisco, It is best example for Mergers & Acquisitions. It has acquired hundred of companies having related products.

Another growth strategy they are following is diversification strategy. Some IT companies are having plans to enter into biotechnology area. Companies like Satyam, TCS and Wipro are already into Bioinformatics. And many IT companies are following the chain.

One more growth strategy these IT companies are following is geographical diversification. Satyam started their development centre in China and Dubai. Majority of Indian software houses are becoming MNCs by starting their development centers abroad. They are recruiting diversified workforce. Infosys is going to global business schools to recruit their management graduate.

Companies like Infosys and i-Flex are entering into IT products segments with their banking products to the global markets. These IT companies are diversifying their customer base. They are not dependent on single customer.

Also these IT companies are diversifying their services offering to the customer. Earlier they were into maintenance and manpower supply to the western IT customers. These days Indian IT companies are providing offshore facilities, project management, program management, design, and architecture services also. In fact, Infosys is providing complete business solutions to the customer by providing management consulting services through their business consulting venture and IT services through their traditional software business.

According to NASSCOM President, Kiran Karnik's article titled Dreaming of a new India published in The Times of India, now every global company is having "India Strategy". The boards of these global players are having the India specific strategies.

Now let us see other side of the spectrum. According to the article published in recent Business Week, 16 Jan 2006 Issue, SUBCONTINENTAL DRIFT written by Nandini Lakshman, there are around 30,000 foreign workers in Indian IT and ITES companies working in India. This number is triple the number of foreigners in India which is two years ago. People from European countries are coming and working in Indian IT enabled services companies in Metro areas. Majority of them are language experts in Spanish, Finish, French, and German. Many foreign program and business managers of global IT companies like IBM are working in India. Indian IT industry is attracting many foreigners to come and work here.

Mumbai based Mastek, is part of the biggest IT program of UK, which is NHS computerization in UK. Mastek is taking care of providing offshore facilities for NHS. It is working along with British Telecom for NHS in UK.

6.3 STRATEGIES OF THE INDIAN TATA GROUP

Complex ownership structures are a common phenomenon across Asian business groups. There has been a large amount of international work focusing on the various aspects of ownership structures and strategies adopted by international business groups. In the Indian literature, we found little work, especially with respect to case studies. In this paper, we use public information of a well known business group (the Tatas) passing through a major restructuring and document the development of ownership structure. The country's second-largest conglomerate, the Tata group, with year 2005 revenue of over Rs. 80,000 crores (US$ 20 billion) and core interests ranging from steel, cars and telecommunications to software consulting, hotels and consumer goods, has come a long way since JRD Tata passed the dynamics mantle to Ratan Tata, in 1991. We examine the interrelation of ownership structure, corporate strategy, and external forces for one of the largest conglomerate from India. In all Tata group affiliates, control is enhanced through pyramidal structures, and cross-holdings among affiliates. This case study on the oldest business empire also explores the rationale behind these moves and examines the tensions and complementarities between stronger ownership ties among group affiliates. While bridging ties among group affiliates does benefit the new dynamics in creating a more cohesive business group yet the findings hold enough water to conclude that these moves are contradictory to the interests of the minority shareholders in the individual operating companies (i.e., its own affiliates).

Box 6.1: Tata Group

INDIAN BUSINESS HOUSES
TATA GROUP

Tata Heritage

- Jamsetji Tata
  - Started textile mill in 1877
  - Inspired steel and power industry
  - Technical education and philanthropy
- JRD Tata
  - Pioneered civil aviation
  - Funded Hom Bhabha's nuclear programme
  - Guided the Tata group for over half a century
- Ratan Tata
  - Present Chairman since 1991

6.4 ROLE OF DIVERSIFICATION

Diversification Strategies- Quadrant 'C'

This entails entry into new markets with new products. There is an underlying struggle for supremacy between the management capabilities of the organization and the discipline of market forces. Market forces try to divide organizations into smaller entities so as to achieve the economist's ideal of a perfect market with a large number of small operators defenseless against the forces of competition. In contrast, corporate managements try to grow and diversify fighting market forces so as to achieve high profits and be able to control their own destinities. This conflict is the basis for the theory of diversification.

Diversification, as a strategy, has had a roller coaster relationship with business. In the 1970s, diversification was the essence of strategy. Organizations tried to diversify in order to minimize risks in their product portfolios and enhance their capability for unlimited growth. Problems in many organizations that followed this dogma, created a new concept of strategy - core competence. Organizations that adhered to this dogma missed the opportunities that were opening up around the globe as markets and technologies converged to create huge new businesses. Since the late nineties, this has brought in a renewed interest in diversification.

When does one diversify and to what extent? Perhaps the answers lie both in the market and the organization. When the organization has a high level of organizational capability, it can bring the market into submission and thereby diversify and earn sustained high profits. As the markets become stronger and more efficient, when competition is high, capital markets are efficient, and labor markets are more flexible, organizations require higher levels of management capability to protect their diversity. Diversification is an exciting option for those who have the management capability.

Diversification may be related or unrelated to the existing operations of the organization. Related diversification is called concentric diversification and unrelated diversification is called conglomerate diversification. The rationale behind the conglomerate diversification decision is that there is a minimum common denominator and some degree of synergy with the original business, even if the diversification is unrelated. Examples of synergy are the ability to share facilities-a sales force, for instance-or reducing the risk profile of the organization by creating a balance in the timing of cash flow, etc. More generally, diversified businesses grow faster and growth tends to be greatest if the diversification is unrelated. However, related diversifications tend to be more profitable.

Box 6.2: Concentric Diversification: Nokia moves Into Mobile Phone Software

Finnish producer Nokia leads the world in sales of cell-phone handsets. When the telecom industry crashed in 2000, Chairman Jorma Ollila invested heavily to turn Nokia into a major mobile phone software player. Under his leadership, the organization licensed its interface software to cell-phone competitors. It also invested heavily in billing and messaging service software. The result: millions of mobile customers using Nokia and others software can now use their handsets to get e-mail, send photos, and download games. Research organization IDC forecasts that global mobile-data business will increase almost 47% in 2003 to $29.5 billion. Diversifying into mobile phone software helped keep Nokia on top of a troubled industry.

Source: "The Comeback Kids," Business Week, September 29, 2003, p. 122.

Concentric Diversification

The acquisition or internal development of a business outside of, but in some way related to a company's existing scope of operations. Related diversification again divides into backward, forward, and horizontal integration.

- Backward integration is a move towards suppliers and raw materials in the same overall business. An example of this would be a brewer acquiring malting facilities or growing hops.
- Forward integration is a move towards the market place or customers in the same overall business. An example of this would be a manufacturer acquiring retail outlets or a hop grower beginning to brew his own beer.
- Horizontal integration is a lateral move into a closely related business such as selling by-products.

6.5 MEANS AND FORMS OF DIVERSIFICATION

6.5.1 Why Diversification?

The two principal objectives of diversification are:

1. improving core process execution, and/or
2. enhancing a business unit's structural position.

The fundamental role of diversification is for corporate managers to create value for stockholders in ways stockholders cannot do better for themselves. The additional value is created through synergetic integration of a new business into the existing one thereby increasing its competitive advantage.

6.5.2 Forms and Means of Diversification

Diversification typically takes one of three forms:

1. Vertical integration - along your value chain
2. Horizontal diversification - moving into new industry
3. Geographical diversification - to open up new markets

Means of achieving diversification include internal development, acquisitions, strategic alliances, and joint ventures. As each route has its own set of issues, benefits, and limitations, various forms and means of diversification can be mixed and matched to create a range of options.

Check Your Progress 1

Define Diversification Strategy.

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6.6 STRATEGIC MANAGEMENT POLICY

All organizations benefit from committing themselves to a strategy that describes the value that an organization intends to produce, the means it will rely on to produce that value, and how it will sustain itself in the future. The most well developed and commonly relied upon models for developing organizational strategies come from the private sector. Yet, these models fail to take account of two crucially important features of the strategic problem faced by nonprofit organizations and governmental bureaucracies: first, that the value that these organizations produce lies in the achievement of social purposes for which no revenue stream is readily apparent rather than in creating wealth for shareholders or satisfaction to customers, and second, that nonprofit and governmental organizations receive revenues from sources other than customer purchases of products and services. An alternative strategy model developed for use with government organizations focuses the attention of managers on three key issues: public value to be created, sources of legitimacy and support for the organization, and operational capacity to deliver the value. This alternative strategy model seems to resonate powerfully with the experience of nonprofit managers precisely because it focuses attention on social purpose and on the ways in which society as a whole might be mobilized to contribute to social purposes rather than on the financial objectives that can be achieved by selling products and services to markets.

Strategies that will stop the organization's decline and put it back on a successful path are called renewal strategies. There are two main types of renewal strategies: retrenchment and turnaround.

The history of post independence industry in India can be divided into three periods. The different phases are identified as: (a) 1947 to 1980; (b) 1990s: Post Liberalization; and (c) 2000s: Emergence of world class organizations.

1947 - 1980: Competition law, trade, investment and technology development came under the purview of Government policy. Government provided licenses, permissions for increases in capacity, determined taxes and duties, and used these as incentives in achieving its objectives. Business organizations were constrained, controlled and protected by the Government.

Business houses organized themselves such that there were four different classes of group companies. They evolved a unique system of control. The owners made an initial investment into a company or a group of companies. These companies invested in other companies and the other companies invested in yet other companies, thus creating a chain of control. The relationship between companies of a group evolved into a complex chain system. The controlling power was with the family.

These corporate groups, although diverse in size and control showed similarities in their strategies. They used different options to enter into as many areas as they could. They grabbed licenses, either directly or through proxy to preempt competitors entering the market. After obtaining licenses, monopoly houses instead of producing more, controlled production levels, thereby creating artificial shortages and increasing prices and consequently his profits. They used a strategy of Joint Ventures to access new technologies through foreign collaborations, etc.

1990s - Post Liberalization: Operating in the licensing raj environment, almost all the Groups had acquired extensively diversified portfolios of businesses by business groups. It was difficult to manage and control such diversified business portfolios efficiently. Divestment strategies were used by many of the existing business houses.

Many of Business Groups did not bring in professional management, which brought about their decline. The decline in the older groups also led to the emergence of new business groups. During the early years of economic liberalization, the new business groups started diversifying into unrelated areas of business.

Banking reforms allowed banks to run more market-oriented operations. While the GDP had increased 9-fold during this period, market capitalization had increased 100-fold.

2000s - Emergence of world class organizations: Imported goods competed with local products. The entry of multinationals into the markets resulted in a massive increase in competition. Many organizations in the Indian corporate sector heeded the warning. Many organizations consolidated their position through financial restructuring. The corporate sector invested more on technology flows, often tied with equity. Firms made efforts to improve manufacturing capability through building alliances and initiatives within the firm. Product differentiation strategies were used to build brand images that were capable of standing up too internationally recognized brands.

6.7 GROWTH OF STRATEGIC THINKING IN INDIAN ENTERPRISES

Changing competitive environments can have a remarkable impact on strategy. Development of the Indian industry is an excellent example of how the forces of change and level of competition impact strategic thinking. “World Class in India” has carefully chosen from a cross-section of industries in different sectors that range from family-run

to multinational corporations to Government enterprises and developed their case histories. Their extensive research shows how companies have transformed themselves from the bottom to the top; revamping their strategies, organization, and management, to become 'world class' organizations.

While the world around us was changing, India spent nearly 40 years after independence in a state of economic hibernation. This period, perhaps, was not wasted. During this period, India created an infrastructure, a healthy capital market, and many of the skills necessary to compete internationally. However, the industry focus was on internal markets. From the point of view of the changes that were taking place around it, India was left behind. As 'change' became increasingly frequent, it made it increasingly difficult to define a strategic direction for Indian organizations.

Increasing competition, forces of globalization, the regulatory environment, customer choices, innovations and technological changes, had created a future that often defied prediction. In the emerging era of rapid, systemic and radical change, organizations required flexible, systemic and dynamic approaches to keep pace with the changes. The old linear and static approaches required rethinking. Business organizations needed to change continuously and very often transform themselves.

Indian business organizations have the potential to change pace or to transform to effectively compete in world markets. They can do this through strategic management, by defining new paths whereby organizations can realize their goals. Strategic management has a horizon that is long term, and it tries to maximize the effectiveness of the limited resources of the firm. It helps the organization to focus its energy, to work toward its goals, to assess and adjust the direction in response to a changing environment. It provides a dynamic process of aligning strategies, performance and business results. It is a disciplined effort to produce decisions and actions that shape and guide what an organization is, what it does, and why it does it, with a focus on the future.

This is an introduction to the development of strategic capabilities in Indian organizations. The objective is to provide insights into issues that matter and the challenges that change the manner in which strategy is formulated. We will begin with the history of the Indian Industry, starting with Independence. We will examine the development of the Indian business ethos through the different periods up to the present. Then we will briefly examine the challenges before Indian Companies and what are the resulting changes in strategic thought required for these organizations to become world class.

6.7.1 Background

The scope and effectiveness of modern business strategy in shaping the survival and growth of the business organization in a competitive environment is determined by the degree of freedom the organization has in influencing its own future. In India, these conditions were not always there. If we were to look at Indian Industry from independence, this period of six decades is clearly sub-divided into three identifiable phases. Each period saw developments and changes taking place and the industry related to the changes in a manner that ensured survival and growth of the business enterprise. Each period saw developments and changes taking place and the industry related to the changes in a manner that ensured survival and growth of the business enterprise.

The period from 1947 to 1980 was the era of license raj, we have called 'post independence'. The phase of 'economic reforms' was witnessed in the 1990s and the 2000s. The 1990s brought in transformational changes in Government policies through economic liberalization. The present phase, the twenty first century, brings to Indian industry a challenge it cannot ignore - industrial transformation, both incremental transformation and radical transformation.

6.7.2 Post Independence

Soon after India obtained independence, the Government of India passed the Industrial Development & Regulations Act (1951). This Act was based on a planned economic growth model. The Industrial Development & Regulations Act (IDRA) required licensing for industry. The Government assumed the responsibility of controlling the direction of investments and growth.

This was an era of policies; Government policies and corporate policies. Strategic options were limited. Competition law, trade, investment and technology development came under the purview of Government policy. Government provided licenses, permissions for increases in capacity, determined taxes and duties, and used these as incentives in achieving its objectives. Business organizations were constrained, controlled and protected by the Government. The business policies of the firm were limited and determined by the regulations and policies of the Government. A parent-child relationship evolved in which business houses would indulge the parent and be rewarded with licenses and capacity enhancement permissions.

The Constitution of India, made industries a state subject, giving the Centre the power to bring "industries, the control of which is declared by law to be expedient in the public interest" under its purview. Independent India started with governance based on a socialistic model for development and growth. Planned economic growth was the goal. Therefore, the power vested in it under the constitution was used to bring industries under the purview of the central Government.

IRDA provided for development and regulation of major industries, by promoting a balanced growth and optimum use of available resources and infrastructure through a licensing regime. The license was issued on the condition that the licensed undertaking took effective steps for implementation of the license agreement; it conformed to the environmental laws of central and state Governments and local regulations regarding zoning and land use regulations. The main provisions of the Act were:

Section 10 of IDRA envisaged compulsory licensing of all industries. Licensing was also required by units:

- Undertaking substantial expansion,
- For producing new articles,
- For moving a factory to new premises,
- For starting a new industrial undertaking

Section 10(1) of IDRA required compulsory registration of all private industries. Any change in production capacity required re-registration.

- IDRA gave the Central Government massive powers for exercising control over industries. The Central Government, if it so wished, could: regulate supply and prices notified order under Section 18-G(1) of the Act. Orders made under this section could not be challenged in any court, as per section 18-G(4) of the Act.
- The Central Government could order full and complete investigation of any industry or industrial undertaking for a number of reasons. After making its investigations, the Central Government could issue directions for regulation of the specific enterprise.
- It could take over the management of Industries in whole or in parts, if the industrial undertaking failed to follow the directions issued after investigation and/or regulation.

It also provided mechanisms for investigation by the central Government in cases of mismanagement and maladministration. The IDRA also described the provisions for liquidation, reconstruction of industries and other laws and bye laws as required. It imposed strict regulations on entry and exit of both domestic and foreign firms in most sectors of the economy. There were strict controls on the exchange rate and flow of foreign capital into India. Unions dominated labor markets, and firms were severely restricted in their ability to fire workers or close down loss making operations.

6.7.3 Corporate Houses

The role of the Business Houses under the British dispensation was largely similar to agents and this mental framework remained largely unchanged. The Managing Agency form of governance had been introduced by the British; this was the organizational form in which most Indian business groups followed.

Business Houses were defined as consisting of units, where a common authority had the power of decision-making. In India, the ten largest business houses, after independence, were Tata, Birla, Martin Burn, Dalmia - Sahu Jain, Bird Heilger, Andrew Yule, Bangur, Thapar, JK, and Shriram.

Led by authorities that demanded obedience and loyalty, these business families were usually known to be epitomes of a top-down approach. Middle managers were seldom empowered to make decisions. The top management mainly consisted of family members or a close cabal of trusted friends. They decided strategy and fostered a corporate culture that encouraged managers to focus on retaining the family's control rather than maximizing the value for the shareholders. Professional managers had limited powers and were generally responsible for implementation of the group strategies and were expected to obey orders. Business Houses were also familiar with dealing with a working class movement, which was largely unorganised, and their objective here was to ensure that labour remained cheap. Therefore, industry was not a preferred employer, and employers found difficulty in recruiting the high quality human resources that industry needed.

Many of these business houses were dominated by Marwari families and in these business houses financial control was exercised through the age-old Marwari system of 'parta'. Parta is a manual system that determines input costs and the daily cash profits as compared to budgeted profits. The organization draws up a series of informed estimates of how much it should cost to manufacture a particular volume of production, sell it and meet a profit target based on this estimate. The amount of capital it takes to support the manufacturing is also taken into account.

Three bodies were constituted to oversee the implementation of the 'parta' system: the first was a board of directors, the second was a group of line officers - CEOs, and the third was comprised mostly of CFOs. The CFOs in most cases did not report to the CEOs of their own companies. The tradition developed in the 'parta' system was that all financial managers are accountable for very specific targets based on capital expenditure- and accountable directly to the top.

The principles of the 'parta' still influence the accounting and financial structure of the industries run by the Birlas. As recently as 2001, Kumarmangalam Birla hired the Boston Consulting Group to install its Cashflow Return on Investment (CFROI) metric, which functions as a kind of computer-spreadsheet era version of 'parta'. This new system of 'parta' is being installed in many companies of the Aditya Birla Group (companies controlled by Kumarmangalam Birla). Interestingly, the current financial control approach in strategic management is similar to the 'parta' system.

6.7.4 Leadership

Often, the head of the conglomerate was a charismatic father figure who was intimately involved with the affairs of the company. This period produced some stalwarts like G.D. Birla, J.R.D. Tata, Purushottamdas Thakurdas and Lala Shree Ram - all charismatic men of vision and a spirit of enterprise. This, to a large extent, led to a corporate culture of parent-child relationships between the headquarters and the operational units, similar to that between the Government and industry. The power centre lay at the corporate headquarters, with the parent. There were limited powers at the operational levels - the relationship was that of a benevolent parenthood.

The data on ownership patterns in Indian public companies, which is applicable in today's business environment also, clearly highlights two issues. First, India continues to exhibit features of the 'business house' model. Founding families continue to not only own large share packages but also maintain control by virtue of their direct shareholdings, intra-family cross-ownership links and passive support by domestic public financial institutions. Second, ownership in Indian companies tends to be concentrated in the hands of promoter families, domestic institutional investors and foreign institutional investors. Although the Indian public increasingly participates in share ownership, the ownership in India is seldom separated from control.

The ownership pattern has often been cited as a reason for the poor standards of governance in companies owned by the business houses. Government restrictions and the social ethos of that period also played a part in stunting development of contemporary thinking. The standard of corporate governance was poor. Auditors were appointed more for their discreetness than for their professional skills; financial consultants were often paid to suggest means to work around legal provisions. Accounting disclosure norms-for the benefit of external investors-were generally poor. The corporate boards were known for their submissiveness and fully abided by the recommendations of the family.

Years ago, the Textile Enquiry Committee demonstrated how the management of the once prospering cotton and jute textile mills turned them into sick units by siphoning off funds to other family-owned subsidiaries. This behavior became systemic in spite of the stalwarts of Indian industry. This was sad state of affairs for a country that had gained independence under the leadership of Mahatma Gandhi and where simplicity and sacrifice were seen as the values of the country. Great businesses are driven by the notion of creating and maximizing their stakeholder's wealth. Indian business houses had yet to evolve to this stage.

The Indian market was virtually a closed economy. It was a market of opportunity, a market with limited product offerings, with little or no competition. Business houses focused on this market to grow their family's wealth. They could do this by using their imagination and ingenuity to control and manipulate the market. Many business houses found ways to influence the rules. They evolved creative and unbelievably inspired systems whereby they could minimize the impact of the restrictions imposed on the growth of their business empires by the Government. Strategies were devised to enrich the parent companies and thereby the family business houses.

There were some exceptions. For example, J.R.D. Tata, the head of the Tata business group emerged as a charismatic figure. He developed and encouraged professional management in the Tata Group of companies. He wanted professionalism to reflect the essence of the Group. This desire for professionalism was perhaps an exception to the rule. Siemens' vision of good governance, entering markets that were not yet in existence, innovation, and rapid growth, were generally missing in the ethos of Indian business houses. It was only in the face of extreme competition that stakeholder interests came to be recognized much later.

6.7.5 Structure as Strategy

In a competitive environment, the degree of freedom the organization has in influencing its own future is extensive. These conditions were being continually weakened in India, following the 1957 foreign exchange crisis. Quantitative restrictions on imports, industrial licensing and foreign exchange controls were progressively tightened and expanded. As the restrictions tightened and expanded, the scope and effectiveness of business strategy in shaping the survival and growth of the organization became limited. However, the ingenuity of the Indian mind prevailed. Indian business houses evolved their own strategic options. Strategic options, though complex, were focused on collecting economic rent by impacting Government policies to the benefit of the business family.

Indian companies, based on the Managing Agency concept, developed an ingenuous and brilliant strategy of control. It not only allowed the initial investors to control their companies but also provided leverage for new investments. It confounded the Government in identifying the antecedents of the company when licensing was required.

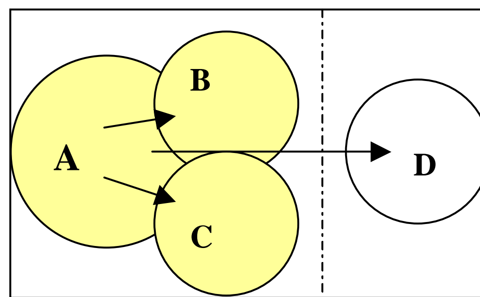

Figure 6.1: Pattern of Control of the Business Complex

We can visualize the patterns of control by considering Business Houses comprising of four different groups as shown in the Figure 6.1. The owners made an initial investment into a company or a group of companies. This group, denoted by "A", was the "Core Group of Companies". These companies were largely or wholly owned by the initial investors. These companies invested in other companies that constituted the "Inner Group" companies. They are denoted by "B", and were under the direct control of the initial investors through nominees and or through subgroups, with some or no public participation.

These "Inner Group" companies invested in yet other companies that were the "Majority owned companies "denoted by" C. The majority owned companies were generally public limited companies, but the decision making power was reserved by the controlling authority of the 'A' Group of Companies. A+B+C, were the "Group Companies" and have been colored yellow in the figure. In addition, there were "Outer Group" companies shown as "D" in the figure. These companies were either 50-50 ownership companies, minority owned companies or management companies. In the "Outer Group" the Group 'A' had material participation and a voice, but it did not have controlling participation. The "Group Companies" plus the "Outer Group" was the "Complex". The business "Complex" were conglomerates, centrally-controlled through managing agencies.

The system of control was comparable to the links of a chain. After some time, the chain of control started to interlink and overlap and it was difficult to know who was controlling whom. For example, Hindustan Shipyards Limited, was a minority owned company of Walchand and Scindia Steamship. But Scindia Steamship was a minority controlled company of Walchand. Was Hindustan Shipyard a majority owned company of Walchand or minority owned company of both Walchand and Scindia? The example given above is of a very simple chain, but generally the system that evolved was much more complex.

Family ownership and management was generally used for extending control and influence through major share holding dispersed among the members of the founder's family, trusts, other companies and benami members. An example of intra-family control is that of Lakshmi Mills. Lakshmi Mills' promoters control 30.90% of the stock and a further 13.45% is owned by private corporate bodies. The latter include Lakshmi Machine Works Ltd. and Lakshmi Textile Exporters Ltd., both of which belong to the Lakshmi group owned by the GK Devarajulu and GK Sundaram family of Coimbatore. Such cross-shareholdings promoted insider dominance of public corporations.

In spite of legislation, there remained a considerable concentration of ownership; it was a period of consolidation of private industry. The direct control of insiders through block shareholding and cross-shareholdings through private corporate bodies was indirectly encouraged through the passivity of domestic institutional investors. In return, the planned development model received the tacit support of Indian business elites as it created a dual economy, the private part of which offered significant business opportunities to the promoter families.

Indian business houses had used structure as a strategy both to exercise control as well as obtain licenses. This was significantly different from the concept of using structure to support strategy. The concept of structure as a strategy is becoming more popular now, internationally. Many new organization structures are being designed which use structure as a strategy.

Additional proof of the ingenuity of the Indian mind can be gauged from the findings of the Hazari Commission set-up by the Government. This commission was set-up in 1958, to look into the working of business houses. The Hazari Report was submitted to the Government of India in 1960. It was a meticulously researched work on Indian industries. It found that the top 13 business houses had a 16% growth in share capital over the period 1951 to 1958. Their share in Gross Capital Stock went up approximately 14% over the period. It validated the growth and concentration of economic power over the period of study (1951 - 1958). The direct implication, in an era of planned economy, was that private business houses were not only thriving, but also growing.

6.7.6 Concentration of Economic Power

The result of the investigation led to major changes in the policies of the Government of India. The Indian Companies Act of 1956 was amended to abolish the system of managing agencies, which had fallen into disrepute through abuse and malpractice in siphoning off corporate wealth for the benefit of a few dominant and controlling shareholders. And importantly, most of the banks were nationalized. The first action provided the individual units a greater degree of control over their options, and the second reform reduced the collusion between the financial institutions and industry. Both these actions were to have an impact on the functioning of industry for the next decade.

In another study, Dr. Aurobindo Ghosh examined the impact of governmental policies on market structure during this period. In his study, "Monopoly in Indian Industry - An Approach", he concluded that Indian markets were monopolistic in nature. In 1131 of the 1300 products that he studied, Dr. Ghosh found that the top three firms produced more than 75% of the total output of the product. Although the reports of Dr. Hazari and Dr. Ghosh have differences in their definition of concepts, they show that a large proportion of stock of productive capital (assets) in the Indian private corporate sector was concentrated in the hands of a few business groups. Government policies had failed to bring down the concentration of economic power in the hands of a few. This pointed to the failure of the licensing mechanism - an instrument of Government control over industries.

How were the business houses able to create a status of monopoly for themselves, when the growth of business houses was limited by the Monopolies and Restrictive Trade Policies (MRTP) Act of 1969 and the Foreign Exchange Regulation Act of 1973? Well, they were able to do so by cornering licenses. Licenses became a weapon in the hands of the industrial houses to be used in a manner beneficial for them. These corporate groups, although diverse in size and control showed similarities in their strategies. These groups used different options to enter into as many areas as they could:

- ***Active Pre-emption:*** Business houses grabbed a disproportionately large share of licenses, either directly or through proxy. They could take their time over investment, fully secure that no other competitor could enter the market. Often, businesses built capacities over and above the licensed capacity and then regularized these with new licenses.
  - ❖ All the groups showed a high level of conglomerate diversification. The larger the Complex, the more diversified the business group tended to be.
  - ❖ All the groups concentrated the bulk of their assets in their core companies. This was a result of a conscious strategy to keep the core companies healthy, because control over other companies stemmed from the core companies.
- ***Passive Pre-emption:*** Business houses maintained a large number of dormant companies on whose name they obtained licenses, thus preventing others from entering the market.
  - ❖ The strategy of the dormant companies was to capture licensing capacities so that they could pre-empt competition. For example, the Malhotra Group had a large number of dormant companies that had licensed capacities to meet the demand for shaving blades for the next millennium. This effectively tied the hands of the Government when it came to issuing fresh licenses to manufacture shaving blades.
  - ❖ The Groups created Trusts that invested in the group companies. These trusts were organizations that did not fall within the purview of the IDRA (1951). They were primarily created to take advantage of tax benefits. However, as they were linked to the ownership in the chains built by the owners, the ownership relationship became more complex and tangled.
- ***Creation of Shortages:*** Licenses also restricted output. After obtaining licenses, monopoly houses instead of producing more, pegged production at the previous levels, thereby creating artificial shortages and increasing prices and consequently their profits.
- ***Formation of Joint Ventures:*** All the groups used a strategy of Joint Ventures to access new technologies through foreign collaborations, etc. In addition, the joint ventures were often used for tax evasions and contracted purchasing, etc., to gain additional economic rent.

The attitude of the Business Houses towards technology was shaped by their experiences. For them technology implied the acquisition of capital goods. This was the knowledge required for how-to-make. Joint ventures were a good way to access their limited requirements. This in turn led to a resistance to induct professional management in industry, as the need did not seem apparent.

Most of the business houses were closely connected to financial institutions either through goodwill, equity ownership, or interlocking of control. This allowed them quicker and cheaper access to funds compared to new entrants. The entry barrier was further raised as new entrants were often vulnerable to price and non-price wars against the entrenched licensees thus increasing their cost of entry and increasing their business risks.

There was also no competition from outside because imports were restricted. The companies growth within the country was limited by licenses and growing outside was difficult due to restrictions in the movement of foreign exchange. In many countries, this had led to innovations, working towards products that were yet to be invented, as was demonstrated in Germany by Siemens. India in contrast was dominated by a high cost of production to low productive efficiencies as there was no incentive to be competitive. Growth and limiting competition were based on the ability of the business houses to corner industrial licenses and letters of intent from the Government.

In an oligopolistic economy based on supply constraints, Industrial Licensing limited not only the area but also the direction of private investment. There seemed to be an implicit belief in the business houses that the Indian market was large enough for their needs and opportunities lay in diversification, providing new, often obsolete, products from the developed countries in a phased manner. The result was a quest for diversification, setting up industries for products that had yet to be adequately licensed. At the end of the day, business houses found themselves with an extensive portfolio of industries that were quite unrelated.

Though this quest for unrelated diversification provided them growth and limited competition in this period, it became a complication when liberalization was implemented. Professors Tarun Khanna and Krishna Palepu of Harvard Business School contend that unrelated diversification does have some merit in the immature markets of the developing countries. Family businesses in India seem to have followed for an extended period of time, Palepu and Khanna's newly researched observations.

During the mid 80s, the reaction to the Hazari Report and Ghosh study had died out. The Government saw the need for more vigorous growth. There was a realization that the public sector had not delivered as expected. The financial situation of the Government was precarious. All these factors led to a change in the Government policy towards industry. Starting in 1985, the clearances needed for capacity expansion were reduced and industrial categories were broadened so that firms would not need approval for small changes in their product mix. Each successive year shortened the list of industries which needed licenses.

This period saw a phenomenal growth in the small and medium industries in the country. New industries, new skills and competencies were developed. It was a period of incubation of a new ethos in Indian industry. This was reflected by a significant acceleration in the growth of manufacturing, which, for the first time since Independence, averaged over 6 per cent in the second half of the 1980s. The changes in the policy in the 1980s were incremental till the new policy of Liberalization, Privatization and Globalization was introduced in 1991.

The 1990s brought in transformational changes in Government policies through economic liberalization. This phase brought to Indian industry a challenge it could not ignore- industrial transformation, both incremental transformation and radical transformation or extinction. This transformation changed the competitive scenario in India in a manner that was, at that time, unimaginable. We were now looking into a new world of surprises-Indian business needed new tools and new strategies to survive in this environment.

6.7.7 Economic Reform

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industry. The changes in the policy in the 1980s were incremental till the new policy of Liberalization, Privatization and Globalization was introduced in 1991. This was a transformation that changed the competitive scenario in India in a manner that was, at that time, unimaginable.

6.7.8 New Dispensation

In 1991, in the wake of a balance of payments crisis, the Government of Narasimha Rao, decided to change its economic policies. The model of planned development underwent a major transformation. To quote the policy statement, the new industrial policy involves a "struggle for social and economic justice, to end poverty and unemployment and to build a modern, democratic, socialist and forward looking India." The three key words of the new policy were Liberalization, Privatization and Globalization.

Protection and controls were replaced by a competitive and deregulated open economic system. The various restraints to competition: (i) investment restraints through licensing; (ii) control over acquisition of economic power through Monopolies and Restrictive Trade Practices Act (MRTP); (iii) public sector reservation for infrastructure and other industries; (iv) product reservation for the small-scale sector; (v) Government procurement policies favoring public and small-scale sectors; (vi) trade restrictions and high tariffs; and (vii) restrictions on foreign direct investment, were dismantled to various degrees.

The objective of the new industrial policy was to create an active competitive environment, and encourage the creation of globally competitive firms with enhanced investment and technological capabilities. Some of the important consequences expected from these changes were:

- Improvements in the efficiency of resource use due to excessive restrictions. These factors were considered to be responsible for the low productivity of capital, large number of sick units, large unutilized capacity, many loss making Public Sector Units, etc.
- The growth rate of the economy was expected to accelerate because of the increase in resources - an increase in investment by the private sector on the domestic front and from international sources in the form of direct or equity capital.
- With a higher rate of growth, expansion in the employment levels was also expected.
- The rate of inflation was also predicted to fall.
- The Balance of Payments would also improve mainly because of the convertibility of the Rupee.

Large enterprises in particular received a boost from a relaxation of the Monopolies and Restrictive Trade Practices Act. They no longer needed to seek Government approval in order to pursue product expansion and enter new markets. Corporate taxation was both simplified and reduced and former restrains regarding industry location were loosened.

The new policy provided for the privatization of the public sector units (PSUs). The Government divested minority shares of its public sector firms, most notably in the steel, oil refining, air transport, and mining industries. A number of activities which so far had been the exclusively in the realm of the public sector were thrown open to private sector. Only 8 industries where security and strategic concerns predominated were reserved for the public sector. The private sector was now allowed to participate significantly in expanding industries such as electronics and motor vehicles. By disinvestment of capital, the Government had made public enterprises accountable to market-related profits.

6.7.9 Governmental Action

The Government also took steps away from their protectionist trade policy towards a more open economy. The first step was the decision to do away with the artificially controlled exchange rate of the Rupee. The rupee was made fully convertible on current account of the balance of payments. Custom duties on imports were also reduced with a view to bring them in line with other countries. Many imports which were formerly subject to quota restrictions were instead now subject only to tariffs. A plan was adopted to impose a gradual reduction of the existing tariff levels from 110% to 65% on raw materials and finished goods, and from 110% to 25% on capital goods. In the beginning of 1992 the Government created policy plans to completely eliminate licensing for imports and exports with only a small exception. Officials promised that this "small exception" would be governed by regulation and would not be subject to bureaucratic discretion.

India also made a commitment to create a more internationally friendly economy. The Government agreed to conform to international patent laws but allowed firms a time period of between five and ten years to comply. The doors of the Indian economy were thrown open to foreign investment. Foreign investors were allowed to have 51% equity holdings. The Government also started the process of lifting price controls placed on many commodities.

Automatic approval up to 51% foreign investment in priority industries listed in Annexure III of the Industrial Policy, would only be subject to the restriction that the foreign equity should cover:

- Requirement of foreign exchange for import of capital goods.
- New, and not second-hand plant and machinery should be brought.
- Import of raw materials, components and royalty fees, etc., will be as the general policy applicable to other domestic industries.

Subject to the above, required permission would be granted within two weeks. Companies not covered in Annexure III and not eligible for automatic approval, were eligible to apply to foreign investment promotion board for:

- Investment up to 51% foreign investment
- Investment for more than 51% foreign investment
- If Foreign exchange required for import of capital goods was more than the foreign equity brought in
- Industries in the service sector, including consultancy and financial sector.

Under the MRTP Act, all firms with assets above a certain limit (Rs. 100 crores since 1985) were classified as MRTP firms. Such firms were permitted to enter selected industries only, and that, too, on a case-by-case approval basis. In addition to control through industrial licensing, separate approvals were required by such large firms for any investment proposals, expansion of existing capacity, establishment of new undertakings, mergers, amalgamations and takeovers.

The new Industrial Policy scrapped the threshold limit of assets in respect to MRTP and dominant undertakings. These firms were now at par with other firms and would not require any prior permission for entry or expansion into the de-licensed areas. However firms holding more than 25% of the market share were now identified as 'monopolies', the emphasis having now shifted to taking appropriate action against monopolistic and unfair trade practices. In this sense it not only strengthened the MRTP Act but also widened its scope.

A large part of industrial investment in India is financed by loans from banks and financial institutions. These institutions followed a mandatory practice of including a convertibility clause in their lending operations for new projects. This has provided them with the option of converting part of their loans into equity. This option was always interpreted as a threat to private firms, of takeovers from financial institutions. The policy provided that henceforth financial institutions would not impose this mandatory convertibility clause.

Despite all the policy changes in the Indian economy, significant restrictions remained on the free operation of labor, capital, and product markets. Further, even late into the nineties there was considerable uncertainly regarding the political will to carry on further economic policy changes.

Box 6.3: Industrial Policy

Industrial Policy

The Indian Government's market liberalization and economic policy reforms program aims at rapid and substantial economic growth and integration of the country's economy with the global economy. The industrial policy reforms have eliminated the industrial licensing requirements except for certain select sectors, removed restrictions on investment and expansion and facilitated easy access to foreign technology and direct investment.

The Industrial Policy Resolution of 1956 and the Statement on Industrial Policy of 1991 provide the basic framework for the Government's overall industrial policy. The procedures for obtaining government approvals have been progressively simplified and quickened. Normal FDI proposals are cleared within a month. Areas earlier reserved for public sector have mostly been opened for private sector participation also.

Industrial Licensing

All industrial undertakings are exempt from obtaining an industrial license to manufacture, except for the following:

- Industries reserved for the Public Sector;
- Industries retained under compulsory licensing;
- Items of manufacture reserved for the small scale sector; and
- Any proposal attracting locational restriction.

Industrial undertakings exempt from obtaining an industrial license are required to file an Industrial Entrepreneur Memoranda (IEM) with the Secretariat of Industrial Assistance (SIA), Department of Industrial Policy and Promotion.

Foreign Investment Policy

Foreign investment is permitted in virtually every sector, except those of strategic concern such as defence (opened up recently to a limited extent) and rail transport. Foreign companies are permitted to set up 100 per cent subsidiaries in India. No prior approval from the exchange control authorities (RBI) is required, except for certain specified activities. The investment should be in accordance with the prescribed guidelines and the details of the investment should be filed with the authorities within the prescribed time limit. This procedure is applicable only for fresh investments directly in Indian companies and not for purchase of shares from the existing shareholders. This investment procedure is commonly known as the "automatic approval route".

6.7.10 Impact on Business Houses

With the removal of controls and restrictions, individual entrepreneurs had the freedom to explore their opportunities in a more meaningful way than was possible before. Tatas, Larson & Toubro, Hindustan Lever, Aditya Birla Group and many other industrial groups in India had already started reorganizing and taking advantage of the changed circumstances.

While some groups gained from these changes, some did not. Those who lost their positions in top business groups included the Scindias, the Sarabhais and the Bhiwandiwalas. Some declined like Bangurs and the Walchand Hirachands. In 1976, United Breweries was 46th, K.F. Goenka 60th and Ambani 67th, while Essar Ruias, the Nagarjuna group, and the Mittals' Ispat group were relatively small.

The older groups like Birlas, Shrirams, Modis, Dalmia, Sahu, Jains, Martin Burn, Bangurs and Singhanias, etc., had become complacent in their monopolistic positions. Most of these business conglomerates were fathered by strong-willed founders whose relentless entrepreneurial spirits emboldened them to take risks which others did not dare to touch. Most of them were ruthless perfectionists possessing an instinctive drive for efficiency and profits. Their businesses were born wherever there was an opportunity to be exploited and a demand to be met. Their political linkages and managerial skills enabled them to exploit the emerging markets.

When these charismatic figures relinquished the helm, in many cases their successors did not clearly see the implications of the changes that were taking place around them. They were affected as a result of 40 years of a planned economy. The groups or the reorganized groups that saw or understood the changing environment like the Tatas, Thapars, JK, Shapoorji, Mahindras, and Kirloskars maintained and even improved their positions.

Speaking at an interactive meeting, in October 2003, organized by the 'All India Association of Industries and Young Entrepreneurs Society' at New Delhi, Mr. Anand Mahindra, Managing Director, Mahindra & Mahindra, and former president of Confederation of Indian Industries, said, " Competing with global players is the biggest challenge for an Indian company, whether it be in India or outside. … We cannot hide in our own backyard and escape from competition, we have to be on the forefront and take it on headlong."

6.7.11 Satisfactory Underperformance

Many business organizations were still trapped in an incrementalist mindset. Operating in the 'licensing raj' environment, almost all the Groups had acquired extensively diversified portfolios of businesses by business groups. Extensive diversification made sense when licensing was prevalent, expansion opportunities were severely limited and Companies had to diversify to grow. With a wide-ranging portfolio of businesses, companies now faced the problem of diffusion of core competencies. To manage such portfolios was a challenging task. It was difficult to manage and control such diversified business portfolios efficiently. The new circumstances exerted an increasing pressure for the enlightened Groups to streamline and restructure the businesses.

Divestment strategies were used by many of the existing business houses. For example, in 1992 the Tata Group came out with a strategic plan contemplating reducing the number of companies from the 107 operating in 25 businesses to less than 30 operating in just twelve. The Group identified the non-core businesses they would divest from. TOMCO was divested and sold to Hindustan Lever, as soaps and detergents were not considered a core business for the Tatas. Similarly, Tata Group divested the pharmaceuticals companies, Tatas-Merind and Tata Pharma, to Wockhardt; the Group cosmetics company, Lakme, was divested and sold to Hindustan Lever. Tata Group's restructuring was aimed at creating a system of integrated planning, focused and rationalized units, synergy between overlapping units, and consolidated holdings in group companies.

Hindustan Levers devised Project Millennium, a comprehensive transformation strategy to restructure and manage change from being a large, diversified conglomerate to become a configuration of empowered virtual companies each built around a single category of

products. Operations were reorganized and restricted to 18 different businesses, grouped under seven different divisions: detergents, beverages, personal products, frozen foods, culinary products, agribusiness, and oil-fats. Hindustan Levers achieved this through acquisitions in identified core businesses and divestment in the non-core businesses like dairy products, animal feeds, and speciality chemicals, etc.

There were similar attempts by many groups to reorganize and streamline their businesses. This included Public Sector companies. State Bank of India sensed the emerging competition soon after liberalization began. In 1993, it appointed McKinsey and Co to devise a restructuring plan. The objective of restructuring was to develop an international perspective and become a world class bank. Steel Authority of India Ltd. had long been affected with problems arising out of the massive investments made in the modernization programs. Its revival efforts were focused on financial restructuring to reduce the debt burden and corporate restructuring aimed at concentrating on its core business of steel. It adopted intensification strategies for its four steel plants and divested its non-core subsidiaries like stainless steel and alloy steel.

But this did not happen across the board. According to management gurus Sumantra Ghoshal and Christopher A. Bartlett, though they are aware of challenges facing them, there is a problem with most Indian organizations. Ghoshal and Bartlett diagnose a pervasive disease called 'satisfactory underperformance' to afflict corporate India. It is a state in which a company continues to make money but gradually loses its competitive edge as a complacent management fails to ask itself what it is doing to value add. The crisis comes and the company suddenly finds itself in a situation where it is fighting for its survival.

Many Business Groups did not bring in professional management. They suffered from Ghoshal's 'satisfactory underperformance' syndrome. They were unprepared for the crisis that accompanied this period of 'extreme turbulence'. Some of them had centralized their operations so much that the operations became unmanageable with the change of guard; this was further complicated by poor financial management and inter-family disputes. The result was that many of them started losing their pre-eminence and some of them started breaking up.

For example, Shriram Group broke up, as did the J.K. Group of the Singhanias. Though the Birla Group was split and many of the new divisions lost their prominence, the BK Birla and the Aditya Birla Groups not only retained but improved their positions. The Aditya Vikram Birla (AVB) group has 61 industrial units spread across 14 countries and its interests include textiles, viscose filament yarn, cement, chemicals, power, fertilizer, telecom, financial services, investment banking, aluminium, copper, infotech, refining and cellular services. The main companies are Grasim, Indo Gulf, Hindalco and Indian Rayon. Even after the sad departure of Aditya Birla, his son Kumaramangalam Birla, the CEO of the AV Birla group, has maintained the Group's progressive outlook. Kumaramangalam Birla has been personally visiting campuses of business schools to recruit management graduates.

The decline in the older groups also led to the emergence of new business groups like the Ambanis, the Ruias, the Dhoots and the Nambiars. The new entrants started building their business empires in the 80s, and 90s; groups like the Ambanis, Ruias and Dhoots became highly visible. Companies like Reliance, Tata group, Samsung and Daewoo have leveraged their track records to create valuable brand names that enhance the market value of the affiliated organization.

The Government had looked to private investors and industry to become significant providers of investment capital. They were not disappointed. The new groups began

conceiving projects and executing plans on a big scale. A strategy of diversification to seek growth continued. During the early years of economic liberalization, the new business groups started diversifying into unrelated areas of business. Most of these business houses saw opportunities in new areas like oil, refining, power, petrochemicals, aviation, etc.

This pattern is explained by the study by Khanna and Palepu which showed that this gave them leverage. However, the pattern that emerged was not expected in the post liberalization era. The new groups were following the strategy of their more experienced peers partly due to the fact that they had seen this strategy to pay off in the past as a means of generating growth and possibly to discover new core competencies.

An estimate of the level of diversification can be gauged from the list given below. This list shows the businesses in which the major Indian business organizations were involved in:

Reliance:	Textiles, man-made fibers, chemicals, petrochemicals, plastics, shipping, finance.
ITC:	Tobacco, cigarettes, edible oils, paper and paper board, aqua farming, hotels, financial and travel services.
A.V.Birla:	Cement, aluminum, fertilizers, iron, manmade fibers, chemicals, textiles, engineering goods, tea, plywood, software.
Tata:	Steel, light and heavy commercial vehicles, power, hotels, cosmetics, watches, consumer electronics, telecom, InfoTech, printing, tea, coffee, cement, engineering, textiles, paints, financial services, refrigerators, air-conditioners.
Ruia:	Steel, fuel, minerals, power, textiles, hair-do culture, shipping, financial service, port services.
M & M:	Automobiles, pharmaceuticals, elevators, chemicals, steel construction, granite.
L.M.Thapar:	Paper, textiles, fans and lights, chemicals, engineering equipment, glass, agro-products, food processing, milk products, aquaculture, fuels, polymers, packaging, telecommunications equipment.
R.P.G.:	Cables, tyres, telecommunications, power, infotech, pharmaceuticals, engineering goods, music, plantations, tissue culture, floricultures, retailing, fiberglass, yarns.
Lalbhai:	Denims, cotton textiles, engineering goods, air-conditioning, telecom, financial services.

6.7.12 Financial Reforms

Banking reforms allowed banks to run more market-oriented operations. Partial minority stakes in public sector banks were made available to the private sector. In late 1994, interest rates on deposits and loans were deregulated. In 1994-95, applications were approved for the construction of 18 new private sector banks (ten domestic and eight foreign banks). This led to a fast expansion of private retail banking.

The reforms had a positive effect on the growth of domestic capital markets, especially the equity markets. The Securities and Exchange Board of India (SEBI) was established to regulate the stock markets and to uphold international standards of investor protection. By the early 1990s, India had 14 stock exchanges which combined listed approximately 5,000 firms. Of the 5,000 listed companies, only 300 to 500 firms were actively traded, however, turnover was rapidly increasing. However, trading got increasingly concentrated

in the hands of speculators and trading volumes were increased mainly through greater speculation. The indicators of this phenomenon were seen in large intra-day as well as day-to-day fluctuations of the Sensex.

The Government tried to encourage organizations to raise resources directly from the investors. The administrative barrier, The Capital Issues Control Act was repealed. The inexperience of SEBI coupled with the Government's failure to arm it with adequate powers in time, enabled the private promoters to misuse the new freedom and generated a series of scams of varying magnitudes and types. Even large houses and transnational corporations took advantage and issued shares to themselves at ridiculously low prices.

Indian enterprises were now allowed to raise equity in global markets. The Government looked to private investors to become significant providers of investment capital. Private mutual funds, institutional investors from abroad, and country funds were now welcome participants of India's capital markets. The result was a multiplying effect on the market capitalization as a percentage of the Indian GDP. This is shown in Table 6.1.

Table 6.1: Select Indicators of Stock Market Growth

(Amount in Rs Crore)

Year	Number of Stock Exchange	# of Listed Cos.	Market Value of Capital	GDP at Current Prices	Market Cap. as % of GDP
(1)	**(2)**	**(3)**	**(4)**	**(5)**	**[(4)/(5) x 100]**
1980	9	2,265	6,750	1,22,772	5.50
1985	14	4,344	25,302	2,32,370	10.89
1991	20	6,229	1,10,279	5,52,768	19.95
1995	22	9,077	6,39,575	9,92,802	64.42

Note: Market capitalization and GDP correspond to calendar and financial years, respectively.
'#': Excluding the National Stock Exchange (NSE).

Source: Based on: (i) Bombay Stock Exchange Official Directory, 'Organisation of the Stock Market in India', Vol. 9(II), 1997

In spite of these hiccups and the learning that took place during this period, there was good news for industry. In year-end of 1990-91 the numbers of listed companies were around 2270 with a capitalization of Rs. 67,500 million. In 1995-96, the number of listed companies had increased to over 9000 and their market capitalization was Rs. 6,395,750 million. While the GDP had increased 9-fold during this period, market capitalization had increased 100-fold.

6.7.13 Entering the Twenty-first Century

The initial euphoria was short lived. High import tariffs had given local products a degree of protection from the products of the more developed nations. These markets were characterized by limited competition, but this was not so true anymore. With India joining the World Trade Organization (WTO), it had to agree to lower tariffs and trade barriers as per an established timetable. The impact of globalization and liberalization, accompanied by lowering of tariffs, was making a great difference in the markets. Imported goods could compete with local products. The entry of multinationals into the markets resulted in a massive increase in competition. MNCs had strengthened their presence in the Indian market by actively participating in the merger and acquisition process to get market entry or to obtain access to various complementary assets. They used their deep pockets and relatively cheaper access to capital to invest in India.

The consumer was demanding high quality at low cost. In order to provide high quality at the lowest costs, the efficient use of inputs of capital, labor, raw materials and energy, etc., became critical. Many companies found the price competition to be so severe that

they were unable to compete in such market conditions. Intense competition like this created fragmentation of demand across the entire industrial spectrum. Domestic manufacturers or providers of services were no longer competing with similar firms. Instead, they found themselves competing with products and services from multinational corporations and overseas manufacturers. To make matters worse, the consumer was looking for more choices and his demand was constantly changing. This was a new experience for manufacturers.

The distribution of age, sex, income, education, lifestyles changing rapidly gave rise to new patterns of need and demand. In India, the urban population changed from 25 percent, a decade ago, to over 30 percent by year 2000. National Council for Applied Economic Research (NCAER) found that in year 2000, over 50 percent of urban Indians were below 30 and a larger number of women from the younger generation were training to be professionals. This provided a huge opportunity for those industries that targeted the young.

Unlike the earlier generation, the new generation of professionals started living on their future income and not on their savings unlike the earlier generation. In terms of numbers and disposal income, this constituted a major shift. This gave a great boost to the consumer and consumer durable markets. New products suited to the urban population, who have the largest disposal incomes, started dominating the markets and these came mostly from multinationals.

There was a change in the sentiment of the market to invest in Indian businesses. After the initial boom, the level of investments in Indian companies in 1997-98 dropped lower than that in 1991-92, a pre-liberalization year. The euphoria had died away. This was a severe warning to the industry, though, to some extent the drop is explained by the chaotic conditions in the stock markets as private promoters tried to take advantage of the situation. But the truth of the matter was that domestic industry needed to transform radically to maintain its position in the domestic markets. The phenomenon of drop in investments was a combination of all the changes that were taking place in the Indian economy.

William W. Lewis in his recently released book writes that the key to development in India lies in moving from a 'producer mindset' towards 'increasing productivity through intense competition and protecting consumer rights'. According to him, that is because 'goods produced have value only because consumers want them'. He compares the productivity of India with that of the US. India's largest employers are in agriculture. In agriculture, he says, 'Indian dairy and wheat farmers have a productivity of about 1 percent of the US farmers', in the modern sector, 'have a productivity of 15 percent of their counterparts in the US'.

This 'producer mindset' was acceptable when business was protected. But with competition warming up, things needed to change. Several Indian companies, such as Telco, Bajaj Auto etc., facing fierce competition from foreign brands found that they were losing in the marketplace. They began to realize the importance of quality, new products, cost reduction, technology upgradation, etc. In an economy transitioning to an industrial economy, the challenge was in developing strategies at the level of the business organization to bring in technological upgradation, improvement in management, and improved competitiveness.

The business organization was now operating in an environment where the protection it received from the state was diminishing and continued to diminish. Those companies that sold their shares to foreign institutional investors felt exposed, for the first time, to more demanding disclosure and performance standards from investors. Traditional lenders,

who gave non-performing management a long rope, through waivers and capital restructuring, suddenly became more demanding. This was largely a result of the new standards of accountability which lenders were exposed to because of entry of public as shareholders and more stringent accounting and disclosure policies by regulatory authorities.

An equally important factor, which pushed corporate governance, was a more demanding capital market regulation. SEBI laid down formats for disclosure, enlarging the scope of information required to be disclosed, improving the quality of disclosure. Another major threat was the possibility of legal takeovers, with the establishment of a Takeover Code.

Check Your Progress 2

State whether the following statements are True or False:

1. Strategic managers face a myriad of challenges due to the rapid nature of change and increasing complexity of today's competitive environment.
2. Strategy plays a vital role in companies for its sustainability and growth.
3. Major issues of strategy are being discussed at national and global levels and research being undertaken to understand what makes some companies outperform their industry peers.
4. The most well developed and commonly relied upon models for developing organizational strategies come from the private sector.
5. The fundamental role of diversification is for corporate managers to create value for stockholders in ways stockholders cannot do better for themselves.

6.7.14 World Class Companies

Many organizations in the Indian corporate sector heeded the warning. They utilized a variety of strategies in the post-reform period to cope with change. Some salient trends that became visible are:

- Many organizations restructured themselves. Restructuring was geared towards consolidation and a heightened activity in financial restructuring. Old funds that had been obtained at high interest rate were retired for funding from international money markets with the issue of GDRs and ADRs by many companies that had the financial strength. Interest rates in India had also fallen significantly, so many other companies renegotiated their financial instruments with their funding sources.
- The corporate sector invested more on technology flows, often tied with equity. In addition, a large variety of inter-firm alliances are taking place. In-house technology generation has taken a backseat for the present in many areas except, perhaps, in areas like pharmaceuticals, bio-technology and IT.
- Firms made efforts to improve manufacturing capability through building alliances and initiatives within the firm. Quality upgradation became an important priority in many organizations. In spite of these efforts at improving manufacturing capability, this area still remains a concern.
- Product differentiation strategies were used to build brand images that can stand up to internationally recognized brands. Interestingly, some majors like Hindustan Lever and Eveready have significantly enhanced their networks into rural India to consolidate and create new markets for their products. These investments have led to higher margins and profitability in the 1990s.

- Export based growth strategies were adopted by some of the corporates but such strategies are not widespread; export orientation - that had increased appreciably in the early years of reform - did not grow significantly since 1997-98, except in the area of IT. For other industrial sectors, the overall exposure to the international market was still inadequate to boost Indian business organizations into higher growth and learning trajectories.

These challenges produced many world class organizations. For example, Reliance Industries transformed itself to the dream of Dhirubhai Ambani, its founder. It became the cost leader in its main businesses and with outstanding competencies in areas as diverse as project management and the mobilization of low cost finance. Ranbaxy Laboratories took opportunities offered by the introduction of the Process Patent Act in 1970 and made human and financial investments in building R&D competencies. It built itself into a 'research-based, international company', one that is able to leverage its learning to carve a niche for itself in international markets.

Thermax excels in the value-creation process; here, innovation in technology is driving growth. Bajaj Auto's value-creation logic is giving customers 'the best value for money'. NIIT Ltd. provides an example of how an organization managed the present from the future in its businesses by aligning its value-creation logic, its organizing principles and its people processes. It is not only the market leader in computer education but enjoys phenomenal brand recall.

Ispat International and Nicholas Piramal grew through the acquisition route. Lakshmi Niwas Mittal, the founder of the Ispat International group, bought out steel-making units using DRI technology to become the world's largest steelmaker. The post-integration process, therefore, concentrated on operations such as plant improvements and better marketing, and leveraging the learning of the other plants. Each acquisition took place in a different country yet it was able to weld together with uncanny success the existing managements in the acquisitions. It has shown its excellence in all three phases a company needs to go through after being taken over: the cleaning up and building up of the foundation, its strategic and organizational revitalization, and finally the integration of people and operations with the rest of the group. Nicholas Piramal has a similar history. It has excelled in managing diversity. Three pharmaceutical companies with three very different products and cultures were merged to build one strong company.

Wipro grew through acquisitions, organic growth and strategic alliances. Though it is better known for its software business, it is composed of eight distinct businesses, each operating independently yet held together by a clearly articulated code of behavior - the Wipro Beliefs, and these values are reinforced through transparency of annual plans and specific goals at all divisions, locations and levels, creating a world class organization.

There are many others. The names that are being discussed are representative. India is rapidly changing. The Indian outsourcing boom - led by companies such as Infosys, Tata Consultancy Services, and Wipro - have made India the world's second largest exporter of services.

This changed environment had changed the fortunes of many business organizations. Most of the top business groups from the license raj era do not find any place in the new order. The relative rankings of business organizations during the early years of economic liberalization have also changed.

There are two lists in Table 6.2. The first is a list of the Top 10 publicly listed companies in India of the 1990s ranked on the basis of their market capitalization; the second is a similar list, compiled in October 2003.

Table 6.2: Market Capitalization-Comparison

Ranking	Year 1970s	Year 2003
1	Tata Steel	ONGC
2	National Rayon	Reliance
3	Bombay Burmah	Hindustan Lever
4	Bombay Dyeing	Wipro
5	Century Rayon	Infosys
6	Kohinoor Mills	Indian Oil
7	Indian Iron	ITC
8	Scindia Shipping	State Bank
9	ACC	ICICI Bank
10	JK Group	Ranbaxy

Notice the differences in these two lists. No company in the 1990s Top 10 is in the 2003 list. Several companies like National Rayon, and Indian Iron are now bankrupt and are no longer in existence. Scindia Shipping came back from the edge of bankruptcy. Almost all in the 1990s list are manufacturing companies. And almost all are part of old business houses that initiated India's early industrialization in the period between the two World Wars.

Some of the leading business groups that dominated the Indian business horizon had already faded away. These included; Martin Burn, Dalmia Sahu Jain, Bird Heilger, Andrew Yule, Bangur, JK, Shriram, Shapoorji, Khatau, Walchand, Mafatlal, Kasturbhai, Seshasayee, Indrashing.

The second list shows the changes that took place during this period. Petroleum has replaced Steel and Cement as the material of choice. There are three petrochemical companies- ONGC, Reliance and Indian Oil - on the list. They have displaced Tata Steel, Indian Iron and Associated Cement Companies. There are two multinational consumer product companies, Hindustan Lever and ITC Ltd., that have climbed to the top. Two information technology services companies, Wipro and Infosys are close to the top. In addition, there are two consumer banking companies - State Bank and ICICI - and a pharmaceutical company, Ranbaxy that have made the cut.

The relative rankings of business organizations during the early years of economic liberalization had also changed. The status of companies in 2003 is shown in Table 6.3.

Table 6.3: Status of Indian Companies

Company Name	Net Sales (Rs crores)	Net Sales Rank	PAT (Rs Crores)	PAT Rank	Net Profit Margin %	Net Profit Margin Rank	Market Cap (Rs Crores)	Market Cap Rank	Year
Reliance Industries Ltd.	45,898.00	3	4,104.00	3	8.94	137	45,328.01	2	31-Mar-03
Hindustan Lever Ltd.	9,954.85	9	1,755.69	5	17.64	39	39,277.19	3	31-Dec-02
Wipro Ltd	4,032.70	33	813.20	18	20.17	31	22,038.93	5	31-Mar-03
Infosys Technologies Ltd.	3,622.69	36	957.93	14	26.44	12	21,626.77	6	31-Mar-03
ITC Ltd.	5,685.78	23	1,371.35	8	23.38	19	18,968.07	8	31-Mar-03
Ranbaxy Laboratories Ltd.	2,948.00	43	623.60	22	21.15	26	14,565.07	9	31-Dec-02
HDFC	2,967.32	42	690.29	21	23.26	20	10,000.22	11	31-Mar-03
ICICI Bank Ltd.	9,368.05	10	1,206.18	10	12.88	76	9,207.78	13	31-Mar-03
Dr. Reddy's Laboratories Ltd.	1,513.61	82	392.09	37	25.90	13	8,375.95	15	31-Mar-03
HDFC Bank Ltd.	2,022.97	65	387.60	39	19.16	33	7,303.14	16	31-Mar-03
Hindalco Industries Ltd.	4,975.50	27	582.10	23	11.70	98	6,889.20	20	31-Mar-03
Tata Iron & Steel Co. Ltd.(TISCO)	8,721.32	15	1,012.31	13	11.61	99	6,221.09	24	31-Mar-03

Contd....

Satyam Computer Services Ltd.	2,023.65	64	307.42	43	15.19	53	6,050.06	26	31-Mar-03
Bajaj Auto Ltd.	4,306.17	31	534.63	26	12.42	86	5,806.72	27	31-Mar-03
Hero Honda Motors Ltd.	5,101.71	25	580.76	24	11.38	105	5,056.09	29	31-Mar-03
Grasim Industries Ltd.	4,626.29	28	367.58	40	7.95	157	4,701.52	30	31-Mar-03
Cipla Ltd.	1,572.44	79	247.48	50	15.74	48	4,528.27	31	31-Mar-03
HCL Technologies Ltd.	723.42	154	401.95	36	55.56	1	4,448.35	32	30-Jun-02
Tata Power Co. Ltd.	4,300.50	32	519.92	28	12.09	90	3,135.74	43	31-Mar-03

According to Mr. Anand Mahindra, Managing Director of Mahindra & Mahindra, competition is going to intensify. It may sound the death knell for many organizations that are profitable at present, unless they decide to change and pick up the gauntlet. In markets where competition will be severe, they will have to decide to transform themselves and take steps today to sustain and enhance their competitive advantage. Otherwise, they will unable to compete in such market conditions. The Indian model has to prove that it is adequate to compete internationally and domestically.

Many business organizations are still trapped in the incrementalist mindset. They should realize that the key issue is of ensuring and managing competition, to derive the most out of existing circumstances, the opportunities as well as the threats. This is an era of perpetual change, fleeting technology leadership, market demands and global competitors. Indian industry will require a radical response to the problems and challenges posed. Liberalization has provided the opportunity to use strategic options that were not available to it before.

Prof. Abad Ahmed and Prof Chopra believe that to take up the new challenges, organizations need outstanding leadership. This means leaders with proactive, positive and optimistic mindsets; clarity of purpose, vision and values; setting challenging and highly ambitious goals; willingness and ability to change; and a passion to win.

6.8 LET US SUM UP

Strategic managers face a myriad of challenges due to the rapid nature of change and increasing complexity of today's competitive environment. Although literature in the field of strategic management has offered many perspectives on how to meet these challenges, managers today would benefit from strategic analysis tools that foster an understanding of the competitive environment from multiple perspectives. This paper provides insights into the synergistic nature of competing strategic analysis perspectives and offers an integrated model that not only synthesises the most prominent perspectives but also captures the dynamic nature of today's competitive environment.

Strategic decisions express how the organization will meet the challenges that face it. They set out how organizations will meet the challenge of providing better services, often in innovative ways, to meet the rising expectations of the citizen.

Strategy should evolve, not passively but creatively. Corporate strategy formulation should be a combination of different currently practiced approaches or a rethinking in the approach of the existing theories. We need to focus on strategic thinking. Strategic thinking looks at the vision for the organization and then works backwards by focusing on how the business will be able to reach this vision. In doing so, it improves the ability of the organization to make its business vision a reality.

Strategic thinking requires a definition of the problem of change to provide a competitive advantage. We have to find ways of putting ourselves into the most favorable position to engage the opposition, and compelling the opposition to engage at a disadvantage. This

evolves ways and means of developing capabilities in team work, problem solving, and critical thinking in the organization. By using strategy as the tool, it will provide clarity of purpose, common understanding and a framework for detailed planning; that will give the business organization a focus on the strategic developments it should be pursuing and a view of the future towards which it is moving.

For several decades, we have celebrated big corporate survivors, praising their excellence and durability. Many of these companies, which operated under an assumption of continuity and longevity, have not been able to keep up with the pace and scale of markets. The markets are often merciless and they relentlessly remove those that cease to perform. Of the 500 companies making up the S&P 500 index when it was introduced in 1957, only 74 remained there through 1997. Of these 74, only 12 outperformed the index from 1957 to 1998. If the S&P 500 now consisted solely of the companies on the list in 1957, the overall performance of the index would have been 20 percent a year lower than it actually was.

The reasons for this are not difficult to see. The 1960s and 70s, with constant positive economic growth, low debt, manageable budgets, and relative political stability, managers could concentrate almost exclusively on the internal dimensions of their organizations and assume constancy in the external environment. Forward calculations were simple, inputs were predictable, and planning was mostly an arithmetic exercise. But circumstances seem to be changing. In the developing world as much as the industrialized nations, the increasingly rapid nature of change as well as a greater openness in the political and economic environments requires a different set of perspectives from that needed during more stable times.

C.K. Prahalad and Yves Doz in their unpublished article 'Value-added of Top Management' first used the term 'value creation logic'. Value creation logic is the unique manner in which an organization creates 'value' to those the organization serves and is distinct from 'shareholder value'. A coherent growth strategy requires a clear value creation logic.

6.9 LESSON END ACTIVITY

Write a note on the three possible corporate strategic directions - growth, stability, and renewal. Also comment, how would you apply these concepts to tomorrow's market?

6.10 KEYWORDS

Strategic Choice: Strategic Choice is concerned with decisions about the organization's future and the way it needs to respond to the influences and impacts identified in strategic analysis.

Strategic Intent: The reason for an organization's existence is given by the Strategic Intent of the organization.

Corporate Level Strategies: Corporate Level Strategies are also known as Grand Strategies. Corporate strategies are concerned with the broad and long-term questions of what business(es) the organization is in or wants to be in, and what it wants to do with those businesses. They set the overall direction the organization will follow.

Horizontal Integration: Horizontal Integration is the acquisition of a company at the same stage of the value chain.

Concentric Diversification: The acquisition or internal development of a business outside of, but in some way related to a company's existing scope of operations. Backward

integration is a move towards suppliers and raw materials in the same overall business. Forward integration is a move towards the market place or customers in the same overall business. Horizontal integration is a lateral move into a closely related business such as selling by-products.

Conglomerate Diversification: Conglomerate Diversification is where a firm diversifies into unrelated areas. It is the acquisition or internal development of a business outside of, and in no way related to a company's existing scope of operations.

Capacity Expansion: Capacity Expansion adds capacity, within the industry, to further the objectives of the firm in order to improve the competitive position of the organization.

Vertical Integration: Vertical Integration is the combination of economic processes within the confines of a single organization. It reflects the decision of the firm to utilize internal transactions rather than market transactions to accomplish its economic purposes. It is expressed by the acquisition of a company either further down the supply chain, or further up the supply chain, or both. Backward integration sometimes is referred to as upstream; forward integration as downstream. Taper integration is a partial integration. Quasi integration is partial control of the suppliers or distributors without actually purchasing them.

Concentration: Concentration consists of strategies aimed at growth within current product lines.

Merger: A Merger occurs when two companies—usually of similar size—combine their resources to form a new company. A merger is a legal transaction in which two or more organizations combine operations through an exchange of stock, but only one organization entity will actually remain.

Acquisition: An Acquisition is transacted by the purchase of one organization by another. It usually happens when a larger company "buys" a smaller one for a set amount of money or stocks, or both.

Takeover: A Takeover is a hostile acquisition in which the organization being acquired did not want to be bought.

Internal Development: Internal Development involves developing the necessary skills among existing staff and acquiring the necessary production capacity.

Reverse Engineering: Reverse Engineering is determining the technology embedded in a product through rigorous study of its attributes. It entails the acquisition of a product containing a technology that the company thinks is an asset, disassembling it, and subjecting its components to a series of tests and engineering analysis to ascertain how it works and the engineering design criteria used in the product's creation.

Strategic Partnering: Strategic Partnering occurs when two or more organizations establish a relationship that combines their resources, capabilities, and core competencies for some business purpose.

6.11 QUESTIONS FOR DISCUSSION

1. What are the types of renewal strategies?
2. What is the difference between retrenchment and turnaround strategies?
3. Understand the different ways that renewal strategies can be implemented (e.g., cost cutting vs. restructuring).

4. What are the different types of strategic partnerships (understand examples of each and how they differ from each other)?
5. What do the three possible corporate strategic directions - growth, stability, and renewal - mean to you in terms of strategy? How would you apply these concepts to tomorrow's markets?

Check Your Progress: Model Answers

CYP 1

corporate managements try to grow and diversify fighting market forces so as to achieve high profits and be able to control their own destinies. This conflict is the basis for the theory of diversification.

CYP 2

1. True
2. True
3. True
4. True
5. True

6.12 SUGGESTED READINGS

Pearce & Robinson, *Strategic Management*, All Indian Travellers N.D.

A.C. Hax and NS., *Strategic Management: An Integrative Perspective*, Majifu, Prentice Hall.

Micheal Porter, *Competitive Strategies*.

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Samul C. Certo and J. Paul Peter, *Strategic Management: Concept and Application* (Second Edition), McGraw Hill.

Georgy G. Dess and Alex Miller, *Strategic Management*, McGraw Hill.

Gerry Jhonson & Keven Scholes, *Exploring Corparate Strategy: Text and Cases*.

Jaunch L Rajive Gupta & William F Glueck, *Business Policy and Strategic Management*, Frank Bros & Co, 2003

Fred R. David, *Strategic Management: Concept and Cases*, Pearson, 2003.

UNIT IV

LESSON

7

TOOLS OF STRATEGIC PLANNING AND EVALUATION

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7.0 AIMS AND OBJECTIVES

After studying this lesson, you will be able to:

- Understand competitive cost dynamics
- Learn about experience curve
- Understand what is BCG approach and cash flow implication

7.1 INTRODUCTION

Continuous Improvement Plan Provides a structural program for identifying root causes to problems and the best solution to help eliminate the problem. It's formatted for use by "your quality tiger team" leader with step-by-step slides to make for easy implementation.

Strengths and Weakness Analysis clearly defines current strengths and weaknesses of a company providing solid information upon which to base strategic decisions. It helps a company to define new business opportunities which may not otherwise have surfaced.

7.2 COMPETITIVE COST DYNAMICS

This strategy emphasizes efficiency. By producing high volumes of standardized products, the firm hopes to take advantage of economies of scale and experience curve effects. The product is often a basic no-frills product that is produced at a relatively low cost and made available to a very large customer base. Maintaining this strategy requires a continuous search for cost reductions in all aspects of the business. The associated distribution strategy is to obtain the most extensive distribution possible. Promotional strategy often involves trying to make a virtue out of low cost product features.

To be successful, this strategy usually requires a considerable market share advantage or preferential access to raw materials, components, labour, or some other important input. Without one or more of these advantages, the strategy can easily be mimicked by competitors. Successful implementation also benefits from:

- process engineering skills
- products designed for ease of manufacture
- sustained access to inexpensive capital
- close supervision of labour
- tight cost control
- incentives based on quantitative targets.

Always ensure that the costs are kept at the minimum possible level.

Examples include low-cost airlines such as EasyJet and Southwest Airlines, and supermarkets such as KwikSave. "Achieving a sustainable competitive advantage in the IT industry through hybrid business strategy: A contemporary perspective" -Tharinda Jagathsiri MBA- University of East London.

When a firm designs, produces and markets a product more efficiently than competitors such firm has implemented a cost dynamics strategy (Allen et al 2006, p.25,). Cost reduction strategies across the activity cost chain will represent low cost dynamics (Tehrani 2003, p.610, Beheshti 2004, p. 118). Attempts to reduce costs will spread through the whole business process from manufacturing to the final stage of selling the product. Any

processes that do not contribute towards minimization of cost base should be outsourced to other organisations with the view of maintaining a low cost base (Akan et al 2006, p.48). Low costs will permit a firm to sell relatively standardised products that offer features acceptable to many customers at the lowest competitive price and such low prices will gain competitive advantage and increase market share. These writings explain that cost efficiency gained in the whole process will enable a firm to mark up a price lower than competition which ultimately results in high sales since competition could not match such a low cost base. If the low cost base could be maintained for longer periods of time it will ensure consistent increase in market share and stable profits hence consequent in superior performance. However all writings direct us to the understanding that sustainability of the competitive advantage reached through low cost strategy will depend on the ability of a competitor to match or develop a lower cost base than the existing cost leader in the market.

A firm attempts to maintain a low cost base by controlling production costs, increasing their capacity utilization, controlling material supply or product distribution and minimizing other costs including R&D and advertising (Prajogo 2007, p.70). Mass production, mass distribution, economies of scale, technology, product design, learning curve benefit, work force dedicated for low cost production, reduced sales force, less spending on marketing will further help a firm to main a low cost base (Freeman 2003, p.86; Trogovicky et al 2005, p.18). Decision makers in a cost dynamics firm will be compelled to closely scrutinise the cost efficiency of the processes of the firm. Maintaining the low cost base will become the primary determinant of the cost dynamics strategy. For low cost dynamics to be effective a firm should have a large market share (Robinson and Chiang 2000, p.857; Hyatt 2001 cited by Allen and Helms 2006, p.435). New entrants or firms with a smaller market share may not benefit from such strategy since mass production, mass distribution and economies of scale will not make an impact on such firms. Low cost dynamics becomes a viable strategy only for larger firms. Market leaders may strengthen their positioning by advantages attained through scale and experience in a low cost dynamics strategy. But is their any superiority in low cost strategy than other strategic typologies? Can a firm that adopts a low cost strategy out perform another firm with a different competitive strategy? If firms costs are low enough it may be profitable even in a highly competitive scenario hence it becomes a defensive mechanism against competitors (Kim et al 2004, p.21). Further they mention that such low cost may act as entry barriers since new entrants require huge capital to produce goods or services at the same or lesser price than a cost leader. As discussed in the academic framework of competitive advantage raising barriers for competition will consequent in sustainable competitive advantage and in consolidation with the above writings we may establish the fact that low cost competitive strategy may generate a sustainable competitive advantage.

Further in consideration of factors mentioned above that facilitate a firm in maintaining a low cost base; some factors such as technology which may be developed through innovation (mentioned as creative accumulation in Schumpeterian innovation) and some may even be resources developed by a firm such as long term healthy relationships build with distributors to maintain cost effective distribution channels or supply chains (inimitable, unique, valuable non transferable resource mentioned in RBV). Similarly economies of scale may be an ultimate result of a commitment made by a firm such as capital investments for expansions (as discussed in the commitment approach). Also raising barriers for competition by virtue of the low cost base that enables the low prices will result in strong strategic positioning in the market (discussed in the IO structural approach). These significant strengths align with the four perspectives of sustainable competitive advantage mentioned in the early parts of this literature review. Low cost dynamics could be considered as a competitive strategy that will create a sustainable competitive advantage.

However, low cost dynamics is attached to a disadvantage which is less customer loyalty (Vokurka and Davis 2004, p. 490, Cross 1999 cited by Allen and Helms 2006, p.436). Relatively low prices will result in creating a negative attitude towards the quality of the product in the mindset of the customers (Priem 2007, p.220). Customer's impression regarding such products will enhance the tendency to shift towards a product which might be higher in price but projects an image of quality. Considering analytical in depth view regarding the low cost strategy, it reflects capability to generate a competitive advantage but development and maintenance of a low cost base becomes a vital, decisive task.

7.3 LEARNING CURVE

The learning curve effect and the closely related experience curve effect express the relationship between experience and efficiency. As individuals and/or organizations get more experienced at a task, they usually become more efficient at it. Both concepts originate in the adage, "practice makes perfect", and both concepts are opposite to the popular misapprehension that a "steep" learning curve means that something is hard to learn. In fact, a "steep" learning curve implies that something gets easier quickly.

The term "learning curve" was introduced by the 19th-century German psychologist Hermann Ebbinghaus in the context of the efficiency of memorizing vs. the number of repetitions.

Later the term acquired a broader meaning. The learning curve effect states that the more times a task has been performed, the less time will be required on each subsequent iteration. This relationship was probably first quantified in 1936 at Wright-Patterson Air Force Base in the United States, where it was determined that every time total aircraft production doubled, the required labour time decreased by 10 to 15 percent. Subsequent empirical studies from other industries have yielded different values ranging from only a couple of percent up to 30 percent, but in most cases it is a constant percentage: It did not vary at different scales of operation. Learning curve theory states that as the quantity of items produced doubles, costs decrease at a predictable rate. This predictable rate is described by Equations 1 and 2. The equations have the same equation form. The two equations differ only in the definition of the Y term, but this difference can make a significant difference in the outcome of an estimate.

1. This equation describes the basis for what is called the unit curve. In this equation, Y represents the cost of a specified unit in a production run. For example, If a production run has generated 200 units, the total cost can be derived by taking the equation below and applying it 200 times (for units 1 to 200) and then summing the 200 values. This is cumbersome and requires the use of a computer or published tables of predetermined values.

$$Y_x = Kx^{\log_2 b_{[2]}}$$

where

- K is the number of direct labour hours to produce the first unit
- Y_x is the number of direct labour hours to produce the xth unit
- x is the unit number
- b is the learning percentage

2. This equation describes the basis for the cumulative average or cum average curve. In this equation, Y represents the average cost of different quantities (X) of units. The significance of the "cum" in cum average is that the average costs are computed for X cumulative units. Therefore, the total cost for X units is the product of X times the cum average cost. For example, to compute the total costs of units 1 to 200, an analyst could compute the cumulative average cost of unit 200 and multiply this value by 200. This is a much easier calculation than in the case of the unit curve.

$$\overline{Y_x} = K\frac{\frac{1}{1+\log_2 b}x^{1+\log_2 b}}{x}$$

where

- ❖ K is the number of direct labour hours to produce the first unit
- ❖ Y_x is the average number of direct labour hours to produce First xth units
- ❖ x is the unit number
- ❖ b is the learning percentage

7.3.1 Experience Curve

The experience curve effect is broader in scope than the learning curve effect encompassing far more than just labor time. It states that the more often a task is performed the lower will be the cost of doing it. The task can be the production of any good or service. Each time cumulative volume doubles, value added costs (including administration, marketing, distribution, and manufacturing) fall by a constant and predictable percentage.

In the late 1960s Bruce Henderson of the Boston Consulting Group (BCG) began to emphasize the implications of the experience curve for strategy. Research by BCG in the 1970s observed experience curve effects for various industries that ranged from 10 to 25 percent.

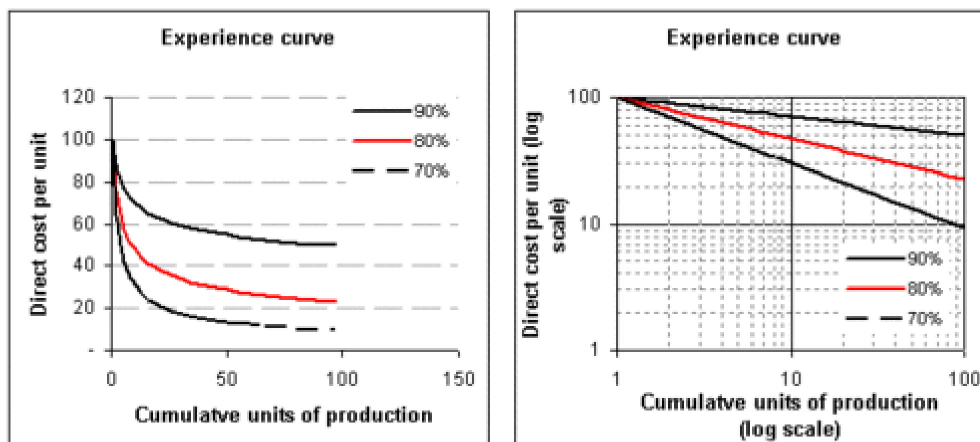

Figure 7.1: Experience Curve

These effects are often expressed graphically. The curve is plotted with cumulative units produced on the horizontal axis and unit cost on the vertical axis. A curve that depicts a 15% cost reduction for every doubling of output is called an "85% experience curve", indicating that unit costs drop to 85% of their original level.

Mathematically the experience curve is described by a power law function sometimes referred to as Henderson's Law:

$$C_n = C_1 n^{-a}$$

where

- C is the cost of the first unit of production
- C_n is the cost of the nth unit of production
- n is the cumulative volume of production
- a is the elasticity of cost with regard to output

1. ***Reasons for the effect***

   Examples: NASA quotes the following experience curves:

   - Aerospace 85%
   - Shipbuilding 80-85%
   - Complex machine tools for new models 75-85%
   - Repetitive electronics manufacturing 90-95%
   - Repetitive machining or punch-press operations 90-95%
   - Repetitive electrical operations 75-85%
   - Repetitive welding operations 90%
   - Raw materials 93-96%
   - Purchased Parts 85-88%

   There are a number of reasons why the experience curve and learning curve apply in most situations. They include:

   - *Labour Efficiency:* Workers become physically more dexterous. They become mentally more confident and spend less time hesitating, learning, experimenting, or making mistakes. Over time they learn short-cuts and improvements. This applies to all employees and managers, not just those directly involved in production.
   - *Standardization, Specialization, and Methods Improvements:* As processes, parts, and products become more standardized, efficiency tends to increase. When employees specialize in a limited set of tasks, they gain more experience with these tasks and operate at a faster rate.
   - *Technology-Driven Learning:* Automated production technology and information technology can introduce efficiencies as they are implemented and people learn how to use them efficiently and effectively.
   - *Better use of equipment:* as total production has increased, manufacturing equipment will have been more fully exploited, lowering fully accounted unit costs. In addition, purchase of more productive equipment can be justifiable.
   - *Changes in the Resource Mix:* As a company acquires experience, it can alter its mix of inputs and thereby become more efficient.

- *Product Redesign:* As the manufacturers and consumers have more experience with the product, they can usually find improvements. This filters through to the manufacturing process. A good example of this is Cadillac's testing of various "bells and whistles" specialty accessories. The ones that did not break became mass produced in other General Motors products; the ones that didn't stand the test of user "beatings" were discontinued, saving the car company money. As General Motors produced more cars, they learned how to best produce products that work for the least money.
- *Value Chain Effects:* Experience curve effects are not limited to the company. Suppliers and distributors will also ride down the learning curve, making the whole value chain more efficient.
- *Network-building and use-cost Reductions:* As a product enters more widespread use, the consumer uses it more efficiently because they're familiar with it. One fax machine in the world can do nothing, but if everyone has one, they build an increasingly efficient network of communications. Another example is email accounts; the more there are, the more efficient the network is, the lower everyone's cost per utility of using it.
- *Shared Experience Effects:* Experience curve effects are reinforced when two or more products share a common activity or resource. Any efficiency learned from one product can be applied to the other products.

2. ***Experience Curve Discontinuities:*** The experience curve effect can on occasion come to an abrupt stop. Graphically, the curve is truncated. Existing processes become obsolete and the firm must upgrade to remain competitive. The upgrade will mean the old experience curve will be replaced by a new one. This occurs when:
   - Competitors introduce new products or processes that you must respond to,
   - Key suppliers have much bigger customers that determine the price of products and services, and that becomes the main cost driver for the product,
   - Technological change requires that you or your suppliers change processes,
   - The experience curve strategies must be re-evaluated because:
     - they are leading to price wars
     - they are not producing a marketing mix that the market values.

Check Your Progress 1

Define Experience Curve.

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....

7.4 BCG APPROACH

The BCG strategists examined the consequences of the experience effect for businesses. They concluded that because relatively low cost of operations is a very powerful strategic advantage, firms should capitalize on these learning and experience effects. The reasoning is increased activity leads to increased learning, which leads to lower costs, which can lead to lower prices, which can lead to increased market share, which can lead to increased

profitability and market dominance. According to BCG, the most effective business strategy was one of striving for market dominance in this way. This was particularly true when a firm had an early leadership in market share. It was claimed that if you cannot get enough market share to be competitive, you should get out of that business and concentrate your resources where you can take advantage of experience effects and gain dominant market share. The BCG strategists developed product portfolio techniques like the BCG Matrix (in part) to manage this strategy.

Today we recognize that there are other strategies that are just as effective as cost leadership so we need not limit ourselves to this one path.

One consequence of the experience curve effect is that cost savings should be passed on as price decreases rather than kept as profit margin increases. The BCG strategists felt that maintaining a relatively high price, although very profitable in the short run, spelled disaster for the strategy in the long run. They felt that it encouraged competitors to enter the market, triggering a steep price decline and a competitive shakeout. If prices were reduced as unit costs fell (due to experience curve effects), then competitive entry would be discouraged and one's market share maintained. Using this strategy, you could always stay one step ahead of new or existing rivals.

In his book Economia, Geoff Davies describes the implications of the learning curve as fundamental. He argues along similar lines to BCG that, through positive feedback, the advantages conferred by the curve and other economies of scale allow one or a few firms to increase market share until they dominate their market. Maintaining that because of the learning curve effect, economies of scale pervade modern economies, Davies infers that since the resulting monopolies distort the market away from equilibrium and optimality, the modern economy is not in equilibrium. "Large, modern free-market economies are characterised not by equilibrium but by exponential growth and instability" (p46, Davies' italics). He concludes that the behaviour of real economic systems is radically different from the predictions of the general equilibrium theory of neoclassical economics, and that therefore this theory fails as a useful description of a modern economy.

Criticisms

Some authors claim that in most organizations it is impossible to quantify the effects. They claim that experience effects are so closely intertwined with economies of scale that it is impossible to separate the two. In theory we can say that economies of scale are those efficiencies that arise from an increased scale of production, and that experience effects are those efficiencies that arise from the learning and experience gained from repeated activities, but in practice the two mirror each other: growth of experience coincides with increased production. Economies of scale should be considered one of the reasons why experience effects exist. Likewise, experience effects are one of the reasons why economies of scale exist. This makes assigning a numerical value to either of them difficult.

Others claim that it is a mistake to see either learning curve effects or experience curve effects as a given. They stress that they are not a universal law or even a strong tendency in nature. In fact, they claim that costs, if not managed, will tend to rise. Any experience effects that have been achieved, result from a concerted effort by all those involved. They see the effect as an opportunity that management can create, rather than a general characteristic of organizations.

Another factor may be the attitude of the individuals involved. A strong negative attitude may negate any learning effect. Conversely a positive attitude may reinforce the effect.

7.5 CASH COW IMPLICATION

A cash cow is a business venture which generates a steady return of profits which far exceed the outlay of cash required to acquire or start it. Many businesses attempt to create or acquire cash cows, since they can be used to boost a company's overall income and to support less profitable ventures. The term is also sometimes used in a derisive way, usually in a discussion of the complacency of a company about a profitable product.

The classic example of a cash cow is a milk cow. Milk cows require a small capital outlay when they are acquired, and minimal maintenance costs afterwards. In return for their low maintenance costs, milk cows generate milk throughout their adult lives, along with calves. Since the 1600s, people were using "milch cow" to refer to a profitable venture; the modern term "cash cow" emerged around the 1970s.

Several features distinguish a cash cow. The first is the relatively small capital outlay and maintenance costs. A cash cow also typically represents significant competition in its market, and it typically generates innovative and interesting products which capture ever-larger market shares. Cash cows tend to attract customers with an array of products and favorable pricing schemes, although some cash cows also sell more expensive products; Apple's famous iPod line is a classic example of a cash cow in the technology sector.

Although a cash cow can be very beneficial for its parent businesses, there are some cautions involved in dealing with cash cows. One of the major problems that companies face is complacency when handling their profitable cash cows. For a cash cow to succeed, a company needs to respond to changes in the market, ensuring business growth and a dependable flow of cash. If a cash cow is allowed to remain stagnant, other companies will capture its market share.

The term "cash cow" is also used in a totally different context, to refer to companies or organizations which have no control over their spending. In this sense, sections of a government budget like defense may be called cash cows, in a reference to the fact that taxpayers are being milked to pay for them. The implication with this sort of cash cow is that funds are being inefficiently and poorly used.

7.5.1 Discounted Cash Flow Analysis

If I were to give you a thousand rupees today, would it be the same as giving you a thousand rupees after 5 years? Obviously, the answer is that it is not. Even if you were put a thousand rupees that you got today in a bank on a compound interest of 10 percent, you would get about two thousand rupees after 5 years. Money loses value due to time; it also loses value due to risk and many other factors. To get around the problem regarding the value of time, the payback period analysis should be used along with discounted cash flow analysis, e.g., the net present value of the project, or the internal rate of return.

Discounted Cash Flow (DCF) analysis is the most widely used investment appraisal technique, and it essentially extends the payback period analysis. Once the net cash flows have been assessed for each of the years they are discounted progressively at a predetermined rate, usually the cost of capital. The Net Present Value (NPV) of the venture is then calculated by adding all the discounted annual cash flows (after taxation) over the anticipated life of the project.

DCF analysis is particularly useful for comparing the financial merits of strategies which have very different patterns of expenditure and return.

7.5.2 Benefit-cost Ratios

A benefit cost ratio is, as the name implies, simply a ratio between the sum of the benefits, measured in some manner, and the costs of the project. There are two versions of the benefit-cost ratio analysis. There is the undiscounted benefit-cost ratio analysis and the discounted benefit-cost ratio analysis.

Undiscounted benefit-cost ratio again has two versions, which we may label "gross" and "net" respectively. In the former, benefits are calculated without deducting depreciation, then added and the sum divided by the investment cost. In the net version, depreciation is deducted in computing the benefits. In the undiscounted version, the benefits are taken at face value, while in the discounted versions calculations are based on a discount factor.

A discounted benefit-cost ratio is a somewhat more sophisticated tool. It is the ratio of the present value of the future benefits, at a specified rate of discount, to the present value of the present and future investment outlays and other costs, at the same rate.

The discounted benefit-cost ratio takes account of all income, whenever received. The introduction of compound interest into the calculation effectively gives more weight to early receipts than to late ones; so that this is the first criterion we have examined which gives effect to both principles.

It can be used to solve problems of choosing techniques by calculating the incremental benefit-cost ratio on the incremental investment required for the more expensive project.

There are different possible values of cost of capital. The cost of capital is of crucial importance in this technique, since rankings will be dependent on the value of the cost of capital chosen. Consider the following two projects:

A costs Rs.100.00 and returns Rs.106.00 in year.

B costs Rs. 100.00 and returns Rs. 112.36 in two years time.

When calculated using discounted benefit-cost ratios at 5 percent, 6 percent and 7 percent respectively, if the discount rate is 5 percent, project B is better. However, if it is 7 percent project, A is better. The yield is exactly 6 percent. If the required rate of return is 6 percent, we can be indifferent whether we accept either or both. If it is 5 percent, both are profitable, while if it is 7 percent neither is.

Judging them on the two basic principles concerned in investment decisions, the 'bigger the better' principle and the 'bird in the hand' principle, both versions of Benefit—Cost Analysis comply with the 'bigger the better' principle. The discounted version complies with both.

Benefit - Cost Analysis is a very useful technique and this method is especially of great use in giving accept-reject decisions.

7.5.3 Sensitivity Analysis

Uncertainty threatens all decisions taken about the future. The strategy selection process has to look into the future and predict outcomes. There is no certainty on the quality of the strategy, and of the impact of the environment on strategy. Sensitivity Analysis (SA) is a useful technique for assessing the extent to which the success of a preferred strategy is dependent on the key assumptions. Sensitivity analysis allows each of the important assumptions underlying a particular strategy to be questioned and changed. In particular, it seeks to test how sensitive each of these assumptions is to predicted performance or outcome.

Good modelling practice requires that the modeller provides an evaluation of the confidence in the strategy, possibly assessing the uncertainties associated with the outcome of the strategy itself. For example, the key assumptions underlying a strategy might be that market demand will grow by 7 per cent p.a., or that the inflation rate will be limited to 3 percent. Sensitivity analysis asks: what would be the effect on performance if the market growth is only 5 percent? How would this impact the strategic decision? How important is the market growth in the decision process? A similar process might be repeated for the other key assumptions. This process helps management develop a clearer picture of the risks of making particular strategic decisions and the level of confidence it can have in a given decision.

It is sometimes referred to as 'what if?' analysis. Sensitivity Analysis is a mathematical technique that is defined by a series of equations, input factors, parameters, and variables aimed to characterize the strategy being investigated. Its use grew with the incorporation of the mathematical equations in the form of computer spreadsheet packages, which are ideally suited to this type of analysis. These tools characterize the uncertainty associated with a strategy and are used to determine:

a. the quality of strategy definition,

b. factors that mostly contribute to the variability of the results

c. the range in which the strategy variation is maximum

d. interactions between the different environmental factors.

There are several possible procedures to perform sensitivity analysis. The most common sensitivity analysis is sampling-based. A sampling-based sensitivity is used when the variables or input factors are subject to many sources of uncertainty. Sometimes, there is absence of information and poor or partial understanding of the driving forces and mechanisms. This imposes a limit on the confidence in the response or output of the model. In the sampling based analysis, the model is repeated for combinations of values sampled, thereby increasing the level of confidence in the results.

The choice of which SA method to adopt is difficult to specify as each technique has strengths and weaknesses. Such a choice depends on the problem the organization is trying to address, on the characteristics of the strategy under study, and also on the computational cost that the organization can afford.

SA is used to increase the confidence in the strategy by providing an understanding of how the strategy variables respond to changes in the inputs. Computational models of sensitivity analysis can be used for a variety of settings and purposes. We can gain insight of possible outcomes of financial investments, the choice of strategy including analysis of options, the assessment of environmental impacts, etc. Sensitivity Analysis models depend upon the information fed into them, upon their structure and upon the framing assumptions made to build them.

7.5.4 Financial Analysis

The same analysis that we described in that section can be carried out on the new investment. Then the data on the new investment can be added to the organization's financial data and an analysis of the combined data carried out. Some of the types of analysis that can be considered, depending on the requirements of the organization, are given in Table 7.1.

Although the evaluation of strategies may be assisted by the use of one or more of these financial techniques, it is important to recognize some of the implicit assumptions which

inevitably limit their use as comprehensive techniques of strategy evaluation. The analyst should use more than one method to evaluate strategy and should evaluate the investment both as a stand-alone investment and also combine it with the operations of the firm to come to a conclusion.

7.5.5 Shareholder Value Analysis

During the 1980s, attempts were made to address many of the limitations and criticisms of traditional financial analyses including looking at how corporate development strategies were, or were not, generating shareholder value. These factors generated Shareholder Value Analysis (SVA). Applying this within the strategic management process requires a new mindset which is called value management.

SVA recognizes the complex interdependencies between the strategic business unit and the investment decision. Therefore, it evaluates strategies at the SBU level and not just separate projects.

It also tries to identify and evaluate the key cash generators of the business, which are called value drivers. However, it is highly subjective as the drivers and their interdependencies are complex and addition to customer value does not necessarily mean that value to the organization is added. It also does not remove many uncertainties surrounding strategy evaluation. Value management's focus on value drivers in making strategic decisions and in implementation and control, however, makes it an important technique of strategy evaluation.

Conventional financial ratios can help in assessing whether or not the shareholder's interests are being protected. Table 7.2 identifies the important areas of concern of the shareholders. These are:

- ***Expected return for shareholders:*** Shareholders would like the return on assets not to be diluted with the new project. The criteria should perhaps be that the project will add to the expected return.
- ***Return on Equity (ROE):*** It is a basic measure of the efficiency with which the firm employs the owners' capital. The shareholders would like the ROE to improve in the long run, and
- ***Dividend Policy:*** Shareholders would like their dividends to remain unchanged.

Table 7.1: Key Stakeholder Requirements

Concept	Description	Remarks
Return on Investment (ROA)	The ROA is a fundamental measure of the efficiency with which a firm manages its assets. ROA is an Economic profitability. It answers the question: How much profit the firm is generating from the use of its assets? "EBIT, earnings before interest and taxes, is the income earned by the company without regard to how it is financed; so EBIT (1 - t) is income after tax where "t" is the corporate tax rate.	ROA= [EBIT.(1-t)/ Assets] x 100 ROA can be improved either by improving the Profit margin; through Cost Control or Revenue increases, or by improving the Asset turnover through a better capacity utilization or a more efficient WCR management
Cash flow	The operating cash flow (Cash flow provided by operations) is a central and crucial concept for financial management. It measures the ability of the firm to generate, through its day-to-day operations, a flow of cash, and therefore evaluates its capacity for survival and for long term growth	Operating cash flow (OCF) = Net profit after taxes (PAT) + Depreciation = Internally generated funds (IGF)/ Increase in WCR or + Decrease in WCR

Contd....

	The OCF is the basic and fundamental source of cash for the investment and financing policies of the company. The higher it is, the better it is, the more freedom and flexibility it gives to the firm to build its LT strategy without constraint and interference from finance.	
Economic Value Added (EVA)	EVA says that a company or division creates value for owners only when its operating income exceeds the cost of capital employed. The weighted average cost of capital (WACC) is also a basis to judge an investment project by using the company WACC to discount the Free Cash Flows on all new projects. Ideally, however, each project should be evaluated at its own Opportunity Cost of Capital (OCC). The true OCC depends on the use of capital.	Condition : ROA > WACC - or- IRR > WACC Stockholders want to make their shares as valuable as possible. Investing in a project is worthwhile if its NPV is positive. In this case, we create value for shareholders.

Table 7.2: Analysis of Key Financial Factors for Shareholders

Concept	Description	Remarks
Expected return for shareholders	The CAPM models the risk expected and expected return trade-off in the capital market. It looks at the company in the market. The CAPM is a forecasting model which allows the calculation of expected profitability using anticipations of risk. To use it correctly, one should use a forecasted ß rather than an historic ß. The calculations above are based on the following: the risk premium from the market portfolio (e.g. S &P500) is stable in time and for the future. If Risk free rate is not stable over time, it is better to use the current Rf at the time of evaluation. The main critique concerning ß is its instability over time. It synthesizes a large amount of information in a single value, and this strength equally represents its main weakness.	The Capital Asset Pricing Model [CAPM] CAPM = Return on stock (Rs) = Rf + ß.(Rm - Rf) Where: Rf : Risk free rate : Rm: Expected market profitability rate. ß (bêta) : is the measure of risk used for a single share.
Return on Equity (ROE)	ROE is a basic measure of the efficiency with which the firm employs the owners' capital and estimates the earnings per Rs. 100 of invested equity capital. It incorporates the consequences of the financing policy of the firm that is the way the assets are financed. This is called the "financial leverage". ROE = (Profit/Sales) x (Sales/ Assets) x (Assets/Equity) This decomposition shows the 3 levels for managerial control of ROE. It also demonstrates that two companies may have the same ROE, but resulting from very different cocktails of strategies.	ROE = Profit/ Equity = ROA +{[ROA - i].D/E} Where 'i' is interest rate; 'D' is Debt; and 'E' is Equity or ROE = ROA + Leverage factor
Dividend Policy	The condition for equilibrium on well-functioning capital markets is that at each point in time all securities in an equivalent risk class are priced to offer the same expected "r". We can express today's price as the present value of a perpetual stream of dividend. Po =Div1/r	r = {[Div1 + P1] – Po}/ Po Po : Current price P1 : expected price at the end of the year Div1 : Expected dividend on share 'r' is return to Stockholder

The table summarizes the requirements of the financial performance from the shareholder's perspective.

In addition, it would be beneficial to carry out a shareholder's analysis to assess stakeholder reaction to the particular strategy. For example, a new strategy may require a substantial issue of new shares that could be unacceptable to powerful groups of shareholders as it

could dilute their voting power. Stakeholder mapping is a useful technique to project both the degree of interest stakeholders may exhibit in the strategy and whether they have the power to influence the decision.

Check Your Progress 2

State whether the following statements are True or False:

1. The experience curve and the learning curve are related.
2. The experience curve deals with the entire realm of possibilities of job element.
3. The BCG Matrix reflects the contribution of the products offered by the firm to its cashflows.
4. Discounted Cash Flow (DCF) is useful for comparing the financial merits of strategies which have very different patterns of expenditure and return.
5. Benefit-cost ratio is a ratio between the sum of the benefits and the costs of project.

7.5.6 Analyzing Risk

Risk is a fact of business life. Risk exists because we are unable to make perfect forecasts. If we could, we would never make unprofitable decisions and plan to meet all commitments with precision. Risk to the firm is in the possibility of unforeseen fluctuations or deviations in its expected cash flows. These can be due to a number of reasons.

Corporate risk does not necessarily vary directly with project risk and may, in fact, vary inversely with it. When we combine any two operations, each of which generates income and there is a negative correlation between the income stream of the project and the existing operations, the riskier project is preferable from the point of view of reducing the risk of the organization. It is also the case when the project's outcomes are sufficiently uncorrelated with the outcomes of the existing operations. In fact, this is one of the reasons for conglomerate diversification by an organization.

As the organization considers a prospective project, it evaluates potential risks to the opportunity, to be able to build a project plan that maximizes the probability of project success. While handling risk, if the decision process poses problems, conceptual and practical, it is here that the decision maker's role is critical. Fortunately, it is possible to plan for risks.

Risk identification is generally done as part of a feasibility study, at the beginning of the active project work, and at each new phase of a large project. The process of identification is assisted by use of risk factor tables that capture indicators of commonly encountered risks.

Analyze Risks

The identified risks are analyzed to establish the project exposure for each risk and to determine which risk items are the most important ones to address. Risk exposure is defined as the product of the likelihood that the risk will occur and the magnitude of the consequences of its occurrence. In rare cases, the overall project risk exposure will be so high that the opportunities represented by the project really cannot be attained at a reasonable expense. In most cases, though, attacking the most significant of the risk items will maximize the project opportunity.

While the initial risk analysis deals with those risks identified early in the project, more analysis may be needed as the project proceeds. In cases where a new risk is identified, that new risk is analyzed and its exposure compared to that risks already being handled. That new risk may or may not be addressed with a mitigation action, depending on the cost of that action and the ranking of this new risk against others already being handled.

Plan Risk Handling Actions

Risks may be handled a number of different ways. Alternatives include:

- Accept the risk, with no investment of effort or cost. This is appropriate when the cost of mitigating exceeds the exposure, and the exposure is acceptable.
- Transfer the risk to someone else, or agree to share the risk. If a customer or partner is better able to handle the risk, this is probably the most effective approach.
- Fund and staff the efforts to reduce the probability that the risk will become a problem. Such mitigation tasks might include providing additional staff to help develop the product, getting special training for members of the team, or following a dual development path for the whole project.
- Fund and staff the efforts to reduce the loss associated with the risk should it become a problem.

For significant risks that cannot be mitigated, or where countermeasures are unreliable, contingency plans may be established and then executed if the risk becomes a problem. Contingency plans are normally budgeted and approved apart from the plans for project deliverables.

Track and Control Risks

Throughout the project, the project team tracks progress handling the risks, to ensure that:

- actions which should reduce the probability of occurrence are effective
- actions which should reduce the loss associated with the risk are effective
- when risks for which there is no possible mitigation action have reached a trigger point for the contingency plan, that contingency plan is performed

In addition, the team watches for additional risks that need to be addressed, as well as changes in impact or probability to previously identified risks.

7.5.7 Verification Activities

While risk management is being done, the following verification activities are appropriate for management:

- When reviewing project progress, include risk management status among the items being reviewed. Ensure that the project manager and project team are performing their planned risk management activities and their planned risk mitigation activities.
- When risk management actions require the assistance of management, ensure that the management tasks have been accomplished according to the plan that was set.

7.5.8 Exit Criteria

Risk exposures for the risks to the project are at or above the level acceptable for the project.

7.6 LET US SUM UP

The starting place of strategy evaluation is the strategic analysis of the organization.

New deflationary pressures are facing businesses today, which are squeezing profit margins and the availability of capital for investment. Indeed, many management thinkers question whether existing business models are sustainable, and if there is a need to develop new business models to face the situation.

Such challenges seem to crop up from time to time. In June 2008, rocketing oil prices and staggering 11.5% level of inflation halted a great period of expansion. Equity returns sank, risk capital dried up, and the economy stagnated. But even then, some companies proved resilient. These conditions overhauled long term planning and gave birth to modern strategic planning. Such challenging times make it particularly necessary for strategists to think clearly and soundly. We need to inspire strategies that will enhance the chances of survival in this environment of changing paradigms.

Recession aftershocks, huge new risks, pervasive uncertainty-the challenges defining today's business environment place a greater premium than ever on good corporate strategy. To meet the challenges of discontinuity and to perform in these markets, a corporation must learn to change as rapidly as they do, without losing control of operations. Management's great task for the coming millennium will be taking strategic control of companies and simultaneously decentralizing operational control. The strategic direction of future organizations will have to be in finding ways of loosening controls without losing control. We need to look at strategic choice in these challenging circumstances. Corporate strategists have coped with very demanding business environments before and will do so again.

7.7 LESSON END ACTIVITY

Prepare a study note on tools of strategic planning and evaluation.

7.8 KEYWORDS

Experience Curve: The experience curve effect is broader in scope than the learning curve effect encompassing far more than just labor time.

Value Chain Effects: Experience curve effects are not limited to the company. Suppliers and distributors will also ride down the learning curve, making the whole value chain more efficient.

Shared Experience Effects: Experience curve effects are reinforced when two or more products share a common activity or resource.

Cash cow: A cash cow is a business venture which generates a steady return of profits which far exceed the outlay of cash required to acquire or start it.

7.9 QUESTIONS FOR DISCUSSION

1. What are the different methods and tools used for strategic planning and evaluation?
2. What do you understand by Competitive Cost Dynamics?
3. Write on the use of experience curve and cash flow implication in strategic planning.

4. Discounted Cash Flow (DCF) analysis is the most widely used investment technique. Discuss.
5. Comment on the implications of cash flow for comparing the merits of strategies.

Check Your Progress: Model Answers

CYP 1

The experience curve effect is broader in scope than the learning curve effect encompassing far more than just labor time. It states that the more often a task is performed the lower will be the cost of doing it.

CYP 2

1. True
2. True
3. True
4. True
5. True

7.10 SUGGESTED READINGS

Pearce & Robinson, *Strategic Management*, All Indian Travellers N.D.

A.C. Hax and NS., *Strategic Management: An Integrative Perspective*, Majifu, Prentice Hall.

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LESSON 8

LIFE CYCLE APPROACH TO STRATEGIC PLANNING

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8.9 Questions for Discussion

8.10 Suggested Readings

8.0 AIMS AND OBJECTIVES

After studying this lesson, you will be able to:

- Understand the IA - BS Matrix
- Learn about Arthur D. Little's life cycle approach to strategic planning
- Know business portfolio balancing
- Make an assessment of the economic contribution of strategy
- Understand strategic funds flow programming

8.1 INTRODUCTION

Formal planning and evaluation processes can play an important part in organizations which develop and select strategies through these fragmented, incremental processes. They can be an important influence to insure that best practice is communicated through

the various parts of the organization, and communicating the wider organizational context to their 'local' decision makers. Planning can be about changing minds, not just making plans.

In some organizations, especially in family managed business houses or the visionary type organizations the dominant process for the selection of strategies is command. The decision is taken at the highest level with involvement/ advice from the organization to varying degrees. The efforts of those involved in formal evaluation are concerned to ensure that selections made through command process are well informed. It is important that, if strategies are selected in this way, they have some completeness and are workable in practice. Without some detailed substance in terms of specific strategic choices development directions and methods, the vision and intentions are not a basis on which strategy selection should proceed. The role of formal planning in these circumstances is to devise useful means of raising the level of debate among the decision-makers during the selection process.

The pace of change, today, is unrelenting. It has created challenges, ranging from direct threats like increased competition to technological discontinuities. Organizations that have to maintain or improve their position in the marketplace and create competitive advantage for themselves will find that well thought out strategies will play an increasingly important role in the future. They will have to move towards a style of management that closely resembles a planned approach.

8.2 IA - BS MATRIX

The Planned Approach; Formal Evaluation: This is the ideal. The rationale of selection of future strategies is 'rational'. The organization's objectives, quantified where possible, are used as direct yardsticks by which options are assessed. For example: whether or not the strategies are likely to meet targets for return on capital or market share. They provide quantified 'answers' regarding the relative merits of different courses of action and to come up with the 'right' strategies.

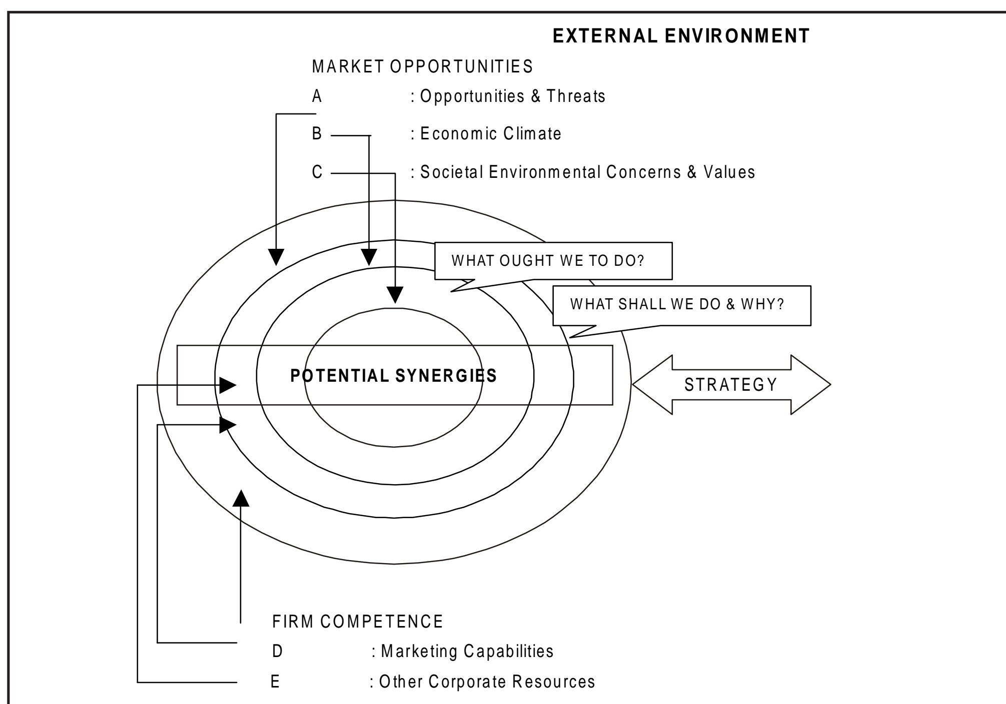

Figure 8.1: Business Strategy Mix Matrix

8.3 ARTHUR. D. LITTLE'S LIFE CYCLE APPROACH TO STRATEGIC PLANNING

Strategy selection is a complex process. Strategy will be driven by the perception of the challenges and opportunities facing the organization, and our strategic response to them. Choice of strategies will depend on the relationship between the company and its competitive environment; allocation of resources among competing investment opportunities; and committing resources—often long-term—needed to realize these opportunities.

Notwithstanding the complexity of the process of strategic choice, the organization cannot live in a vacuum; it has to choose its strategies so that it can survive in the marketplace. Once strategy formulation is undertaken by the organization, it needs to evaluate the strategic options it can exercise. In assessing strategies, there are three types of evaluation criteria that can be used.

- Suitability
- Acceptability, and
- Feasibility

8.3.1 Assessing Suitability

Assessing the suitability of strategic options is the starting point of the selection process. On the basis of the results of the exercise, a more detailed analysis concerning the acceptability and feasibility of these options can be undertaken.

It addresses the concern that under what circumstances of the organization and its strategic intent, does the strategy bring the results that it is looking for. There are a number of analytic techniques that can be used to bring in clarity.

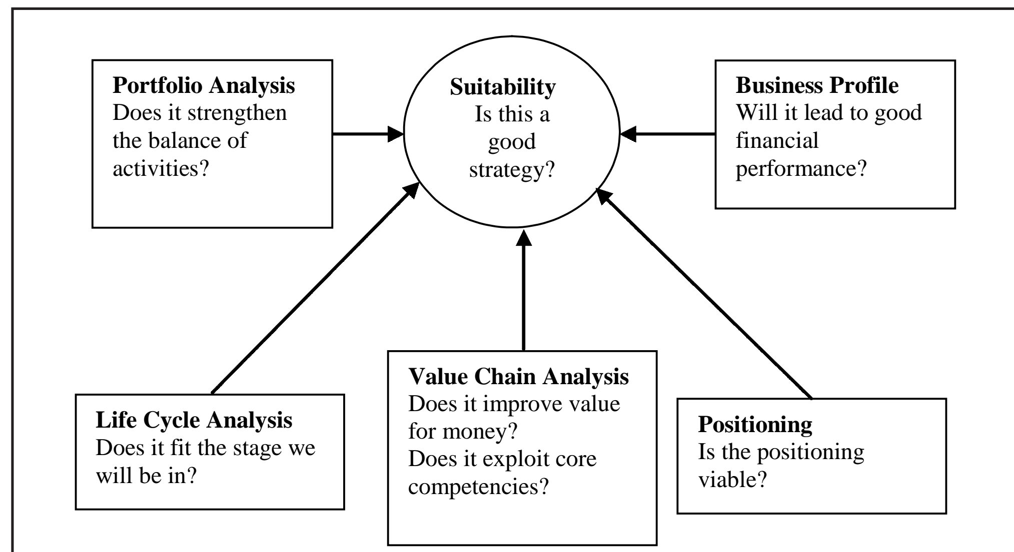

Figure 8.2: Testing Suitability

As has been shown in Figure 8.2, the different techniques that have been identified provide answers for different points of view. Life Cycle Analysis examines the stage of development of the products; Portfolio Analysis examines the ability of the strategy to strengthen the balance of activities; the Business Profile examines the financial performance; Positioning tells the organization whether or not the position is viable; and

Value Chain Analysis provides information whether or not the strategy improves the value for money and exploits the core competencies of the organization. An organization can use all or a combination of some of these techniques described above. A short explanation on each of these analytical tools is given in the paragraphs that follow.

8.3.2 Life Cycle Analysis

One of the tools described in this lesson is the Product Life Cycle Model. The product life cycle model is a representation of life stage of a product. Based on the life stage of the product the organization can decide the type of strategy it would like to follow for the product.

Table 8.1: Life Cycle - Portfolio Matrix, by Arthur D. Little

		STAGES OF INDUSTRY MATURITY			
		Embryonic	**Growth**	**Mature**	**Ageing**
COMPETITIVE POSITION	**Dominant**	Fast Grow Start-up	Fast Grow Cost Leadership Renew Defend Position	Defend Position Cost Leadership Renew Fast Grow	Defend Position Focus Renew Grow
	Strong	Differentiate Fast Grow Start-up	Fast Grow Catch-up Differentiate Cost Leadership	Cost Leadership Renew Focus Differentiate Grow	Find Niche Hold Niche Grow Harvest
	Favorable	Differentiate Fast Grow Focus Start-up	Catch-up Differentiate Focus Grow	Harvest; Hang-in; Find Niche; Hold Niche; Renew; Turn around; Focus; Differentiate; Grow	Retrench Turn around
	Tenable	Focus Start-up Grow	Harvest; Hang-in Find Niche; Hold Niche; Catch-up Turn around; Focus Differentiate; Grow	Harvest Find Niche Turn around Retrench	Divest Retrench
	Weak	Find Niche Turn around Grow	Turn around Retrench	Withdraw Divest	Withdraw

Table 8.1 describes the relationship between the stage of the product's life and its market position. This is called the Life Cycle - Portfolio matrix. The market status is defined by its competitive position. This has been broken up into five categories ranging from dominant to weak. The product development stage has been classified as embryonic, growth, mature and aging. The purpose of the matrix is to establish the appropriateness of particular strategies in relation to the two dimensions. It shows the likely or suitable strategies that can be used, depending upon the life cycle position of the product.

The position of the product within the life cycle is normally determined by eight external factors; market growth rate; growth potential; breadth of product lines; number of competitors; spread of market share between these competitors; customer loyalty, entry barriers and technology.

The competitive position of the organization within its industry can also be established by looking at the characteristics of each category. Few organizations are in a dominant

position in an industry, unless they are state monopolies. For example, the State Trading Corporation and the Mines & Minerals Trading Corporation were set up by the Government of India in the early sixties to give the Government better control over foreign exchange. Even now, Oil & Natural Gas Corporation (ONGC) has virtual monopoly in the exploration sector. Normally, dominant businesses are controlled by the State under the monopolies prevention legislations. However, in specific products it is possible for an organization to be in a dominant position.

Strong organizations are those that are in a position to follow strategies without feeling threatened by competition. An organization is in a favourable position where no single competitor stands out, but where the company is better placed than most. Tenable and weak competitive position indicates either the organization is maintained by specialization or will find it difficult to survive independently in the long run.

8.3.3 Positioning

Positioning is a basic proposition promoted by Michael Porter in determining the generic strategies for competitive advantage. So assessing whether the existing and future positioning is viable can be done by asking whether demand is likely to grow or decline. For example, the quality of the resources and the uniqueness of the competencies are the basic features that determine the ability and suitability of a positioning the product or service using a strategy of differentiation. The extent to which the organization is capable of supporting a particular positioning can be determined by using the format given as Table 8.2.

Table 8.2: Assessing the Suitability of a Strategy

A	**B1**	**B2**	**C**			
Resources & Competencies underpinning Strategy	**Which of these Resources/ Competencies is likely to create**		**Which will be sustainable/ difficult to Imitate**			
	Cost Reduction	**Added Value in terms of Needs perceived by Customers**				
			Valued	**Rare**	**Complex**	**Tacit**

The first step in the analysis on the suitability of the positioning strategy of the organization is to list out the key resources and competencies underpinning the strategy. In order to complete the first step, you need to fill in column A in the table.

These are then scored against two important competencies of the firm. These competencies, 'cost reduction' and 'value added' have a significant impact on the outcome. In the table above, these are given in columns B1 and B2. We need to ask the question whether each of the competencies identified in A strengthens cost reduction or adds to the perceived value. A score is given on a scale of 1 to 5. For example, the in-house R&D activities may be the source of significant cost reductions and unique product features valued by the customers. It would, then, score highly both in columns B1 as well as B2.

Finally, the analysis requires reexamining each of the resources and competencies to establish whether it is sustainable and/ or difficult to imitate. Unique resources and core

competencies are sources of competitive advantage. The criteria used to judge the competitive advantage through the resources and competencies include: whether it is valued by the consumers; whether it is rare; is it complex to replicate; and whether it is embedded in the tacit knowledge of the organization.

Generally speaking, few resources and competencies are difficult to imitate. Most often, competitive advantage may not come directly from specific resources and competencies but on the ability of the organization to mange linkages between the separate activities. However, assessing the relationship between the generic product / market strategy and the strategic capability of the organization is useful in preparing resource plans for the strategy and in identifying its critical success factors.

Check Your Progress 1

Define the position of product within the life cycle.

....

....

8.4 BUSINESS PORTFOLIO BALANCING

A number of techniques have been developed for displaying a diversified organization's operations as a portfolio of businesses. The techniques provide simple frameworks for reviewing the performance of multiple Strategic Business Units (SBUs') collectively. A SBU is a business that can be planned separately from others, has its own set of Competitors, and is managed as a Profit Centre. Techniques of portfolio analysis have their greatest applicability in developing strategy at the corporate level. It charts and characterizes the different businesses in the organization's portfolio and helps in determining the implications for resource allocation.

A business portfolio is the collection of Strategic Business Units (SBU) that makes up a corporation. The optimal business portfolio is one that fits perfectly to the company's strengths and helps to exploit the most attractive industries or markets. A SBU can either be an entire mid-size company or a division of a large corporation. It normally formulates its own business level strategy and often has separate objectives from the parent company.

The aim of a portfolio analysis is:

1. Analyze its current business portfolio and decide which SBUs should receive more or less investment
2. Develop growth strategies for adding new products and businesses to the portfolio
3. Decide which businesses or products should no longer be retained

The basis for many of these matrix analyses grew out of work carried out in the 1960s by the Boston Consulting Group (BCG). BCG observed in many of their studies that producers tend to become increasingly efficient as they gain experience in making their product and costs usually declined with cumulative production. They came up with a hypothesis to explain how an organization with the highest market share in the industry generally will have the greatest accumulated volume of production and therefore the lowest cost relative to other producers in the market.

Techniques of business portfolio balancing have their greatest applicability in developing strategy at the corporate level. It charts and characterizes the different businesses in the organization's portfolio and helps in determining the implications for resource allocation. The Boston Consulting Group Matrix (BCG Matrix) is the best-known portfolio planning framework. The GE/ Mckinsey Business screen is another well known portfolio framework, but it is a more complex version of the BCG matrix. The aim of these techniques is to develop growth strategies for adding new products and businesses to the portfolio, and decide which businesses or products should no longer be retained.

Check Your Progress 2

State whether the following statements are True or False:

1. The programming of strategic funds begins with the identification of basic organisational units.
2. A market penetration strategy may call for a more intensive investment of funds in the current business.
3. A.D. Little's Life Cycle analysis does not examine the stage of development of the products.
4. Positioning is a basic proposition promoted by Michael Porter in determining the generic strategies for competitive advantage.
5. The programming of strategic funds simply identifies feasible options under different physical assumptions.

8.5 STRATEGIC FUNDS PROGRAMMING

Funds are used to maintain (1) the same level of production or services, (2) the organization's "market share," or (3) a specified, ongoing rate of growth.

Strategic funds are invested in the new programs required to meet the organization's goals and objectives. They are used to purchase new assets, such as equipment, facilities, and inventory; to increase working capital; and to support direct expenses for research and development, marketing, advertising and promotion. In the private sector, strategic funds are also used for mergers, acquisitions and market development. A market penetration strategy, for example, may call for a more intensive investment of funds in the current business. A market expansion strategy usually requires aggressive use of strategic funds for advertising and promotion. A company must use strategic funds to produce more disverse products or services and to develop new markets for them.

The programming of strategic funds begins with the identification of basic organizational units (program or budget units) and the formulation of goals and objectives for these units. The total amount of strategic funds available to the organization can be determined by subtracting baseline funds from total assets (revenue or appropriation). Strategies must be formulated to carry out the goals and objectives of each unit. Once estimates have been made as to the funds required for each strategy, they can be ranked according to their potential contribution to the achievement of the identified goals and objectives. In undertaking this ranking, the kinds of strategic funds available and the level of risk involved must be taken into account.

The available strategic funds should be allocated to each program according to some set of priorities. Key decision points concerning risk and return are encountered (1) when funds available from internal sources have been fully consumed, and (2) when readily available credit sources have been exhausted. At this point, proposed strategies must be evaluated in terms of changes required in the financial structure of the organization. The final step is to establish a management control structure to monitor the generation and application of funds to achieve the desired results.

The programming of strategic funds simply identifies feasible options under different fiscal assumptions. A further assessment or risk and return on investment must be made before the final option is chosen.

8.6 LET US SUM UP

Different techniques that have been identified provide answers for different points of view. Life Cycle Analysis examines the stage of development of the products; Portfolio Analysis examines the ability of the strategy to strengthen the balance of activities; the Business Profile examines the financial performance; Positioning tells the organization whether or not the position is viable; and Value Chain Analysis provides information whether or not the strategy improves the value for money and exploits the core competencies of the organization.

The position of the product within the life cycle is normally determined by eight external factors; market growth rate; growth potential; breadth of product lines; number of competitors; spread of market share between these competitors; customer loyalty, entry barriers and technology.

Positioning is a basic proposition in determining the generic strategies for competitive advantage. Gap analysis is a useful technique that can be used to identify the extent to which the existing strategies will fail to meet the performance objectives in the future. Screening options basically are concerned with the relative merits between different strategies.

The Life Cycle - Portfolio matrix depicts the relationship between the stage of the product's life and its market position. The market status is defined by its competitive position. This has been broken up into five categories ranging from dominant to weak. The product development stages have been classified as embryonic, growth, matures and aging. The purpose of the matrix is to establish the appropriateness of particular strategies in relation to the two dimensions.

Positioning - Resource Analysis is used to assess whether the existing and future positioning are viable. The first step in the analysis on the suitability of the positioning strategy of the organization is to list out the key resources and competencies underpinning the strategy. In order to complete the first step, you need to fill in column A in the table. These are then scored against two important competencies of firm. These competencies, 'cost reduction' and 'value added' have a significant impact on the outcome. Finally, the analysis requires reexamining each of the resources and competencies to establish whether it is sustainable and/ or difficult to imitate.

8.7 LESSON END ACTIVITY

Compile a study note on the use of A. D. Little’s Life Cycle Approach to strategic planning in strategy evaluation and selection of the product’s life cycle and its market position.

8.8 KEYWORDS

Consortia: Consortia is when a group of companies that form a joint entity for a specific purpose, when the project is finished, the consortium breaks up.

Franchising: Franchising is another form of contractual arrangement wherein the franchisee pays the franchiser a fee for services and royalties, typically for use of the company name, business approaches, and advertising.

Joint Venture: A Joint Venture is when two or more organizations form a separate legal undertaking, which is an independent organization for strategic purposes. The partnership is usually focused on a specific market objective, with a given timeframe and often involves a cross-border relationship.

Licensing: Licensing is an arrangement between two or more organizations that enter a legal contract for a specific business purpose. It is generally a technology transfer transaction and the intellectual property rights for the invention are retained by the licensee. Such contracts normally have a defined duration.

Strategic Alliance: Strategic Alliance is an intention to cooperate at a strategic level, to share information, and to work together in a way that goes beyond a clear contractual arrangement.

Body Shopping: "Body Shopping" is a system whereby the firm buys the services of trained personnel from another organization for limited period of time, based either on specific project requirements or on a 'time' basis.

Multi-domestic Organization: A Multi-domestic Organization decentralizes operational decisions and activities to each country in which it is operating and tailors its products and services to each market.

Global Organization: Global Organizations offer standardized products and use integrated operations for their offerings in different parts of the world.

Transnational Organization: Transnational Organization is a combination of both the multi-domestic and global strategies whereby an organization globally integrates operations while tailoring products and services to the local market.

Worldwide Sourcing: "Worldwide sourcing" is a system used by multinational companies of integrating the supply chain by operating supplier's plants abroad and integrating those plants to manufacture components as subdivisions of a globally organized production process.

Spin-off: A Spin-off is when an organization sets up a business unit as a separate business through a distribution of stock or a cash deal. Spin offs are another expression of withdrawal strategy.

Divestment: A Divestment is a sale of healthy firms that don't "fit" the organization's strategic plan or those businesses that the organization cannot operate effectively.

Stability Strategies: Stability Strategies are characterized by an absence of significant changes.

Stable Growth: This is the generic form. It simply means that the organization's strategy includes no bold initiatives. It will just seek to do what it already does a bit better.

Profit Strategy: A profit strategy is one that capitalizes on a situation in which a long-time trend or type of product is being replaced by a new one.

8.9 QUESTIONS FOR DISCUSSION

1. Describe the relationship between the stage of product's life and its market position.
   or
   Comment on Life Cycle-Portfolio matrix.
2. How does the programming of strategic funds is useful in meeting the goals and objectives of organisational units?
3. Portfolio balancing provide a framework for reviewing the performance of multiple Strategic Business Units (SBUs) collectively. Comment.
4. The Programming of Strategic funds identifies feasible options under different physical assumptions. Discuss.

Check Your Progress: Model Answers

CYP 1

The position of the product within the life cycle is normally determined by eight external factors; market growth rate; growth potential; breadth of product lines; number of competitors; spread of market share between these competitors; customer loyalty, entry barriers and technology.

CYP 2

1. True
2. True
3. False
4. True
5. True

8.10 SUGGESTED READINGS

Pearce & Robinson, *Strategic Management*, All Indian Travellers N.D.

A.C. Hax and NS., *Strategic Management: An Integrative Perspective*, Majifu, Prentice Hall.

Micheal Porter, *Competitive Strategies*.

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Georgy G. Dess and Alex Miller, *Strategic Management*, McGraw Hill.

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Jaunch L Rajive Gupta & William F Glueck, *Business Policy and Strategic Management*, Frank Bros & Co, 2003

Fred R. David, *Strategic Management: Concept and Cases*, Pearson, 2003.

UNIT V

LESSON

9

STRATEGY IMPLEMENTATION

CONTENTS

9.0 Aims and Objectives

9.1 Introduction

9.2 Various Approaches to Implementation of Strategy

  9.2.1 Factors Affecting Organizational Design

  9.2.2 Organizational Culture

  9.2.3 Characterizing an Organization's Culture

9.3 Matching Organization Structure with Strategy

9.4 7S Model

9.5 Let us Sum up

9.6 Lesson End Activity

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9.8 Questions for Discussion

9.9 Suggested Readings

9.0 AIMS AND OBJECTIVES

After studying this lesson, you will be able to:

- Understand various approaches to implementation of strategy
- Learn how to match organisation structure with strategy
- Know about the use and importance of 7S model

9.1 INTRODUCTION

Prahalad and Hamel related strategy to the internal world of a company. Strategy, according to them, consisted of all the resources and competencies of the organization, and how they were leveraged. Porter, on the other hand, believed strategy focused on the external world of industry structure and the strategy of competitors. However, a rational view—taking into consideration both these approaches to strategy—is that strategy is a dynamic and evolutionary process of finding external opportunities into which the competencies can be meshed to provide competitive advantage.

Strategy is based on three iterative processes. The first process is to continuously look for growth by identifying new market opportunities into which the company's existing resources and competencies can be exploited. This concept is based on the classic economic model that Porter postulated. C. K. Prahalad and Gary Hamel together, provide the rationale for the second iterative process. They explained that an organization has to face a different type of competition: the competition for resources and capabilities. The second process, then, is to continuously improve on the strategic architecture, both by strengthening existing competencies and also by developing or acquiring new ones. What drives these two processes is the third process. This is to create a sense of purpose that energizes the whole strategic process.

These two views are connected through the strategy implementation process. Even though strategy may be about deciding what to do based on competitive considerations, implementation is about getting it done through the use of resources and competencies. In order to have a competitive edge over its rivals, an organization with a superior strategy needs a superior ability to execute strategy. The superiority comes from its portfolio of resources and competencies. The superiority can be maintained by continuously improving on the strategic architecture, both by strengthening existing competencies and also by developing or acquiring new ones.

Conventional management models also view implementation of strategy as being as important as the strategy itself, but they see the relationship between structure and strategy in a different way. They view strategy formulation as a top management function and the rest of the organization as a means to implement the strategy. Therefore, for the proper implementation of strategy, it has to be translated such that it is accepted and adopted by the rest of this organization. This requires the capacity to design good working environments, working environments that motivate and effectively coordinate the activities of the people working in the organization.

To a large extent, this is determined by its organizational architecture and structure. An appropriate organizational structure is crucial for success. It helps develop the capacity to implement strategy effectively. The structural components are a means to facilitate the smooth translation of organizational strategy and policies to action that motivate and coordinate the activities of the people working in the organization. A lack of motivation or coordination (or both), can cause the organization to lose its competitive advantage.

9.2 VARIOUS APPROACHES TO IMPLEMENTATION OF STRATEGY

Strategic control approach is based on improving the competitive capacity of the organization by providing a high level of autonomy to the operating units. It is basically a hands-off organizational strategy with control systems to monitor and evaluate the performance of the business unit. The objective is to control efficiency, quality, innovation, and responsiveness to customers. Therefore, it looks at the strategic plan from a perspective that lies between the two extremes - the strategic planning approach and the financial control approach and creates an appropriate structure. Strategic control approach, therefore, is not a single stereotype architecture, but a set of organizational structures that bridges the space between strategic planning and financial control.

Unlike the system used in Strategic Planning architectures, which focused on the consequences of the increasing size of the organization, goals are set in a participatory manner based on a belief that the unit has a better knowledge of the requirements of the customers and the efficiency, quality and innovation required to meet the objectives of

the corporate centre. The graphical representation of the Strategic Control Approach is shown in Figure 9.1.

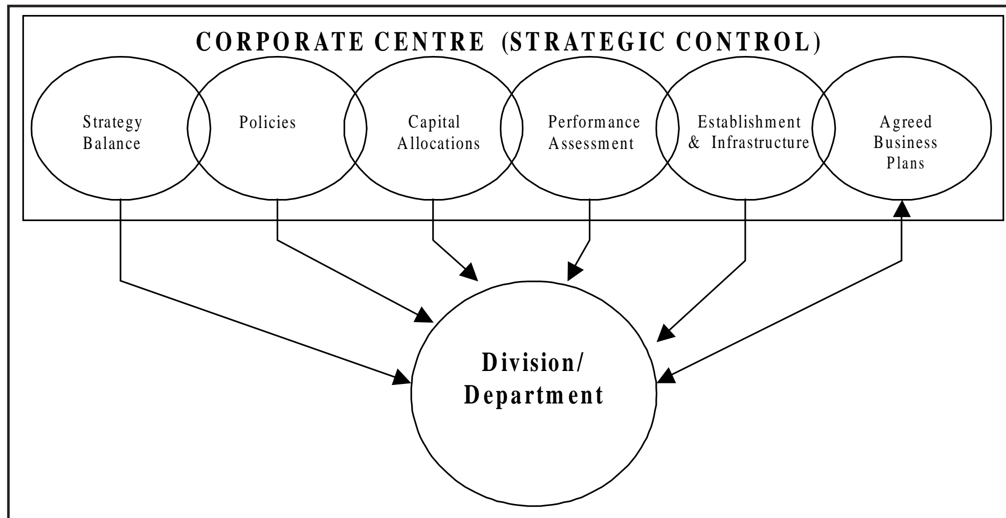

Figure 9.1: Strategic Control Approach

The corporate centre is not concerned with developing strategy through structuring the tasks of its various departments or divisions. It is concerned with shaping the behaviour in departments and divisions. And it is concerned with the context within which others are operating. Generally, business plans are produced by divisions - but within central guidelines based on the use of long-term and strategically relevant criteria to set up the strategic plan.

There can be many different types of strategic controls. However, the controls that are commonly used in the preparation of the strategic plan are financial controls, output controls and behaviour controls. Behaviour control is exercised by monitoring and evaluation systems. Operationally this is affected through operating budgets and standardization of inputs, e.g., policies on employment, market coverage, etc.; conversion activities of inputs, throughputs and outputs; the reward structure, e.g., Commission Systems, Bonus Plans, etc. Financial control is exercised through defining and agreeing to specific financial parameters and laying down targets for a number of measurable financial quantities, e.g., stock market price, return on investment, market share and cash flow, etc. Output control is exercised by agreeing upon on targets for the divisional and functional goals. Table 9.1 shows the summary of some of the possible control systems.

Table 9.1: Types of Strategic Controls

Financial Control	Output Control	Behaviour Control
Stock Prices	Divisional Goals	Budgets
ROI	Functional Goals	Standardization Rules & Procedures

On the one hand, the philosophy of conventional organizations that focus of organizational design is based on 'flexibility' so that the changing environmental forces are exploited effectively. On the other hand, what is being promoted as a philosophy by new economy companies is that design of the organization could itself be used as the strategy.

The emergence of new economy companies in the 1990s revived interest in the use of structure as strategy. Perhaps, in a sense, this represents a revival of the use of strategy by Indian companies to gain competitive advantage. However, the framework was

different. The new economy companies were led by a group of corporations, primarily in the information technology businesses. These organizations were enabled by technology and its concomitant focus on reduction in prices and their aspirations were compelled by the expectations of pioneering trends. They have now become the drivers of the markets and the investment community in the new millennium.

The philosophy of the new technology companies has resulted in the development of new organization forms where structure is seen as strategy. Their strategic framework is different; these businesses have flat matrix-like structures and avoid vertical integration and diversification. The organizations are tiered vertically, e.g., from components to subassemblies to systems. For example, Apple's open architecture sharply reduced interaction costs in the computer industry. By conforming to a set of well-documented standards, specialized companies could, for the first time, work together easily to produce complementary products and services. As a result, tightly coordinated webs of companies-such as Adobe Systems, Apple, Intel, Microsoft, Novell, and Sun Microsystems-could form and ultimately compete effectively against the entrenched, vertically integrated giants.

This has empowered component developers to bring out radically new devices with the assurance that the 'system' will adopt superior new components without hesitation. This has permitted a free flow of the latest technologies from components to subassemblies to systems, and so on. Intel invests more than $100 million each year to help other companies develop software and hardware that use Intel technology. It supports advances across the entire computer, communications and media sector, while assuring the need for its own microprocessors.

With the success of these new forms of organizational structures, new approaches to organizational design have gained acceptance, e.g., the 'virtual structure' and 'opportunity based designs'.

'Virtual Organization'

The 'virtual organization' is described as one which will appear almost edgeless, with permeable and continuously changing interfaces between company, supplier, and customer; ... operating divisions [will be] constantly reforming according to need [and] job responsibilities will regularly shift, as will lines of authority. Even the very definition of employee will change, as some customers and suppliers begin to spend more time in the company than will some of the firm's own workers. (Davidow and Malone, 1992: 5-6). One of the Canada's best performing natural resources companies created a unique organizational structure that combines the advantages of small business units with Virtual Structures - groupings of these business units - that can address different strategic issues and competitive environments. It created over 100 business units. Based on the requirement, it subdivided the units on the basis of:

- Business Units serving a common customer group,
- Business Units located in a common geography
- Business Units served by a common supplier group, and
- Business Units in a similar phase of development.

Each of the 100-plus business units represents a small team with accountability for strategy, resources and performance. According to the authors, "This enables the CEO and his team to push accountability for value as close as possible to the 'coal face', where value is actually created or destroyed."

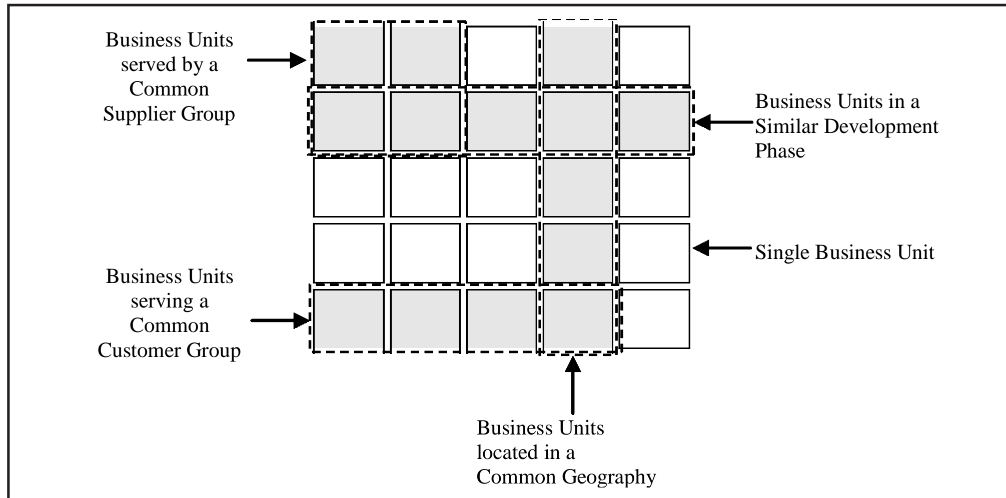

Figure 9.2: 'Virtual' Organizational Structure

Virtual structure is a grouping of business units that can address different strategic issues and competitive environments. It is a unique organizational structure and form of business organization that is emerging. The benefit of these virtual business units is their ability to tackle corporate strategic issues that the operational business units cannot address on their own without creating new layers of bureaucracy that too often become permanent.

Moreover, because they are "virtual", these larger groupings of business units can be "organized" in many different ways to meet the company's priorities, even as they evolve over time. This gives the company enormous capacity to organize and reorganize in response to an ever-moving agenda and competitive environment. In some ways, the Virtual Structure resembles the horizontal structure we had discussed earlier.

Table 9.2: Contrasts between modern and virtual organizations

Modern organization	Virtual organization
1. Function in design structure	1. De-functionalized project-based design held together by network capabilities
2. Hierarchy governing formal communication flows and managerial imperative – the major form and basis of formal communication.	2. Instantaneous, remote computer communication for primary interaction; increase in face-to-face informal interaction; decrease in imperative actions and increased governance through accountability in terms of parameters rather than instruction or rules.
3. The files	3. Flexible electronic immediacy through IT.
4. Impersonal roles	4. Networking of people from different organizations such that their sense of formal organizational roles blurs.
5. Specialized technical training for specific careers	5. Global, cross-organizational computer-mediated projects.

In a conventional business organization the mission statements and competitive strategy making, reflected in the business objectives, flow naturally from the vision statement. This is not so in the new organizational architecture. The single-minded emphasis on focus means that corporate culture, corporate missions and corporate objectives are determined at the unit level and requires a hands-off policy from the corporate centre.

The organization design is based on the technological capacities of digitalization amongst other things. Digitalization is just one part of the tendencies towards 'virtuality'. The enabling mechanism of the 'virtual organization' allows time and space to be collapsed, and the informational controls of conventional bureaucracies superseded. This is reflected in Table 9.2.

These new organizational structures are based on being able to pick points of leverage carefully. The relationship among the business units is inconsistent and asymmetric. The asymmetrical structure of these organizations runs counter to traditional notions of balance, equity, and fairness. There are flexible relationships among its business units. R&D, for example, could be managed centrally for two businesses, but not a third. Or the corporate centre might play a role in managing certain processes in one business unit but it may not do so in another. The logic is that just like there are differences between a mature business and a start-up there are differences between units and these need to be recognized. The organization has to avoid imposing standardized rules and procedures that ignore the unique requirements of each business unit. Therefore, it has many of the advantages of small business units.

The organizational architecture of this type of organization is based on conflict. The conflict is encouraged to help incubate new ideas and foster innovation; very often, conflict within the organization is essential - and inevitable. Though the advantages of this structure outweigh its disadvantages, managing this type of organization is challenging. The conflict has to be managed so that it does not become self destructive. Management has to create a relationship between the corporate centre and the unit in a manner such that the strategic choices are integrated to the vision of the larger organization.

Opportunity based Designs

Some companies, rather than viewing the corporation as a portfolio of business units, regard it as a portfolio of resources and of opportunities to create value. This opportunity-based design perspective gives these companies the flexibility to bring the most useful resources to bear on the most promising opportunities. For example, in 1994 the government of Norway floated a scheme for Oslo's new airport. ABB is an engineering company with a decentralized structure. ABB's country manager immediately appointed an airport project leader, who persuaded ABB's businesses in the country to work under his guidance. These businesses, with their networks, offered the complete set of resources needed for the project. Because the project leader-the "opportunity owner"-was empowered to coordinate these resources, and because the heads of ABB business units and functions-the "resource owners"-were willing to dedicate them to an opportunity that others had identified, ABB won 70 airport contracts, with a total worth of more than $300 million.

In opportunity-based designs, owners of opportunities and resources typically exist within or alongside the business-unit structure. The organization must therefore be managed on two levels. Its foundation is a host of stable business units that conduct the company's day-to-day work, such as creating and marketing individual products. On top of that lie a number of fluid "opportunity units" that pull together elements of different businesses in order to tackle particular projects. The resulting organization is more complex and poses new managerial challenges. Opportunity-based design helps established companies emulate the market responsiveness of start-ups without sacrificing the advantages of scale and scope.

This opportunity-based structure has tricky implications for an organization and for human resources in particular. In a traditional line organization, everything is connected directly to the formal structure: careers, accountability, and decision-making processes. But all that changes when people begin to think of themselves as entrepreneurial resources that can be applied to a range of opportunities. In this case, employees need to juggle independent assignments, to build careers that move outward as well as upward.

9.2.1 Factors Affecting Organizational Design

Today's modern business practices demand leveraged operations, technology, and knowledge throughout the enterprise, using a multiplicity of corporate structures for competitive advantage. The task of organization is particularly challenging because most large companies are active not in one line of business but in several, and even a company that makes a single product will probably wish to excel in a number of dimensions.

An organization with a focused approach normally employs a multi-divisional structure. Many companies in India use this model. For example, Tata Motors was organized into three major manufacturing divisions at Jamshedpur: the Automotive Division, the Excavator Division and the General Engineering Division. Escorts Ltd. was organized into the Tractor Division, the Motorcycle Division, the Agency Sales Division, the Automotive Division, and the Farm Equipment Division, etc.

When operations are related to a limited set of businesses, corporate management is likely to perform better in forming the strategic direction of the different units. Highly diversified organizations do well when the corporate management follows a 'hands off' relationship with the different units. The greater the diversity among the businesses in multi business firms, the greater is the necessary degree of decentralization and self containment.

The complex challenges have pioneered a range of novel hybrid organizational designs. An industrial company might, for example, have manufacturing units that are organized geographically by product, as well as customer-oriented business units dealing with sales and services that are organized by the industries they serve. These hybrids require complex coordination, promoted by advanced information technology and by corporate cultures that foster cooperation.

Different strategies require different types of organizational structures to deliver results. The structure of the organization must support the organization's competitive approach. For example, if the organization uses a low-cost leadership strategy, the organization has to be designed for efficiency whereas if the organization uses the differentiation strategy, the design calls for a learning structure with strong horizontal coordination. Therefore, organizational structure and design are vital in context of the strategic management of organizations.

Even two organizations, competing in the same industry with a similar set of products, technologies, and markets, may find that a structure that works for one organization may need some modification in another; the issue depends on several factors such as environment, strategy and goals, culture, technology, and size.

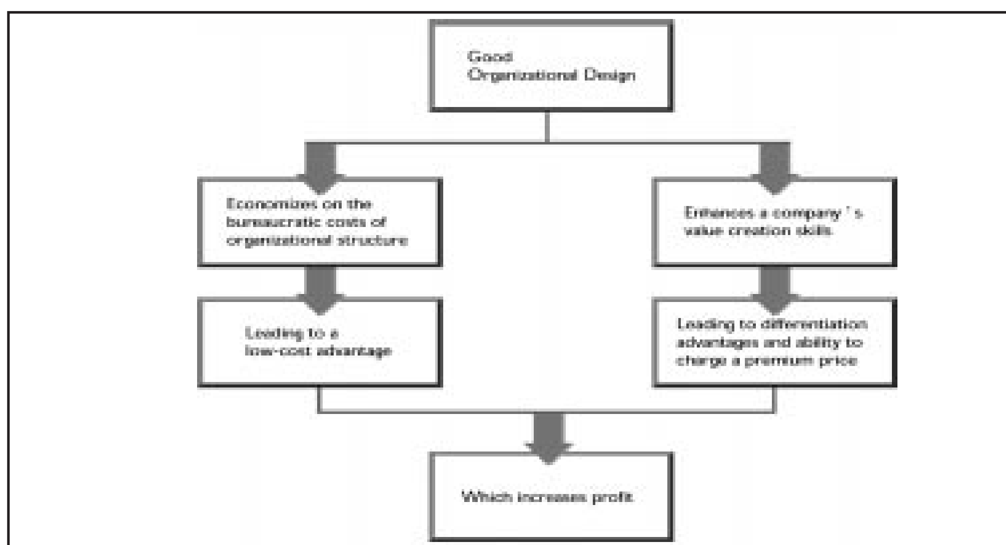

Figure 9.3: Structure and Strategy

The schematic relationship between structure and how the organization benefits from good organizational design is shown in Figure 9.3. The structural components of an organization facilitate the smooth translation of organizational strategy and policies into action. They distribute authority and accountability; establish systems of control and inspection. Properly designed, the organizational structure encourages desired behaviour. Above all, it infuses the corporation's work with meaning, for the people working in the organization. It also supports the organization's competitive approach. Therefore, a strategy-structure fit is one of the necessary requirements for competitive advantage.

Good organizational design can lead to optimizing the bureaucratic costs which results in a low cost advantage, providing increased profits. In addition, enhancing the value creation skills of the organization leads to differentiation advantages and the ability to charge a premium price, thereby impacting the bottom line. In order to maximize the benefits to the organization, it is necessary and important that the structure of the organization should align itself and focus on furthering organizational objectives. There should be benchmarks by which an organization can determine whether or not it is benefiting from the way the organizational structure is designed.

The main factors that need to be considered in deciding on the design of the organization are how to group tasks, functions, and divisions; how to allocate authority and responsibility; should it be a tall or flat organization; how to ensure a minimum chain of command; should there be centralization or decentralization? In addition, the important requirements for organizational alignment are that the design should incorporate integration and integrating mechanisms; it should define degrees of direct contact, liaison roles and the function and structure of specialized teams.

One or more of the following symptoms of structural deficiency may appear as an indication of the structure being out of alignment:

- Decision making is delayed or lacking in quality.
- The organization does not respond innovatively to a changing environment.
- Too much conflict from departments being at cross purposes is evident.

In case it becomes apparent from its symptoms that there is a lack of alignment or such a danger is imminent, an analysis of the structure is necessary. Analysis involves the examination of the various factors that may influence the structure of the organization. Some factors that have an influence on structure are discussed below.

Size on Structure

There is considerable evidence that an organization's size is a significant influence on structure. It has been seen that as the size of the organization increases, the number of hierarchical levels also goes up. This is shown in Figure 9.4.

The larger the size of the organization, the greater is the specialization and horizontal differentiation. In order to facilitate coordination, there is a corresponding increase in vertical differentiation. The increase in complexity makes it more difficult for top management to directly oversee what is going on throughout the organization. Direct control and communication, therefore, is replaced by formalized rules and regulations. This increases the distance between the top management and the operating level and often results in the inability of the organization to make rapid and informative decisions.

This type of problem creates the need to redesign the organization such that decision making becomes more decentralized. The result is a new organizational framework.

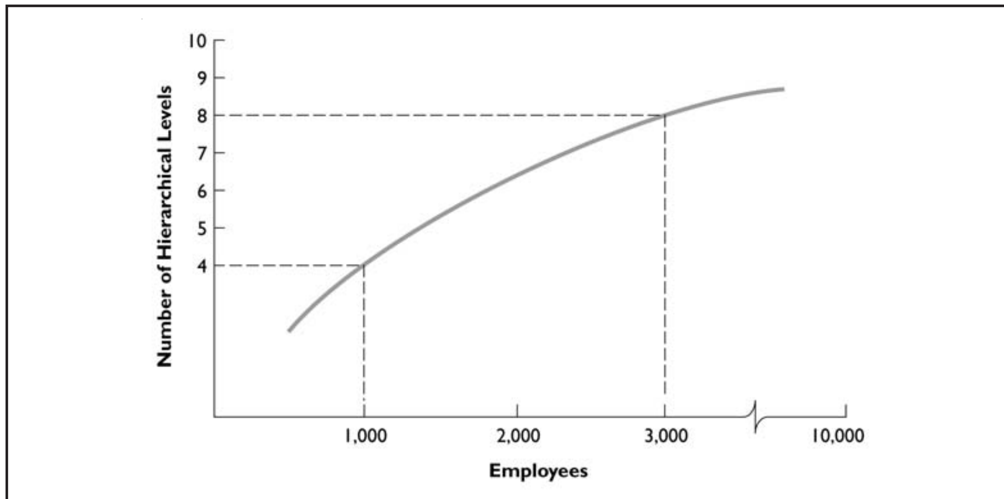

Figure 9.4: Number of Levels

Information-Processing Perspective on Structure

Through most of the 20th century, the hierarchical, functional structure predominated. But in recent years, organizations have developed other structural designs, often aimed at increasing horizontal communication. Vertical linkages are designed primarily for control, in contrast to horizontal linkages that are designed for coordination and collaboration; all organizations need a mix. Figure 9.5 shows the relationship between the organizational structure and the capability of information processing.

Vertical Information Linkages: The lines of the organization chart act both up and down the chain as the communication channel. Vertical linkages emphasize on efficiency and control. For repetitious problems and decisions, rules or procedures are established so employees know how to respond without communicating on each separate issue. For example, the strategy for budgetary control is through an increase in vertical information capacity in the form of periodic reports, written information and computer-based communications distributed to managers.

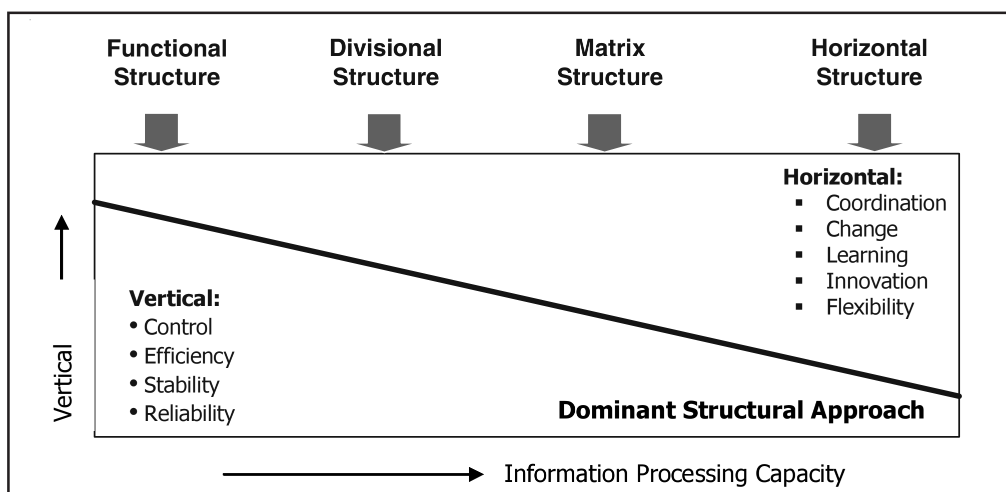

Figure 9.5: Effect of Structure on Information Processing

Horizontal Information Linkages: Horizontal linkages emphasize on learning. Many organizations require a considerable amount of information flow. Structure that is flat is more responsive to flow of information. Organizations that require large amounts of information flow are normally designed with flatter organizational structure.

A functional structure will have the maximum number of vertical linkages and the minimum amount of information processing capability. Such organizations are typified with values that promote control, efficiency, stability and reliability. The least number of vertical linkages are found in a horizontal structure and it has the maximum information processing capability. These organizations value coordination, change, learning, innovation and flexibility. The other organizational structures fall in between these two. The structure must fit information requirements of the organization so people have neither too little information nor too much irrelevant information.

Where flatter organizational structures are not possible, cross-functional information systems can be used. These enable employees to routinely exchange information. Alternatively, a liaison role can be used. This involves identifying a person in one department who has the responsibility for communicating and achieving coordination with another department.

Where the problem is more acute, task forces or temporary committees composed of representatives from each department which links several departments are used to solve common problems. The task force is disbanded after tasks are accomplished.

Box 9.1: Vertical and Horizontal Linkages

Vertical linkages - emphasis on efficiency and control	Specialized tasks, hierarchy of authority, rules and regulations, formal reporting systems, few teams or task forces, centralized decision making
Horizontal linkages - emphasis on learning	Shared tasks, relaxed hierarchy and few rules, face-to-face communication, many teams and task forces, informal / decentralized decision making

Box 9.1 summarizes the emphasis that different types of linkage mechanisms provide. Depending upon the nature of the business and the core capabilities required for the functions of the organization, the linkages need to be selected.

External Environment on Structure

The external environment influences 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. If the structure fits the type of environment that it faces, the organization will be more successful.

Often, different departments and divisions of the organization may have to respond to different environments. The structure of these sub-units should be designed taking this into consideration. For example, many medium sized organizations in India prefer to set up small legally independent units rather than consolidate their operations due to the legal protection provided to workers and to avoid union formation.

People on Structure

To be effective, the basic structure is governed by a set of rules and regulations, reward-punishment systems, information networks, control procedures, etc. These apply to the people who are a part of the organization. The result is the organization attracts and retains those whose attitudes, aspirations, experiences and roles as organization members are related to and reflected in the structure of the organization.

Depending on the nature of the work, it is necessary to design the organization for excellence in performance. Organizations should accommodate the psychological needs

of employees adequately. Choosing the right structure for the type of people the organization requires, therefore, assumes importance. For example, an organization in the knowledge industry will require a structure that is different from that of a manufacturing organization. An international organization's requirements of its people and organizational structure may differ significantly from that of a local organization.

New Developments

Changes in the nature of business, social structures and technology are bringing in new aspects into organizational design. The new forms of organizations will perhaps be intelligent organizations. What characterizes 'intelligent organization'? Until quite recently, if we wanted to answer this question we would have looked for it in the automobile industry, such as Toyota. Until very recently the 'lean production' associated with Toyota would have been seen as the very model of ultra-modern and intelligent management, where cross functional teams are used to improve operations and increase productivity.

The use of cross-functional teams to improve operations and increase productivity is not new. In the USA, as long ago as the 1930s Mogenson's 'work simplification' process utilized problem-solving teams, and the 'Scanlon Plan' involved the establishment of 'productivity committees' to explore ways of improving productivity. The engineering concept of 'Group Technology' (GT) aims to exploit product and process similarities in order to achieve smoother production flows in job-shops producing batches of parts or products. The origins of GT have been traced back to the concept of 'group production' ('Gruppenfabrikation') which was introduced during the early 1920s in Germany. This was an attempt to re-integrate through the production of whole families of parts or products by teams of workers conducting complete work sequences.

Cellular Manufacturing

Cellular manufacturing is an application of group technology where a portion of a firm's manufacturing system has been converted to cells. A manufacturing cell is a cluster of dissimilar machines or processes located in close proximity and dedicated to the manufacture of a family of parts that are similar in their processing requirements.

Toyota's 'lean production' system is a part of the generic system of 'Cellular Manufacturing'. The 'Toyota Production System' also called as 'lean production', has been heralded by many commentators as the future for competitive manufacturing. It is a team concept and incorporates a philosophy of constantly reducing production costs through the progressive elimination of waste. This waste is seen everywhere in the manufacturing operation, and includes excessive work or 'over-production'. This has given rise to the Just-in time system (JIT). JIT is a simple principle that includes 'produce and deliver finished goods just-in-time to be sold, sub-assemblies just-in-time to be assembled into finished goods… and purchased materials just-in-time to be transformed into finished parts'

In Japanese management practice, the team concept is mainly associated with kaizen or continuous improvement, the constant drive to remove waste from the production process. Central to this are suggestion schemes which capture the skillful, creative thinking or inventive ideas, from workers, either as individuals or through the team-based activities of quality circles. The Japanese have developed it to a fine art.

Tomorrow's Factors of Design

Yesterday's organizations were modelled on the automobile industry as a standard. The standard was lean production and flexible manufacturing systems, where small batches can be rapidly set-up, produced, and equipment rapidly reconfigured to start-up

manufacturing another set of small batches. Today, as the automobile age is overtaken by the software age, we have to look instead at firms like Microsoft and Intel to project what these developments might be. What would the 'best practice' prepare us to see?

We would expect to see organizations that are:

1. Customer driven for service. Customers, both internal and external, will be sovereign.
2. De-structuring units through distributed and networked technology.
3. Where quality is evolving as the crucial leadership factor.
4. Where the drive to quality will be the accountable basis for everyone's work.
5. Linking rewards to quality to ensure its continual support.
6. Characterized by reduced cycle time. 'Do it better, do it faster' is the maxim.
7. Focused on prevention not detention: try to make it right the first time.
8. Practicing management by analysis and push management to imaginative analytic techniques.
9. Long-term in outlook. How will they do what they will do, better, in the foreseeable future?
10. Practicing partnership development. The quality of the business will reside in the quality of its long-term partnering networks with other firms and customers.
11. An example of civic responsibility. The organization will be a corporate citizen and will abide by good citizenship rules.

In addition, there will be a 'specialization' aspect of the niche or specialist market and marketing, as opposed to mass markets. Organization will be designed to move on 'push' and will be designed to respond effectively to it.

Development in tomorrow's organizations will also consider the 'flexible' aspect to the restructuring of the labour market and the labour process. Flexible specialization based on Information Technology (IT) will the hallmark of new organizational structures that will evolve from this philosophy.

New structures will be based on the tacit learning and embedded skill of the work forces with the objective of making them portable. As it becomes increasingly possible to embed learning and skills and make them portable, the innovations of the cleverest countries will rapidly be standardized, modified and abstracted into organizational processes in the least clever of countries. Here, workers with lower standards of schooling and education can be organizationally tooled-up to match the competencies of more creative employees in the cleverest of countries.

9.2.2 Organizational Culture

According to Mintzberg, one of the basic building blocks of organizational design is the ideology or culture of the organization. This consists of the values, beliefs, and taken for granted assumptions. It is essential to study the culture of the organization in order to design an organizational structure that functions properly.

The strategic decision is taken by the Governing Board. The strategy decided upon has then to be implemented by the functionaries of the organization. Management cannot be conceived of just in terms of the manipulation of techniques or tools of analysis; it is also about the application of experience built up over years, often within the same organization

or industry. This is rooted not only in individual experience, but also in group and organizational experience accumulated over time. There are fundamental constraints to the implementation of different strategy and policy options. These influences need to be understood when deciding on strategy. Ethics, social factors and cultural factors will influence the way in which the organization works and the priorities which actually emerge in practice.

Historically, emphasis has been placed on administrative controls as ways of delivering the co-ordination needed to implement successful strategies. In reality, the performance of an organization is also determined by the 'softer' controls within organizations - the social controls and self-controls. It is important that social controls are working well in organizations with highly devolved structures, since they can be the primary mechanism for co-ordination in the organization. Organizations often commit significant resources to maintaining professional social networks, both inside and between organizations, as a method of keeping in touch with best practice.

There are many frames of reference which exist at the organizational level and can be especially important as an influence on the development of organizational strategy. The social and cultural influences that impact the organization can be based on many different influences. These can be segregated into two groups, external and internal. The combination of these two has its impact on the individual. The external influences are the national or regional, professional/ institutional, and industry influences; and the internal influences are those of the organization and the functional/ divisional influences. The frames of reference are shown in Figure 9.6. Different group categories have been shaded differently in the figure.

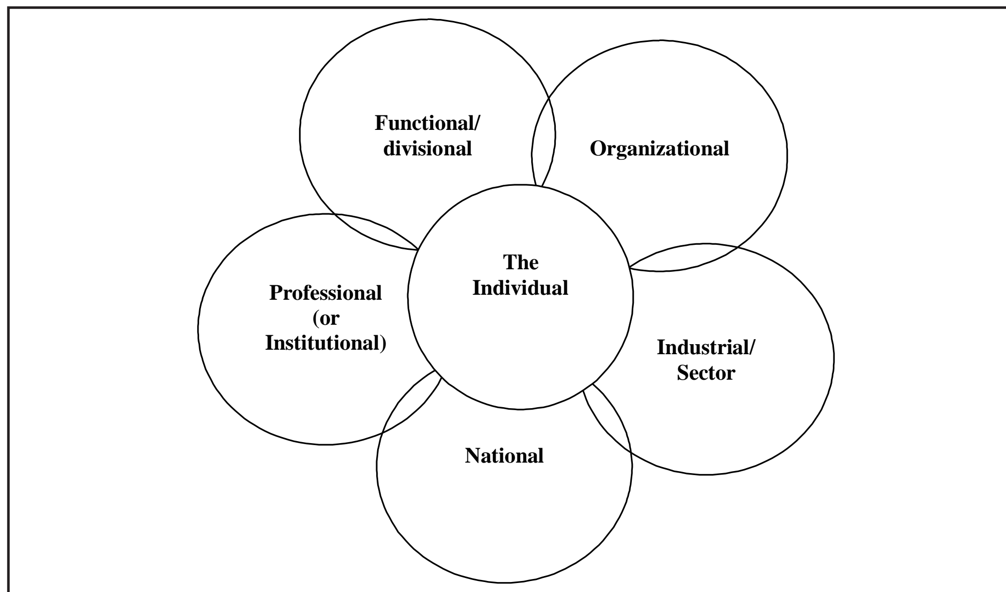

Figure 9.6: Frames of reference

1. ***External Cultural and Social Influences:*** Strategy has to do with people and the culture in which the people interact. An understanding of organizational culture is necessary to identify the capacity of an organization to implement change. Organizational culture is the reflection of the basic assumptions and beliefs that are shared by members of an organization. They operate unconsciously and define an organization's view of itself and its environment. Faced with similar environments, different organizations respond differently. Strategic logic needs to recognize the complex role which people and institutions play in the evolution of strategy.

2. ***National/ Regional:*** There are significant differences in the corporate governance frameworks between countries, and the ethical stance and corporate social responsibility agenda. But the cultural context also influences the expectations of stakeholders directly. For example, attitudes to some aspects of employment, supplier relationships and, certainly, consumer preferences would differ significantly at the national and regional levels.

   It is important to understand these influences for two reasons. First, values of society change and adjust over time, and therefore strategies which were acceptable and successful earlier ago may not be so today. Second, companies which operate internationally have to cope with the very different standards and expectations of the various countries in which they operate:

   (a) *Professional/institutional:* Many individuals are members of a professional or institutional group whose values and beliefs are a powerful influence on that individual's expectations of the organization and its purposes, e.g., membership of a trade union or professional association. They may also be more informal and unrelated, but still very influential. For example, many organizations are promoting their trade union activists to supervisory roles where they are not protected by trade union legislation.

   An important trend in the 'post-industrial' economies has been the growing importance of professional groups. As the number of 'knowledge workers' increases, the organization will require to adjust to the key differences in expectations, purpose, resource allocation, ethical stance and priorities in the design of the organizational structure.

   (b) *Industry:* There tends to develop a common view about organizational purposes and how to develop and manage organizations within an industry. It often proves difficult for individual firms to step out of line from this industry recipe. For example, a number of public sector managers who found themselves working in private companies during the recent privatization drive of the Government of India, experienced difficulties in adjusting their management style to the different tradition and expectations of their new organization management.

   Sometimes there is an advantage to such cultural influences, in terms of maintaining standards and consistency in the industry. However, the danger is that managers may not look beyond their industry in thinking through strategies for the future. They become victims of industry 'groupthink' and fail to see the lessons which can be learnt from outside their own industry.

3. ***Internal Cultural & Social Influences:*** Strategies do not deliver full benefit unless explicit attention is given to understanding the motivations and developing relationships with the people involved. Strategy is also about the purposes of the organization and what the people in it want the organization to be like. This brings out the strong relationship between culture and an organization's strategies. In understanding the influence of culture on organizational purposes, it is important to be able to characterize culture. The statements of values and beliefs are often statements of aspiration or strategic intent of a particular stakeholder rather than accurate descriptions of the culture as it exists in the minds and hearts of people within and around the organization.

In seeking to describe, analyze and understand the relationship between culture and an organization's strategies, it is not usually possible to characterize the whole organization as one particular type of culture. There are usually important subcultures within organizations. The organizational culture and the subcultures are discussed in the paragraphs that follow:

(a) *Organization:* The culture of an organization has been considered to consist of three layers: values about the organization's mission, objectives or strategies; beliefs which people in the organization talk about; taken-for-granted assumptions or the organizational paradigm.

The paradigm includes the sort of assumptions which are rarely talked about, which are not considered problematic, and about which managers are unlikely to be explicit. It is likely to evolve gradually rather than change rapidly. For an organization to operate effectively there has to be such a generally accepted set of assumptions; in effect, it represents collective experience without which people would have to 'reinvent their world' for different circumstances that they face. The public statements of the organization's values, beliefs and purposes are not descriptions of the organizational paradigm. They are likely to partially reflect the real organizational culture.

This 'real' culture is evidenced by the way the organization actually operates. Matching strategic positioning and organizational culture is a critical feature of successful organizations. For example, there is a common belief that the culture in a Birla Organization is different from that in a Tata Organization. Their collective behaviour often is determined by paradigms which are created by the culture of the organization.

(b) *Functional/divisional:* It is not usually possible to characterize the whole organization as one particular type of culture. There are usually important subcultures within organizations. These subcultures may relate directly to the structure of the organization. For example, the differences between functional groups such as finance, marketing and operations. In a divisional structure, different divisions may be positioned in different ways and pursue different generic strategies. The different positions foster different cultures.

9.2.3 Characterizing an Organization's Culture

There is a relationship between the paradigm and organizational strategy. It is the people within the organization who create strategy. The forces at work in the environment, and the organization's capabilities in coping with these, can be understood by charting the individual experience of managers and the collective assumptions within the paradigm. For example, many consumer goods companies in the USA which were very powerful in the 1970s lost significant market share as they failed to recognize the impact of the increasing buying power of the retail outlets. They believed they had direct influence over consumer buying behaviour and the retailer was seen just as a distributor. Many consumer goods companies continued to be driven by their long established paradigms, failing to accept that the retailers had the same major strategic importance as customers in their own right. These companies lost market share and profits, and some were eventually taken over.

There is not a 'best' and 'worst' culture. The issue is how well the culture matches and supports the strategy of the organization. This becomes important as there is evidence that organizational cultures are not easy to change, and therefore they can impair or assist in the development of organizational strategies.

An organization with a relatively stable management, and a long-term momentum of strategy, is likely to have a more homogeneous paradigm than one in which there has been rapid turnover of management. A cohesive corporate culture can sometimes find itself bound by established routines; by the powerful 'tribal' symbols and stories which encourage a commitment to the strategies which the organization has pursued historically. In these types of organizations there is little tolerance of questioning and challenge.

It is important that the organization must develop a degree of coherence in its culture to be able to function effectively. The situation is healthy when there is constructive friction-where a strong corporate culture is maintained, but where the core beliefs and assumptions are continuously subjected to critique from within the organization. Challenge and debate, although not comfortable, are regarded as legitimate and signs of strength.

Miles and Snow categorized organizations as ‘defender’, ‘prospector’ and ‘analyzer’ organizations in terms of how they behave strategically. Defender cultures find change threatening and tend to favour strategies which provide continuity and security. Therefore, it is supported by a bureaucratic approach to management. The analyzer culture matches the new ventures to the shape of the existing business and favours growth through market penetration, exploitation of applied research and is generally a follower in the market. In contrast, a prospector culture flourishes on change. It favours strategies of product and/or market development supported by a more creative and flexible management style. A summary of their findings is given as Table 9.3.

Table 9.3: Characterizing Culture

Organization Type	**Characteristics of Strategic Decision making**		
	Dominant Objectives	**Proffered Strategies**	**Planning & Control Systems**
Defender	Desire for a secure and stable niche in the market	Specialization; cost efficient production; emphasis on price and service to defend current business; tendency to vertical integration	Centralized with detailed control; emphasis on cost efficiency; extensive use of formal planning
Prospector	Location and exploitation of new product and new market opportunities	Growth through product and market development; constant monitoring of environmental change; multiple technologies	Emphasis on flexibility, decentralized control, use of ad hoc measurements
Analyzer	Desire to match new ventures to present shape of business	Steady growth through market penetration; exploitation of applied research; followers in the market	Very complicated; coordinating roles between functions; intensive planning

There are several issues that need to be borne in mind, especially how well the culture matches and supports the product/market positioning of the organization. This needs to be linked to a match between positioning and organizational competencies. For example, a 'low-price' positioning of a commodity product or service is best supported by a defender culture with competencies which emphasize cost improvement and perhaps a largely bureaucratic management regime. In contrast, a positioning of differentiation matches well with a prospector culture, as product features or service quality requires more creative competencies and a more flexible management regime.

This matching of positioning, competencies and dominant culture, becomes a part of successful organizations. Over a period of time, the key elements of the strategy represent core competencies of the organization. The relationship between strategy and dominant culture is often self-perpetuating. So not only does a defender culture match well with a

commodity's positioning, but it is likely to seek out those parts of the market which secure such a positioning. Moreover, the organizational routines - for example, selection/ recruitment - are likely to perpetuate the dominant culture by not selecting individuals who will 'rock the boat'. This is exemplified by the fact that people who are attracted to the large multinational companies in the country have different values than those attracted to, say, the Tata or the Birla organizations.

Cultural Web

Given the overall strategic direction of the organization, it is necessary to identify forces within the organization that could help or hinder change. Many aspects of the culture of the organization work to shape and guide strategy. The cultural web is a useful way of considering forces for and against change. The cultural web provides an understanding on how an organization's culture will affect its ability to change and adapt to new policies or environments.

The organization's cultural web is a set of assumptions about the organization that have been internalized. It represents the collective experience built up over years and all organizations develop a degree of coherence in their culture to be able to function effectively. Because organizational cultures are not easy to change, they have an important impact on strategy.

Figure 9.7 is a schematic representation of the cultural web. The different elements of the cultural web are described in greater detail below:

Stories: Stories are told about the organization by its members to each other and to new recruits. They distil the organization's past and legitimize behaviour, in the tradition of tribal lore, complete with myths, legends, heroes and taboos.

Routines and rituals: 'Routine' is the way members behave towards each other and towards those outside the organization. 'Rituals' are the special events through which the organization emphasizes what is important and how things are done in the organization.

Symbols: These are the trappings of status and privilege in the organization. Symbols such as logos, offices, cars and titles become a representation of the nature of the organization.

Organizational structure: This reflects the power structure and sets down important relationships within the organization.

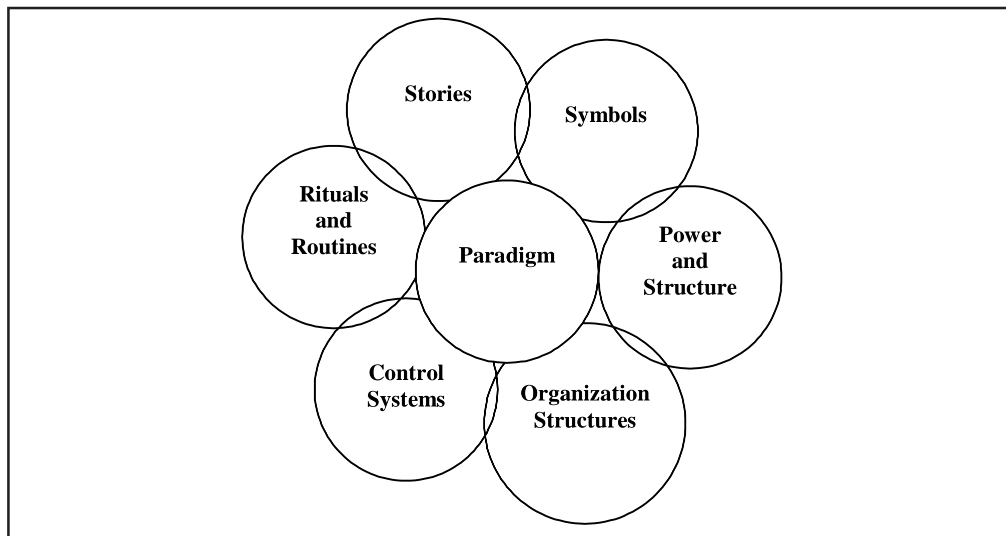

Figure 9.7: Cultural Web

Control Systems: These are the measurement and reward systems that represent what are important areas of focus of the organization.

Power Structures: The powerful managerial groupings are likely to be associated with the set of core assumptions and beliefs of the organization.

Miles and Snow used the cultural web as a means of assessing the dominant culture of the organization. By reviewing the clues from the cultural web analysis, it is possible to distinguish between a defender and a prospector organization, and hence judge the extent to which new strategies might fit the current paradigm. Mapping out the cultural web of the organization provides a visual image of many of the aspects of the organization which are often not discussed - the underlying power structures, the day-to-day routines, the symbols and stories, and the taken-for-granted assumptions which guide everyday life.

The cultural web can, therefore, facilitate debate about those aspects of the organization that are rarely brought out into the open. Without such an openness of debate about the really significant blockages to change, it is unlikely that the organization will undergo change that is often essential to the implementation of strategy.

Strategic Drift

Strategy often involves change, this is especially true when changes are taking place in the environment around the organization. Faced with pressures for change, there is a tendency for managers to postpone change so as to avoid ambiguity and uncertainty created by the new situation. They try to revert to the paradigm to find a solution. The solution they find is constrained by the core assumptions and routines of the cultural web. If conditions keep worsening, they try to reconstruct strategy in the image of the existing paradigm.

Changing the strategy within the paradigm makes sense if it permits the strategy of the organization to be in line with the change in the environment. Under such conditions, management is using the experience of the organization and working within limits that are familiar. However, within the limitations of the cultural web, the changed strategy may not be adaptive to the forces in the environment. Over time, this will give rise to 'strategic drift', where the organization's strategy gradually moves away from facing the forces at work in its environment and will effect the organization's performance.

Strategic drift is difficult to detect and reverse because not only are changes being made in the strategy, but also because the changes are familiar they often provide short term relief. This relief often provides legitimacy to the changes. Organizations continue to fight the 'effect', while the 'cause' is neglected. Even the most successful organizations have drifted in this way. They have become victims to their past successes.

Strategic drift has been shown in Figure 9.8. The first stage that has been described reflects phase 1 in the diagram. The distance between the strategic change and the environmental change in the figure is shown to be gradually increasing. If the drift is detected during this phase, the organizational performance can be corrected by incremental change. During phase 2 the influence of the paradigm impacts the development of strategy. Strategy development is likely to be in a flux, with no apparent direction. The drift becomes apparent and performance is visibly affected. The performance of the organization keeps deteriorating. The failing performance creates a stage where incremental change is no longer a solution and transformational change is required. This has been shown as phase 4. If action is not taken at this stage the organization becomes sick and has to be wound up. This is represented by phase 5.

It is important to gauge when incremental change gives rise to strategic drift. Unfortunately, there is no absolute set of conditions which describe a state of strategic drift - this is a matter of managerial judgment. However, there are a number of possible symptoms, given below, that can indicate the possibility of a drift:

- A highly homogenous organizational culture and paradigm with strongly established routines; powerful symbols and stories of a historical and conservative nature, etc. If there is little tolerance to questioning or challenge in the organization, it might well be a candidate for drift.
- Major power blockages to change, either because of resistant dominant leaders or because some group or layer of management is resistant to change.
- An organization with little focus on its external environment, particularly its markets. Such an organization is likely to be building strategy on its skill base. This can be checked by means of research comparing managerial and customer perceptions of the organization.
- Deteriorating relative performance: for example, is the performance of a business unit keeping pace with or outstripping its rivals; or has there been a gradual decline in relative performance? This may be detected, for example, by benchmarking.

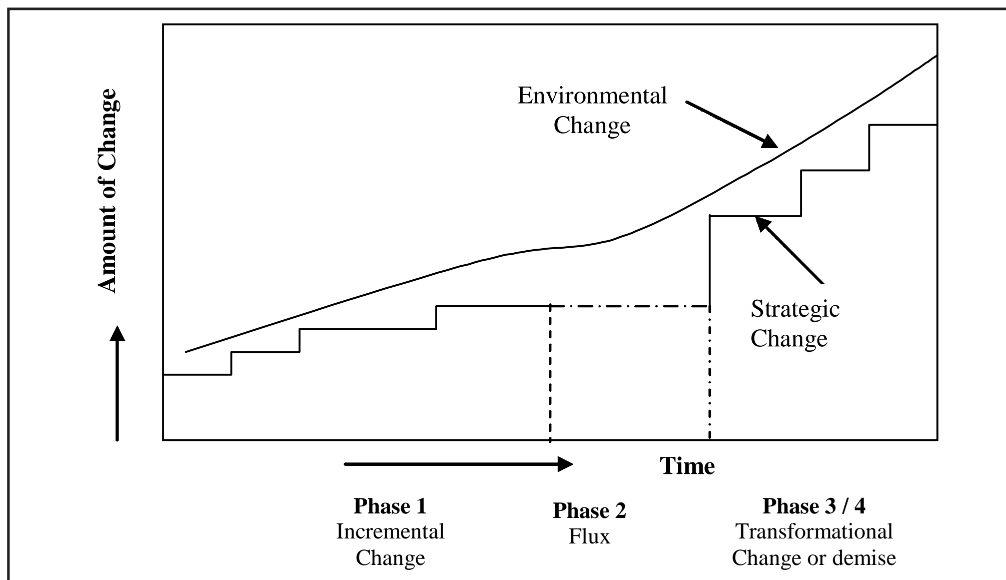

Figure 9.8: Strategic Drift

Many aspects of the culture of the organization work to shape and guide strategy. The cultural web is therefore a useful way of considering forces for and against change. If there are predominant forces against change, it points to the danger of strategic drift. The cultural web also provides a basis upon which the formal structures and systems of the organization can be considered, especially as some aspects of culture - for example, organizational rituals and routines - are capable of being managed and can prove to be powerful messages of change.

Check Your Progress 1

Define Organisational Culture.

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9.3 MATCHING ORGANIZATION STRUCTURE WITH STRATEGY

Structure is only one element of organizational design. For effective implementation of strategy, the atmosphere within the organization is equally important. A favourable atmosphere is essential for employees to work in a productive and satisfying manner. Organizational culture determines the atmosphere within the organization. It helps employees to understand that a new direction for the company is essential for its success. The culture of the organization also makes them identify what they believe is critical, achievable, and personally important to them. Organizational culture is the way the organization generates and renews strategy.

Organizations have to create conditions where thousands of people can figure out what they must do, cooperate to get it done, and experience it as being personally fulfilling. The skill of management lies in the realm of design of systems and mechanisms to guide and motivate the actions of employees. Without a proper fit between strategy and organizational design, various elements required for implementation will not move in harmony, ultimately leading to inefficient use of facilities and failure.

Organizations have to identify their challenges and design the organization based on these challenges. For many companies, the chief challenge is insufficient entrepreneurialism, a failure to motivate top talent to seize opportunities and make the most of them. For others, the problem is an inability to develop, apply, and capture value from new technologies and practices, and to forge value-creating linkages between processes, business units, and core functions. The design of the organization must take all these factors into consideration.

Seen either in terms of the model of Prahalad and Hamel or conventional management modeling, organizational design is a critical area. We will study organizational structure and the culture of the organization. These are essential components of organizational design and impact the ability of the organization to implement strategy and also the ability to strengthen existing competencies and develop resources.

Though successful strategy implementation requires a suitable organization structure to translate ideas into concrete action plans, in spite of having all these supporting elements, strategy implementation is still found to be challenging. Creating a 'fit' of the organization's strategic intent with its activities is complex. Strategy is dependent on many variables - internal as well as external. In addition, there are countless, interrelated change factors that could upset managerial calculations overnight. Towards the end of 1970s, Mckinsey Company, a well known management consultancy firm, was asked to find a solution to this issue.

9.4 7S MODEL

Based on the findings, Mckinsey came out with a report which was later published as a book, "In Search of Excellence". The researchers, Peters and Waterman, suggested a model for organizational excellence that has been popularly called the 7-S framework. They found, after examining America's best run companies that the problem in strategy lay in its implementation. There were seven levers that needed to be considered and a strategy is usually successful when all the elements in the 7-S framework fit into or support the strategy. The 7-S framework is shown as Figure 9.9.

The different elements of the model are described below:

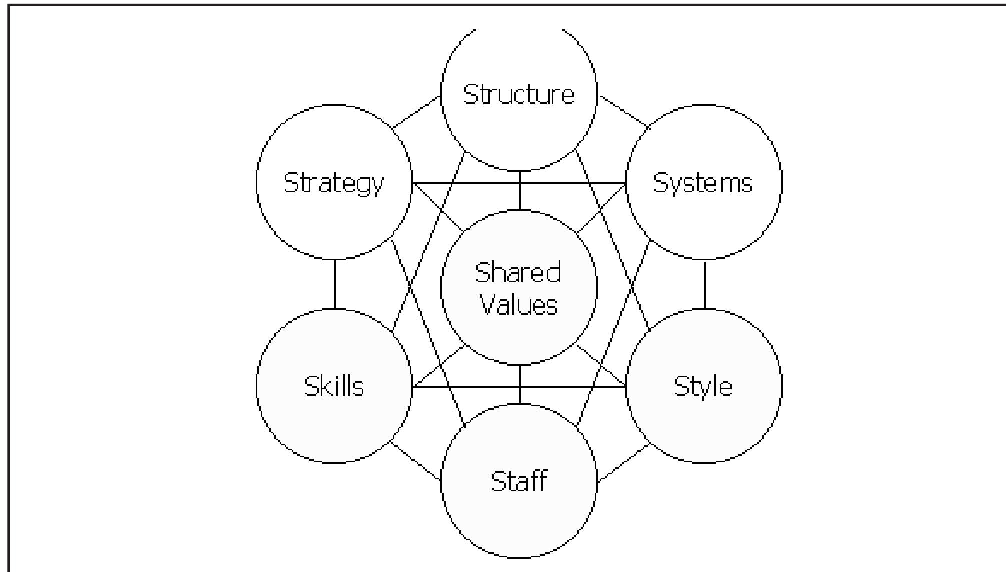

Figure 9.9: Mckinsey's 7-S Model

Super-ordinate Goals or Shared Values: The interconnecting center of McKinsey's model is 'Shared Values'-What the organization stands for and what it believes in—the shared vision of the company. This is strongly related to the culture of the organization.

Strategy: The broad framework for the allocation of a firm's scarce resources, over time, to reach identified goals.

Structure: The way the organization's units relate to each other in accomplishing the successful implementation of strategies: centralized, functional divisions; decentralized; matrix, network, holding, etc.

System: The procedures, rules and regulations and routines that characterize how important work is to be done: financial systems; hiring, promotion and performance appraisal systems; information systems. It includes both the formal and informal systems.

Style: Cultural style of the organization and how key managers behave in achieving the organization's goals.

Staff: Selection, placement, training and development of appropriately qualified personnel within the organization, both in terms of numbers and type.

Skill: Distinctive capabilities of personnel or of the organization as a whole. It includes the characteristics that most people use while describing a company. For example, Larsen & Toubro is generally described as an engineering firm because of its distinctive skills.

These seven elements are distinguished in so called hard S's and soft S's. The hard elements – strategy, structure and systems – are easy to identify. They can be found in strategy statements, corporate plans, organizational charts and other documentations. Management has some control over the hard elements and can exercise influence over them. The four soft S's – shared values, style, staff and skills – are difficult to describe since capabilities, values and elements of corporate culture are continuously developing and changing. They are determined by the people at work in the organization. Therefore, it is much more difficult to plan or to influence the characteristics of the soft elements.

The successful implementation of a strategy depends on the right alignment of all the seven elements. Generally, it has been found that it is difficult to identify which of the

seven factors would be the driving force in changing an organization at a point of time. When the seven elements are in good alignment, an organization is poised and energized, though benchmarking the hard elements in the model is a highly subjective matter. The 7-S framework highlights the importance of some interrelated and interconnected factors within the organization and their role in successful implementation of strategy.

The model has been effectively used to audit various organizations. However, Peters and Waterman found that in the successful implementation of strategy perhaps the most effective tools within the control of management were the 'structure' ‘strategies’ and 'systems' - the 3 hard S's.

The other elements of the 7 S framework, the soft S's, were generally not within the control of management, at least in the short and medium run, although they can have a great impact on the hard Structures, Strategies and Systems of the organization. We will discuss these later on in this chapter when we discuss 'strategic change'.

Check Your Progress 2

State whether the following statements are True or False:

1. Strategy implementation refers to the sum total of the activities and choices required for execution of a strategic plan.
2. Strategy is the broad framework for the allocation of a firm’s scarce resources, over time, to reach identified goals.
3. Strategic control approach is based on improving the competitive capacity of the organisation by providing a high level of autonomy to the operating units.
4. An appropriate organizational structure helps develop the capacity to implement strategy effectively.
5. Strategy implementation can be referred to as a process by which strategies and policies are put into action by programs, budgets and procedures.

9.5 LET US SUM UP

The strategy implementation process is a bridge between the classic economist's view and the view of the resource school. Critical areas related to the implementation of strategy are organizational structure, the culture of the organization, and the strategic change process.

The structure of the organization determines three key components pertaining to organizing the activities of the people in the organization. The organization chart is the visual representation of underlying activities and processes being undertaken by the organization. The principle underlying the organization chart is that vertical linkages primarily show control, while horizontal linkages indicate coordination and collaboration.

Based on the manner in which the strategic plan is structured and executed, organizations can be divided into three organizational architectures. These are the strategic planning, the financial control, and the strategic control approaches.

Strategic Planning Architecture is based on a top-down system of management. There are different organizational structures that use the Strategic Planning Architectural approach. These include the Simple Structure, the Functional Structure, the Divisional Structure and the Geographical Structure.

9.6 LESSON END ACTIVITY

Prepare a study note on strategy implementation in an organisation.

9.7 KEYWORDS

Strategy Implementation: Strategy Implementation refers to the sum total of the activities and choices required for execution of a strategic plan.

Organization Chart: It is the visual representation of underlying activities and processes being undertaken by the organization.

Organizational Architecture: It is the model of strategic planning used by the organization and determines the role of the corporate centre and the various parts of the organization.

Organizational Structure: It is the model by which the components of the organization are related to facilitate the translation of organizational strategy and policies to action.

Strategic Planning Approach: It is a top-down system of management where the corporate office takes all the strategic decisions and execution is carried out by the operating units.

Style: Cultural style of the organization and how key managers behave in achieving the organization's goals.

Staff: Selection, placement, training and development of appropriately qualified personnel within the organization, both in terms of numbers and type.

Skill: Distinctive capabilities of personnel or of the organization as a whole. It includes the characteristics that most people use while describing a company.

9.8 QUESTIONS FOR DISCUSSION

1. Write a note on various approaches to implementation of strategy.
2. What is the importance of matching organisation structure with strategy in strategic implementation?
3. What is the use and importance of 7S model in strategic implementation?
4. ‘Strategic Drift’ is a phenomenon caused by the organisational paradigm. Comment.
5. Strategy implementation process is a bridge between the classical economist’s view and the view of the resource school. Comment.

Check Your Progress: Model Answers

CYP 1

According to Mintzberg, one of the basic building blocks of organizational design is the ideology or culture of the organization. This consists of the values, beliefs, and taken for granted assumptions. It is essential to study the culture of the organization in order to design an organizational structure that functions properly.

CYP 2

1. True
2. True

Contd....

3. True
4. True
5. True

9.9 SUGGESTED READINGS

Pearce & Robinson, *Strategic Management*, All Indian Travellers N.D.

A.C. Hax and NS., *Strategic Management: An Integrative Perspective*, Majifu, Prentice Hall.

Micheal Porter, *Competitive Strategies*.

Micheal Porter, *Competitive Advantage of Nations*.

Samul C. Certo and J. Paul Peter, *Strategic Management: Concept and Application* (Second Edition), McGraw Hill.

Georgy G. Dess and Alex Miller, *Strategic Management*, McGraw Hill.

Gerry Jhonson & Keven Scholes, *Exploring Corparate Strategy: Text and Cases*.

Jaunch L Rajive Gupta & William F Glueck, *Business Policy and Strategic Management*, Frank Bros & Co, 2003

Fred R. David, *Strategic Management: Concept and Cases*, Pearson, 2003.

LESSON 10

STRATEGY CONTROL

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10.0 AIMS AND OBJECTIVES

After studying this lesson, you will be able to:

- Understand strategic control process
- Know about Du Pont's Control Model and other quantitative and qualitative tools
- Learn about balance score card
- Understand M. Porter's approach for globalization
- Guess the future of Strategic Management

10.1 INTRODUCTION

In order that the system should work effectively, credibility of its leaders has to be maintained. For example, credibility may arise from being a member of the peer group – this is why so many seniors in professional service departments or organizations are professional themselves. The software industry – which is one of the country's best growth industries – reflects the values of such organizations. Generally, the head of the department is competent enough to undertake assignments personally as well as overseeing the work of others.

The contribution of senior managers to this process is to ensure that individuals have the channels to interact, and that the social/cultural controls which this process of interaction creates are properly regulated to avoid rigidities. Senior managers have to be actively concerned with shaping the context in which the members of the organization are working so that the individuals remain highly motivated.

One of these key resources to maintain the channels of interaction is likely to be information. The organization's IT strategy is a critical ingredient in this process of supporting such individuals. The control through information technology is being discussed separately.

10.2 STRATEGIC CONTROL PROCESS

Different types of Strategic Control Systems are required to effectively exercise control. Standard systems of controls are generally classified into four types:

- Premise controls
- Implementation controls
- Strategic surveillance
- Special alert control

Premise Control: Strategy is built around certain premises about future events. It highlights and identifies these and checks if these are still valid as future events unfold. The sooner these invalid premises are detected, better are the chances of devising an acceptable shift in the strategy. These premises can be from environmental factors external to the organization. The firm has little control on them, but they have a profound impact on the success of strategy. These include:

- Rate of inflation
- Interest rates
- Legislations and regulations by government
- Demographic changes
- Social changes, etc.

Other industry factors external to the organization that set are unique to the industry that should be considered include:

- Competitors
- New entrants
- Suppliers

- Substitutes
- Buyers
- Barriers to entry and exit, etc.

These premises may be major or minor; they are categorized on the basis of their impact on the success of strategy. Since tracking all premises is time consuming, short lists of premises that have a significant effect on the implementation of strategy are prepared. These are identified and recorded and their monitoring responsibility is fixed. If these premises are not in line with the assumptions made at the beginning, adjustments to strategy, either operational or functional, may become necessary.

Implementation Control: Implementation control serves the purpose of assessing whether the overall strategy needs modification/changes in the light of events unfolding and results accomplished. It is of two types:

- Assessing Strategic Thrust, and
- Milestone Reviews

This information on the thrust of the strategy is used to point out changes that may have to be incorporated in the strategy. However, it is important to agree to the evaluation of thrust points during the formulation of strategy itself. And also agree to gate-keeping thresholds in terms of time, cost, degree of progress of project, or/ and success of a program. These are major hold-points for the overall strategy, and lack of progress or unforeseen happenings at these checkpoints may even require abandonment of the strategy.

Milestone review is a full-scale reassessment of the overall strategy and is usually linked to:

- Critical events
- Stage of major allocation of resources
- Time frame.

Milestones are more effective if they are related to major stages where uncertainty needs to be resolved. These reviews may determine the need to continue or reinforce strategy implementation.

Strategic Surveillance: Strategic surveillance, as the name implies, is intended to monitor a very broad range of events inside and outside the firm. The choice of the events is not pre-selected or pre-planned. It is a general system of monitoring different sources of information to uncover important but unanticipated information that can have major impact on the strategy. This is somewhat of a loose scanning activity. Trade magazines, technical or industry conferences, business newspapers, industry watchers, etc., provide a wide range of information.

Special Alert Control: This control is a subset of the other types of controls. This is a rapid but thorough review of the entire strategy in the light of sudden and unexpected events. Unforeseen events trigger immediate reassessment of strategy. Many firms have ‘crisis teams’ in place to respond and coordinate the activities through the period of crisis. These reviews often lead to contingency plans.

Controls can be generated either to focus on the actual outputs or on the activities that generate the performance. Output control specifies what is to be accomplished by focusing on the end result of the behaviours through the use of objectives and performance targets. Behaviour control specifies how something is to be done through policies, rules, standard

operating procedures, etc. This type of control is used when performance results are difficult to measure but the cause-effect relationship between activities and results is clear. Output control and behaviour control are not interchangeable.

Strategic Control: The process needs to be an ongoing and continuous process. It provides, on a continuous basis, a clinical check-up on the progress of the business objectives in the near term Annual Operating Plan and the long-term Strategic Plan. It determines if the performance requirements are being met within the timeframe. In addition, evaluation and control process determines whether the results are meaningful and whether they add to the goals of continuous improvement for the organization and add real value to the customer.

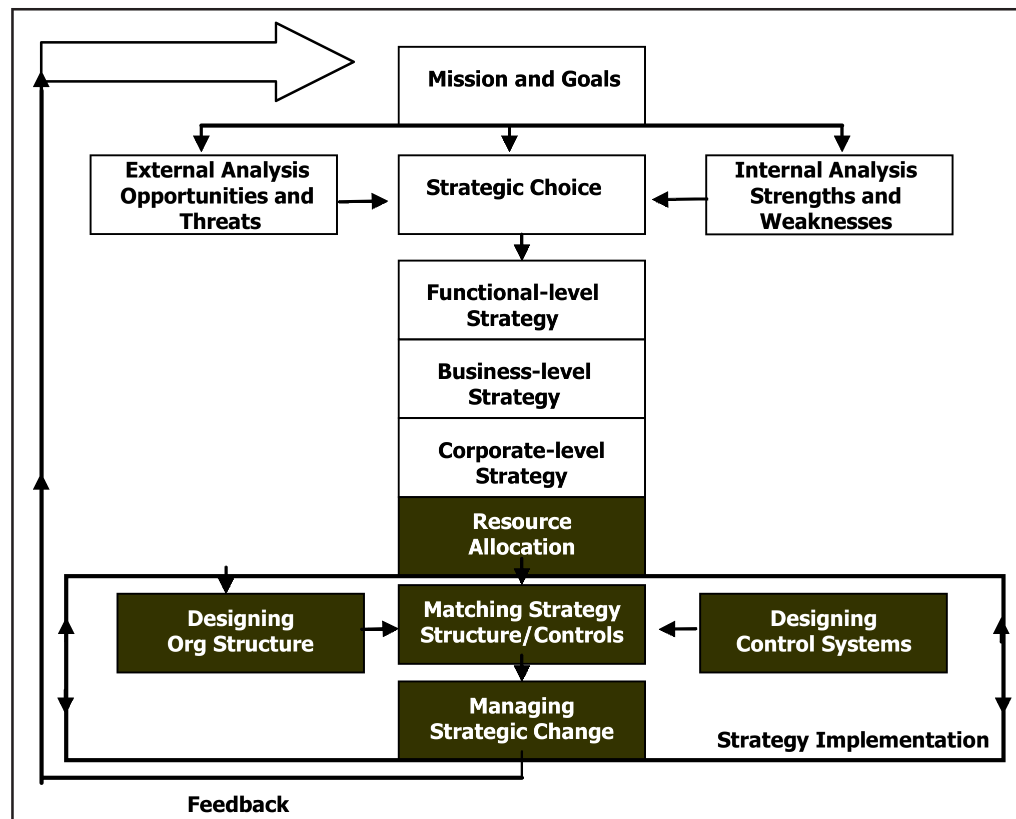

Figure 10.1: Control through the Planning Process

Figure 10.1 shows the different components of the strategy control process with a control system in place. The relationship of the strategy control process with the strategy of the organization is apparent. As will be seen from the figure, the different components and the feedback loop is cyclical and the different elements mesh into each other to form two connected systems. One is the strategy implementation system, and this is connected to the different components of strategy which is the second system. The control process is the connecting element.

10.3 DU PONT'S CONTROL MODEL AND OTHER QUANTITATIVE AND QUALITATIVE TOOLS

While the actual number of small business failures is often a topic of debate, the fact that poor financial planning and control ranks as one of the top causes of business distress and ultimate failure has been widely documented. Further, owners and managers of both struggling and successful small businesses alike often ponder how to improve the return

they are getting from their enterprises. Ratio analysis provides a wealth of information that is useful in this regard and one type of analysis in particular – the modified Du Pont technique – can be used to enhance decision making with an eye on improving return. This paper: 1) explains the development and mechanics of the "really" modified Du Pont ratio model, 2) gives practical direction for the use of the model, and 3) discusses implications for the model's use as a strategic management tool for small business owners, managers, and consultants.

10.3.1 Introduction

Like many business students, a lot of small business owners and managers tend to shy away from quantitative analysis. The qualitative aspects of a business – such as creating marketing campaigns or dealing with customer service – are far more "fun" than financial record keeping and analysis. However, there is much evidence that a lack of financial control is often a quick path to business failure. According to Dun & Bradstreet's Business Failure Records, "poor financial practices" is second only to "economic conditions" as a cause of business failures. Further, studies such as those published by Bruno, Leidecker, and Harder (1987); Gaskill, Van Auken, and Manning (1993); Lauzen (1985); and Wood (1989) specifically cite poor financial control as a chief cause of unsuccessful businesses. Gill (1994) stresses the importance of monitoring the "financial health" of a small business. Thus, it would be useful for small business owners to have a relatively simple tool for not only assessing how their businesses are faring, but also for devising strategies for bottom line improvement. Such a tool exists in the form of an updated version of the classic Du Pont model.

10.3.2 The Du Pont Model: A Brief History

The use of financial ratios by financial analysts, lenders, academic researchers, and small business owners has been widely acknowledged in the literature. (See, for example, Osteryoung & Constand (1992), Devine & Seaton (1995), or Burson (1998) The concepts of Return on Assets (ROA hereafter) and Return on Equity (ROE hereafter) are important for understanding the profitability of a business enterprise. Specifically, a "return on" ratio illustrates the relationship between profits and the investment needed to generate those profits. However, these concepts are often "too far removed from normal activities" to be easily understood and useful to many managers or small business owners. (Slater and Olson, 1996)

In 1918, four years after he was hired by the Du Pont Corporation to work in its treasury department, electrical engineer F. Donaldson Brown was given the task of untangling the finances of a company of which Du Pont had just purchased 23 percent of its stock. (This company was General Motors!) Brown recognized a mathematical relationship that existed between two commonly computed ratios, namely net profit margin (obviously a profitability measure) and total asset turnover (an efficiency measure), and ROA. The product of the net profit margin and total asset turnover equals ROA, and this was the original Du Pont model, as illustrated in Equation 1 below.

Eq. 1: (net income / sales) x (sales / total assets) = (net income / total assets) i.e. ROA

At this point in time maximizing ROA was a common corporate goal and the realization that ROA was impacted by both profitability and efficiency led to the development of a system of planning and control for all operating decisions within a firm. This became the dominant form of financial analysis until the 1970s. (Blumenthal, 1998)

In the 1970s the generally accepted goal of financial management became "maximizing the wealth of the firm's owners" (Gitman, 1998) and focus shifted from ROA to ROE. This led to the first major modification of the original Du Pont model. In addition to profitability and efficiency, the way in which a firm financed its activities, i.e. its use of "leverage" became a third area of attention for financial managers. The new ratio of interest was called the equity multiplier, which is (total assets / equity). The modified Du Pont model is shown in Equations 1 and 2.

Eq. 2: ROA x (total assets / equity) = ROE

Eq. 3: (net income / sales) x (sales / total assets) x (total assets / equity) = ROE

The modified Du Pont model became a standard in all financial management textbooks and a staple of introductory and advanced courses alike as students read statements such as: "Ultimately, the most important, or "bottom line" accounting ratio is the ratio of net income to common equity (ROE)." (Brigham and Houston, 2001) The modified model was a powerful tool to illustrate the interconnectedness of a firm's income statement and its balance sheet, and to develop straight-forward strategies for improving the firm's ROE.

More recently, Hawawini and Viallet (1999) offered yet another modification to the Du Pont model. This modification resulted in five different ratios that combine to form ROE. In their modification they acknowledge that the financial statements firms prepare for their annual reports (which are of most importance to creditors and tax collectors) are not always useful to managers making operating and financial decisions. (Brigham and Houston, p. 52) They restructured the traditional balance sheet into a "managerial balance sheet" which is "a more appropriate tool for assessing the contribution of operating decisions to the firm's financial performance." (Hawawini and Viallet, p. 68) This restructured balance sheet uses the concept of "invested capital" in place of total assets, and the concept of "capital employed" in place of total liabilities and owner's equity found on the traditional balance sheet. The primary difference is in the treatment of the short-term "working capital" accounts. The managerial balance sheet uses a net figure called "working capital requirement" (determined as: [accounts receivable + inventories + prepaid expenses] – [accounts payable + accrued expenses]) as a part of invested capital. These accounts then individually drop out of the managerial balance sheet. A more detailed explanation of the managerial balance sheet is beyond the scope of this paper, but will be partially illustrated in an example.

The "really" modified Du Pont model is shown below in Equation 4.

Eq. 4: (EBIT / sales) x (sales / invested capital) x (EBT / EBIT) x (invested capital / equity) x (EAT / EBT) = ROE

(Where: invested capital = cash + working capital requirement + net fixed assets)

This "really" modified model still maintains the importance of the impact of operating decisions (i.e. profitability and efficiency) and financing decisions (leverage) upon ROE, but uses a total of five ratios to uncover what drives ROE and give insight to how to improve this important ratio.

The firm's operating decisions are those that involve the acquisition and disposal of fixed assets and the management of the firm's operating assets (mostly inventories and accounts receivable) and operating liabilities (accounts payable and accruals). These are captured in the first two ratios of the "really" modified Du Pont model. These are:

1. ***Operating Profit Margin:*** (Earnings Before Interest & Taxes or EBIT / sales)
2. ***Capital Turnover:*** (sales / invested capital)

The firm's financing decisions are those that determine the mix of debt and equity used to fund the firm's operating decisions. These are captured in the third and fourth ratios of the "really" modified model.

3. ***Financial Cost Ratio:*** (Earnings Before Taxes or EBT / EBIT)
4. ***Financial Structure Ratio:*** (invested capital /equity)

The final determinant of a firm's ROE is the incidence of business taxation. The higher the tax rate applied to a firm's EBT, the lower its ROE. This is captured in the fifth ratio of the "really" modified model.

5. ***Tax Effect Ratio:*** (Earnings After Taxes or EAT / EBT)

The relationship that ties these five ratios together is that ROE is equal to their combined product. (See Equation 4.)

10.3.3 Example of Applying the "Really" Modified Du Pont Model

To illustrate how the model works, consider the income statement and balance sheet for the fictitious small firm of Herrera & Company, LLC.

Conclusions & Implications

The "really" modified Du Pont model of ratio analysis can demystify relatively complex financial analysis and put strategic financial planning at the fingertips of any small business owner or manager who takes the (relatively little) time needed to understand it. Each operating and financial decision can be made within a framework of how that decision will impact ROE. Easily set up on a computer model (such as a spreadsheet), one can see how decisions "flow through" to the bottom line, which facilitates coordinated financial planning. (Harrington & Wilson, 1986).

In its simplest form, we can say that to improve ROE the only choices one has are to increase operating profits, become more efficient in using existing assets to generate sales, recapitalize to make better use of debt and/or better control the cost of borrowing, or find ways to reduce the tax liability of the firm. Each of these choices leads to a different financial strategy.

For example, to increase operating profits one must either increase sales (in a higher proportion than the cost of generating those sales) or reduce expenses. Since it is generally more difficult to increase sales than it is to reduce expenses, a small business owner can try to lower expenses by determining: (1) if a new supplier might offer equivalent goods at a lower cost, or (2) if a website might be a viable alternative to a catalog, or (3) can some tasks currently being done by outsiders be done in-house. In each case net income will rise without any increase in sales and ROE will rise as well.

Alternatively, to become more efficient, one must either increase sales with the same level of assets or produce the same level of sales with less assets. A small business owner might then try to determine: (1) if it is feasible to expand store hours by staying open later or on weekends, or (2) if a less expensive piece of equipment is available that could replace an existing (more expensive) piece of equipment, or (3) if there is a more practical way to produce and/or deliver goods or services than is presently being used.

Further, small business owners can determine if they are using debt wisely. Refinancing an existing loan at a cheaper rate will reduce interest expenses and, thus, increase ROE. Exercising some of an unused line of credit can increase the financial structure ratio with a corresponding increase in ROE. And, taking advantage of tax incentives that are often offered by federal, state, and local taxing authorities can increase the tax effect ratio, again with a commensurate increase in ROE.

In conclusion, ROE is the most comprehensive measure of profitability of a firm. It considers the operating and investing decisions made as well as the financing and tax-related decisions. The "really" modified Du Pont model dissects ROE into five easily computed ratios that can be examined for potential strategies for improvement. It should be a tool that all business owners, managers, and consultants have at their disposal when evaluating a firm and making recommendations for improvement.

Income Statement

Net Sales	$766,990
Cost of Goods Sold	(560,000)
Selling, General, & Administrative Expenses	(143,342)
Depreciation Expense	(24,000)
Earnings Before Interest & Taxes	$ 39,648
Interest Expense	(12,447)
Earnings Before Taxes	$ 27,201
Taxes	(8,000)
Earnings After Taxes (net profit)	$ 19,201

Balance Sheet

Cash	$ 40,000	Notes Payable	$ 58,000
Pre-paid Expenses	12,000	Accounts Payable	205,000
Accounts Receivable	185,000	Accrued Expenses	46,000
Inventory	200,000	Current Liabilities	$309,000
Current Assets	$437,000	Long-Term Debt	
Land/Buildings	160,000	Mortgage	104,300
Equipment	89,000	8-Year Note	63,000
Less: Acc. Depreciation	(24,000)	Owner's Equity	185,700
Net Fixed Assets	$225,000		
Total Assets	$662,000	Total Liabilities & Equity	$662,000

Computation of ROE

1. Operating Profit Margin = $39,648 / $766,990 = .0517
2. Capital Turnover = $766,990 / $411,000* = 1.8662
3. Financial Cost Ratio = $27,201 / $39,648 = .6861
4. Financial Structure Ratio = $411,000 / $185,700 = 2.2132
5. Tax Effect Ratio = $19,201 / $27,201 = .7059

ROE = .0517 x 1.8662 x .6861 x 2.2132 x .7059 = .1034** or 10.34%

* Invested Capital = Cash ($40,000) + Working Capital Requirement [$185,000 + $200,000 + $12,000] – [$205,000 + $46,000] (or $146,000) + Net Fixed Assets ($225,000) = $411,000

** Note that this is the same as conventional computation of ROE: $19,201 / $185,700 = .1034

Check Your Progress 1

Define Strategic Control.

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10.4 BALANCED SCORE CARD

Strategic management is a disciplined process that requires both top-down support and bottom-up participation. For most lower-level employees, financial performance measures are generally too aggregated and too far removed from their actions to provide useful guidance or feedback on their decisions. Management needs measures that more directly and accurately relate to outcomes that they can influence.

The Balanced Scorecard (BSC) moves beyond the traditional goals of income, cash flow and financial ratios. It adds process performance measurements around issues like continuous improvement, supply chain management, and customer satisfaction. BSC offers two significant improvements over traditional financial or even non-financial measures of performance. It identifies the four related core processes that are critical to nearly all organizations and all levels within organizations:

- Learning and growth capability
- Efficiency of internal processes
- Customer value
- Financial returns

There is emphasis on leading indicators of future performance in all four areas, along with the tracking of past performance, which are often stated in financial terms. While informative but not controllable performance measures may be important, positive motivation requires some measures should reflect managers' actions. For example, relative performance evaluation (e.g., across similar business units), which can identify "influenceable" but not completely controllable outcomes, is an important component.

In its most basic use, a properly configured BSC could provide comprehensive picture of the state of the organization. Thus, the BSC could promote positive organizational outcomes such as improvements in administrative activities and the BSC itself. These areas closely correspond to the core processes, we have identified earlier in this chapter. This is shown in Figure 10.2.

BSC is not primarily an evaluation method, but is a strategic planning and communication device. It provides strategic guidance to managers and describes links among lagging and leading measures of financial and non-financial performance. The BSC describes the steps necessary to reach financial success – invest in specific types of knowledge to improve processes, etc. The business "score" is kept to report results, to effect behavior, to reward and to recognize performance. But, it is also kept to determine progress against the long-term goals of the Strategic Plan and the short-term goals of the Annual Business Plan.

10.4.1 Role of the BSC for Strategy Implementation and Performance Measurement

BSC is being expanded in its use, employing it as a foundation of an integrated and iterative strategy management system. Unlike traditional financial measures, which by expensing costs of many improvements, work against strategies based on quality, flexibility, and minimization of manufacturing time, the BSC is used to align critical measures with strategy and link the measures to valued outcomes.

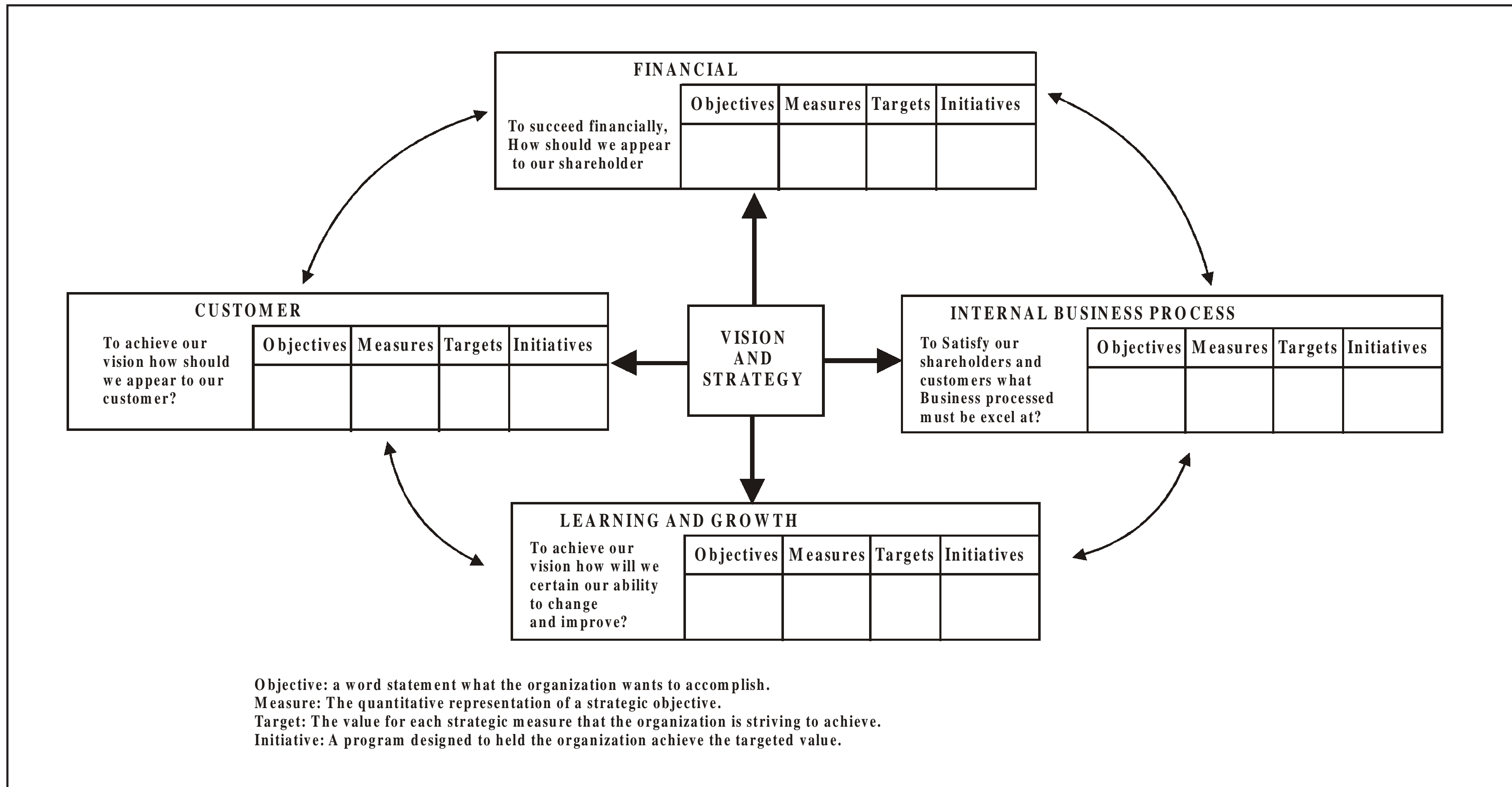

Figure 10.2: The Balanced Scorecard

BSC introduces four new management processes that contribute in linking long term strategic objectives with short term activities. The processes are; translating the vision, communication and linking, business planning and feedback and learning. These processes are shown in Figure 10.3.

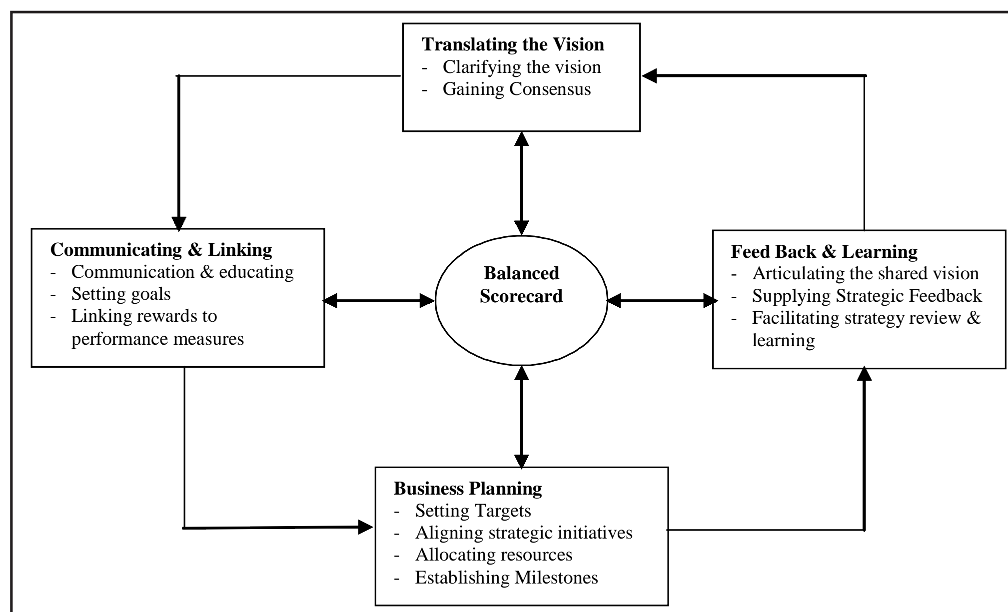

Figure 10.3: Managing Strategy – 4 Processes

The BSC seeks to link these measures into a model that accurately reflects cause and effect relations among categories and individual measures. Such a model could support operational decisions, make predictions of outcomes given decisions and environmental conditions, and provide reliable feedback for learning and performance evaluation.

Firstly, an effective management control device, which is capable of promoting desired organizational outcomes, should have the following, observable management control attributes to attain strategic alignment:

- A comprehensive but parsimonious set of measures of critical performance variables, linked with strategy
- Critical performance measures causally linked to valued organizational outcomes
- Effective – accurate, objective, and verifiable – performance measures

Secondly, to further promote positive motivation, an effective management control device should have attributes of:

- Performance measures that reflect managers' controllable actions and/or influenceable actions, e.g., measured by relative performance
- Performance targets or appropriate benchmarks that are challenging but attainable
- Performance measures that are related to meaningful rewards

Management control theory predicts that, if the BSC has these attributes, it is likely that the BSC will promote strategic alignment and positive motivation and outcomes.

10.4.2 Research Results

According to a research studies at the Harvard Business School and University of Colorado, the results show evidence that managers respond positively to BSC measures by reorganizing their resources and activities, in some cases dramatically, to improve their performance on those measures.

More significantly, managers believe that improving their BSC performance is improving their business efficiency and profitability. Managers react favourably to the BSC and heed its messages when:

- BSC elements are measured effectively, aligned with strategy, and reliable guides for changes, modifications, and improvements
- The BSC is a comprehensive measure of performance that reflects the needs of effective management
- The BSC factors are seen to be causally linked to each other and tied to meaningful rewards
- BSC benchmarks are appropriate for evaluation and useful for guiding changes
- Relative BSC performance is a guide for improvement

The following factors were found to negatively affect perceptions of the BSC and cause significant conflict and tension between the company and its distributors.

- Measures are inaccurate or subjective
- Communication about the BSC is one-way (i.e., top-down and not participative)
- Benchmarks are inappropriate but used for evaluation

These lists represent value-added and non-value-added BSC activities. To successfully design, implement and use the BSC, organizations should enhance the former, positive factors and eliminate or correct the latter, negative factors. Though some of these adverse findings are associated with recommendations for improvement, most are found to be causes of unproductive conflict and tension or a general atmosphere of ineffectiveness.

10.4.3 Building a Scorecard

Each organization is unique and can follow its own path for building a scorecard. However, Kaplan and Norton have evolved a procedure that can be used with modifications by different organizations. The process is as follows:

First Round – Formulation: Senior managers, principal shareholders and some key customers - typically between 6 and 12 in number – are provided background material on the balanced scorecard. They are also provided internal documents that describe the company's vision, mission and strategy by a balanced scorecard facilitator. The facilitator then conducts interviews with the senior managers to obtain their input on the company's strategic objectives and tentative proposals for balanced scorecard measures.

The top management team then is brought together in a workshop, with the facilitator, to undergo the process of developing the scorecard. The group debates the proposed mission and strategy statements until a consensus is reached. The group then moves from the mission and strategy statement to answer how their performance will differ for shareholders; for customers; for internal business processes; and their ability to innovate, grow and improve.

After defining the key success factors, the group formulates a preliminary balanced scorecard containing operational measures for the strategic objectives. Straw votes can be taken to see whether or not some of the proposed measures are viewed as low priority by the group. At this time, narrowing the choices is not critical.

Second Round – Implementation: The second round is a workshop, after the facilitator reviews, consolidates, and documents the output from the executive workshop and interviews each senior executive about the tentative balanced scorecard. The facilitator

involves the senior management team, their direct subordinates, and a larger number of middle managers. The participants, working in groups, comment on the proposed measures, link the various change programs to measures, and try to develop an implementation plan. At the end of the workshop, participants are asked to formulate stretch objectives for each of the proposed measures, including targeted rates of improvement.

The set of BSC measures should completely describe the organization's critical performance variables, but should be limited in number to keep the measurement system cognitively and administratively simple. An exhaustive set of performance measures may accurately reflect the complexity of the organization's tasks, but too many measures may be distracting, confusing, and costly to administer. Positive motivational impact induces managers to exert effort to achieve organizational goals.

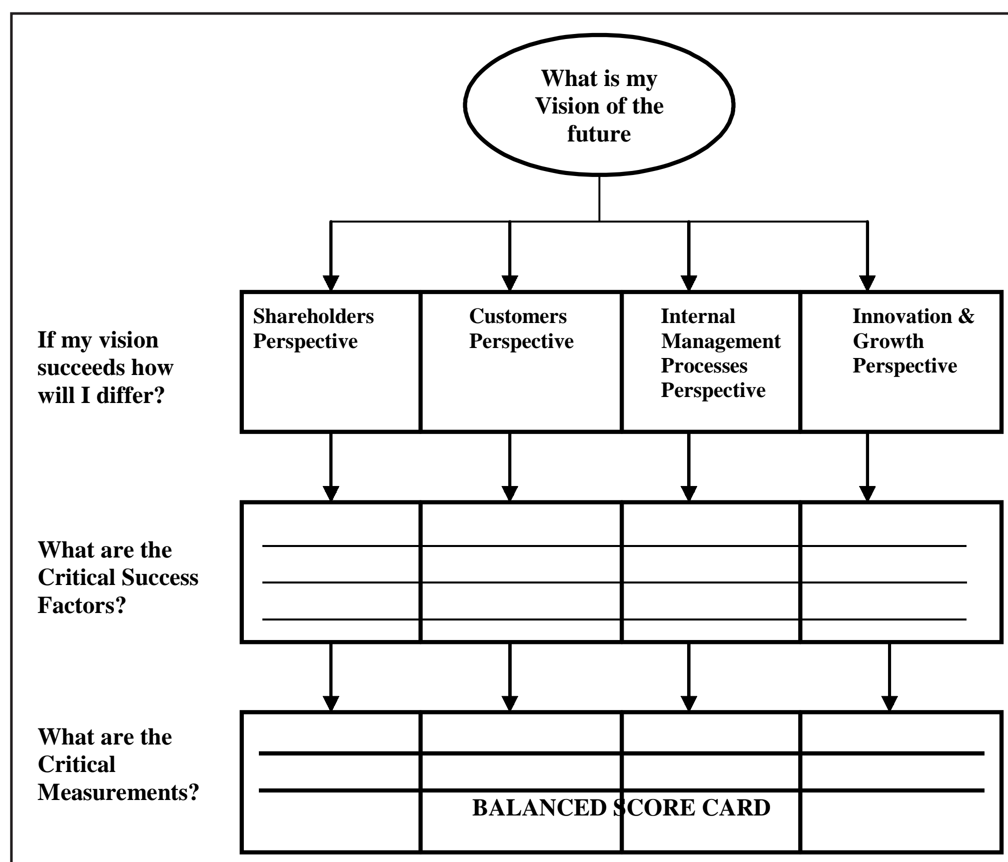

Figure 10.4: Begin by Linking Measurements to Strategy

Third Round – Consensus: The senior executive team meets to find consensus on the vision, objectives and the measurements developed in the first two workshops. They develop stretch targets for each measure on the scorecard and identify preliminary action programs to achieve the targets. The team must agree on an implementation program, communicating the scorecard to employees, integrating the scorecard into management philosophy, and developing an information system to support the scorecard.

Following are examples of financial goals appropriate for consideration on the Balanced Scorecard:

- 3% Increase in Sales for the current Year to reach 11% Increase in Sales for next three Years
- Inventory Reduction to Rs. 50 crore in the current year and to Rs. 40 crore in the next three years

- Maintain Current Profit Margins to 25%
- Increase Inventory Turnover from 1.9 to 2.6 in the current year to 4.3 times within three years

The examples of non-financial goals related to metrics are not directly reported on traditional financial statements. However, these metrics are related to process and execution issues that can substantially impact and influence the financial metrics. Examples might include the following:

- Improve Customer Satisfaction Levels to 9.8 from 9.5 (on a 10 point scale)
- Improve On-Time Delivery to 99 % from 98%
- Reduce Obsolete Inventory from 3% of Sales to 1% of Sales
- Reduce the number of stock keeping units by 10%
- Reduce employee turnover by 25%
- Promise employees a positive working environment where they can grow professionally and financially through continuous education, job stability, and competent management. (measure through employee surveys)

Implementation: A newly formed team finalizes an implementation plan for the scorecard. It also encourages and facilitates the development of second-level metrics for decentralizes units. The result is an entirely new executive information system that links top-level business unit metrics down through shop floor and site-specific operational measures can be developed.

Periodic Reviews: At specified intervals, information on the balanced scorecard measures is prepared for both top management review and discussion with managers of decentralized divisions and departments. The balanced scorecard metrics are reexamined annually as part of the strategic planning, goal setting, and the resource allocation processes.

Though BSC is highly regarded, it should be kept in mind that problems of designing and implementing the BSC may be no different from those associated with any major change in performance-measurement systems.

10.4.4 Issues

The problem with financial data is that it can seldom make available complete information that is relevant to stakeholder values. As has been mentioned earlier, business organizations have three kinds of core processes: a customer relationship process, a product innovation process, and an infrastructure or operational process. Many of the performance requirements for customer relationship and product innovation processes are difficult, if not impossible to quantify using financial data. A number of studies have found evidence that traditional, financial measures of performance are most useful in conditions of relative certainty and low complexity – not the conditions faced by many organizations today.

Traditionally, companies have used the balanced scorecard to help communicate and implement their strategies. Companies develop the links in the scorecard based on ex ante expectations. The non-financial and financial measures, and the hypothesized links between these measures, can be used more extensively for continuous hypothesis testing *ex post*. If the company consistently applies its scorecard across multiple units, these tests can be performed at an early stage. Companies should consider alternative hypotheses when formulating the scorecard. By collecting data related to alternative hypotheses, one can assess the merits of another strategy, relative to the current strategy.

The ‘Balanced Scorecard’ (BSC), is regarded as a significant development in management accounting. 60 percent of the U.S. FORTUNE 500 companies have implemented or are experimenting with a BSC, according to published reports. The BSC has been offered as a superior combination of non-financial and financial measures of performance. Because the BSC focuses on links among business decisions and outcomes, it is intended to guide strategy development, implementation, and communication. Furthermore, a properly constructed BSC also provides reliable feedback for management control and performance evaluation.

To be effective, BSC measures should be accurate, objective, and verifiable. Otherwise, measures will not reflect performance and may be manipulated, or managers could in good faith achieve good measured performance but cause the organization harm. If managers can achieve good measured performance by cheating, the system will quickly lose credibility and desired motivational effect.

Some of the tools that are used for evaluation-control include the Pareto charts, activity based costing, strategy maps, balanced scorecard and strategic auditing. A Pareto chart is used to graphically summarize and display the relative importance of the differences between groups of data. Activity Based Costs (ABC) integrates what were once several activities - value analysis, process analysis, quality management, and costing into one analysis. ABC is a cost allocation methodology. The “Balanced Scorecard” (BSC) identifies the four related core processes that are critical to nearly all organizations and all levels within organizations: learning and growth capability, efficiency of internal processes, customer value, and financial returns. It includes financial and non-financial measures of performance.

10.5 M. PORTER’S APPROACH FOR GLOBALIZATION

Strategies exist at several levels in any organization-ranging from the overall business (or group of businesses) through to individuals working in it. Business Unit Strategy or competitive strategy is concerned more with how a business competes successfully in a particular market. It concerns strategic decisions about choice of products, meeting needs of customers, gaining advantage over competitors, exploiting or creating new opportunities etc.

Competitive strategy is an area of principal concern to managers. It provides the framework that guides competitive positioning decisions. It examines the way in which an organization can compete more effectively to strengthen its market position. The purpose of its competitive strategy is to build a sustainable competitive advantage over the organization's rivals. This means the ability to anticipate correctly how businesses respond strategically to competitive threats and opportunities.

Competitive strategy provides an understanding of the fundamental decisions that guide the organization's marketing, financial management and operating strategies. It hinges on a company's capabilities, strengths, and weaknesses in relation to market characteristics and the corresponding capabilities, strengths, and weaknesses of its competitors. Michael Porter identified the five competitive forces within an industry. Competitive strategies, according to Porter, are driven by these five basic forces. There are the generic competitive strategies that arise in response to these five factors; competitive strategy can take one of three generic forms: focus, differentiation, and cost leadership.

In addition, there is the resource based theory. Instead of looking at the industry as the source of profitability, the Resource-Based View of the firm argues that the attention should turn to the firm. Instead of seeking profitability at the intersection of the products and markets, the Resource-Based View looks for value derived from resources, capabilities and competencies. We will also discuss this view.

Most organizations have to make decisions on strategy based on either sequential or simultaneous decisions made by competitors. An understanding of how to make strategies under these conditions can be learnt from Game theory.

Finally, we will also look at competition for tomorrow's market. The dynamic changes that are taking place around us, project that the products we will be using in the next ten years may not even be on the drawing boards today. This market is simply too large to be ignored.

Every business has a competitive strategy. However, many strategies are implicit, having evolved over time, rather than having been explicitly formed out of a thinking and planning process. Implicit strategies lack focus, produce inconsistent decisions, and unknowingly become obsolete. Without a well-defined strategy, organizations will be driven by current operational issues rather than by a planned future vision. Porter's model provides a process to make your competitive strategy explicit so it can be examined for focus, consistency, and comprehensiveness.

Developing a competitive strategy is developing a broad framework for the business - how is it going to compete; what are its objectives; and what policies will be needed to carry out its objectives. The competitive strategy is a combination of 'ends' for which an organization is striving and 'means' by which it is seeking to get there.

A number of authors have written to illustrate key issues in the convergence - divergence debate, which is central to the process of globalization.

Some authors (most notably Levitt) argue that markets are converging upon a global market and that corporations need to base their strategies on global economies of scale by selling standardized products.

However others (e.g., Porter, Douglas & Wind, Prahalad & Doz, Bartlett & Ghoshal) argue that globalization is more complex than this, with companies facing competing pressures to be both global and local. This could involve centralizing some activities, or at least co-coordinating activities on a global basis, whilst responding to local requirements in other activities.

The central role of technology in determining both the nature of markets and the strategic/ operational opportunities and constraints upon organizations could usefully be mentioned. Further, there is a debate over whether a strong home base provides the innovative conditions necessary to compete on an international basis. This could lead to some corporations moving key activities, like research and development, to a location exposed to more favourable innovative conditions within an industrial cluster (argued by Porter).

Check Your Progress 2

State whether the following statements are True or False:

1. Strategic control approach is an organisational approach with a hand-off organisational strategy.
2. Strategic surveillance is intended to monitor a very broad range of events inside and outside the firm.
3. The strategy evaluation process is designed to ensure that the organisation is achieving its goals and objectives.
4. The evaluation process is the early warning system for the organisation.
5. Organisational design and various processes of resource allocation need not support each other for the successful implementation of an organisation's strategies.

10.6 FUTURE OF STRATEGIC MANAGEMENT

In essence, the vision of an organization that is continually expanding its capacity to create its future. The world is simply too complex to figure it all out from the top, and too rapidly changing to abide with the slow bureaucratic decision-making processes that come with top-down decision making in complex organizations. It is profoundly important in getting people to think about new ways of managing organizations rather than creating new organizational structures. You have to start with new ideas and concepts before you can change people's actions and behaviour. But even with the insight and inspiration that these ideas give, there's a very great challenge in figuring out how to operationalise them.

In a modern, multi-product, multi-unit business world; the usefulness of traditional financial analysis has limited usefulness as a strategic management tool. Financial measures need to be reinforced by other measures that will reflect the true state of affairs of the organization. Many new tools are evolving that include Activity based Costing and Management, Balanced Scorecard, and Strategy Maps, etc. There will be other new tools that will appear as the limitations of traditional tools become more apparent. This will give rise to a new breed of managers who will be smarter and better equipped with all the changes that are taking place around us.

10.7 LET US SUM UP

There are many kinds of strategic control systems. The evaluation and control process is designed to ensure that the organization is achieving its goals and objectives. The Evaluation Process is the early warning system for the organization. The objective of the activities of the organization is to implement the critical success factors which identify the levels of performance needed to outperform competition, to measure corporate performance as well as implement the appropriate strategy. Performance is the end result of activities. The organization has to develop a system of measurement of outputs through a series of agreed Performance Indicators (PIs).

Strategic control approach is based on providing a high level of autonomy to the operating units. It is basically a hands-off organizational strategy with control systems to monitor and evaluate the performance of the business unit. Strategic control architecture, therefore, is not a single stereotype architecture, but a set of organizational structures that bridge all of the space between strategic planning and financial control.

This lesson has it is important here to understand how the processes of resource allocation and control will influence the success or failure of strategy implementation. It tries to weave a thread through the different theories that have been studied so far, in an attempt to connect them or show the relationship that exists between them.

Resource allocation and implementation control consists of several related aspects. The first issue is to bring the organization to an understanding about the resources and competencies it will need for the future, and how they can be developed and sustained. At this broad level, this can be called the resource configuration of the organization. It includes the way in which linkages and relationships are managed both inside the organization and in the wider value-system of its stakeholders. Within this broad framework, these will be resourced and sustained.

There are many different processes by which resource allocation and control can be managed. Identifying the appropriate resources and competencies to support strategy implementation is important, but it will not result in successful implementation unless the organization is also able to allocate resources and control performance in line with the strategy. This is likely to be influenced by the extent of change needed in resources and

competencies, and the management style. The management style reflects the degree of devolved authority that executives have over resource allocation decisions. Therefore, there is a wide variety of approaches ranging from centrally imposed resourcing plans to competitive processes within the organization.

As was mentioned in the lesson, information technologies combined with proper selection, training, and the willingness of managers to rethink their jobs, have the potential for literally turning organizations upside down, changing forever what we have thought of as the role of management, if not leadership. The information capability of the organization has a major influence on its resource competencies and processes of control.

10.8 LESSON END ACTIVITY

Choose strategic developments for an organization that you are familiar with and compare the resource configuration implications. What advice would you give the management based on your analysis?

10.9 KEYWORDS

Self-control: Self-control is a co-coordinating mechanism of mutual adjustment, whereby resource allocation and controls are largely determined by the direct interaction of individuals without supervision.

Reinforcing Cycle: A Reinforcing Cycle is formed when there is a dynamic interaction between the various factors of environment, configuration systems, etc., to strengthen the cycle.

Evaluation and Control Process: The Evaluation and Control Process is a process designed to ensure that the organization is achieving its goals and objectives. It compares performance with the desired results and provides the management with a feedback to evaluate results and take the necessary corrective action.

Output Control: Output Control specifies what is to be accomplished by focusing on the end result of the behaviours through the use of objectives and performance targets.

Behaviour Control: Behaviour Control specifies how something is to be done through policies, rules, standard operating procedures, etc.

10.10 QUESTIONS FOR DISCUSSION

1. Write a short report to the Chief executive of an organization that you are familiar with and explain to him how he should use performance measurement criteria to improve the implementation control in the organization. What specific areas of their organization would benefit the most, and why?

2. How do organizations manage change? Explain the methods used to manage change and compare and evaluate the approaches to strategic change followed by any two Indian organizations that you have studied.

3. There are a number of combinations that are possible considering the structure, strategy, technology, environment, style etc. that will provide reinforce the strategic development or affect it negatively. Students should be able to identify the main sources of reinforcement and demonstrate how the resource configuration of the organization may be used effectively to contribute to the strategy decision.

Check Your Progress: Model Answers

CYP 1

Strategic Control: The process needs to be an ongoing and continuous process. It provides, on a continuous basis, a clinical check-up on the progress of the business objectives in the near term Annual Operating Plan and the long-term Strategic Plan. It determines if the performance requirements are being met within the timeframe.

CYP 2

1. True
2. True
3. True
4. True
5. False

10.11 SUGGESTED READINGS

Pearce & Robinson, *Strategic Management*, All Indian Travellers N.D.

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