BBA-16

Vardhaman Mahaveer Open University, Kota

Strategic Management

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CONTENTS

Strategic Management

Unit - 1 : Strategic Management: An Overview

Structure of Unit:

1.0 Objectives

After completing this unit, you would be able to:

- To understand the evaluation and concept of Strategic Management;
- To understand the hierarchy of strategic management;
- Point out various levels of strategic management hierarchy.
- Know about importance of strategic management;
- Learn and appreciate the significance of strategic decision making;
- Understand Strategic Decision Making Process in detail.

1.1 Introduction

The complex business scenario has compelled organizations to constantly keep their eye on strategies. The decision making has become intricate process due to global business forces. Under such situation, strategic management is a powerful tool to facilitate the managerial decision making.

Multi-national corporations are spreading their wings in various globalized economies and this poseschallenges for local firms. To mitigate the impact of market forces, local firms must step-up the ladder of strategic management and strategists deliberately use the strategic weapons to counter attack the gaps between present and future state of organization.

As the intensity of competition increases day-by-day it becomes mandatory for organizations to respond strategically to market forces. The fundamental task of management is to make decisions and take actions. This involves the process of strategic management. The aim of strategic management of is to make the best use of a firm's resources in a changing business environment.

1.2 What is Strategic Management?

As we can see that there are two words "Strategic Management" and before going into the details, for better understanding, we must understand the words separately. We know that functions of management is planning, organizing, directing and controlling of the resources. The term "strategy" is known as the action plan which is devised to achieve the organizational objectives and it is only possible when proper direction to the available resources is given by top management.

Thus, the integrated meaning of the term "Strategic Management" is usually considered as the process of formulation, implementation, control and evaluation of strategies for an organization in order to respond market challenges posed by business environment. The purpose of strategic management is to bridge the gap between the envisioned state and the present state of the organization. Top management of the organization is responsible to direct the firm's resources effectively. It is possible when the top management has fair knowledge about the strengths and weakness of the firm and opportunities and threats of markets. Strategic management is nothing but a tool through which a fine link between strengths of the organizations and opportunities available in market is created by working upon weaknesses of the firm and threats of markets. For proper and better understanding of strategic management it becomes essential to understand the evolution of strategic management.

1.2.1 Evolution of Strategic Management?

In the beginning of 19th century, the planning for day to day business activity was carried out for short period and on daily basis, which was a tough task and it made business process intricate. The classical theorist like F. W. Taylor, Weber and Fayol propounded the concepts of planning and gave new dimensions to management. Therefore, initially strategic management was considered as business policy and in 1920s, when Harvard University introduced a course known as 'Business Policy' for the business administration programme and focused on integrating the functional areas of business administration like accounting, management, marketing, human resource, finance and production. In the beginning, this course aimed to provide learners the ability to apply the knowledge learned in previous courses to solve problems of organizations. As such the business policy course provided formal training and experience in handling issues affecting the business and systematic and analytical thinking in resolving problems affecting the performance of organizations. Thus, the birth of strategic management was in the form of business policy took place but the term strategy was used by military, hence we need to explore the word "strategy" further.

Here, it is worth to mention the Etymology of the term "strategy" indicates that it is taken from Ancient Greek "*stratçgia*" which means office of general, command, and generalship or army leader or "*stratçgos*" which means "the leader or commander of an army, a general. It was interpreted as science and art of military command as applied to the overall planning and conduct of warfare, an action plan intended to achieve a specific goal. On the other hand, the complexity of business was growing and policy makers started planning for future i.e. long term rather than today i.e. short term. Thus, the academic origin of the term strategic management was used by policy makers. The practical implication of the term strategic management supported the decision making process effectively and efficiently. During 1960s, researchers like Peter Drucker found that each organizational situation was different and the best way to managing them was to be dependent on situational analysis.

During 1970s and 1980s, strategic management became a distinct academic field as researchers began to empirically study companies. The current business scenario is crucial as it includes all such activities which are organized and operated to provide goods and services to the society, and cater societal needs like creation of employment opportunities, offer better quality of life, contribution to the economic development of a country.

Thus, we can say that strategic management is the comprehensive collection of ongoing activities and processes. Organizations systematically coordinate and align resources and actions with mission, vision and strategy. Strategic management activities transform the static plan into a system that provides strategic performance feedback to decision making and enables the plan to evolve and grow as requirements and other circumstances change.

1.2.2 Strategic Management: Definition and Meaning

Ansoff (1965) defines strategy in his book *Corporate Strategy* as "The common thread among the organizations' activities and product markets that defines the essential nature of business that an organization was or plans to be in future."

Glueck (1972) defines strategy as, "A unifies, comprehensive and integrated plan, designed to assure that the basic objectives of the enterprise are achieved."

According to Drucker (1986, p. 57) strategy determines what the key activities are in a given business and strategy requires knowing "what our business is and what it should be."

According to Dess, Lumpkin and Eisner (2006) strategic management has three pillars viz. analysis, decisions and actions on which the success of an organization largely depends. The top management of the organizations is concerned about the strategic analysis of their vision, mission, objectives (long term and short term) and their goals. To deal with this the most basic but important questions must be answered by the management, which are: What industries should we compete in? How should we compete in those industries? These questions also often involve an organization's domestic as well as its international operations. Now, considering these questions the analysis is usually done by collecting and analyzing the information related to the internal and external environment of the organization. This analysis will give certain strategic choices and at last but not the least the most suitable actions will be taken by the management. Decisions are of little use unless they are acted on. Firms must take the necessary actions to implement their strategies. This requires leaders to allocate the necessary resources and to design the organization to bring the intended strategies to reality. As we will see in the next section, this is an ongoing, evolving process that requires a great deal of interaction among these three processes.

Thus, we can find that strategic management provides a framework containing a set of rules, which is helpful in taking organizational decisions for sustainable development. Strategic management covers following aspects of:

- Envisioning the future business environment
- Identifying and getting the pulse of the industry in which a firm operates
- Scanning the business environment of a firm
- Drafting of vision and mission statements for the firm
- Setting of short term and long term objectives
- Identifying the strengths and weaknesses of the firm

- Identifying the opportunities and threats for the firm
- Creating a strategic fit for sustainable development
- Directing the resources for optimum utilization
- Controlling the business activities by balancing the objectives and output

1.2.3 Nature and Scope of Strategic Management

The nature of Strategic management is that it is interactive and interconnected with other functional areas of organization. The existence and success of strategic management, to a large extent, depends on organizational structure. There is a relationship between strategic management, organizational structure and various levels of strategy corporate level, strategic business unit (SBU), functional and operational level. Here, it becomes important to discuss the four distinct levels where strategy operates. The below mentioned figure 1 is diagrammatic representation of Interrelationship between various levels of management and hierarchy of strategy.

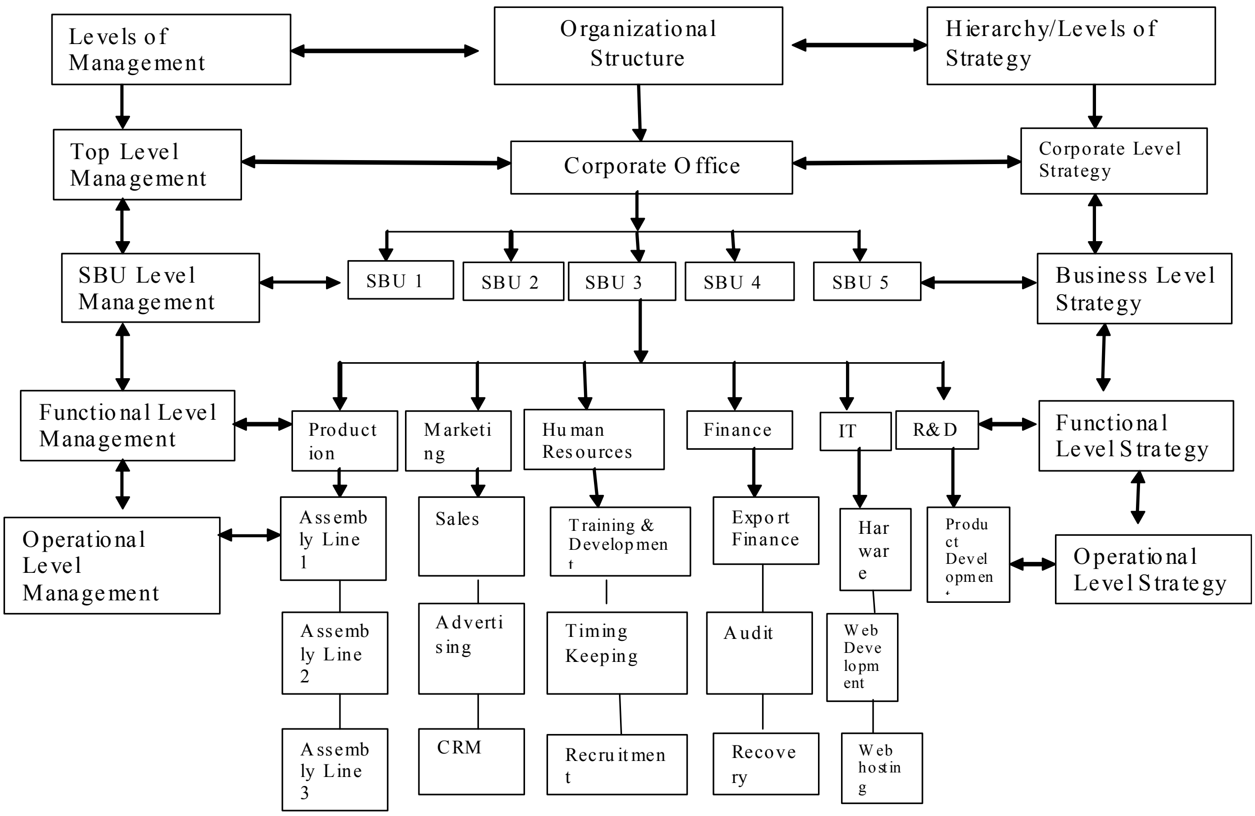

Figure - 1.1: Interrelationship Between Various Levels of Management and Strategy

Thus, we can include following points as nature and scope of strategic management.

1.3 Hierarchy of Strategic Management

1.3.1 Corporate Level Strategies

Typically, in an organization, there are four basic levels. The top level of management consists of chairman/ directors/chief executive officers of the company. They are basically responsible for providing directions of the future to the organization. The conceptual skill of top management executives is quite strong and they adopt holistic approach to scan the respective business environment. The implied responsibility of top management it to draft the vision statement, mission statement, aims and objectives. Top management of any business organization has bird's eye view to light-up the path of success.

It is the top management, which takes decision on various corporate level strategies like growth strategies, stability strategies, retrenchment strategies and combination strategies. By adopting the process of strategic management, the CEOs, CFOs, CMOs, CIOs and other top executives will determine the fate of organization as they are responsible for decision making. Usually, top management will take decision with regard to expansion strategies like whether to expand the existing business in domestic or international market by introducing new product line or adopting diversification strategy like entry into new industry as such with a complete new range of products as Canon entered in office equipment manufacturer from a camera producing firm. Apart from this, top management can adopt the retrenchment strategy, where top management has to decide whether to turnaround, divestment or liquidify the assets of the organization as Hindustan Unilever Ltd. divested its marine foods business to Mumbai based Temptation foods.

Therefore, top management executives provide broad guidelines to the business conglomerate in the form of vision, mission and objectives to the middle management who comprises with strategic business unit level and functional level.

Figure - 1.2 : Nature of Corporate Level Strategy

1.3.2 SBU Level Strategies

Strategic business unit level management comprises primarily the business managers, presidents/vicepresidents/ general managers and senior managers. At this level, the businesses managers will get hold the nerve of their business in the respective industry. Business managers are responsible to have in depth knowledge about the policy and legal framework of the respective business in which they are operating, market forces like competitors, customers, suppliers and intermediaries. Here, the strategic intent of the organization will be translated into general statements with regard to functional areas. The direction received by top management will now be in more specific terms to core areas of the business. The competitors are evaluated by the managers and either pro-active or re-actives actions in the form of strategies and tactics will be taken to achieve the stated objectives and targets. The organizational values, beliefs and ethics will be further inculcated to the functional and operational level. The vision and mission statements would be further interpreted in more specific terms and this will form a base for for individual to integrate their personal objectives with organizational objectives.

1.3.3 Functional Level Strategies

Organizational structure is such where; all the activities are segregated with their respective nature i.e. marketing related activities will fall under Marketing Department which will further be divided in various sub-departments as shown in fig. 1.

Here, various functional managers will play their role by drafting short-term strategies and tactics in order to achieve the organizational objectives. The functional areas are the components of the organization. The management of these components requires the equal amount of technical skills and managerial skill to perform their duties and responsibilities. A functional manager will follow the instructions of middle management so as to accomplish the task. At this level, directions are given by functional managers for utilization of resources. The managers of various products, geographic and other functional areas at this level will develop annual objectives and short-term strategies, which would cater the needs of specific market. The strategies are designed in every functional area like research and development, finance and accounting, marketing, sales, human relations etc. The responsibilities of functional level managers will also include the integration of administrative systems and organizational structure and strategic and operational modes to seek the congruency between managerial and the corporate culture.

Sub-strategies are undertaken by the respective functional level to target the departmental aspects of the operations. The important thing here is to have proper alignment of the sub-strategies with other strategies and sub-strategies of the organization. Like a machine can merely work when its components are well fitted and properly oiled, similarly, if all the functional areas are well integrated with well woven strategies, then only the organization can get success.

1.3.4 Operational Level Strategies

As the name indicates, all the organizational resources like men, material and machines get operationalised to prove the worth of vision and mission statements and to realize them. At the operational level the various organizational tasks are actually performed and the broad directions will be further broken up into day-to-day activities.

The strategies are needed to mobilize the huge amount of resources. The planning will alone will not be able to achieve the organizational objectives. One of the most herculean tasks is to implement the planning and mobilizing the resources in the right direction at the right time. Therefore, all the tasks, whether small or big, are deliberately carried out. Operational level strategies will determine whether the organization will achieve the objectives or not.

1.4 Importance of Strategic Management

In the globalized economic scenario, where the level of consumer awareness is quite high due to easy accession of information with the help of information and communication technologies, multinational corporations are making foray with innovated products, complex but liberalized legal and policy framework and huge amount of bargaining power of buyers and suppliers, making the business an intricate process. The question arises how to view the market so as to survive and sustain in such a vivid market scenario. The solution lies with strategic management.

It is argued that strategies are needed to give companies directing. Without strategies, incorporating objectives would be futile and organizations will face challenges to sustain and survive in the industry. If companies do now decide where they want to go, employees of the organization would not know what they are doing and what for. Employees would be aim less and they will lose focus on their tasks.

To avoid such circumstances, organizations avail the benefits of strategic management by adopting the concepts to overcome from intricate and complex situations. We can understand the importance of strategic management in following lines:

- Strategic management facilitates all levels of management to realize the sense of purpose.
- Strategic management integrates the activities of the functional areas.
- Strategies are the tools in the hands of all the managers at all the levels to cater the needs of market successfully.

- Strategic management can be considered as the eyes of organizational management, which will get the insights into the micro and macro factors of the business.
- Strategic management will lay down the foundation to response the challenges of market
- Strategic management is a key to resolve the issues of complex economic scenarios.

Thus, we can say that strategic management is common thread among all the functional areas of the organization. It bridges the various levels of organization by creating a link of objectives.

Activity A:

1. Analyze the concept of strategic management. Discuss interrelationship between various levels of management and strategy and correlate this with an imaginary case.

1.5 Strategic Decision Making

According to Ansoff (1965) strategic decisions are primarily concerned with external rather than internal problems and more specifically with the selection of the product mix which the firm will produce and the markets to which it will sell thus establishing an impedance match between the organization and its environment. Jauch and Glueck (1988) define strategic decisions as means to achieve ends. These decisions encompass the definition of business, products and markets to be served, functions to be performed and major policies needed for the organization to execute these decisions to achieve objectives. According to Pearce and Robinson (1996) the complexity and sophistication of business decision making requires strategic management. Managing various and multifaceted internal activities is only part of the modern executive's responsibilities. The firm's immediate external environment poses challenging factors and it includes competitors, suppliers of scarce resources, government agencies monitoring regulatory framework, intermediaries and customers. Apart from this, the remote external environment also contributes to the general but pervasive climate in a business organization exists. This includes diverse economic conditions, socio-cultural, political factors, technological developments and natural environmental factors largely formulate the base for decision making.

To deal effectively and efficiently with all the factors, the ability of company to grow profitably, managers design strategic management decision making process. Thus, strategic management facilitates organizational management at all the hierarchy levels with strategic levels. The effective decision making will position a firm in its desired state. But, mismanagement of these environmental factors may lead to critical situations. The recent example of mismanagement of environmental factors is Kingfisher Airlines, whose license is canceled by Director General of Civil Aviation (DGCA).

The strategic management approach emphasized interaction by managers at all the levels of the organizational hierarchy in planning and implementation. Therefore, strategic management has certain behavioral consequences that are also characteristics of participative decision making. Therefore, a firm must be prepared to effectively and efficiently respond to the external and internal environmental factors. It is mandatory for survival of a firm, achieve new growth path and maintain the sustainable competitive advantage.

According to Allen and Coates (2009), the ontology of strategic decision making is that Strategic decisions are non-routine and involve both the art of leadership and the science of management. Routine decisions of how to efficiently manage resources according to established procedures and clearly understood objectives is the technical work of management. Routine decisions are normally the purview of supervisors and middle-level managers that have the requisite authority and responsibility to take action. However, non-routine decisions require what Harvard Professor Ron Heifetz refers to as “adaptive work” where senior leadership must consider the broader implications of the situation, take an active role in defining the problem, and creatively explore potential solutions, and apply judgments as to what should be done. The USAWC defines Strategic Leadership as the process of influence for “achievement of a desirable and clearly understood vision by influencing the organizational culture, allocating resources, directing through policy and directive, and building consensus,” implicitly requires the capacity for strategic decision making.

Thus, on the basis of above discussion we can identify following characteristics of strategic decision making.

- Strategic decisions are taken by top management and it is imperative because these decisions are related with several areas of operations of the organization and affect the entire organization.
- Strategic decisions require commitment of organizational resources like human, physical, capital etc.
- Strategic decisions have significant impact on the organization’s future development and affluence.
- Due to future implications of strategic decisions, it has close link with business environment of a firm.
- Strategic decisions will be directional for various functional areas of organization.
- Thus, strategic decisions are highly integrated with organizational levels.
- Merely, integrations of strategic decisions are not enough, proper implementation of these decisions will lead an organization to success.

Therefore, human assets of an organization must live with the decisions taken by the management. Strategic management decisions are made using rational, conscious and initiative personal courage in the light of existing realities.

1.5.1 Criteria for Strategic Decision Making

The broad criteria for strategic decision are usually governed by the vision of decision maker. The conceptual clarity of all the variables of business constituents like buyers, competitors, suppliers, intermediaries, legal frameworks etc., is mandatory. In the uncertain business environment, to lay down the criteria for strategic decision making is extremely significant in order to avoid the strategic miss-match organizational resources and market requirements. Thus, the decision maker must select the criteria which suits to his current requirements. Strategic decision making is a means of realizing the stated vision and mission of the organization.

Rationality: Rationality in decision making process implies the presence of logical reasoning in selecting the available alternatives. A number of alternatives may be created based on different situational analysis, but, the alternatives are largely determined by the availability of resources means the capability of the firm. Therefore, the objectives are to maximize the profitability and attainment of desired state. For strategic decision making social sciences facilitates the decision makers. For example, a firm wants to expand their business to foreign markets then decision makers must scan and understand the economic scenario of respective market and it is only possible when decision maker posses the knowledge the economic concepts. Now-a-days, decision makers are utilizing the technology to rationally analyze the market related information with the help of some statistical and mathematical software.

Creativity: Creativity and innovations bring some unusual ideas. There are various ways through which, companies can utilize the creativity of their employees. Some of them are brain storming; attribute listing, Gorden techniques etc. to generate alternative strategic options. It is important for managers who are in the field of strategic management to develop creative ways of lateral thinking and looking beyond the obvious to come up with break-through ideas. This process involves short-listing of ideas and evaluating workable strategies with weightage scores.

Dynamism: Human beings are dynamic in nature; therefore, it is natural that two people cannot think in same manner. The two managers involved in strategic decision making will probably arrive at two different conclusions and therefore, difference of opinion exists. These differences may arise due to difference of perception of the problem. Moreover, managers may differ in their approach because of their experience, training, and mind set etc.

1.5.2 Type of Personality or Individual Factors

Age, experience, qualification, intellectual capability, logical and rational thinking training, values etc. play a very crucial role in strategic decision making. Difference styles of leadership quality may lead to varying degree of information availability and its assimilation, thus affecting the decision. The values, ethics, beliefs etc. of a person also reflects on decisions taken by him.

1.5.3 Strategic Decision Making under Uncertainty

Recently, a new approach has been adopted to deal with uncertainty in business According to Tean (2011) strategic decision making play a crucial role to manage uncertainty of business.

A Conceptual Framework for Strategic Decision Making under Uncertainty

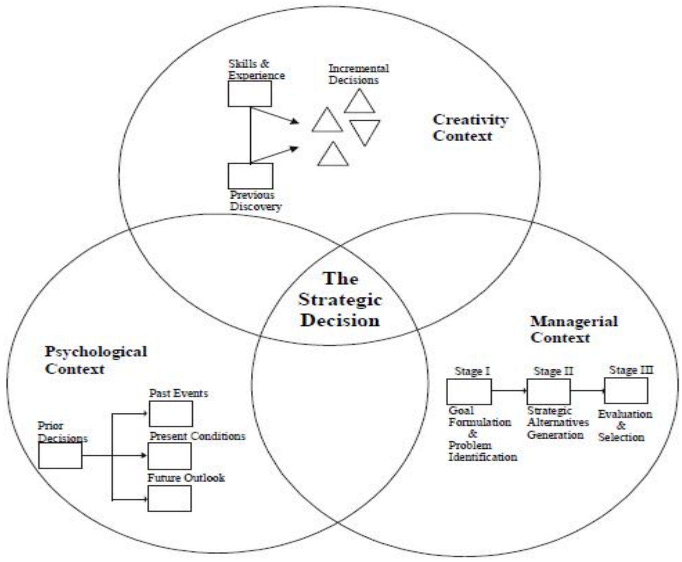

Figure – 1.3

Source: Teal, E. J. (*2011*). Strategic Decision Making Under Uncertainty from the Foundations of Creativity, Psychology, and Management Research: An Examination and Synthesis. *Journal of Business Administration Online,* 10(1).

Creativity Context of Strategic Decision Making

According to Teal (2011) the key points identified by creativity researchers suggest that creative problem solving is an incremental process that is most successfully implemented by intelligent and insightful individuals with the skills and experience necessary for creation who may have produced successful creations in the past A conceptual framework for strategic decision making within the context of the field of creativity is provided in above figure.

Psychological Context of Strategic Decision Making: Teal (2011) referred the model of Bateman & Zeithaml (1989), who developed a theoretical model of the psychological context of strategic decisions. The model was supported through empirical testing and suggests that the psychological context of a strategic decision is influenced by prior decisions and is dependent upon present conditions, past events, and the future outlook of the decision maker. A version of their model is reproduced in above Figure and represents the psychology portion of the conceptual framework for strategic decision making.

Managerial Context of Strategic Decision Making: Teal (2011) stated that following an extensive review of the decision making literature in the field of management, Schwenk (1984) derived a model of strategic decision making. The model, which is divided into three stages, identifies Stage I as goal formulation and problem identification, Stage II as strategic alternatives generation, and Stage III as evaluation and selection. Schwenk noted the difficulty inherent in strategic decision making in that "Strategic decisions occur relatively infrequently and involve ambiguous data and possible disagreement about which data are relevant. Further, the feedback about the success of the strategy is often ambiguous, since there may be multiple evaluation criteria, and evaluation data may not be available for years after implementation" (1984). A schematic model based on Schwenk's derived model of the strategic decision making process is provided in above Figure and represents the management portion of the conceptual framework for strategic decision making.

Thus, as per above discussion we can say that strategic decision making is the function of management. These decisions are deliberately taken by considering the relevant facts and figures pertaining to the business problems.

Strategic decisions are the decisions that are concerned with whole environment in which the firm operates the entire resources and the people who form the company and the interface between the two.

1.5.4 Features and Characteristics of Strategic Decision Making

- Strategic decision making has major resource propositions for an organization. These decisions may be concerned with possessing setting new plants, new resources, organizing and allocating them.
- Strategic decision making deals with harmonizing organizational resource capabilities and giving directions to deal with the threats and opportunities prevailing in market.
- Strategic decisions deal with the range of organizational activities.
- Strategic decisions always involve a change in dealing with resources as an organization operates in dynamic environment.
- Strategic decisions are complex in nature.
- Strategic decisions are at the top most level, are uncertain as they deal with the future, and involve a lot of risk.

Strategic decisions are different from operational decisions and administrative decisions. Operational decisions are technical decisions which help execution of strategic decisions. Administrative decisions are routine decisions which facilitate strategic decisions or operational decisions. For example to reduce cost is a strategic decision which is achieved through operational decision of reducing the number of employees and how we carry out these reductions will be an administrative decision.

The differences between Strategic, Operational and Administrative decisions can be summarized as follows:

Table – 1.1

Strategic Decisions	Operational Decisions	Administrative Decisions
These are long-term decisions.	These are seldom taken.	Routine Decision
Considered future planning.	These are medium-period based decisions.	These are short-term based Decisions.
Strategic decisions are taken in Accordance with organizational mission and vision.	These are taken in accordance with strategic and administrative decision.	These are taken according to strategic and operational Decisions.
These are related to overall Counter planning of all Organization.	These are related to production.	These are related to working of employees in an Organization.
These deal with organizational Growth.	These are related to production and factory growth.	These are in welfare of employees working in an organization.

1.5.5 Strategic Decision Making Process

Strategic decision making process is important to solve complex business issues for different managers of the organization. Managers must rely on their own intuition or gut feeling when dealing with a complex strategic issue. According to Randrup (2011), for managers with a subject matter or specialist background, they will typically reflect on the problem and find a solution to it eventually without the involvement of others. Most of the Managers with a strong team or group orientation typically discuss the problem and potential solutions with their peers and colleagues to collect information and opinions about what should they do.

For major strategic issues in a business, for example next year's operational or strategic business plan, a company might have standardized the process of the decision making to ensure a professional approach to make or revise the yearly strategy. Nevertheless, for most other complex business problems, managers do not seem to have or follow a standard method or approach to solving these problems.

In order to have a better approach towards the strategic decision making, a structured step typically brings a higher quality of decision making. Based on various research of different strategic decision making processes, hereby we have developed a six step structured approach to solving strategic business problems, which includes

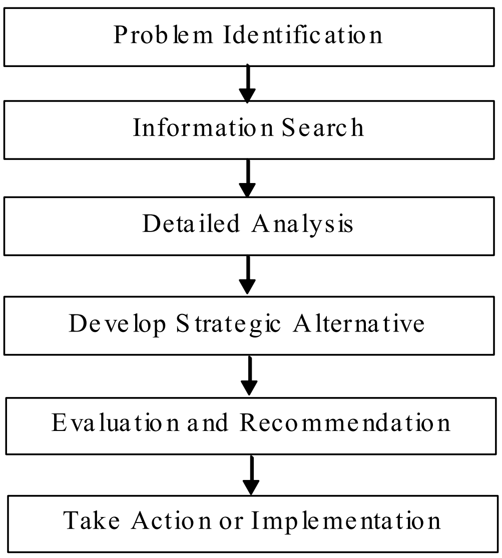

Figure – 1.4 : Strategic Decision Making Process

Step One: Problem Identification: Problem identification is the first step which intends to search the issues which creates problems in business. This can be done by constant observation of day to day activities of organization.

Step two: Information Search: In the second step relevant information is searched by the experts. The sources of information can be primary or secondary. Primary sources may include the surveys and secondary sources may be previous studies, secondary data, government agencies etc. Without a sound understanding of the relevant facts of the situation, the decision cannot be made on a factual background. So an analysis of the situation is relevant to unveil key facts about the situation, especially the ones that deal with what issues have caused the need to make a decision now.

Step three: Detailed Analysis: The purpose of the detailed analysis is to find and describe both the potential root causes as well as the consequences of the issues at hand, and thereby describe what the decision should focus. There may be a number of causes or issues, and a good situation analyst must unveil.

If there is more than one clear issue, the manager must be able to choose the solution path, and prioritize what causes or issues to solve first, and which ones to address later. It can resemble a sort of decision tress. However, in order to determine what root causes to focus on first, the manager or researcher must first be able to identify and describe the different issues. Then the importance must be considered, as well as any cause effect relationships. And with that done, a precise strategic diagnosis must be formulated, which outlines what specific issues must be dealt with and in which order.

Step four: Alternative Options: A strategic alternative includes the strategic direction, a number of strategic scheduling oriented decisions and a list of key actions that needs to be done in order to implement the solution. The strategic alternative can be developed through different ways. The most common ways may include brain storming sessions with key staff members, looking at the experiences of other companies, what they have done in the similar situations, and gathering ideas from managers who have a direct or indirect stake in the decision. It is also possible to get inspiration from business text books and articles, to the extent that there is anything published about the decision.

Step Five: Evaluation and Recommendation: Based on the different available alternatives, managers must deliberately decide that what kind of criterion they should adopt to evaluate the consequences. By having diverse options, it is practically possible to compare the positive and negative points of the different alternatives against each other. The evaluation criteria must be developed on the basis of an analysis of what would happen, if one or the other options are implemented. Evaluation criteria are therefore outcome oriented and value oriented. Typically, strategic alternatives have a financial impact on the company, and therefore the financial consequences supposed to be included in the evaluation criterion. Likewise, there is always a unforeseen risks involved in terms of how big a risk the company is running when choosing one alternative over another one. Another area for evaluation criteria is typically the strategic fit of the alternatives with the current corporate strategies and policies.

Step Six: Implementation: Most of the strategies fail because of lack of proper implementation and it is not because the strategic thinking and the strategic alternatives chosen is not the best one. More often, it is the execution of the strategy that is weak, which leads to poor results. Consequently, for any good strategic decisions, the manager must outline an implementation plan for how the strategic alternatives chosen should be carried out in the present scenario.

A good implementation plan includes first and foremost a list of all key activities and deliverables of the option at hand. Each activity must have a start and an end point. The responsibility of the individual activities must be decided as well as who had the responsibility and who should participate in the activity. Considerations about how many resources should be used on the strategic alternatives must be outlined, both in terms of manpower and in terms of other costs. As part of the implementation plan, the manger must also include different communication initiatives as well as activities that address and mitigate the most serious and obvious risks of the strategic solution chosen.

Activity B:

1. Try to establish a relationship among above described steps?
2. Elaborate the strategic management process with the help of a suitable example.

1.6 Summary

The first chapter deals with the introduction and evolution of strategic management along with the present status of the subject. Attempt has been made to throw light on nature and scope of strategic management with the help of a suitable model which presents a picture of interrelationship among various levels of strategy and organizational hierarchy. It becomes imperative to inculcate the concept of integration of strategic management with SBU and functional areas of organization at initial stage of the subject in order to have better understanding and implication of the subject.

Hierarchy of strategic management is well conceived with reflecting the basic role of top management which they are supposed to have and other areas of organization. The points are explained by keeping the current status of business model adopted by most of the organizations.

The end part of chapter first deals with strategic decision making which is of upmost importance because it is the pivotal point of success for organizations. Mainly the process of strategic decision making includes the problem identification, search of relevant information, detailed analysis and developing strategic alternatives. Further, suggestions are made and followed by evaluation and control of implemented strategies.

1.7 Self Assessment Questions

1. What do you mean by "Strategic Management"? Explain in detail.
2. What are the different aspects of the hierarchy of strategic management? How do these influence business?
3. Discuss the nature and importance of strategic management.
4. Discuss the importance of strategic management in context with contemporary business scenario.
5. Elaborate the Strategic Decision Making in details with suitable example.
6. Discuss the Strategic Decision Making process relevant example.

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Unit - 2 : Strategic Management Process

Structure of Unit

2.0 Objectives

After completing this unit, you would be able to:

- Understand the process of strategic management;
- Classify the comprehensive model of strategic management;
- Point out various roles of top management;
- Know about implications of strategic management process;
- Learn and appreciate the significance of strategic management to society;
- Understand strategic management with practical approach.

2.1 Introduction

The complex business scenario has compelled organizations to constantly keep their eye on strategies. The decision making has become intricate process due to global business forces. Under such situation, strategic management is a powerful tool to facilitate the managerial decision making. Multi-national corporations are spreading their wings in various globalized economies and this poses challenges for local firms. To mitigate the impact of market forces, local firms must step-up the ladder of strategic management and strategists deliberately use the strategic weapons to counter attack the gaps between present and future state of organization. As the intensity of competition increases day-by-day it becomes mandatory for organizations to respond strategically to market related factors. Therefore, the need of the hour is to inject the fundamental aspects of strategic management among budding managers.

To inculcate the concept of strategic management, one must adopt the holistic approach towards the business organization. As organization is a set of various departments having various and different functions altogether, strategic management process is the common thread which keeps all the departments in proper alignment. Thus, we can say that strategic decision making is done by following the process of strategic management. In this section we specifically deal with comprehensive model of strategic management, process and sequence of strategic management, role of top management and at the end strategic management process implementation.

2.2 Strategic Management: Comprehensive Model

According to Kazmi (2010) strategic management defined as the dynamic process of formulation, implementation, evaluation and control of strategies to realize the organization's strategic intent.

From the above definition we can say that strategic management is a dynamic process and it is not static and one time process. Therefore, strategic management is a continuous process which keeps on evolving on regular input from the operational environment of the organization. It can be interpreted that strategic management is not a rigid process rather it is step-by-step gathering and collection of information pertaining to the existing business which a firm intends to carry out in a sequential order.

To understand the strategic management process, initially, one must have fair conceptual clarity about the comprehensive model of strategic management, which represents the sequence of steps of strategic management and decision makers in any organization usually follow this. The comprehensive model of strategic management is exhibited in figure 1 which is derived by Pearce and Robinson in 1996. It clears the picture that how strategic management process along with hierarchy of organization works. This model also clarifies the roles played by the top management which includes Board of Directors, Chief Executive Officers, Corporate Planning Staff, middle level managers and operational level managers.

Thus, strategic management includes a set of managerial decisions and actions which determine long-term planning and effective performance of superior objectives and goals of the organizations. Moreover, it involves important aspects like setting the organization mission, company of organization profile, external environment, operating industry, multinational analysis, developing objectives, development of strategic analysis and choice and implementing the strategies, to accomplishment of the long-term objectives and short-term objectives and finally control, monitor, guide and evaluates the organizational objectives.

According to Pearce and Robinson (1996) this strategic management model serves three major functions. First it provides a visual representation of the major components of the entire strategic management process. The model also shows how the components are related and how they are arranged in sequence throughout the process. Second, the model will serve as the outline for this text. After providing a general overview of the strategic management process, the major components of the model will be discussed in the other chapters. Finally, the model is suggested for use in analyzing case.

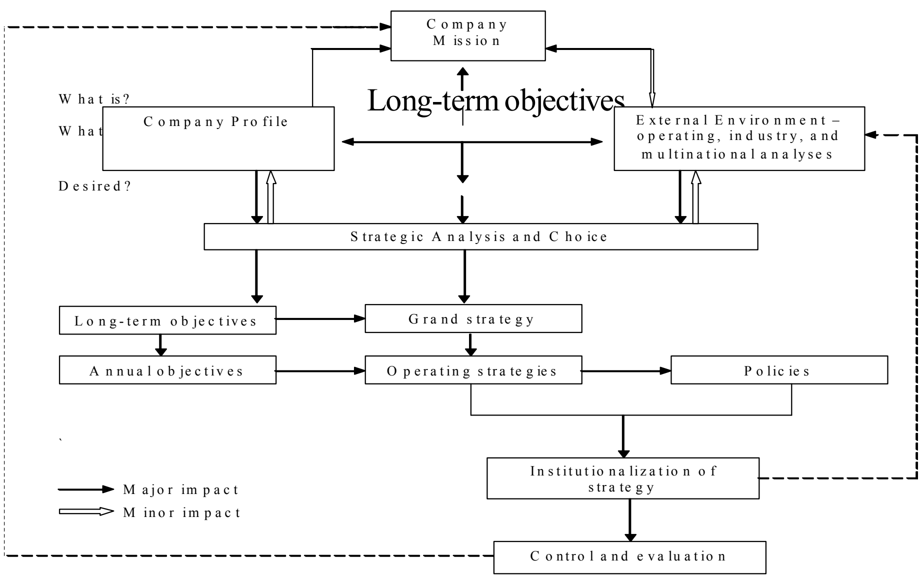

Figure – 2.1: Comprehensive Model of Strategic Management

Source: Pearce, J. A. II and Robinson, R. B. Jr. (1996). *Strategic Management: Strategy Formulation and Implementation*. New Delhi: AITBS Publishers and Distributors.

Brief Sketch of Components of Strategic Management Model:

Mission of Company: The mission of any business represents the unique purpose, which sets apart from the other firms in the same business. A mission is a statement which clearly indicates the intent of the company. It embodies the philosophy of business practiced by decision makers. It reflects the image of the company, self concept and indicates the principal product or services areas specifically targeted to satisfy customer needs. Pearce and Robinson (1996) emphasized that the mission describes the product, market, and technological areas of emphasis for the business in a way that reflects the values and priorities of the strategic decision makers. Thompson (1997) defines mission as the essential purpose of the organization, concerning particularly why it is in existence, the nature of the business(es) it is in and the customers it seeks to serve and satisfy. Hunger and Wheelen (1999) say that mission is the purpose or reason for the organization's existence.

Internal Environment: The analysis of a firm based on its available resources determines its performance capabilities. The component of the analysis includes the financial resources, human resources, and physical resources available to a firm. The internal analysis of a firm will end up in inherent strengths and weaknesses. This analysis will frame the base for strategic decision making for managers.

External Environment: External environment of a firm plays a crucial role as far as strategic decision making is concerned as it comprises with uncontrollable factors which affects the managerial decision. External environment can be divided in two types; one is micro factor which includes the customers, competitors, suppliers and intermediaries etc. These factors prevail in an industry and can be termed as operating factors too as it directly affect the firm's decision and performance in market. On the other hand, macro factor which includes the government policies, legal factors, socio-cultural factors, political factors, economic factors, technological factors and natural factors etc. These factors will affect the industry as a whole. Therefore, external analysis will create the picture of opportunities and threats available in market.

Strategic Analysis and Choice: Decision makers must create a match between a firm's strengths and available opportunities where as strive hard to face the challenges of weaknesses and threats raised by internal and external environment. This is a dynamic and continuous process which will pose new challenges for a firm. A firm must assess and interact with the internal and external environment on regular basis so that the best possible decision can be taken in context with given set of conditions. When internal and external analysis is carried out by a firm, prevailing set of conditions are scanned closely by the strategists. Strategists have number of options to select but depending upon the strengths and weaknesses of firm strategists make their choice of selecting one of them which has to be in conformance with the mission statement.

Long-Term Objectives: An organization seeks desired result over a period of time to comprehend the vision and mission statement. Such objectives, according to Pearce and Robinson (1996), typically involve some or all of the following areas of business i.e. profitability, return of investment, competitive position, technological leadership, productivity, employee relations, public responsibility and employee development. To add value each objective must be specific, measurable, achievable and consistent with other objective of firm. For example a firm wants to double its market share in five years may compel strategic decision makers to take specific decisions and prepare specific strategy.

Grand Strategy: An organization must have a comprehensive plan of major actions in order to achieve long-term objectives in ever changing business environment. Grand strategies are tools in the hands of strategists and this enables them to take decisions in the interest of organization. Grand strategies are of four types Stability, Expansion, Combination and Retrenchment. Every grand strategy is, in fact, further divided in various long term strategies like concentration, market development, product development, innovation, horizontal integration, vertical integration, joint venture, concentric diversification, conglomerate diversification, retrenchment, turnaround, divestiture and liquidation.

Annual Objectives: Annual objectives can be considered as short-term objectives. A firm seeks desired result to be achieved within one year period are annual objectives. The term-objectives are achieved by dividing them in annual objectives. For example a company sets long-term 20 percent growth rate in coming five years, so annually, company has to set target to achieve 4 percent growth rate. Therefore, short-term objectives i.e. annual objectives are always in conformance with long-term objectives.

Functional Strategies: To achieve organizational objectives, each functional area or division needs a specific and integrative plan of action. Every organization develops operational or functional strategies to combat the challenges of achieving the objectives. Here, all the functional strategies are integrated to long-term and short-term objectives. These are also known as operating strategies. Operating strategies are the statements of the means that will be used to achieve objectives in following year.

Policies: Policies of a company are designed to give directions and to guide thinking, decisions, and actions of managers and their subordinates in implementing the organization's strategy. Policies provide guidelines for establishing and controlling the existing operating processes of the company. Policies are often referred to as standard operating procedures and serve to increase managerial effectiveness by standardizing many routine decisions and to limit the discretion of managers and subordinates in implementing operation strategies.

Implementation of Strategy: A company's long-term and short-term objective, functional strategies and policies provide specific guidelines that what must be done to implement the overall strategy. Here, by interpreting the long-term objectives into short-term objectives in action, we implement the strategy or we make the strategy operational. At this juncture, the strategies must also be institutionalized and permeate the day-to-day life of the company for effective implementation. According to Pearce and Robinson (1996) three organizational elements provide the fundamental, long-term means for institutionalizing the company's strategy i.e. a) structure, b) leadership and c) culture. So, for successful implementation, it requires effective management and integration of these three elements to ensure the strategy take hold in the routine life of the company.

Control and Evaluation: Control ensures that the implementation of strategy takes place according to predetermined plans. There are various types of control mechanism which are intended to check whether appropriate strategies are being used. Therefore, an implemented strategy must be monitored to determine the extent to which objectives are achieved. For evaluation purpose, the early reviews are made by the company. Although, early reviews and evaluation of the strategic process concentrates on market-responsive modifications, the underlying and ultimate test of a strategy is ability to achieve its end i.e. long-term objectives, annual objectives and mission. Therefore, at the end of the analysis, a company is successful when its strategy achieves designated objectives.

2.3 Strategic Management Process

As per the above discussion, we can interpret that the systematic flow of information from all the constituents of business (whether internal or external) will frame the base for success. The role of strategic management is to keep the organization on right track with proper alignment of the actives so as to achieve the stated aims and objectives. The above mentioned comprehensive strategic management model represents the fundamental process which is followed an organization in order to step up on the ladder of success.

According to Kazmi (2010) strategic management is the dynamic process of formulation, implementation, evaluation and control of strategies to realize the organizations' strategic intent. Thus, strategic management is a dynamic process and it is not one-time and static process rather it is continual, evolving and iterative process. Strategic management process can be a rigid step wise collection of information and arranged in a sequential order. Rather, it a continuous evolving process which largely depends upon the available set of conditions prevailing at specific time.

Broadly, strategic management process can be understood in four phases, which are as follows:

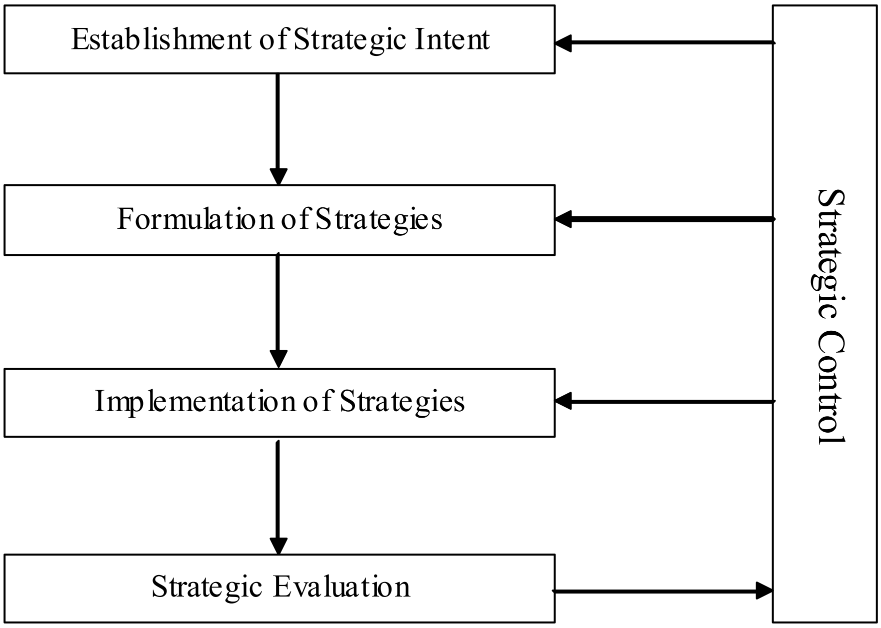

Figure – 2.2: Strategic Management Process

Source: Based on Kazmi, A. (2010). *Strategic Management and Business Policy.* New Delhi: Tata McGraw Education Pvt. Ltd. (p. 20)

2.3.1 Strategic Intent

As per the above diagram the first phase in strategic management process is establishing of strategic intent for an organization. Strategic intent is the term which is used to express the purpose of an organization. In broad terms strategic intent is vision and mission statement of the organization and to be more specific it is further integrated and interpreted as aims and objectives of business level.

Vision and mission defines what business the company is presently in and conveys the essence of 'who we are', 'what business we do' and 'current position of company'. Mission statement reflects the image of the company and it comprises with fundamental elements like customer needs, target customer groups, technologies and competencies. Moreover, setting objectives means converting the strategic vision and mission into specific target. Objectives pose challenges for managers to perform accordingly and strive to compliance with mission of the organization.

2.3.2 Formulation of Strategies

The second phase of strategic management process is formulation of strategies. This phase is concerned with devising the strategies on the basis understanding the operational environment of a company. Since an organization is a social system its environment consists of many factors which includes political, legal, cultural, socio-economic etc. Here, organization must relate its strength with these factors so as to effectively penetrate the market. Apart from this, organization also evaluates its internal environment, which works as mirror; organization can identify their strengths and weaknesses.

On the basis of organizational analysis various strategic alternatives can be identified in the light of strategic opportunities and threats and strength of the organization has to be in conformance with opportunities. Organization must strive to improve the areas where they are weak and convert weaknesses into strength in order to face the threats of market.

2.3.3 Implementation of Strategies

As per the above mentioned model the third phase is known as implementation of strategies. In this phase the strategic plans are put into action with the help of various administrative and managerial actions. These actions comprises with project implementation, process implementation, resources allocation, structural implementation, behaviour implementation and functional and operational implementation. In other words, all the activities like organization structure, effective leadership, allocation of resources are done so effectively that implementation become successful.

2.3.4 Strategic Evaluation

The last phase of strategic management process is strategic evaluation and control. At this phase all the strategies are constantly monitored. The implemented strategies are reviewed and assessed on the basis of their outcome. Here, the deviations are found and necessary and corrective actions are taken so as to keep the actual performance in conformance with desired performance of the resources.

Thus, as per the discussion we can say that these four phases are considered to be interwoven to each other and each successive phase provides a feedback to the previous phase. To achieve the organizational objectives these feedback are deliberately reviewed, redefined, strategies and reformulated and again corrective actions are implemented.

Activity A:

1. Discuss the Strategic Management Process with the help of an imaginary case.

2.4 Role of Top Management

The term "top management" refers to a relatively small group of employees, which include board of directors, president, chief executive officer, vice president, and executive vice president etc. Because the insights of these executives play such a very crucial and critical role, a number of experts have stressed the importance of matching the characteristics of these executives with the firm's strategies.

According to Companies Act 1956, Board of Directors is a body of elected or appointed members who jointly oversee the activities of a company or organization. A board's activities are determined by the powers, duties, and responsibilities delegated to it or conferred on it by an authority outside itself. These matters are typically detailed in the organization's bylaws. The bylaws commonly also specify the number of members of the board, how they are to be chosen, and when they are to meet.

2.4.1 Board of Directors

The duties of boards of directors include:

- The board leads the organization by establishing policies and objectives for organization,

- The board select, appoint, support and review the performance of the chief executive officers,
- The board ensures the availability of adequate resources to the organization,
- The board approves annual budgets for the organizational activities,
- The board is accountable to the stakeholders for the organization's performance;
- The board set the salaries and compensation of company management.

The legal responsibilities of boards and board members vary with the nature of the organization, and with the jurisdiction within which it operates. For public corporations, these responsibilities are typically much more rigorous and complex than for those of other types. Typically, the board chooses one of its members to be the chairperson, who holds whatever title is specified in the bylaws.

2.4.2 Chief Executive Officers

The strategic management process of contemporary business world tends to be dominated by the chief executive officers (CEOs), chief marketing officers (CMOs), chief financial officers (CFOs) and chief operating officers (COOs).

The role of the CEOs in strategic management is as follows:

- The CEO must comprehend strategic management as his responsibility. Parts of this task can be delegated to his followers.
- The CEO is liable for establishing a climate in the organization that is congenial to strategic management.
- The CEO is accountable for ensuring that the organizational design and strategic management process is appropriate to the unique characteristics of the company.
- The CEO is responsible for determining whether there should be a corporate planner. If so, the CEO generally should appoint the planner (or planners) and see that the office is located as close to that of the CEO as practical.
- The CEO must get involved in planning phase.
- The CEO should have face-to-face interactions with executives for making plans and should ensure that there is a proper evaluation of the plans and feedback to those making them.
- The CEO is responsible for reporting the results of the strategic management process to the board of directors.
- The chief executive officer (CEO) is responsible for the final decisions, but its decisions are the culmination of the ideas, information, and analyses of others.

2.4.3 Corporate Planning Staff

Corporate Planning Staff whose main function is the gathering and processing of data necessary in order to support top management executives. The major duties and responsibilities of corporate planning staff are given below:

Duties and Responsibilities of Corporate Planning Staff

- Plan & execute Corporate Mid-term business planning & annual business planning.

- Plan the annual & mid-term corporate schedule.
- Study market environment, consumer, competitor and product/service, collect data, assessment of area conditions, ocular inspection, operational process appraisal, etc.
- Plan & execute the corporate event. Corp with various divisions within company to coordinate the corporate event.
- Establish and maintain research database on past and current project studies as well as key statistical and economic data.
- Create and maintain accurate and timely records on project studies
- Plan & execute the corporate public relation matter.
- Evaluate and interpret the soundness and sufficiency of gathered data
- Perform statistical, quantitative, and other necessary analysis required to process data collected and report the results/findings thereof
- Plan & execute the CSR matter.
- Various type of the management support.
- Various type of the staff support such as support for the staff training plan.

Activity B:

1. Discuss the role of tope management with the help of suitable case study.

2.5 Implications of Process of Strategic Management

On the basis of above discussion we can say that the strategic management process is scientific way of strategic decision making where all the decisions are rational and supposed to be based on some facts and figures. This statement signifies the implication of strategic management process. At this juncture, it becomes of utmost importance to understand the aim and implication part of strategic management.

The primary aim of strategic management process is to enable companies to achieve strategic competitiveness and earn above average return. Strategic competitiveness is achieved when a company successfully formulates and implements a value-creating strategy. By implementing a value-creating strategy, a firm can get sustainable competitive advantage over their competitors. As long as a firm maintains the sustainable competitive advantage, investors of the firm will earn above average returns.

The implications of strategic management process involve organizing the available resources and employing change management procedures within an organization so as to achieve organizational objectives. This can be done if top management practices the generic concepts of strategic management like organizing, resourcing, change management etc.

There could be various objectives for implementing a strategy, it may include organizational changes, such as establishing new units, assimilation of existing units or even switching from a geographical structure to a functional one, and apart from it organizations may enter to foreign markets in order to achieve economies of scale. Implementation of process of strategic management may require significant shifts in allocating funds to all the functional areas; it may affect human resources and capital expenditure. Implementing a strategy may have influential effects that move across an organization. The implication of strategic management must be in alignment of the organizational objectives so as to achieve them within the time frame by minimizing disruption, reduce costs and save time. One approach is to appoint an individual to implement the changes effectively; address and eventualities, enlist and proactively identify and strive to mitigate problems.

1. Discuss the role of Top Management with the help of a suitable example.
2. What are the different aspects of Top Management through which they manage the organizational strategies?
3. Consider a case to understand the implication of process of strategic management.

2.6 Summary

As per the above discussion, it can be said that Strategic Management is a continuous process, which may have three stages: strategy formulation, strategy implementation, and evaluation and control. Strategic management is also viewed as series of different but integrated steps; therefore, the strategic management process can be studied and applied using the compressive model. A review of the major strategic management models indicates that they all include the steps of performing an environmental analysis, establishing organizational direction, formulating organizational strategy, implementing organizational strategy, evaluating, and controlling strategy.

The process of strategic management predominantly involves top management, board of directors, and planning staff. Broadly, a strategic decision is moulded from the streams of inputs, decisions, and actions, which are based on scientific facts and figures. All organizations are engaged in the strategic management process to achieve the organizational objectives. The success rate of an organization is generally depending upon the implication part of strategic management and organizational abilities of the managers to create a synergy between external opportunities and organizational strengths by counter attacking threats and effectively improve their weaknesses.

Many research based studies indicates that both financial and nonfinancial benefits which can be derived from a strategic-management approach to decision making. Moreover, the concept of strategic management is still involving and will continue to undergo change. Therefore, understanding, following, and complete process of strategic management can be helpful to practicing managers to gain organizations' objectives and realising the vision.

2.7 Self Assessment Questions

1. Strategic Management is the need of the hour. Discuss in the realm of current business scenario.
2. What do you understand by the the Strategic Management Process? Discuss in detail.
3. Summarize the Comprehensive Model of Strategic Management.
4. Elaborate the various roles of top management.
5. Consider yourself a Chief Executive officer of a Retail giant and discuss the roles and responsibility.
6. Explain the implications of process of strategic management in your own words.

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Unit - 3 : Environmental Threat and Opportunity Profile (ETOP)

Structure of Unit:

3.0 Objectives

After completing this unit, you would be able to:

- Explain the concept of business environment.
- Identify and describe the components and characteristics of business environment.
- Explain the concept of strategy.
- Describe meaning and process of environmental scanning.
- Appraise the environment.
- Prepare the Environmental Threats and Opportunities Profile (ETOP) for an organization.

3.1 Introduction

Business is an important institution in society. Be it for the supply of goods or services, creation of employment opportunities, offer of better quality life, or contribution to the economic growth of a country, the role of business is crucial. “A Business is nothing more than a person or group of persons properly organized to produce or distribute goods or services”. The study of business is the study of activities involved in the production or distribution of goods and services-buying, selling, financing, personnel and the like”.

Everything exists in physical environment, similarly organizations exists in the business environment. To understand any business the critical step is to explore all the factors related to business and properly judging its impact on the business. There are many factors and forces which have considerable impact on any business. All these forces come under one word called environment. Hence understanding the business means understanding its environment. Environment refers to all external forces which have a bearing on the functioning of business.

From the micro point of view, a business is an economic institution, as it is concerned with production and/or distribution of goods and services, in order to earn profits and acquire wealth. Different kinds of organizations (i.e., sole proprietorship, partnership, Joint Stock Company and Cooperative organization) are engaged in business and are operating from small scale, as in case of grocery in a start, to large scale, as in case of Tata Iron and Steel Co., Maruti Udyog, Bajaj Auto, and Reliance Industries.

3.2 Business Environment

The term Business Environment is composed of two words 'Business' and 'Environment'. In simple terms, the state in which a person remains busy is known as Business. The word Business in its economic sense means human activities like production, extraction or purchase or sales of goods that are performed for earning profits. The word 'Environment' refers to the aspects of surroundings. Therefore, Business Environment may be defined as a set of conditions – Economic, Social, Political, Legal or Institutional that are either controllable or uncontrollable in nature and affects the functioning of organization.

Business Environment has two components:

1. Internal Environment
2. External Environment

Internal Environment: It includes 5 Ms i.e. man, material, money, machinery and management, usually within the control of business. Business can make changes in these factors according to the change in the functioning of enterprise.

External Environment: Those factors which are beyond the control of business enterprise are included in external environment. These factors are: Government and Legal factors, Geo-Physical Factors, Political Factors, Socio-Cultural Factors, Demo-Graphical factors etc. It is of two Types:

1. Micro/ Operating Environment
2. Macro/ General Environment

Micro/ Operating Environment: The environment which is close to business and affects its capacity to work is known as Micro or Operating Environment. It consists of Suppliers, Customers, Market Intermediaries, Competitors and Public.

a. **Suppliers:** They are the persons who supply raw material and required components to the company. They must be reliable and business must have multiple suppliers i.e. they should not depend upon only one supplier.

b. **Customers:** Customers are regarded as the king of the market. Success of every business depends upon the level of their customer's satisfaction.

c. **Market Intermediaries:** They work as a link between business and final consumers. Types of market intermediaries are as follows:

   i. **Middlemen like wholesalers, retailers etc.**
   ii. Marketing Agencies
   iii. Financial Intermediaries
   iv. Physical Intermediaries

d. **Competitors:** Every move of the competitors affects the business. Business has to adjust itself according to the strategies of the Competitors.

e. **Public:** Any group who has actual interest in business enterprise is termed as public e.g. media and local public. They may be the users or non-users of the product.

Macro/General Environment: It includes factors that create opportunities and threats to business units. Following are the elements of Macro Environment:

a. **Economic Environment:** It is very complex and dynamic in nature that keeps on changing with the change in policies or political situations. It has three elements:
i. Economic Conditions of Public
ii. Economic Policies of the Country
iii. Economic System
iv. Other Economic Factors: Infrastructural facilities, Banking, Insurance Companies, Money Markets, Capital markets

b. **Non-Economic Environment:** Following are included in non-economic environment:

i. **Political Environment:** It affects different business units extensively.

Components of the same are as follows:

(a) Political Belief of Government
(b) Political Strength of the Country
(c) Relation with other countries
(d) Defense and Military Policies
(e) Centre State Relationship in the Country
(f) Thinking Opposition Parties towards Business Unit

ii. **Socio-Cultural Environment:** Influence exercised by social and cultural factors, not within the control of business, is known as Socio-Cultural Environment. These factors include: attitude of people to work, family system, caste system, religion, education, marriage etc.

iii. **Technological Environment:** A systematic application of scientific knowledge to practical task is known as technology. Everyday there has been vast changes in products, services, lifestyles and living conditions, these changes must be analyzed by every business unit and should adapt these changes.

iv. **Natural Environment:** It includes natural resources, weather, climatic conditions, port facilities, topographical factors such as soil, sea, rivers, rainfall etc. Every business unit must look for these factors before choosing the location for their business.

v. **Demographic Environment:** It is a study of perspective of population i.e. its size, standard of living, growth rate, age-sex composition, family size, income level (upper level, middle level and lower level), education level etc. Every business unit must see these features of population and recognize their various need and produce accordingly.

vi. **International Environment:** It is particularly important for industries directly depending on import or exports. The factors that affect the business are: Globalization, Liberalization, Foreign Business Policies, Cultural Exchange etc.

Characteristics of Business Environment: Business Environment (or simple environment) exhibits many characteristics. Some of the important and obvious characteristics are briefly described here:

a. **Environment is Complex and Compound in Nature:** The environment consists of a number of factors, events, conditions and influences arising from different sources. All these do not exist in isolation, but interact with each other to create an entirely new set of influences. It is difficult to comprehend at once what factors constitute a given environment. All in all, environment is a complex phenomenon, relatively easier to understand in parts but difficult to grasp in its totality.

b. **Environment is Dynamic:** The environment is constantly changing in nature. Due to the many and varied influence operating, there is dynamism in the environment causing it to continuously change its shape and character.

c. **Environment is Multi-faceted:** What shape and character an environment assumes depends on the perception of the observer. A particular change in the environment, or a new development, may be viewed differently by different observers. This is frequently seen when the same development is welcomed as an opportunity by one company while another company perceives it as a threat.

d. **Environment Has a far Reaching Impact:** The environment has a far reaching impact on organizations. The growth and profitability of an organization depends critically on the environment in which it exists. Any environmental change has an impact on the organization in several different ways.

e. **Business Environment is Different for Ddifferent Business Units:** As each business unit is unique and different from each other, so is the environment of the businesses.

f. It has both long term and short term impact.

g. Unlimited influence of external environment factors.

h. It is very uncertain and has inter-related components.

i. It includes both internal and external environment.

Let us get ahead and grapple with the complexity of environment by its division into internal and external environments.

The internal environment refers to all factors within an organization that impact strengths or cause weaknesses of a strategic nature. The external environment includes all the factors outside the organization which provide opportunities or pose threats to the organizations.

3.3 What is Strategy?

Strategy is a plan of action or policy designed to achieve a major or overall aim. It is also defined as the art of planning and directing overall military operations and movements in a war or battle. Johnson and Scholes define strategy as follows:

"Strategy is the direction and scope of an organization over the long-term: which achieves advantage for the organization through its configuration of resources within a challenging environment, to meet the needs of markets and to fulfill stakeholder expectations". In other words, strategy is about:

a. Where is the business trying to get to in the long-term (direction)
b. Which markets should a business compete in and what kind of activities is involved in such markets? (markets; scope)
c. How can the business perform better than the competition in those markets? (advantage)
d. What resources (skills, assets, finance, relationships, technical competence, facilities, etc.) are required in order to be able to compete? (resources)
e. What external, environmental factors affect the businesses' ability to compete? (environment)
f. What are the values and expectations of those who have power in and around the business? (stakeholders)

Strategy at Different Levels of a Business

Strategies exist at several levels in an organization - ranging from the overall business (or group of businesses) through to individuals working in it.

a. **Corporate Strategy**: It is concerned with the overall purpose and scope of the business to meet stakeholder expectations. This is a crucial level since it is heavily influenced by investors in the business and acts to guide strategic decision-making throughout the business. Corporate strategy is often stated explicitly in a "mission statement".

b. **Business Unit Strategy:** It 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.

c. **Operational Strategy**: It is concerned with how each part of the business is organized to deliver the corporate and business-unit level strategic direction. Operational strategy therefore focuses on issues of resources, processes, people etc.

William F. Glueck defines business strategy "as the process by which strategists monitor the economic, governmental, market, supplier, technological, geographic, and social settings to determine opportunities and threats to their firms".

3.4 Environmental Scanning

Environmental scanning can be defined as 'the study and interpretation of the political, economic, social and technological events and trends which influence a business, an industry or even a total market'. Environmental scanning refers to the macro environment. The global environment refers to the macro environment which comprises industries, markets, companies, clients and competitors. Consequently, there exist corresponding analyses on the micro-level. Suppliers, customers and competitors representing the micro environment of a company are analyzed within the industry analysis. In simple words, Environmental scanning can be defined as the process by which organizations monitor their relevant environment to identify opportunities and threats affecting their business for the purpose of taking strategic decisions.

Factors to be considered for Environmental Scanning

The external environment in which an organization exists consists of a bewildering variety of factors. These factors (could also be termed as influencers) which need to be considered for environmental scanning are events, trends, issues and expectations of the different interest groups. These factors are explained below:

- Events are important and specific occurrences taking place in different environmental sectors.
- Trends are the general tendencies or the courses of action along with events take place. A trend break could be a value shift in society, a technological innovation that might be permanent or a paradigm change. A trend can be defined as an 'environmental phenomenon that has adopted a structural character'.
- Issues are the current concerns that arise in response to events and trends. Issues are often forerunners of trend breaks. Issues are less deep-seated and can be 'a temporary short-lived reaction to a social phenomenon'.
- Expectations are the demands made by interested groups in the light of their concern for issues.

We can take the example of the first public issue of shares of Reliance Industries in 1977. That was a specific event. The trend that started was of wider participation of public in equity investment in private sector companies. Note that earlier to that event, equity participation in India was limited to an exclusive class of investors and the general public was not aware or interested in investing money in shares. The issue that emerged was of the development of equity culture in India. The expectation by the general public that resulted was that the fruits of the economic development in the corporate sector would be shared by all and sundry. An allied expectation that ensued was of protection of small or minority stakeholders from rapacious private business persons through legislation and governmental action.

By monitoring the environment through environmental scanning, an organization can consider the impact of the different events, trends, issues and expectations on its strategic management process. Since the environment facing an organization is complex and scanning it is absolutely essential, strategists have to deal cautiously with the process of environmental scanning. It has to be done in a manner that unnecessary time and effort is not expended, while important factors are not ignored. For this to take place, it is important to devise an approach, or a combination of different approaches, to environmental scanning.

3.5 Approaches to Environmental Scanning

Kubr has suggested three approaches which could be adopted for sorting out information for environmental scanning:

1. **Systematic Approach:** Under this approach, information for environmental scanning is collected systematically. Information related to markets and customers, changes in legislation and regulations that have a direct impact on an organization's activities, government policy statements pertaining to the organization's business and industry etc. could be collected continuously to monitor changes and take the relevant factors into account. Continuously updating such information is necessary not only for strategic management but also for operational activities.

2. **Ad hoc approach:** Under this approach, an organization may conduct special surveys and studies to deal with specific environmental issues from time to time. Such studies may be conducted, for instance, when an organization has to undertake special projects, evaluate existing strategies or devise new strategies. Changes and unforeseen development may also be investigated with regard to their impact on the organization.

3. **Processed form approach:** For this approach, the organization uses information in a processed form, available from different sources both inside and outside the organization. When an organization uses information supplied by government agencies or private institutions, it uses secondary sources of data and the information is available in a processed form.

Since environmental scanning is absolutely necessary for strategy formulation, organizations use different practical combinations or approaches to monitor their relevant environments.

Sources of Information for Environmental Scanning

The various sources of information tapped for collecting data for environmental scanning could be classified in different ways. There could be formal and informal sources. Then there could be written as well as verbal sources. In terms of origin, data sources could be external and internal.

Given below are some of the important types of sources of information:

1. Documentary or secondary sources of information like different types of publications. These could be newspapers, magazines, journals, trade and industry association newsletters, government publications, annual reports of competitor companies, commercial databases etc.

2. Mass and new media such as radio, television, and internet.

3. Internal sources like, company files and documents, internal reports and memoranda, management information system, databases, company employees, sales staff etc.

4. Formal studies done by employees, market research agencies, consultants and educational institutions.

5. External agencies like customers, marketing intermediaries, suppliers, trade associations, government agencies, etc.

6. Spying and surveillance through ex-employees of competitors, industrial espionage agencies, or by planting 'moles' in rival companies. The ethicality of these resources is doubtful but nevertheless, these are used and so need a mention.

3.6 SWOT Analysis

SWOT Analysis: A systematic approach to understanding the environment is known as SWOT (Strengths, Weaknesses, Opportunities, and Threats) analysis. SWOT analysis, evolved during 1960s at the Stanford Research Institute, is a very popular strategic planning technique having applications in many areas including management. Organizations perform a SWOT analysis to understand their internal and external environments. SWOT, which is the acronym for Strengths, Weaknesses, Opportunities, and Threats is also known as WOTS-UP or TOWS analysis. Through such an analysis, the strengths and weaknesses existing within an organization can be matched with the opportunities and threats, operating in the environment so that an effective strategy can be formulated. An effective organizational strategy is therefore, one that capitalizes on the opportunities through the use of strengths and neutralizes the threats by minimizing the impact of weaknesses, to achieve pre-determined objectives. A simple application of SWOT analysis technique involves these steps:

1. Setting the objectives of the organization or its unit.

2. Identify its Strengths, Weaknesses, Opportunities, and Threats

3. Asking four questions:
   a. How do we maximize our strengths?
   b. How do we minimize our weaknesses?
   c. How to capitalize on the opportunities in our external environment?
   d. How to protect ourselves from threats in our external environment?

4. Recommending strategies that will optimize the answers from the four questions.

3.7 Techniques of Environmental Scanning: ETOP

The identification of environmental issues is helpful in structuring the environmental appraisal so that the strategists have a good idea of where the environmental opportunities and threats lie. Structuring the environmental appraisal is a difficult process as environmental issues do not lend themselves to a straightforward classification into neat categories. An issue may arise simultaneously from more than one factor (sector) of the environment. Strategists have to use their experience and judgement to place the different environmental issues where they mainly belong, so that clarity emerges.

In order to draw a clear picture of what opportunities and threats are faced by the organization at a given time. It is necessary to appraise the environment. This is done by being aware of the factors that affect environmental appraisal identifying the environmental factors and structuring the results of this environmental appraisal. The identification of environmental issues is helpful in structuring the environmental appraisal so that the strategists have a good idea of where the environmental opportunities and threats lie. The environmental scanning can be done in the structured way. There are many techniques available to structure the environmental appraisal. One such technique suggested by Glueck is that of preparing an Environmental Threat and Opportunity Profile (ETOP) for an organization. The preparation of an ETOP involves dividing the environment into different sectors and then analyzing the impact of each sector of the organization.

In order for the environmental analysis to have a useful input into the business planning process, a wide range of information and opinions needs to be summarized in a meaningful way. The Environmental Threat and Opportunity Profile provide a summary of the environmental factors that are most critical to the company.

The preparation of an ETOP involves dividing the environment into different sectors and then analyzing the impact of each sector on the organization. A comprehensive ETOP requires dividing each environmental sector into sub-factor and then the impact of each sub-factor on organization is described in the form of a statement. A summary ETOP may only show the major factors for the sake of simplicity. Table 3.1 provides an example of ETOP prepared for an established company which is in the bicycle industry. The main business of the company is in sports cycle manufacturing for domestic and exports market. This example relates to a hypothetical company but the illustration is realistic.

Environmental Sector	**Nature of Impact**	**Impact of each Sector**
Economic	↑	Growing affluence among urban consumers; rising disposable incomes and living standards.
Market	→	Organized sector a virtual oligopoly with four major manufacturers, buyers critical and better informed; overall industry growth rate not encouraging; growth rate for niche segments like sports, trekking, racing and fancy city cycles is high; largely unsaturated demand in niche segments; slender margins; traditional distribution systems.
International	↓	Global imports growing but India's share shrinking; India second globally as manufacturer, consumer and exporter after China; major importers are the US and EU but India exports mainly to Africa; threat of cheap Chinese imports.
Political	→	Bicycle principal mode of transport for low and lower-middle income; industry too small for any major political attention.
Regulatory	→	Bicycle industry a thrust area for exports; regulatory restrictions heavy; duty drawbacks rate lowered.
Social	↑	Environment and Health friendly transport option; wide usage like commuting to work or school and as recreation and physical fitness equipment; easier negotiating traffic congestions; customer preference for sports cycles which are easy to ride and durable.
Supplier	→	Mostly ancillaries and associated companies in small scale sector supply parts and components; rising steel prices; increasing use of aluminum; industrial concentration in Punjab and Tamilnadu
Technological	↑	Technological up-gradation of industry in progress; import of machinery simple; product innovations ongoing such as battery-operated and lightweight foldable cycles.
Up arrows indicate favorable impact; down arrows indicate unfavorable impact, while horizontal arrows indicate a neutral impact		

Figure 3.1: Environment Threat and Opportunity Profile (ETOP) for a Bicycle Company

As observed from Table 3.1 sports cycle manufacturing is an attractive proposition due to many opportunities operating in the environment. Prospects in the economic, social and technological sectors are bright. Market environment can throw up opportunities in the niche segment that the company operates in. The company can capitalize on the burgeoning demand by taking advantage of the various government policies and concessions that still exist despite the low attention value of the industry. It can also take advantage of the high exports potential that already exists and has not been adequately capitalized upon. Since the company is an established manufacturer of bicycles, it has a favorable supplier environment with traditionalties binding it to its vendors. But contrast the implications of this ETOP for a new manufacturer, who is planning to enter this industry. Though the economic, social and technological environment sectors would still be favorable, much would depend on the extent to which the company is able to ensure the supply of raw materials and components, have access to the latest technology and have the facilities to use it.

The preparation of an ETOP provides a clear picture to the strategists about which sectors and the different factors in each sector have a favorable impact on the organization. By the means of an ETOP, the organization knows where it stands with respect to its environment. Obviously, such an understanding can be of great help to an organization in formulating appropriate strategies to take advantage of the opportunities and counter the threats in the environment.

Before the formulation of strategies can be undertaken, strategists have to assess whether the organization has the required strengths or whether it has weaknesses which can affect its capability of taking advantage of the opportunities. This assessment is done through an analysis of the strengths and weaknesses of the organization and forms a part of SWOT analysis. The strengths and weaknesses can be analyzed through an organizational appraisal.

3.8 Summary

The environment of business is very complex and dynamic. To be successful as a business entity an organization has to understand its environment, which is divided into two parts external and internal. The external environment poses a challenge for a business entity in the form of threats and opportunities, whereas the internal environment on an organization provides the necessary strengths and the weaknesses to combat external environment. Environmental appraisal is the process of identifying opportunities and threats facing an organization for the purpose of strategy formulation. SWOT analysis is a systematic approach to find the strengths, weakness, opportunities and threats pertaining to an organization and its environment. Organizations are concerned about their external environment in general, but more attention is paid to the relevant environment, which has an immediate and a direct impact on their activities. The different sectors of the environment have to be continuously monitored by strategists for factors that may create opportunities or threats. Such a monitoring is done though the process of environmental scanning i.e. the process by which organizations monitor their relevant environment to identify opportunities and threats affecting their business. A variety of methods and techniques are available for environmental scanning. There are formal and systematic techniques as well as intuitive method available. Strategists may choose from among these methods and techniques those suits their demands. The structuring of the environmental appraisal is done by the preparation of the Environmental Threats and Opportunities Profile (ETOP) that involves dividing the environment into different sectors and then analyzing the impact of each sectoer on the organization.

3.9 Self Assessment Questions

1. What aspects does an environmental appraisal deal with?
2. Mention some of the important characteristics of environment?

3. Differentiate between the external and internal component of the environment?

4. Provide a few examples of the opportunities and threats facing any organization of your choice?

5. What is the rationale behind performing a SWOT analysis?

6. Explain these terms clearly in the context of environmental scanning:

   a. Events
   b. Trends
   c. Issues
   d. Expectations

7. How does the systematic approach to environmental scanning differ from the processed form approach?

8. Name some important institutional publications in India which could serve as a source of environmental information?

9. How is summary ETOP prepared?

10. What information does an ETOP contain?

3.10 Reference Books

- Kazmi Azhar, (2011), 'Strategic Management and Business Policy', Tata McGraw Hill Education Private Limited, New Delhi.

- Francis Cherunilam, (2009), 'Business Environment', Himalaya Publishing House, New Delhi.

Unit - 4 : Strategic Advantage Profile

Structure of Unit:

4.0 Objectives

After completing this unit, you would be able to:

- Understand the relationship between organizations and environment;
- Classify the business environment as internal and external;
- Point out various Characteristic of SAP;
- Know about various internal environment factors of businesses;
- The significance of Dynamics of internal organizational environment;
- Understand different methods of organizational appraisal.

4.1 Introduction

STRATEGIC ADVANTAGE PROFILE (SAP) Every firm has strategic advantages and disadvantages. For example, large firms have financial strength but they tend to move slowly, compared to smaller firms, and often cannot react to quick changes. No firm is equally strong in all its functions. In other words, every firm has its own strengths as well as weaknesses. Strategists must be aware of the strategic advantages or strengths of the firm to be able to choose the best opportunity for the firm. On the other hand they must regularly analyse their strategic disadvantages or weaknesses in order to face environmental threats and challenges effectively Examples: The Strategist should look to see if the firm is stronger in these factors than its competitors. When a firm is strong in the market, it has a strategic advantage in launching new products or services and increasing market share of present products and services.

4.2 Strategic Advantage Profile

A profile of strategic advantages (SAP) is a summary which provides an overview of the advantages and disadvantages in key areas likely to affect future operations of the firm. It is a tool for making a systematic evaluation of the strategic advantage factors which are significant for the company in its environment. The preparation of such a profile presupposes detailed analysis and diagnosis of the factors in each of the functional areas (Marketing, Production, Finance and Accounting, Personnel and Human Resources, R & D). The relevant data for the critical areas may go as a supplement to the profile. The following Strategic Advantage Profile relates to a food processing company in India. It started as a branch of a US corporation, later became a 100% subsidiary, and now has 40% shareholding of the foreign enterprise. Many Indian households are familiar with its consumer products: jelly, baking powder, custard powder, squash and soft drinks concentrate. However, not many know about its industrial products- caramel coloring, adhesives, starch binders and fillers.

Since the Strategic Advantage Profile is a summary statement of corporate capabilities, in summarizing the functional competencies a comparative view needs to be taken in the light of external conditions and the time horizon of projections. For example, while comparing the level of inventory holding, one may find it to be relatively higher than that of competing firms; as such it should be regarded as a weakness. But if the market demands show an increasing trend, apparent weakness should be considered strength.

In the preparation of SAP one must also reckon the probability of the strength or advantage continuing in future and how long it can be equally alert and may bridge the gap sooner or later. Or, complementary factors in some areas may be a drag on the company's strength in other areas. A company may identify its relative strength in the personnel area with highly skilled workmen and technical staff manning the production department; however, its production facilities may be old and outdated. It is obvious that the technical competence in the personnel area can hardly be regarded as a potential strength unless the company removes the weakness of outdated production facilities. No doubt the company should recognize the importance of its unique capabilities and capitalize the distinctive advantages rather than spreading its resources thinly across a number of functional areas. At the same time, it must recognize the danger of relying on strengths in a particular area without simultaneously reckoning the capabilities in other interdependent units of activity. It is thus very well suggested that "a firm should develop a strategy over time which revolves around an area of distinctive advantages, develop slack resources, and these can evolve into new areas of strength when old ones falter."

Exhibit-1

Strategic Advantage Profile (SAP) of ABC Indian Ltd.

Internal Area		(+) Strength (-) Weakness
Marketing	(+)	Capable sales force; sales agents dispensed with.
	(-)	Shrinking market for most products.
	(-)	Stagnating sales performance.
Operations	(+)	Profits after tax picking up after 1982.
	(-)	Plant facilities are old.
R & D	(-)	No R & D effort so far.
	(+)	Backing in R & D expected from parent US company.
	(-)	No additional investment since 1980.
Finance	(-)	Heavy reliance on fixed deposits and bank loans.
	(+)	Parent US company now interested in expansion.
Corporate Resources	(+)	Management team comprises young, ambitious executives.

4.3 Organizational Appraisal

The process of observe an organizational internal environment to identify the strengths and weaknesses that may influence the organization's ability to achieve goals. A firm can exploit its opportunities successfully, depending on its corporate strengths. It can be said that the corporate capabilities of the firm become the focal point for its performance and survival. They play a crucial role, both in identifying the strategy and its success. Corporate capabilities go beyond sales, profit and net worth. It is concerned with the state of mind and outlook of the firm. Corporate strategy ultimately means a matching game between environmental opportunities and organizational strengths to gain competitive advantage. Assessment of organization's strengths and weaknesses is also known as Corporate Appraisal.

The internal environment of an organization includes forces that operate inside the organization with specific implications for managing organizational performance. Internal environmental factors, unlike external environmental factors come from within. These factors, collectively defined both trouble sports that need strengthening and the core competencies that the firm can build. An organization can better analyze how much activity might and value or contribute significantly to shape an effective strategy by systematically examining its internal environment.

The appraisal of the external environment of a firm helps it to think of what it might choose to do. The appraisal of the internal environment, on the other hand, enables a firm to decide about what it can do.

What shall build a foundation for understanding the internal environment through an explanation of its dynamics? This has been done by referring to the resource-based view of strategy. The resources, behavior, strengths and weaknesses, synergy, and competencies constitute the internal environment, and shall deal briefly with each of these aspects initially. All these together determine the organizational capability that leads to strategic advantage.

Organizational capabilities could be understood in terms of the strengths and weaknesses existing in the different functional areas of an organization. We shall consider six such areas: finance, marketing, operations, personnel, information management and general management. For each of these, we shall mention the importance factors influencing them and clarify the nature of the various functional capabilities factors.

The various considerations involved in organizational appraisal are discussed next. We deal with the factors that affect appraisal, the approaches adopted for appraisal, and the sources of information used to perform organizational appraisal. With regard to the methods and techniques used for organizational appraisal, we consider a range of factors grouped under the three headings of internal analysis, comparative analysis, and comprehensive analysis. The application of these methods results in highlighting the strengths and weaknesses that exist in different functional areas. The results of organizational appraisal are structured through the preparation of an organizational capability profile and a strategic advantage profile.

4.4 Dynamics of Internal Environment

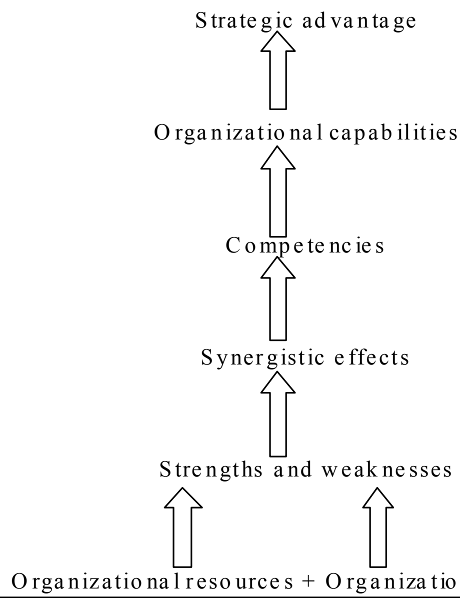
The internal environment provides an organization with the capability to capitalize on the opportunities or protect itself from the threats that are present in the external environment. Ultimately it is the fit that takes place between the external and the internal environment that enables an organization to formulate its strategy. We attempt to understand the internal environment of an organization in terms of the organizational resources and behavior, strengths and weaknesses, synergistic effects, and competencies.

An organization uses different types of resources and exhibits a certain type of behavior. The interplay of these different resources along with the prevalent behavior produces synergy or dysergy within an organization, which leads to the development of strengths or weaknesses over a period of time. Some of these strengths make an organizational specially competent in a particular area of its activity causing it to develop competencies. Organizational capability rests on an organization's capacity and ability to use its competencies to excel in a particular field.

The resources, behavior, strengths and weaknesses, synergistic effects and competencies of an organization determine the nature of its internal environment. Exhibit-2 depicts a diagram showing the framework that we have adopted for the explanation of the process of development of strategic advantage by an organization. It is expected that the readers of this book are aware of these terms in general. However, we shall explain each of these terms here to place them in the specific context of strategic management and business policy.

Exhibit-2

Framework for the Development of Strategic Advantage by an Organization



4.4.1 Organizational Resources

The dynamics of the internal environment of an organization can be best understood in the context of the resource-based view of strategy. According to Barney (1991), who is credited with developing this view of strategy as a theory, a firm is a bundle of resources- tangible and intangible- that includes all assets, capabilities, organizational processes, information, knowledge, and so on. These resources could be classified as physical, human, and organizational resources. The physical resources are the technology, plant and equipment, geographic location, access to raw materials, among others. The human resources are training, experience, judgment, intelligence, relationships, and so on, present in an organization. The organizational resources are the formal systems and structures as well as informal relations among groups. Elsewhere, Barney has said that the resources of an organization can ultimately lead to a strategic advantage for it if they possess four characteristics, that is, if these resources are valuable, rare, costly to imitate, and non-substitutable.

4.4.2 Organizational Behavior

Organizational behavior is the manifestation of the various forces and influences operating in the internal environment of an organization that create the ability for, or place constraints in the usage of resources. Organizational behavior is unique in the sense that leads to the development of a special identity and character of an organization. Some of the important forces and influences that affect organizational behavior are: the quality of leadership, management philosophy, shared values and culture, quality of work environment and organizational climate, organizational politics, use of power, among others.

The perceptive reader would note that what we are proposing here is a marriage of the hard side of an organization- its resource configuration- with the soft side of behavior. The resources and behavior are thus the yin and yang of organizations. What they collectively produce are the strengths and weaknesses.

4.4. 3 Strengths and Weaknesses

Organizational resources and behavior do not exist in isolation. They combine in a complex fashion to create strength and weaknesses within the internal environment of an organization. Strength is an inherent capability which an organization can use to gain strategic advantage. A weakness, on the other hand, is an inherent limitation or constraint which creates a strategic disadvantage for an organization. Financial strength, for example, is a result of the availability of sources of finance, low cost of capital, efficient use of funds, and so on. Another example is of a weakness in the operations area which results due to inappropriate plant location and layout, obsolete plants and machinery, uneconomical operations, and so on. In the following sections, we will take up a detailed discussion of the strengths and weaknesses in different functional areas within an organization.

Strengths and weaknesses do not exist in isolation but combine within a functional area, and also across different functional areas, to create synergistic effects.

4.4.4 Synergistic Effects

It is the inherent nature of organizations that strengths and weaknesses, like resources and behavior, do not exist individually but combine in a variety of ways. For instance, two strong points in a particular functional area add up to something more than double the strength. Likewise, two weaknesses acting in tandem result in more than double the damage. In effect, what we have is a situation where attributes do not add mathematically but combine to produce an enhanced or a reduced impact. Such a phenomenon is known as the synergistic effect. Synergy is the idea that the whole is greater or lesser than the sum of its parts. It is also expressed as “the two- plus –two –is equal- to –five- or- three effect”.

4.4.5 Competencies

On the basis of its resources and behavior, an organization develops certain strengths and weaknesses which when combined lead to synergistic effects. Such effects manifest themselves in terms of organizational competencies. Competencies are specific qualities possessed by any organization that make them withstand pressures of competition in the marketplace. In other words, the net results of the strategic advantages and disadvantages that exist for an organization determine its ability to compete with its rivals. Other terms frequently used as being synonymous to competencies are unique resources, core capabilities, invisible assets, embedded knowledge, etc.

Many organizations achieve strategic success by building distinctive competencies around the CSFs. Recall that CFS's are those factors which are crucial for organizational success. A few examples of distinctive competencies are given below.

- Superior product quality in a particular attribute, say, a two- wheeler, which is more fuel- efficient than its competitors products
- Creation of a market niche by supplying highly- specialized products to a particular market segment
- Differential advantages, based on the superior R&D skills of an organization not possessed by its competitors
- An organization's access to a low-cost financial source like equity shareholders, not available to its competitors

A distinctive competence is "any advantage a company has over its competitors because it can do something which they cannot or it can do something better than they can". It is not necessary, of course, for all organizations to possess a distinctive competence. Neither do all the organizations, which possess certain distinctive competencies, use them for strategic purposes.

4.4.6 Organizational Capabilities

Organizational capability is the inherent capacity or potential of an organization to use its strengths and overcome its weaknesses in order to exploit opportunities and face threats in its external environment. It is also viewed as a skill for coordinating resources and putting them to productive use. Without capability, resources, even though valuable and unique, may be worthless. Since organizational capability is the capacity or potential of an organization, it means that it is a measurable attribute. And since it can be measured, it follows that organizational capability can be compared. Yet it is very difficult to measure organizational capability as it is, in the ultimate analysis, a subjective attribute. As an attribute, it is the sum total of resources and behavior, strengths and weaknesses, synergistic effects occurring in and the competencies of any organization.

4.4.7 Strategic Advantage

Strategic advantages are the outcome of organizational capabilities. They are the result of organizational activities leading to rewards in terms of financial parameters, such as, profit or shareholder value, and/or non-financial parameters, such as, market share or reputation. In contrast, strategic disadvantages are penalties in the form of financial loss or damage to market share. Clearly, such advantages or disadvantages are the outcome of the presence or absence of organizational capabilities. Strategic advantages are measurable in absolute terms using the parameters in which they are expressed. So, profitability could be used to measure strategic advantage: higher the profitability better is the strategic advantage. They are comparable in terms of the historical performance of an organization over a period of time or its current performance with respect to its competitors in the industry.

4.5 Organizational Capability Factors

Capabilities are most often developed in specific functional areas, such as, marketing or operations, or in a part of a functional area, such as, distribution or R&D. It is also feasible to measure and compare capabilities in functional areas. Thus, a company could be considered as inherently strong in marketing owing to a competence in distribution skills. Or a company could be competitive in operations owing to a superior R&D infrastructure.

Organizational capability factors (or, simply, capability factors) are the strategic strengths and weaknesses existing in different functional areas within an organization which are of crucial importance to strategy formulation and implementation. Other terms synonymous with organizational capability factors are: strategic factors, strategic advantage factors, corporate competence factors, and so on.

4.5.1 Financial Capability

Financial capability factors relate to the availability, usage, and management of funds, and all allied aspects that have a bearing on an organization's capacity and ability to implement its strategies. Some of the important factors which influence the financial capability of any organization are as follows:

1. Factors related to sources of funds. Capital structure, procurement of capital, controllership, financing pattern, working capital availability, borrowings, capital and credit availability, reserves and surplus, and relationship with lenders, bank and financial institutions.

2. Factors related to the usage of funds. Capital investment, fixed asset acquisition, current assets, loans and advances, dividend distribution, and relationship with shareholders.

3. Factors related to the management of funds. Financial, accounting, and budgeting system; management control systems; state of financial health, cash, inflation, credit, return and risk management; cost reduction and control; and tax planning and advantages.

Exhibit-3 Typical Strengths that Support Financial Capability

- Access to financial resources
- Amicable relationship with financial institutions
- High level of credit worthiness
- Efficient capital budgeting system
- Low cost of capital as compared to competitors
- High level of shareholder's confidence
- Effective management control system
- Tax benefits due to various government policies.

4.5.2 Marketing Capabilities

Marketing capabilities factors relate to the pricing, promotion and distribution of products and services, and all the allied aspects that have a bearing on an organization's capacity and ability to implement its strategies. Some of the important factors which influence the marketing capability of an organization are as follows:

1. Product related factors- variety, differentiation, mix quality, positioning, packaging

2. Price-related factors- pricing objectives, policies, changes, protection, advantages

3. Place related factors- distribution, transport and logistics, marketing channels

4. Promotion related factors- promotional tools, sales promotion, etc.
5. Integrative and systemic factors- Marketing mix market standing, company image, marketing organization, marketing system, marketing management information system, etc.

Exhibit-4 Typical strengths that support marketing capability

- Wide variety of products
- Better quality of products
- Sharply-focused positioning
- Low prices as compared to those of similar products in the market
- Price protection due to government policy
- High quality customer service
- Effective distribution system
- Effective sales promotion
- High profile advertising
- Favorable company and product image
- Effective marketing management information system

4.5.3 Operations Capabilities

Operations capability factors relate to the production or services, use of material resources and all allied aspects that have a bearing on an organization's capacity and ability to implement its strategies.

Some of the important factors which influence the operations capability of an organization are as follows:

1. Factors related to production system- Capacity, location, layout, product or services design, work systems, degree of automation, extent of vertical integration, etc.
2. Factors related to the operations and control system. Aggregate production planning, material supply, inventory, cost and quality control; maintenance systems and procedures, and so on.
3. Factors related to the R&D system. Personnel, facilities, production development, patent rights, level of technology used, technical collaboration and support, and so on.

Exhibit-4 Typical Strengths that Support Operations Capability

- High level of capacity utilization
- Favorable plant location
- High degree of vertical integration
- Reliable sources of supply
- Effective control of operational costs
- Existence of good inventory control system
- Availability of high caliber R&D personnel

4.5.4 Personnel Capabilities

Personnel capability factors relate to the existence and use of human resources and skills, and all allied aspects that have a bearing on an organization's capacity and ability to implement its strategies. Some of the important factors which influence the personnel capability of organization are as follows:

1. Factors related to the personnel system. System for manpower planning, selection, development, compensation, communication, and appraisal; position of the personnel department within the organization; procedures and standards; and so on.

2. Factors related to organizational and employee's characteristics. Corporate image, quality of managers, staff and workers; perception about and image of the organization as an employer; availability of developmental opportunities for employees; working conditions; and so on.

3. Factors related to industrial relations. Union management relationship, collective bargaining, safety, welfare and security; employee satisfaction and morale; among others.

Exhibit-6 Typical Strengths that Support Personnel Capability

- Genuine concern for human resource management and development
- Efficient and effective personnel
- The organization perceived as a fair and model employer
- Excellent training opportunities and facilities
- Congenial working environment
- Highly satisfied and motivated workforce
- High level of organizational loyalty
- Low level of absenteeism

4.4.4 Information Management Capability

Information management capability factors relate to the design and management of the flow of information from outside into, and within, an organization for the purpose capacity and ability to implement its strategies. Some of the important factors which influence the information capability of an organization are as follows:

1. Factors related to acquisition and retention of information. Sources, quantity, quality, and timeliness of information, retention capacity, and security of information.

2. Factors related to the processing and synthesis of information. Availability and appropriateness of information formats, and ability to synthesize information.

3. Factors related to the retrieval and usage of information. Availability and appropriateness of information formats, and capacity to assimilate and use information.

4. Factors related to transmission and dissemination. Speed, scope, with, and depth of coverage of information, and willingness to accept information.

Exhibit-7 Typical Strengths that Support Information Management Capability

- Ease and convenience of access to information sources
- Widespread use of computerized information system
- Availability and operability of high-tech equipment
- Positive attitude to sharing and disseminating information
- Wide coverage and networking of computer systems
- Presence of foolproof information security systems
- Presence of buyers and suppliers conversant with IT applications
- Top management's understanding of, and support to, IT and its application within the organization

4.5.6 General Management Capability

General management capability relates to the integration, coordination, and direction of the functional capabilities towards common goals, and all the allied aspects that have a bearing on an organization's capacity and ability to implement its strategies.

Some of the important factors which influence the general management capability of an organization are as follows:

1. Factors related to the general management system. Strategic management system processes related to setting strategic intent, strategy formulation and implementation machinery, strategy evaluation system, management information system, corporate planning system, rewards and incentives system for top managers, and so on.

2. Factors related to general managers. Orientation, risk-propensity, values, norms, personal goals, competence, capacity for work, track record, balance of functional experience, and so forth.

3. Factors related to external relationships. Influence on and rapport with the government, regulatory agencies and financial institutions; public relation; sense of social responsibility, philanthropy, public image as corporate citizen, and so on.

4. Factors related to organizational climate. Organizational culture, use of power, political processes, balance of vested interests; introduction, acceptance and management of change; nature of organizational structure and controls, and so on.

Exhibit-8 Typical Strengths that Support General Management Capability

- Effective system for corporate planning
- Control, reward and incentive system for top managers geared to the achievement of objectives
- Entrepreneurial orientation and high propensity for risk-taking
- Good rapport with the government and bureaucracy
- Favorable corporate image
- Commonly being perceived as a good organization to work for
- Development oriented organizational culture

4.6 Organizational Appraisal

The purpose of organizational appraisal (also referred to as internal appraisal, internal analysis, organizational analysis, company analysis, etc.) is to determine the organizational capability in terms of the strengths and weaknesses that lie in the different functional areas. This is necessary since the strengths and weaknesses have to be matched with the environmental opportunities and threats for strategy formulation to take place. In organizational appraisal, the various forces and influences operating within the internal environment of an organization have to be analyzed. These forces and influences are a result of the organizational resources, behavior, synergistic effects, and the competencies of the organization.

4.6.1 Factors Affecting Organizational Appraisal

The factors that affect organizational appraisal relate to the strategists, the organization, and to the internal environment. The various characteristics of strategists- they matter so far as their general management capability is concerned- affect the manner in which organizational appraisal would be done.

- The ability of the strategists to comprehend complexity determines how well the different forces and influences operating within the internal environment are analyzed
- The size of the organization affects the quality of appraisal. Large organizations are usually more difficult to appraise than smaller ones.
- If the internal environment of an organization is vitiated owing to opposing political forces and power games, the quality of appraisal is likely to suffer. A cohesive management team, on the other hand, is more likely to appraise the organization better.

4.7 Profile- Method and Techniques used for Organizational Appraisal

The methods and techniques used for organizational appraisal can be identical to those used for the performance evaluation of an organization. But there is an important difference between performance evaluation and organizational appraisal. In evaluating performance the emphasis is on assessing the current behavior of the organization with respect to its efficiency and effectiveness, and such an assessment is generally of a short term nature. On the other hand, organizational appraisal is of a comprehensive and long-term nature and the emphasis is not just on current behavior but also on what the organization needs to do in order to gain the capability to compete in the market, take advantages of the available opportunities, and overcome the threats operating in its relevant environment.

Keeping in view the differences between evaluation and organizational appraisal, the methods and techniques used could be classified broadly in three parts as below.

4.7.1 Internal Analysis

A. Value chain analysis

B. Quantitative analysis

   (i) Financial analysis

   (ii) Non-financial quantitative analysis

C. Qualitative analysis

4.7.2 Comparative Analysis

A. Historical analysis

B. Industry norms

C. Benchmarking

4.7.3 Comprehensive Analysis

A. Balance scorecard

B. Key factor rating

We now proceed to explain the methods and techniques of organizational appraisal.

4.7.1 Internal Analysis

The internal analysis of an organization deals with an investigation into its strengths and weaknesses by focusing on factors that are specific to it. In contrast, as we will see a while later, comparative analysis deals with an examination of the strengths and weaknesses of an organization in relation to its own past record or with reference to its competitors.

A. **Value Chain Analysis:** This is a method for assessing the strengths and weaknesses of an organization on the basis of an understanding of the series of activities it performs. Porter (1984) is credited with the introduction of the framework called value chain.

B. **Quantitative Analysis:** Relying on numbers is a popular technique for assessing the performance of an organization. Among number are the financial figures which are most often used for performance evaluation, as well as, the assessment of strengths and weaknesses. (i) Financial Analysis- The traditional methods used for evaluating financial performance cover various types of activities in different functional areas within an organization. (ii) Non-financial quantitative analysis- The obvious advantage of financial analysis is that all number can be expressed in terms of a common monetary unit, such as, rupees, pounds or dollars.

C. **Qualitative analysis:** An organizational appraisal can be based primarily on qualitative analysis since it is possible to measure and compare on a numerical or financial basis. Yet, as most strategists are aware, quantification has its limitation.

1.7.2 Comparative Analysis

Comparative analysis thus forms the cornerstone of the assessment of the strengths and weaknesses of an organization. It can be done in three ways: historical analysis, on the basis of industry norms, and by benchmarking, all of which we have described below.

A. **Historical Analysis:** One way to compare performance and identify strengths and weakness is to start with the historical analysis of one's own organizational over a period of time Historical analysis is a good measure of how well or badly an organization has progressed with respect to its own past performance.

B. **Industry norms:** The industry to which a business belongs is the most obvious choice for comparison with regard to a wide range of parameters. A company might check whether its cost structure is comparable to that of its competitors, or if the budget spending on advertising is equal to that of its nearest rival.

C. **Benchmarking:** A benchmarking is a reference point for the purpose of measuring. The process of benchmarking is aimed at finding the best practices within and outside the industry to which an organization belongs. The purpose of benchmarking is to find the best performers in an area so that one could match one's own performance with them and even surpass them.

1.7.3 Comprehensive Analysis

While it would be useful to use a range of analytical methods to evaluate the strengths and weaknesses of a firm and to determine its capability, a better way is to use a combination of techniques as each one of these have a different purpose and limitations.

A. **Balance Scorecard:** Among a newer techniques used to measure the performance of an organization is that of the balanced scorecard. The balance scorecard identifies four key performance measures as follows:

- Customer perspective
- Internet business perspective
- Innovation and learning perspective
- Financial perspective

Each of these perspectives could be used individually; but using them in combination provides deeper insights and a balanced approach to strategy formulation.

B. **Key Factors Rating:** A comprehensive method, which can be used in association with financial analysis, is that of key factor rating.

Exhibit-9 Summarized Form of Organizational Capability Profile

1) Financial capability factors
   a) Sources of funds
   b) Usage of funds
   c) Management of funds
2) Marketing capability factors
   a) Product related
   b) Price related
   c) Promotion related
   d) Integrative and systematic
3) Operations capability factors
   a) Production System
   b) Operational capability factors
   c) R&D systems
4) Personnel capability factors
   a) Personnel system
   b) Organizational and employee characteristics
   c) Industrial relations
4) Information management capability factors
   a) Acquisition and retention of information
   b) Processing and synthesis of information
   c) Transmission and dissemination of information
6) General management capability factors
   a) General management system
   b) External relations
   c) Organizational climate

4.8 Summary

The main points covered in this chapter are as below:

- Meaning and importance of SAP along with the factor prevailing in the organizational internal environment.
- The dynamics of the internal environment are understood in terms of the complex interplay of organizational resources and behavior, strengths and weaknesses, synergistic effects, and the competencies of the organization.
- The resources possessed by an organization are the physical, human, and organizational resources. Organizational behavior is the manifestation of the various forces and influences operating in the internal environment of an organization that create the ability of or place constraints in the usage of resources.
- Organizational capabilities are the inherent capacity or potential of an organization to use its strengths and overcome its weaknesses in order to exploit opportunities and face threats in its external environment.
- The ultimate goal of an organization is to secure strategic advantage. Competitive advantage where there is one or more identified rivals against whom the rewards or penalties of performance could be measured.

- Organizational capability is described in terms of the six areas of finance, marketing, operations, personnel, information management, and general management. For each capability factor, we have first defined that factors and then pointed out some of the important elements that support capability in an area.
- The various considerations involved in organizational appraisal related to the factors that affect appraisal, the approaches that can be adopted to appraise them, and the sources of information available to perform the appraisal.
- The factor that affect organizational appraisal relate to the strategists, the organization, and to the internal environment.

4.9 Self Assessment Questions

1. What do you mean by organizational appraisal?
2. What impact do organizational resources and behavior have on the internal environment of an organization?
3. How can industry norms and benchmarking be used for organizational appraisal?
4. How does the 'key factors rating' method work for organizational appraisal?

4.10 Reference Books

- A. Kazmi, "Strategic Management & Business Policy", The Tata McGraw-Hill, Third Edition, 2008.
- A, Sharpin, "Strategic Management", New York: McGraw – Hill, 1984.
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- Miller, A and G G Dess, Strategic Management, New York: McGraw- Hill, 1996.

Unit - 5 : Hierarchy of Strategic Intent

Structure of Unit:

5.0 Objectives

After completing this unit, you would be able to:

- Explain the concept of strategic intent;
- Describe the concept of vision and mission;
- Explain the process of objective setting;
- Know about various external environment factors of businesses;
- Describe business model and their relationship with strategy;
- Critical success factors in setting objectives.

5.1 Introduction

Strategic Intent: Organizational vision statement is sometimes called a picture of your company in the future. The vision statement answers the question, "Where do we want to go? A clear vision provides the foundation for developing a comprehensive mission statement. A mission statement is a formal, short, written statement of the purpose of a company or organization. The mission statement should guide the actions of the organization, spell out its overall goal, provide a sense of direction, and guide decision-making. It provides "the framework or context within which the company's strategies are formulated. Vision is like destination mission the path.

5.2 Meaning of Strategic Intent

Strategic intent refers to the purposes the organization strives for. At the business level of firms, these could be expressed as the business definition and business model. The leveraging of a firm's internal resources, capabilities and core competencies to accomplish the firm's vision, mission and objectives in a competitive environment is 'Strategic Intent'. Hamel and Prahalad quote several examples of global firms, almost all of American and Japanese origin, to support their view. In fact, the concept of strategic intent- as evident from their path breaking article published in 1989 in the Harvard Business Review- seems to have been proposed by them to explain the lead taken by the Japanese firms over their American and European counterparts. Yet, strategic intent has wider implications and carries a lot of meaning for the strategic management of firms. There is merit in their view as business groups and companies, which have aspired for global leadership, can be found in the Indian context too. It is about winning competition battles and gaining leadership position by putting organizational resources to best use. When established effectively, a strategic intent can cause people to turn out excellent performance. Strategic intent is said to exist when all employees and levels of a firm are committed to the pursuit of a specific but significant performance target. The intent can take the form of a broad vision or mission statement or a more focused route covering specific objectives and goals. In a way, thus, strategic intent tries to establish the parameters that shape the values, motives and actions of people throughout their organization.

Based on the Strategic Intent is the organizations provide products and services for consumers, profits for investors, jobs for employees, taxes for governments, and economic stability for the communities. Strategic intent also identifies the commitment of the organization to contribute to the welfare of society by setting standards on being economically productive and socially responsible. The goals identified through the strategic intent of the organization represent a synthesis and demands placed on the organization by its stakeholders these choices, collectively, set apart the organization from others.

The most important characteristics of successful organizations are their clarity of purpose, adherence to their core values, their distinct identity and their vision of the organization. In practice there will always be limits on the range of possible choices. Small enterprises tend to be limited by their resources, whereas large enterprises may find their range of choice limited because it is difficult to change quickly and therefore, they tend to be constrained by their past. In the public sector, strategic choices may be made at a political level and the role of the manager may be limited to devising best to implement strategies rather than on fundamental choices of future direction. Wherever may be the limitations on choices, organizations have to co-exist in competitive markets by contributing to economic progress by creating new value to society, each organization doing so in its own way.

Strategic analysis, strategic choice and strategy implementation are the three parts of the Strategic Management. 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. Choice becomes an idle exercise if the strategy is not properly implemented. These three divisions, therefore, form a closed loop in which the tail and the head are often indistinguishable.

We will generally follow the conventional framework based on these divisions. However, for pedagogical simplicity, in this chapter, we will begin our foray into hard-core strategic management by discussing strategic intent- through strategic intent is considered to be a past of strategic choice. We will start with the vision, mission and objectives as well as value statements. These concepts are at the core of the strategy of managements. If different organizations do not have differences in their vision and goals, there is going to be significant difference between organizations.

5.3 Concept & Definition of Strategic Intent

Hamel and Prahalad coined the term 'strategic intent' which they believe is an obsession with an organization: an obsession of having ambitions that may even be out of proportion to their resources and capabilities. This obsession is to win at all levels of the organization, while sustaining that obsession in the quest for global leadership. They explain the term 'strategic intent' like this: 'On the one hand, strategic intent envisions a desired leadership position and establishes the criterion the organization will use to chart its progress… At the same time, strategic intent is more than simply unfettered ambition… The concept also encompasses an active management process that includes: focusing the organization's attention on the essence of winning, motivating people by communicating the value of the target, leaving room for individual and team contributions, sustaining enthusiasm by providing new operational definition as circumstances change and using intent consistently to guide resource allocations'. We will discuss these parameters as a hierarchy of strategic intent. The hierarchy of strategic intent includes the following elements.

- A broad *vision* of what the organization should be.
- The organization's *mission*
- The strategic *objectives* and specific goals to be pursued relentlessly
- The *plans* that are developed to accomplish the intentions of management in a concrete way.

The elements of the hierarchy specify the pious intentions, lofty ideals and clear-cut ideas that serve to unify the energy and forces scattered throughout an organization. They are beginning points for any formal planning process, but they also provide the sense of direction necessary to assure that incremental behavior culminates in overall progress. Strategic intent is said to have expressed effectively when people believe fervently in their products and industry and when they are focused totally on their firm's ability to outperform its competitors.

5.4 Vision

Aspirations, expressed as strategic intent, should lead to an end; otherwise they would just be castles in the air. That end is the vision of an organization or an individual. It is what the firm or a person would ultimately like to become. For instance, some of you, say in 10 years, or maybe even earlier, would like to become general managers managing an SBU in a large, diversified multinational corporation. Or some others among you would like to believe that you will be an entrepreneur in 10-15 years owning your own company dealing with IT services and employing cutting-edge technology to serve a global clientele. A firm thinks like that too.

Witness what Tata Steel sys about its vision: 'Tata Steel enters the new millennium with the confidence of learning, knowledge-based and happy organization. We will establish ourselves as a supplier of choice by delighting our customers with our service and our products. In the coming decade, we will become the most cost competitive steel plant and so serve the community and the nation'. A vision, therefore, articulates the position that a firm would like to attain in the distant future. Seen from this perspective, the vision encapsulates the basic strategic intent.

Understanding Vision: A vision is more dreamt of than it is articulated. This is the reason why it is difficult to say what vision an organization has. Sometimes it is not even evident to the entrepreneur who usually thinks of the vision. By its nature, it could be as hazy and vague as a dream that one experienced the previous night and is not recall perfectly in broad daylight. Yet it is a powerful motivator to action. And it is from the actions that a vision could often be derived. Henry Ford wished to democratize the automobile when the visualized that an affordable vehicle could be available for the masses. Walt Disney probably wanted to make people happy.

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.

The world over, backwards and forwards in history, just one thing has fired the imaginations of the people: a vision of future that promises to right today's wrongs, a graphic image of a time when injustice, impoverishment will have disappeared. Moses used the vision of a land mark of milk and honey to motivate his people to set off for the Promised Land. Indian's freedom fighters used the vision of a country free of its colonial rulers to wrest independence. In the corporate context, vision refers to an inspirational picture of a future that can be created, offering clarity amidst confusion, hope against despair, and unity of purpose amidst diversity of personal causes.

Defining Vision: Vision has been defined in several different ways.

1. Kotter defines it as a "description of somethings (an organization, corporate culture, a business, a technology, an activity) in the future".
2. El-Namaki considers it as a "mental perception of the kind of environment an individual, or an organization, aspires to create within a broad time horizon and the underlying conditions for the actualization of this perception".
3. Miller and Dess view it simply as the "category of intentions that are broad, all inclusive, and forward thinking".

The common strand of thought evident in these definitions and several others available in strategic management literature relates to 'vision' being future aspirations that lead to an inspiration to be the best in one's field of activity.

Characteristics of Vision:

1. **Vision is Developed Through Sharing Across an Organization:** Famous stories of successful vision involve visions that have been widely shared across entire organizations. Of course, an individual leader, often a founder has a powerful impact on the others.
2. **Methods of Convincing the Others About Vision:** The leaders by working hard along with others convince the others in the organizations rather than simply by delivering speeches.
3. **Change Agents:** Leaders must recognize the complexity of changing an outmoded vision to reflect new realities. Organizations must redefine themselves through updated visions of the future through new objectives and strategies.

The Benefits of Having a Vision: Parikh and Neubauer point out that several benefits accruing to an organization having a vision. Here is what they say:

- Good visions are inspiring and exhilarating.
- Visions represent a discontinuity, a step function and a jump ahead so that the company knows what it is to be.
- Good visions help in the creation of a common identity and a shared sense of purpose.
- Good visions are competitive, original and unique. They make sense in the marketplace as they are practical.
- Good visions foster risk-taking and experimentation.
- Good visions foster long-term thinking.
- Good visions represent integrity; they are truly genuine and can be used for the benefit of people.

Vision Statement: When you begin the process of 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 demands, to make the organization highly competitive with growth and profits as the rewards. The long-term benefits are substantial, because visioning:

- Break you out of boundary thinking.
- Provides continuity and avoids the stutter effect of planning fit 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.

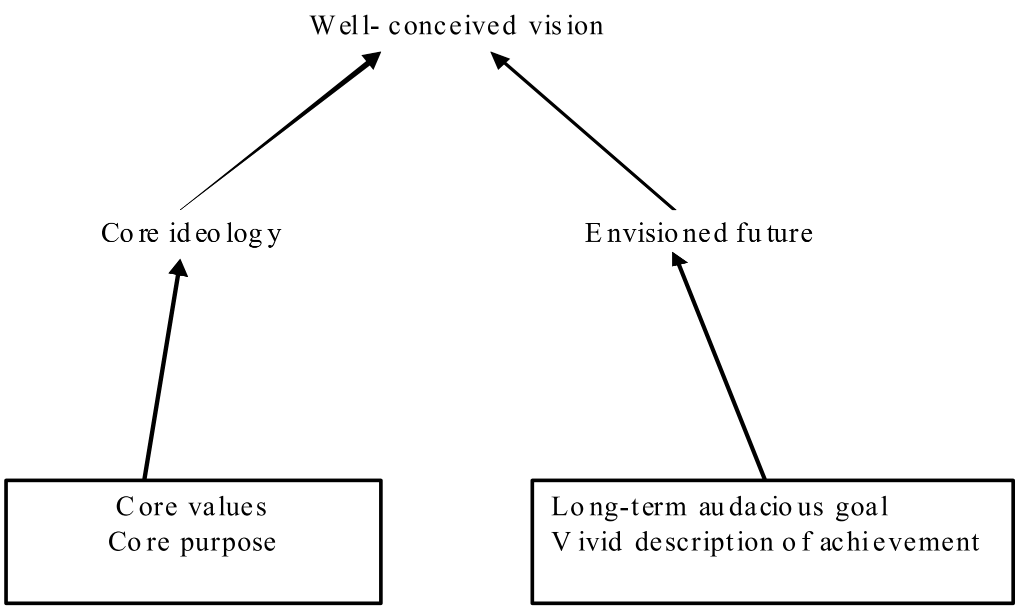
Building a Vision: The vision statement should be build around certain core values. Thus, Sony’s vision rests on the values of encouraging individual creativity and its determination to be a pioneer. Such core values reflect how you want your future to look, the timeless principles to be followed while running the show- irrespective of what happens in and around the organization. Values, thus, are the essential glue of vision. Since a company’s different business may need to operate with different strategies, it’s their shared values that will prevent them from going in different directions. The vision statement should also spell out the core purpose of an organization very clearly. For example, we know that 3M’s purpose is to solve problems innovatively; Nike wants to provide the experience and emotion of competition – winning and crushing competitors; Blue Star wants to provide world class engineering products and services. Unstructured inputs could be taken from everyone developing the corporate vision. Companies like Larsen & Toubro, Crompton Greaves, Gujarat Heavy Chemicals typically follow certain steps in this regard:

1. Elicit ideas from employees as to how their dream organization should be like in terms of characteristics;
2. Combine these with the company's core values and purpose to build the vision statement.

Creating a Shared Vision: Most managers now-a-days talk about a shared vision meaning that individuals from across the organization have a common mental image and a mutually supported set of aspirations that serve to unite their efforts. People at all levels must share a common inspirational image that compels them to give their best and realize their own dreams. The vision once finalized, must be injected into the veins of the organization, being shared, owned and lived by every single person in the company.

The Process of Envisioning: The process of envisioning is a difficult one as we see from what Collins and Porras (1995) have to say about it. According to them, a well- conceived vision consists of two major components: core ideology and envisioned future. The core ideology defines the enduring character of an organization that remains unchangeable as it passes through the vicissitudes of vectors such as technology, competition or management fads. The core ideology rests on the core values (the essential and enduring tenets of an organization) and core purposes (an organization's reason for being). The envisioned future too consist of two components: a 10-30 years audacious goal and vivid description of what it will be like to achieve that goal. The process of envisioning is shown in Exhibit-1. Many organizations mention terms such as corporate philosophy, corporate values and the like, that are used to convey what they stand for and what principles guide them in strategic and day-to-day decision making. These terms are all part of an effort to state what the organization's vision is. From vision, we now move on to the second level of strategic intent that is the mission.

Exhibit-1 THE PROCESS OF ENVISIONING



Based on ideas in J. Parikh & F. Neubaure, 'Corporate Visioning' International Review of Strategic Management, Vol. 4, Ed: D. E. Hussey, West Sussex, England: John Wiley &

Figure - 5.1

5.5 Mission

Organization, whether it is a business or a social organization, or university or government organization, takes resources from the environment and converts the resources into goods and/or services. It supplies the goods and services to the environment at an acceptable price. The organizations which make a net contribution to the society are called 'legitimate.' The organizations should protect this legitimacy over the long-run. Thus, every organization comes into being and exists to accomplish something in the larger environment, and that purpose or mission is clear that start. As time passes, technology, consumer preferences and other environmental factors change, the firm's produces new products or renders new services and the interest of the management and employees change. This results in significant change in the firm. The original mission or purpose may become irrelevant in the long-run due to changes in internal environment of the organization and/or appropriate external environment. When these changes take place, management must search for new purpose or new state the mission or restate the original mission.

Understanding Mission: Organizations relate their existence to satisfying a particular need of the society. They do this in terms of their mission. Mission is a statement which defines the role that an organization plays in a society. It refers to the particular needs of that society for instance, its information needs. A book publisher and a magazine editor are both engaged in satisfying the information needs of society but they do it through different means. A book publisher may aim at producing excellent reading material while a magazine editor may strive to present news analysis in a balanced and unbiased manner. Both have different objectives but an identical mission.

Definitions: A mission was earlier considered as the scope of the business activities a firm pursues. The definition of mission has gradually expanded to represent a concept that embodies the purpose behind the existence of an organization.

Whether developing a new business or reformulating direction for an ongoing company, the basic goals, characteristics and philosophies that will shape a firm's strategic posture must be determined. Thus, company mission will guide future executive action.

Company mission can be defined as the fundamental, unique purpose that sets a business apart from other firms of its type and identifies the scope of its operations in product and market term. It embodies the business philosophy of strategic decision-makers; implies the image the company seeks to project; reflects the firm's self-concept; indicates the principal product or service areas and primary customer needs the company will attempt to satisfy. In short, the mission describes the product, market and technological areas of emphasis for the business.

1. Thompson defines mission as the "essential purpose of the organization, concerning particularly why it is in existence, the nature of the business it is in, and the customers it seeks to serve and satisfy."
2. Hunger and Wheelen say that mission is the "purpose or reason for the organization's existence".
3. According to John Pearce "mission is an enduring statement of purpose that distinguishes one firm from other similar firms".

Characteristics of a Mission: A mission statement incorporates the basic business purpose and the reason for its existence by rendering some valuable functions for the society. An effective mission statement should possess the following characteristics.

1. **Feasible:** The mission should be realistic and achievable. For instance, UTI declared its mission as

"to encourage saving and investment habits among common man". By providing tax relief under Sec 88c, the investment upto 1lakh in UTI is exampled from income tax. Hereby common man's savings habit is encouraged by UTI.

2. **Precise:** A mission statement should not be narrow or too broad.

3. **Clear:** A mission statement should lead to action. BSNL'S mission of 'connecting India' leads it to a variety of service with varied tariff structure so as to cater to the preferences of mobile phone users.

4. **Motivating:** The mission should be motivating for the employees to be inspired for action. For example India Post's mission is to expectations of the customer' with dedication, devotion and enthusiasm. So customer service has become a value and it is inspiring and motivating the postal employees.

5. **Distinctive:** A mission statement will indicate the major components of the strategy to be adopted. The mission should be unique. When HCL defines its mission as 'to be a world class competitor' it creates a unique place in the minds of Indian personal computer users who across personal computers of MNCs on most of the occasions.

6. **Indicates Major Components of Strategy:** "The mission statement of IOC emphasizes petroleum refining, marketing and transportation with international standards and modern technology. It indicates that IOC is going to adopt diversification strategy in future.

The mission provides direction to insiders and outsiders on what the firm stands for. It is the guiding star for any firm.

Need for an Explicit Mission: The mission contains few specific directives, only broadly outlines or implied objectives and strategies. It is a statement of attitude, outlook and orientation rather than of details and measurable targets.

To ensure unanimity of purpose within the organization;

- To provide a basis for motivating the use of the organizations resources;
- To develop a basis, or standard, for allocating organizational resources;
- To establish a general tone or organizational climate;
- To serve as a focal point for those who can identify with the organization's purpose and direction;
- To facilitate the translation of objectives and goals into a work structure involving the assignment of tasks; and
- To specify organizational purposes and the translation of these purposes into goals.

Formulating a Mission: The process of defining the mission for a specific business can be understood by thinking about a firm at its inception. The sense of mission is usually based on several fundamental elements.

- Belief that the product or service can provide benefits at least equal to its price.
- Belief that the product or service can satisfy a customer need currently not met adequately for specific market segments.
- Belief that the technology to be used will provide a product that its cost and quality competitive.

- Belief that hard-work and the support of others, the business can grow and be profitable.
- Belief that the management philosophy of the business will result in a favorable public image.
- Belief that the entrepreneur's self concept can be communicated and adopted by employees and shareholders.

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 it in? These are all questions of purpose. They deal with the deeper motivations and assumptions underlying the values and purpose and function.

- Your mission statement draws on your belief statements.
- Your mission statement must be orientated and portray your organization as it will be, 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 are 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 answer to the above questions. It should arouse a strong sense of organizational identity and business purpose. Through 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.

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 and Mission 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 were 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 identifying 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 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 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. 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.

5.6 Business Definition

Understanding business is vital to defining it and answering the question 'What is our business?' It could also be a pointer to answer to questions such as: 'What will it be?' Vision and mission statements can use the ideas generated through the process of understanding and defining business.

Dimensions of Business Definition: The wrist watch has traditionally been considered to have just one function- to display the time. Today it is becoming a fashion accessory, which might also mean that you need to have more than one watch. It is a reflection of one's personality and status; it makes a statement. High-value, rare watches could also be pieces of art.

Dereak Abell, in a path breaking analysis, suggesting defining a business along the three dimensions of customer groups, customer functions and alternative technologies. Customer groups relate to 'who' is being satisfied, customer needs describe 'what' is being satisfied and alternative technologies means 'how' the need is being satisfied. The three dimensions diagrammatic presentation is as follow:-

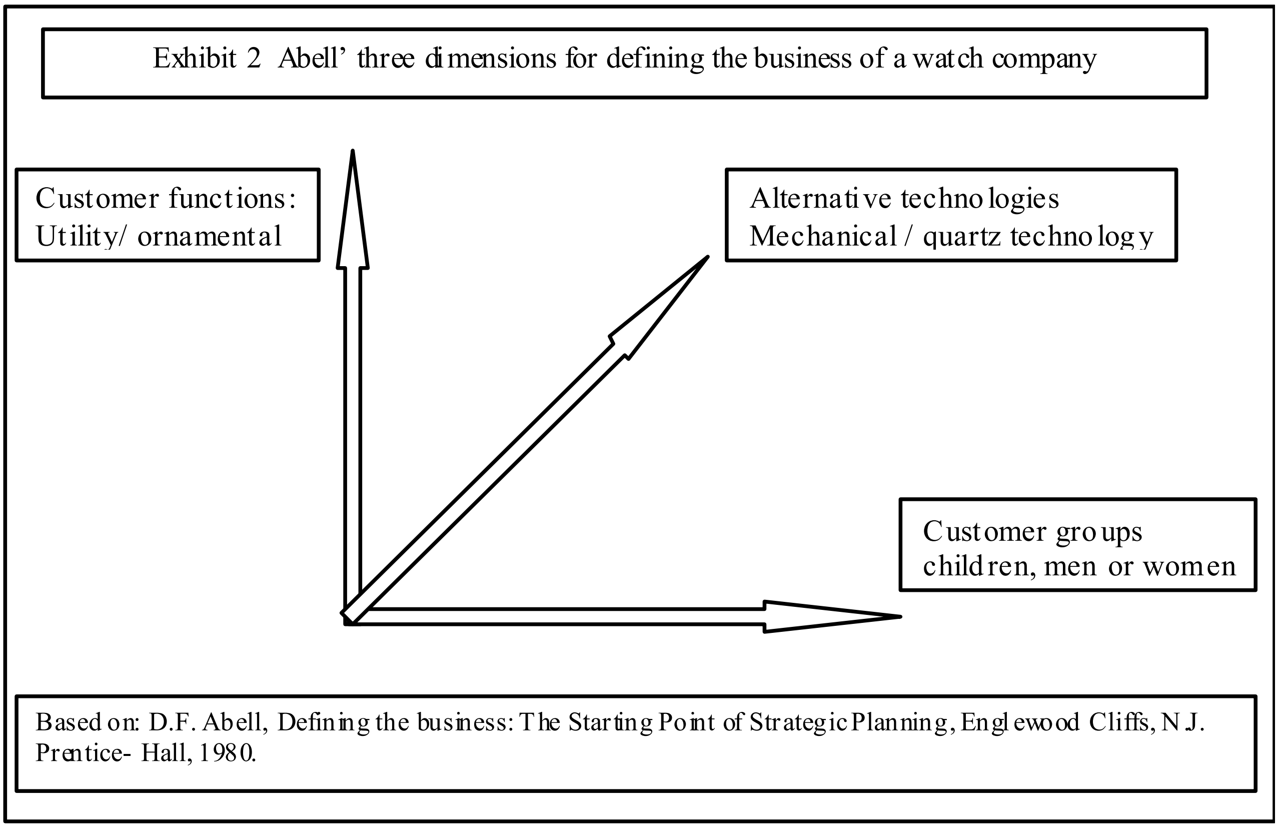


Figure - 5.2

Customer groups are created according to the identity of customers. Customer functions are based on what the products or services provide for the customers. Alternative technologies describe the manner in which a particular function can be performed for a customer.

Applying Abell's three- dimension model to the illustration of timekeeping business, we could identify the three dimensions as follows:

1. Customers groups could be industrial customers or industrial users.
2. Customer functions could be finding time, recording time, and using watches as a fashionable accessory, a gift item or a piece of art.
3. Alternative technologies could be the mechanical, quartz digital and quartz analogue types.

Such a clarification helps in defining business explicitly. A clear business definition is helpful for strategic management in many ways.

5.7 Goals & Objectives

Goals denote what an organization hopes to accomplish in a future period of time. They represent the future state or outcome of effort put in now. A broad category of financial and non-financial issues are addressed by the goal that a firms sets.

Objectives are the ends that state specifically how the goals shall be achieved. They are concrete and specific in contrast to goals that are generalized.

The accomplishment of purpose or mission of an organization requires the formulation of a number of objectives. Achievement of the organizational objectives, in turn, requires the formulation and fulfillment of departmental and unit goals. Long-range objectives specify the results that are desired in pursuing the organization's mission and normally extended beyond the current financial year of the organization. Lon-range objectives are notably speculative for distant years. Short-range objective are performance targets, normally of less than one-year duration, that are used by management to achieve the organization's long-range objectives. The selections of short-range objectives are from an evaluation of priorities relating to long-range objectives. Departmental objectives, both long-range and short-range are formulated based on the respective long-range and short-range objectives of the organization. Unit objectives are generally specific and are draw from the departmental objectives.

An objective indicates the result that the organization expects to achieve in the long run. It is an end result, the end point, something that you aim for and try to reach. It is a desired result towards which behavior is directed in an organization. The organization may or may not reach the desired state, but the chances of doing so are greater if the objectives are framed and understood properly. Objectives are the products of specific concrete thinking. They commit persons and organizations to verifiable accomplishments. Again, objectives determine the scope of future events. They provide the spotlight on the routes over which activities are organized. They serve as reference points to concentrate resources and efforts. They determine what action to take today to obtain results tomorrow. Goals and targets are more precise and expressed in specific terms. In this section we will refer to only objectives assuming that these include the goals as well.

They are stated in precise terms as quantitatively as possible. The emphasis in goals is on measurement of progress toward the attainment of objectives. Goals have the following features they: 1. are derived from objectives, 2. offer a standard for measuring performance, 3. are expressed in concrete terms, 4. are time-bound and work-oriented.

Formulating Objectives: The mission and directional course are converted into designated performance outcomes in the process of formulating objectives. Objectives represent a managerial commitment to achieve specified results in a specified period, of time. The clearly spell out the quantity and quality of performance to be achieved, the time period, the process and the person who is responsible for the achievement of the objective.

An organization's mission statement will be just window-dressing, unless, it is translated into measurable and specific performance targets and managers are pressured to achieve these targets. Thus, objective formulation is a critical step in the strategic management process. It is viewed that, whose managers formulate objectives for each key result area and then actively pursue actions to achieve their performance targets will outperform the companies whose managers operate with hopes and more good intentions. Performance objectives must be stated in quantifiable or measurable terms. They must also contain a deadline for achievement.

Characteristics of Objectives: Objectives have the following features:

1. **Objectives Form a Hierarchy:** In many organizations objectives are structured in a hierarchy of importance. There are objectives within objectives. They all require painstaking definitions and close analysis if they are to be useful separately and profitable as a whole. The hierarchy of objectives is a graded series in which an organization's goals are supported by each succeeding managerial level down to the level of the individual. The objectives of each unit contribute to the objectives of the next higher unit. Each operation has a simple objective which must fit in and add to the final objective. Hence no work should be undertaken unless it contributes to the overall goal.

2. **Objectives Form a Network:** Objectives interlock in a network fashion. They interrelated and inter-dependent. The concept of network of objectives implies that once objectives are established for every department and every individual in an organization, these subsidiary objectives should contribute to meet the objectives of the total organization. If the various objectives in an organization do not support one another, people may pursue goals that may be good for their own function but may be detrimental to the company as a whole. Managers have to trade off among the conflicting objectives and see that the components of the network fit one another. Because, as rightly pointed out by Koontz , "It is bad enough when goals do not support and interlock with one another. It may be catastrophic".

3. **Multiplicity of Objectives:** Organizations pursue multifarious objectives. At every level in the hierarchy, goals are likely to be multiple. For example, the marketing division may have the objective of sale and distribution of products. This objective can be broken down into a group of objectives for the product, advertising, reach, promotion managers. The advertising manager's goals may include: designing product messages carefully, create a favorable image of the product in the market, etc. Similarly goals can be set for other marketing managers. To describe a single, specific goal of an organization is to say very little about it. It turns out that there are several goals involved. This may be due to the fact that the enterprise has to meet internal as well as external challenges effectively. Internal problems may hover around profitability, survival, growth, an so on. External problems may be posed by government, society, stockholders, customers etc. In order to meet the conflicting from various internal and external groups, organizations generally pursue multiple objectives. Moreover, no single objective would place the organization on a path of prosperity and progress in the long run.

4. **Long and Short-range Objectives:** organizational objectives are usually related to time. Long-

range objectives extending over five or more years are the ultimate or dream objectives for organization. They are abstractions of the entire hierarchy of objectives of the organization. For example, planning in India has got objectives like eradication of poverty, checking population growth through birth control etc. which reflect certain 'ideals' the government wishes to accomplish in the long run. Short-range objectives (one-year goals) and medium-range objectives (two to five year period goals), reflect immediate, attainable goals. The short-range and medium-range objectives are the means for achieving long-term goals and the long-term goals supply a framework within which the lower level goals are designed. Thus, all these goals reinforce each other in such a way that the total result is greater than the sum of the efforts taken individually. That is why goal setting is called a "synergistic process". In order to remain viable, every organization needs to set goals in all three time periods.

Importance of Objectives: Why do organizations formulate objectives? And what is their importance? The following four factors explain the need for and importance of objectives.

1. **Objectives Help to Define the Organization in its Environment:** The organizations justify their existence to their stakeholders in the environment like customers, government, creditors and society at large.
2. **Objectives Help in Coordinating Decisions and Decision-Maker:** Stated objectives impose some constraints on the employees and modify it towards the desirable direction. It coordinates decision-making process by different employees.
3. **Objectives Help in Formulating Strategies:** Mission statements are translated into objectives and objectives are the basis for formulating strategies.
4. **Objectives Provide Standards for Assessing Organizational Performance:** Objectives provide not only the direction to move to the organization but also provide the ultimate goals and targets that the organization is expected to achieve. These targets and goals become the standards to judge the organizational performance. Organizations, without clear objectives will not have basis for evaluating their performance or success.

5.8 Summary

Strategic Intent is the leveraging of a firm's internal resources, capabilities and core competencies to accomplish the firm's vision, mission and objectives in a competitive environment. The corporate vision has the potential power to focus the collective energy of insiders and to give outsiders a better idea of what an organization really is. Vision is what keeps the organization moving forward. The vision statements present the values, philosophies and aspirations, the guide organizational action. Mission is an enduring statement of purpose that distinguishes one organization from other similar organization. Organization do exist to satisfy a particular need of the society or to fulfill a particular deficiency in the society. A mission statement is a declaration of an organization's reason of being. Management must take into account three key elements in developing mission statements viz., history of the organization, organization's distinctive competencies and the organization's environment.

The accomplishment of purpose or mission of an organization requires the formulation of objectives. These objectives are classified into overall organizational objectives, departmental objectives as well as unit level objectives. Based on the time objectives are classified into long-range objectives and short-range objectives. Long-range objectives are notably speculative for distant years. Short-range objectives are performance targets, normally of less than one-year's duration. Objectives represent a managerial commitment to achieve specified results in a specified period of time.

5.9 Self Assessment Questions

1. What do you mean by "Hierarchy of Strategic Intent". Explain in detail.
2. Mention the characteristics of a good mission and vision statements?
3. Explain the three dimensions of business definition?
4. Identify the roles that objectives play in strategic management?

5.10 Reference Books

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Unit - 6 : Strategies Formulation I

Structure of Unit:

6.0 Objectives

- To know about the process of strategy formulation.
- To understand corporate strategy and identify its components.
- To understand business level strategy and its components.
- To know about functional level strategy.
- To learn how different corporate strategies could add value to a corporation.

6.1 Introduction

Strategic management is the set of managerial decisions and actions that determine the long run performance of an organisation and include: (i) external and internal environmental scanning, (ii) strategy formulation, (iii) strategy implementation, evaluation and control.

Strategy formulation is the second phase in the strategic management process. The four primary steps in this phase are:

i. Review of the current key objectives and strategies of the organization, which have been identified and evaluated as part of the environmental scanning.

ii. Identifying a wide range of strategic alternatives for all the three levels- corporate, business and functional.

iii. Analysing the advantages and disadvantages of the alternatives with respect to: (i) the feasibility of their implementation and (ii) its effect on the success of the organization

iv. Deciding about the alternatives that should be implemented or recommended.

While formulating the strategy, the following points should be considered:

i. It should be effective in solving the stated problems.

ii. It should be practical, feasible and cost-effective, which means that it can be implemented with respect to the resources available.

iii. It should be workable within a reasonable time frame.

iv. It should be acceptable to key stakeholders of the organization.

v. In light of the opportunities identified, it should be a case of best fit between the resources and competencies, and also between risks and expectations.

The strategy is formulated at three levels: corporate level, SBU or business level and functional level. For each level, there are a variety of strategic alternatives available. An organisation may first choose the corporate strategy and then the SBU or business level strategy and after that, the functional level strategy.

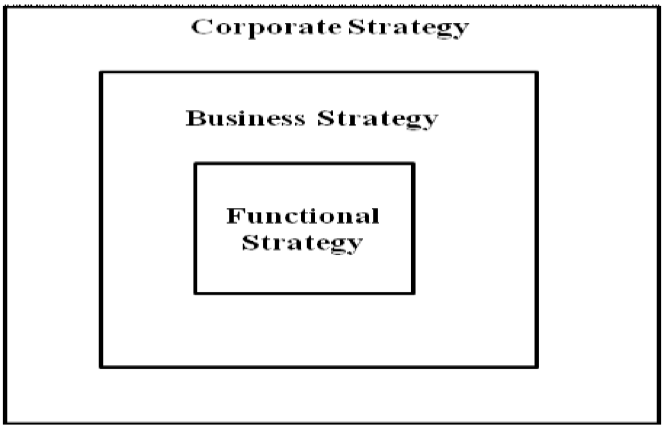

Figure – 6.1 : Hierarchy of Strategy

6.2 Corporate Level Strategy

It is also called as **Grand Strategy**. It is a firm's overall approach to gaining a competitive advantage by operating in several businesses simultaneously. Gaining a competitive advantage requires setting a clear purpose for the entire organisation and identifying plans and actions to achieve that purpose. Organisations need to constantly ask themselves what the lines of business they are in, how these lines of business fit together, what business they should be in and what are their basic directions for the future. To respond to the dynamism in the business environment and enhance competitiveness, organisations should develop flexible corporate strategies.

Porter has described it as the overall plan for a diversified business. In case of a small firm or a single business organisation, it is about deciding about the overall direction of the firm. In case of a large organisation having multiple business units, it is about managing various businesses units in light of the overall corporate objectives and moving resources between businesses for maximising their contribution towards corporate objectives.

Developing a competitive corporate strategy requires:

- Making the necessary moves to establish positions in different businesses and achieve an appropriate amount and kind of diversification.
- Deciding about how many, what types, and which specific lines of business the company should be in. This may involve deciding to increase or decrease the diversification by closing/ adding out some lines of business or changing emphasis among lines of business.
- Initiating actions to maximise the contribution of diversified business lines towards corporate objectives performance. This may lead to four types of actions: (i) vigorously pursuing rapid growth strategies in the most promising lines of business, (ii) keeping the other core businesses healthy, (iii)

initiating turnaround efforts in weak-performing lines of business with promise, and (iv) dropping lines of business that are no longer attractive or do not fit into the organisation's broader plans.

- Moving resources into the most attractive lines of business.
- Pursuing ways to capture valuable cross business strategic fits and turn them into competitive advantages, especially transferring and sharing related technology, procurement leverage, operating facilities, distribution channels, and/or customers.

Thus it can be said that corporate strategies are basically about decisions regarding allocation of resources among different business units, diversion of resources from one set of business units to others and managing a portfolio of businesses.

According to Glueck, there are four strategic alternatives possible at corporate level:

1. Growth,
2. Stability,
3. Retrenchment and
4. Portfolio restructuring.

6.2.1 Growth Strategies

These are also known as expansion or intensification strategies. The corporate strategy of growth is followed when an organization aims at growth in sales, profits, market share or some other measure as a primary objective.

The various strategies covered under Growth strategy are:

1. Concentration
2. Integration
3. Diversification
4. Mergers and acquisitions
5. Joint Venture
6. Strategic Alliances

1. **Concentration:** Concentration strategy is one in which an organization focuses on a single line of business. The firm directs its resources to the profitable growth of a single product, in a single market, and with a single technology. When a company's current industries are attractive, have good growth potential, and do not face serious threats, concentrating resources in the existing industries makes good sense. For example, McDonald's concentrates on the fast food industry.

The advantages of concentration strategies are:

- by concentrating on one product, in one market and with one technology, a firm can gain competitive advantages over its more diversified competitors in production skill, marketing know-how and customer sensitivity.
- they are lowest in risk and requires less additional resources.
- they are based on the known competencies of the firm (doing what is known best and where more value can be created.)

The disadvantages of concentration strategies are:

- they tend to result in steady but slow increases in growth and profitability and a narrow range of investment options. A corporate may miss out on other opportunities to create more value and increase profitability

- concentrated firms are especially susceptible to performance variations resulting from industry trend because of their narrow base of competition.

2. **Integration:** Integration means combining activities related to the present activity of the firm. The activities are combined on the basis of value system. A value system is a group of inter linked activities performed by an organisation starting from procurement of raw material to marketing of finished product. To grow, a firm can move up or down the value system i.e. the firm expand into its value system by making some or all of its own inputs and/or distributing or selling some or all of its own products. Through integration strategy, a firm tries to widen the scope of business and enters into adjacent businesses.

Integration may take two forms: vertical and horizontal integration.

(i) Vertical Integration: This type of strategy can be helpful when the company has a strong competitive position in a growing and attractive industry. Vertical integration is used to obtain greater control over a line of business and to increase profits through greater efficiency or better selling efforts.

Vertical integration strategy involves growth through acquisition of other organizations in a channel of distribution. When an organization purchases other companies that supply it, it engages in **backward integration**. For example, when a garment manufacturer gets in the spinning business, it is adopting backward integration.

The advantages of this strategy are: benefit in cost and quality of components, stability, and making operations more difficult for competitors. The disadvantages of this strategy are: it provides more control over such things as final products/services and distribution, but may involve new critical success factors that the parent company may not be able to master and deliver, reduces flexibility, raises exit barriers for the company to leave that industry, prevents the company from seeking the best and latest components from suppliers competing for their business and increases risk of being tied into old, obsolescent, and high cost technology.

The organization that purchases other firms that are closer to the end users of the product (such as wholesalers and retailers) engages in **forward integration.** It is growing by taking over functions forward in the value chain previously provided by final manufacturers, distributors or retailers. This strategy provides more control over such things as final products/services and distribution, but may involve new critical success factors that the parent company may not be able to master and deliver. For example, being a world-class manufacturer does not make a company an effective retailer. For example, when a garment manufacturer gets into retailing of its manufactured garments, it is adopting forward integration. When a spinning business, gets into the business of garment manufacturing it is adopting forward integration.

The following points should be considered while pursuing vertical integration:

- Vertically integration should be done into those industries in the value chain that will realise the most value at the least cost.

- Integrating should be stopped when the extra value created by entering new industry falls and the costs of managing exchanges along the industry value chain increases.

- When operating costs rise faster than the value being created in the integrated industry, then it is time to vertically disintegrate, that is, to exit from the unprofitable industries.

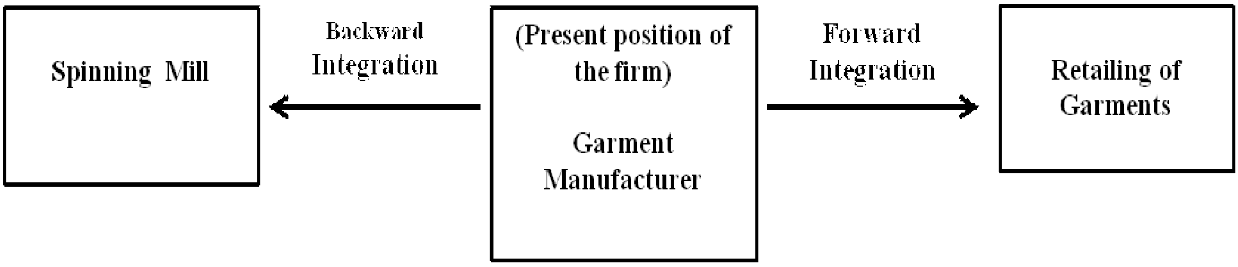

Figure - 6.2 : An Example of Vertical Integration

(ii) Horizontal Integration: This strategy involves growth through in the same line of business. It amounts to expanding sideways in the value chain that the company is currently engaged in. It keeps the organisation at the same level with respect to value chain. For example a garment manufacturer adopting horizontal integration will become a bigger garment manufacturer.

A horizontal strategy is adopted in an effort to increase the size, sales, profits, and potential market share of an organization. It results in a bigger size with benefits of a stronger competitive position. The reasons behind adopting this strategy are: expanding the company's existing products into other locations and/or market segments, (expanding geographically), increasing the range of products/services offered to current markets, increasing market share and acquiring economies of scale.

There are many examples of Indian banks following this strategy for consolidation purpose. Bank of Mathura and Sangli Bank were taken over by ICICI Bank. ICICI bank has also taken over Bank of Rajasthan in the year 2009. Standard Chartered Bank acquired ANZ Grindlays bank in the year 2000. These takeovers as part of horizontal integration were done to widen the reach and enhance regional presence.

This strategy is sometimes used by smaller firms in an industry dominated by one or a few large competitors, such as the soft drink and computer industries.

3 **Diversification:** Diversification strategy involves entering one or more industries that are different from a company's core/original industry in order to find ways to use distinctive competences to increase the value of products offered by those other industries. Diversification can be 'related' or 'unrelated'.

(i) Related Diversification Strategy: It is also known as concentric diversification. In this alternative, a company expands into a related industry that is having synergy with the company's existing lines of business, creating a situation in which the existing and new lines of business share and gain special advantages from commonalities such as technology, customers, distribution, location, product or manufacturing similarities. This is often an appropriate corporate strategy when a company has a strong competitive position and distinctive competencies, but its existing industry is not very attractive.

(ii) Unrelated Diversification Strategy: It is also known as conglomerate diversification. In this alternative, a company expands by diversifying into a line of business unrelated to the current ones. The primary reason to consider this alternative is to invest available funds in more attractive opportunities rather than investing in unattractive opportunities in existing industries. Other reasons for adopting this alternative are: risk reduction, and/or preparing to exit an existing line of business which is in the decline stage of the product life cycle. This may be an appropriate strategy when, not only the present industry is unattractive, but also the company lacks outstanding competencies that it could transfer to related products or industries. The disadvantage associated with it is that, as it is difficult to manage and excel in unrelated business units, the expected value addition may not take place.

4. **Mergers and Acquisitions:** Merger and acquisition strategy are growth strategy based upon external expansion. Merger is a combination of two or more organisations in which one acquires the assets and liabilities of the other in exchange of share or cash, or both the organisations are dissolved and assets and liabilities are combined and new stock is issued. For the organisation which acquires another organisation, it is an acquisition. For the organisation which is acquired, it is a merger. Takeover is a common way for acquisition. Takeover can be defined as an attempt of one firm to acquire ownership or control over another firm. Takeovers can be either hostile when it happens against the wishes of the acquired company or friendly when it happens with consent of the acquired company.

   Some examples of merger and acquisition are as follows:

- The formation of Brook Bond Lipton India Ltd. through the merger of Lipton India and Brook Bond.
- The merger of BSES (Bombay Suburban Electric Supply) Ltd. with Orissa Power Supply Company.
- The merger of ACC (erstwhile Associated Cement Companies Ltd.) with Damodar Cement

   Various forms of mergers and acquisitions have emerged and are used extensively in many industries today. They are used particularly to bridge resource and technology gaps, and to obtain expertise and market positions more quickly than could be done through internal development. They are particularly necessary and potentially useful when a company wishes to enter a new industry or new markets.

   The strategic alternatives of Integration (vertical and horizontal) and Diversification (concentric and conglomerate), discussed in the earlier section, can be achieved through merger and acquisition methods.

5. **Joint Venture:** A joint venture can be defined as: cooperative business activity, formed by two or more separate organizations for strategic purposes that creates an independent business entity with a set of allocated ownerships, operational responsibilities, financial risks and rewards to each member while preserving their separate identity". Disadvantages of joint ventures include loss of control, decrease in profitability, transfer of technology to the partners and probability of conflict between the partners. However research shows that joint ventures tend to be more successful if both the partners are having equal stake in the partnership and are dependent on each other for the success.

6. **Strategic Alliances:** A strategic alliance is the cooperation between one or two companies to achieve the mutually beneficial strategic objectives. The reasons for the formation of strategic alliance could be:

- To obtain technology or manufacturing capabilities. A company having competitive advantage in one field could alliance with another company of different competitive advantage to gain over the other competitors.

- To obtain access to specific markets. Instead of buying or building its own companies the firm could give rights to companies in other countries to market its product.
- To reduce the financial risk. By means of strategic alliance the company could reduce the loss that may happen if the new project fails.
- To achieve competitive advantage. By forming the strategic alliance the company would be able to achieve new competitive advantage or increase its existing competitive advantage.

6.2.2 Stability Strategies

There are a number of circumstances in which the most appropriate alternative chosen by an organisation is stability, rather than growth. Often, this may be used for a relatively short period, after which further growth is planned. Such circumstances usually involve a reasonable successful company, combined with circumstances that either permit a period of comfortable coasting or suggest a pause or caution.

This is a useful strategy in following situations:

- An organization that is large and dominates its market may choose this strategy to avoid government controls or penalties for monopolizing the industry.
- An organization may find that further growth is too costly and could have detrimental effects on profitability.
- An organization in a low- growth or no-growth industry may be forced to select a stability strategy

Depending upon the circumstances initiating the choice of a stability strategy and in the intentions for future strategic actions, stability strategy can take following three forms:

(i) **Pause and Then Proceed:** This strategy is like testing the ground before moving ahead with a full fledged strategy. It may be appropriate in either of two situations: (a) the need for an opportunity to rest, and consolidate after growth or some turbulent events; and before continuing a growth strategy, or (b) an uncertain or hostile environment in which it is prudent to stay in a 'holding pattern' until there is a favourable change in the environment.

(ii) **No Change:** In this strategy, it is decided to do nothing new and to continue with the present business. This alternative could be either a matter of indecision in making a choice for change, or may be a matter of comfort in a mature & stable environment. For example, a small business in a small town with few competitors adopts stability rather than growth.

6.3 Business Level Strategy

This is the second level of a company's strategy. It focuses on how to compete successfully in each of the lines of business the company has chosen to engage in. The central thrust is how to build and improve the company's competitive position for each of its lines of business. It is also called as competitive strategy.

The thrust of business level strategy is on improving the competitive position of a company or a business unit's product or service within its industry or within the market segment the company serves. A company has competitive advantage whenever it can attract customers and defend against competitive forces better than its rivals. Companies want to develop competitive advantages that are sustainable. Successfulcompetitive strategies usually involve building uniquely strong/ distinctive competencies in areas crucial to success and using them to maintain a competitive edge over rivals. Some examples of distinctive competencies are superior technology and/or product features, better manufacturing technology and skills, superior sales and distribution capabilities, and better customer service and convenience.

Business strategy can be competitive (battling with all the competitors for advantage) or cooperative (combining with one or two competitors to compete with the other competitors).

6.3.1 Generic Competitive Strategies

According to Michel Porter, 'Competitive strategy is about being different. It means deliberately choosing to perform activities differently or to perform different activities than rivals to deliver a unique mix of value'. He asserts that a business needs to make two fundamental decisions in establishing its competitive advantage: (a) whether to compete primarily on price (cost) or to compete through providing some distinctive points of differentiation that justify higher prices (differentiation), and (b) how broad a market target it will aim at (its competitive scope). These two basic types of competitive advantage (cost or differentiation) 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, also called as Generic competitive strategies are:

1. Cost Leadership,
2. Differentiation and
3. Focus

1. **Cost Leadership:** The objective of this kind of strategy is to achieve overall cost leadership in the industry through cost focus on various functional areas. Implementing this strategy successfully requires continuous and exceptional efforts to reduce costs without excluding product features and services that buyers consider essential. It requires aggressive pursuit of cost reduction through tight cost and overhead control, avoidance of marginal customer accounts, and cost minimisation in areas like R&D, service, sales force, advertising etc.

   Overall cost leadership emphasizes producing standardized products at a very low per-unit for consumers who are price sensitive. It also requires achieving cost advantages in ways that are hard for competitors to copy or match.

   However, this strategy often requires high relative market share or other advantages, such as favourable access to raw materials or the ready availability of cash to finance the purchase of the most efficient equipment. Some other requirements necessary for success of this strategy are:

- The industry's product is much the same from seller to seller.
- The marketplace is dominated by price competition, with highly price-sensitive buyers.
- There are few ways to achieve product differentiation that have much value to buyers.
- There are common user requirements as most of the buyers use product in same way.
- Switching costs for buyers are low.
- Buyers are large and have significant bargaining power.

   Example: Reliance is number one company of India in polyester production because of its cost leadership strategy. Presently it is the lowest-cost polyester producer in the world. Reliance's project management skills are among the best in the business anywhere in the world and its competencies in mobilising large amount of low cost finance enables it to set up large scale plants at the highest speeds and lowest capital costs.

Some of the risks associated with this strategy are as follows:

- Technological development that makes the product obsolete.
- Inability to foresee the development either in the product or the market fronts due to the narrowed focus on cost.
- Inflation of cost that may upset the cost advantage of the player.

2. **Differentiation:** The objective of this strategy is to achieve uniqueness either in the product or the service offered by the company. The uniqueness is so attractive that customers are willing to pay premium prices for the products or services.

   This differentiation could be achieved in technology, design or brand image, features, customer service, dealer network etc. The benefits of differentiation are:

- It provides the company with increased customer loyalty.
- It insulates the firm from the other competitors and also from the new entrants.
- It yields higher margins and it clearly mitigates buyer power, since buyers lack alternative for comparison.

   Some requirements which are necessary for differentiating the products or services offered are:

- Development of core competencies, unique company resources or capabilities and superior management of value chain activities.
- Extensive R&D, product design, high quality products and intensive customer support are required to differentiate either their product or their service which hinders the policy of maintaining low cost for their product or services.

   The differentiation strategy will be beneficial when:

- There are multiple ways to differentiate the product/service that buyers think have substantial value.
- Buyers have different needs or uses of the product/service.
- Product innovations and technological change are rapid and competition emphasises the latest product features.
- Presence of only a few rivals who are following a similar differentiation strategy.

While adopting the differentiation strategy, the following risks should be taken care of:

- If the differentiation in the cost between the low cost players and differentiation players is too high, it will be difficult to sustain the strategy. The customers may overlook the feature of differentiation to gain the price advantage.
- Buyers need for differentiation may decrease.
- As industries mature, the imitation could happen which narrows down the differentiation.

3. **Focus:** This strategy focuses on serving a particular target fully (niche). Firms are thus able to serve narrow targets than its competitors who choose to serve the market widely. As a result the firm is able to achieve low cost position or differentiation or both the advantages in its narrow market. Focus strategy can, thus be either cost focused or differentiation focused.

Some conditions that tend to favour price/ differentiation focus are:

- Buyer's needs of the item are diverse; there are many different niches and segments in the industry.
- Buyer segments differ widely in size, growth rate, profitability, and intensity, making some segments more attractive than others.
- Industry leaders don't see the niche as crucial to their own success.
- Few or no other rivals are attempting to specialize in the same target segment.
- The business is new and/or has modest resources.
- The company lacks the capability to go after a wider part of the total market.

The focus strategy involves following risks:

- The cost differential between broad range competitors and the focused firm widens to eliminate the cost advantages of servicing a narrow target or to offset the differentiation achieved by the focus.
- The difference between the products of the specific target and the market as a whole may narrow down.
- Competitors may find sub markets within the specific market or out focus the focused player.

6.3.2 Competitive Tactics

A tactic is a sub strategy. It is shorter in time horizon and narrower in scope than strategy. It is a specific operating plan describing how to implement the business strategy. There are two categories of competitive tactics:

1. Timing tactics (when to enter a market) and
2. Market location (where and how to enter and/or defend the market).

1. Timing Tactics: These are regarding the timing of making the strategic move of cost leadership/ differentiation/ focus. The tactics related to time are: **First-movers** (i.e., the first to provide a product or service), **second-movers** or rapid followers and **late movers** (wait-and-see). Each tactic can have advantages and disadvantages.

First-movers: The first company to introduce a new product or service is called as the First mover organisation. The advantages associated with this tactics are: (i) it builds an important image and reputation with buyers; (ii) early adoption of new technologies, different components, exclusive distribution channels, etc. can produce cost and/or other advantages over rivals; (iii) first-time customers remain strongly loyal in making repeat purchases; and (iv) moving first makes entry and imitation by competitors hard or unlikely. For example, Eureka Forbes was the first to introduce vacuum cleaners and water purifiers in Indian market.

It is not always that the First mover will be in advantage. Under certain circumstances, even a second/ late mover could also be in advantage, like: (i) the second/ late mover has an example of first mover in front of it. The first mover's skills, technology, and strategies can be easily copied or even surpassed by the second/late mover and (ii) second/ late mover has the advantage of minimizing risks by waiting until a new market is established.

Sometimes it is better to wait and watch and be a skillful follower rather than a first-mover, especially when: (i) being a first mover is more costly than imitating, (ii) the products of an innovator are of primitive nature, so that second/ late mover can introduce better performing products and attract buyers away from the leader, (iii) technology is advancing rapidly, giving second/ late movers the opening to leapfrog a first mover's products with more attractive and full-featured second and third generation products and (iv) the first mover ignores market segments that can be picked up easily.

2. Market Location Tactics: These tactics are related to the market location of the business. They may be offensive or defensive types. Offensive tactics are designed to take market share from a competitor, while defensive tactics attempt to keep a competitor from taking away the present market share, under the onslaught of offensive tactics by the competitor.

Some **offensive tactics** are:

• **Frontal Assault:** going head-to-head with the competitor, matching each other in every way. To be successful, the attacker must have superior resources and be willing to continue longer than the company attacked.

• **Flank Attack:** attacking a part of the market where the competitor is weak. To be successful, the attacker must be patient and willing to carefully expand out of the relatively undefended market niche or else face retaliation by an established competitor.

The principles of flank attacking are:

(i) A good flanking move must be made in an uncontested area.

(ii) Tactical surprise should be incorporated in the plan.

(iii) Pursuit is as critical as the attack.

• **Encirclement:** usually evolving from the previous two, encirclement involves encircling and pushing over the competitor's position in terms of greater product variety and/or serving more markets. This requires a wide variety of abilities and resources necessary to attack multiple market segments.

• **Bypass Attack:** attempting to cut the market out from under the established defender by offering a new, superior type of produce that makes the competitor's product unnecessary or undesirable.

• **Guerrilla Warfare:** using a "hit and run" attack on a competitor, with small, intermittent assaults on different market segments. This offers the possibility for even a small firm to make some gains without seriously threatening a large, established competitor and evoking some form of retaliation.

The principles of guerrilla warfare are:

(i) Find a segment of the market small enough to defend,

(ii) No matter how successful you become, never act like the leader

(iii) Be prepared to a buyout at a moment's notice.

Some **Defensive Tactics** are:

• Increasing expected retaliation: to signal challengers that there is threat of strong retaliation if they attack.

• Reduce inducement for attacks: to lower profits so as to make things less attractive.

Prices can be kept low so that a new entrant finds it less attractive to enter a market due to lesser profit incentive.

This is essentially recommended for market leaders. A leader has to spend more time in safeguarding its interests against government, social and public environment rather than getting offensive at the next competitor.

6.4 Functional Strategy

Once higher level corporate and business strategies are developed, management needs to formulate and implement strategies for each functional area. For effective implementation, strategists have to provide direction to functional managers regarding the plans and policies to be adopted. In fact, the effectiveness of strategic management depends critically on the manner in which strategies are implemented. Strategy of one functional area cannot be looked at in isolation, because it is the extent to which all the functional tasks are interwoven that determines the effectiveness of the major strategy.

Functional strategies are relatively short-term activities that each functional area within a company will carry out to implement the broader, longer-term corporate level and business level strategies. Each functional area has a number of strategy choices that interact with and must be consistent with the overall company strategies. Three basic characteristics that distinguish functional strategies from corporate level and business level strategies are: shorter time horizon, greater specificity, and primary involvement of operating managers.

Functional area strategy such as marketing, financial, production and Human Resource are based on the functional capabilities of an organisation. For each functional area, first the major sub areas are identified and then for each of these sub functional areas, contents of functional strategies, important factors, and their importance in the process of strategy implementation is identified. Functional strategies are built in all the functional area, like:

- Marketing strategy deals with product/service choices and features, pricing strategy, markets to be targeted, distribution, and promotion considerations.
- Financial strategies include decisions about capital acquisition, capital allocation, dividend policy, and investment and working capital management.
- The production or operations functional strategies address choices about how and where the products or services will be manufactured or delivered, technology to be used, management of resources, plus purchasing and relationships with suppliers.
- Research and Development (R&D) strategies include decisions regarding the relative emphasis between product and process R&D, how new technology will be obtained (internal vs. external development, through purchasing, acquisition, licensing, alliances, etc.), and degree of centralization for R&D activities.
- Human resources functional strategy includes decisions regarding job categories and descriptions; pay and benefits; recruiting, selection and orientation; career development and training; evaluation and incentive systems; policies and discipline; and management/executive selection processes.

6.5 Summary

The strategy is formulated at three levels: corporate level, business level and functional level. Strategy formulated at corporate level is called Grand Strategy. It is a firm's overall approach to gaining a competitive advantage by operating in several businesses simultaneously. According to Glueck, there are four strategic alternatives possible at corporate level: Growth, Stability, Retrenchment and Portfolio restructuring. The various strategies covered under Growth strategy are: Concentration, Integration, Diversification, Mergers and Acquisitions, Joint Venture and Strategic Alliances. The thrust of business level strategy is on improving the competitive position of a company or a business unit's product or service within its industry or within the market segment the company serves. Business level strategy include Generic competitive strategies, which are: Cost Leadership, Differentiation and Focus. Competitive Tactics are adopted for implementing business level strategies. A tactic is a sub strategy. It is shorter in time horizon and narrower in scope than strategy. Functional strategies are relatively short-term activities that each functional area like marketing, finance, production, research and Development (R&D) and human resource, have within a company to implement the broader, longer-term corporate level and business level strategies.

6.6 Key Words

- **Corporate Level Strategy**: It is also called as Grand Strategy.
- **Growth Strategies**: These are also known as expansion or intensification strategies.
- **Concentration Strategy**: Focusing on a single line of business.
- **Forward Integration**: Gaining ownership or increased control over distributors or retailers.
- **Backward Integration**: Seeking ownership or increased control over a firm's suppliers.
- **Horizontal Integration**: Seeking ownership or increased control over competitors.
- **Diversification**: It involves entering one or more industries that are different from a company's core/original industry.
- **Mergers and Acquisitions**: are growth strategies based upon external expansion.
- **Joint Venture**: It is a cooperative business activity, formed by two or more separate organizations for strategic purposes, that creates an independent business entity.
- **Strategic Alliances**: It is cooperation between one or two companies to achieve the mutually beneficial strategic objectives.
- **Business Level Strategy:** It is also called as competitive strategy.

6.7 Self Assessment Questions

1. 'Grand strategies are intended to provide basic direction for strategic actions'. Discuss.
2. Identify various grand strategies that firms adopt.
3. Explain the generic strategies given by Michel E. Porter with Indian examples.
4. Examine the significance of Gluck's grand strategies and discuss how they help achieve overall objectives of a firm.
5. Explain horizontal and vertical integration strategies.
6. What is diversification? Explain why it is followed.
7. What are stability strategies? When do firms employ them?

8. What are the risks associated with cost leadership, differentiation and focus strategies.

9. What do you understand by competitive tactics? Identify various competitive tactics that firms adopt.

10. Write short notes on: mergers and acquisition, joint venture, strategic alliance.

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Unit - 7 : Strategies Formulation II

Structure of Unit:

7.0 Objectives

- To learn how different Internationalisation strategies would add value to a corporation.
- To discuss Digitalisation strategies.
- To know about Combination Strategies.
- To study Corporate Restructuring.
- To study Retrenchment strategy.
- To understand Portfolio restructures strategy and its models.

7.1 Introduction

The strategy formulated at corporate level is called Grand Strategy. It is a firm's overall approach to gain a competitive advantage by operating in several businesses simultaneously. Gaining a competitive advantage requires setting a clear purpose for the entire organisation and identifying plans and actions to achieve that purpose. Organisations need to constantly ask themselves what lines of business they are in, how these lines of business fit together, what business they should be in and what are their basic directions for the future. To respond to the dynamism in the business environment and enhance competitiveness, organisations follow various growth or expansion strategies like internationalisation and digitalisation. Further, in case of decline, organisations follow various retrenchment strategies.

7.2 Internationalisation

Internationalisation strategy is a type of growth strategy. Under this strategy, an organisation expands through marketing their products and services outside the national market. The organisation can enter the international market through various modes.

Various factors due to which an organisation adopts internationalisation strategy are:

- Slow growth rate or restricted domestic market.
- Slump in domestic economy whereas foreign economy may still be away from slump,for diversification and risk spreading.
- Threat of low priced imports in domestic market.
- To prevent competitors from gaining access to key customers in new locations.
- Lesser legal restrictions in foreign market as compared to domestic market.
- Cost of labour and cost of resources is low in certain countries; businesses thus get advantage of lower costs of labour, material and energy.
- Some countries provide incentives of various types like tax breaks, loans, grants etc. for certain businesses.
- Domestic market may be protected through various laws so that further expansion is not possible.
- Emergence of globalisation, ease of transportation and technological advancement in communication are some of the other factors which have facilitated international expansion.

Some of the advantages associated with international expansion are:

- By expanding internationally, there will be an increase in sales volume which results in cost reduction due to economies of scale.
- Access to cheap labour, material, finance and energy resources in foreign land which results in decrease in production cost.

Although internationalisation strategy offers many advantages to a firm, yet for expanding to foreign land certain additional cost like infrastructure cost has to be incurred. Some of the disadvantages associated with adopting this strategy are:

- Higher risk: operating in foreign market has higher risk with respect to uncertainty in economic and political environment.
- Cultural difference: it is difficult to manage employees and customers who come from different cultural backgrounds.
- Higher cost: increased cost in coordinating and controlling operations internationally, also additional cost has to be incurred for establishing new channels of distribution.

Types of International Strategies

According to Barlett and Ghoshal, four types of international strategies are possible based upon two sets of variables - 'pressure for cost reduction' and 'pressure for local responsiveness'. Pressure for cost reduction means minimising cost by achieving economies of scale through single location production of standardised products and global distribution. Pressure for local responsiveness means customising products and producing differentiated products in light of customer preferences, government policies or business practices.

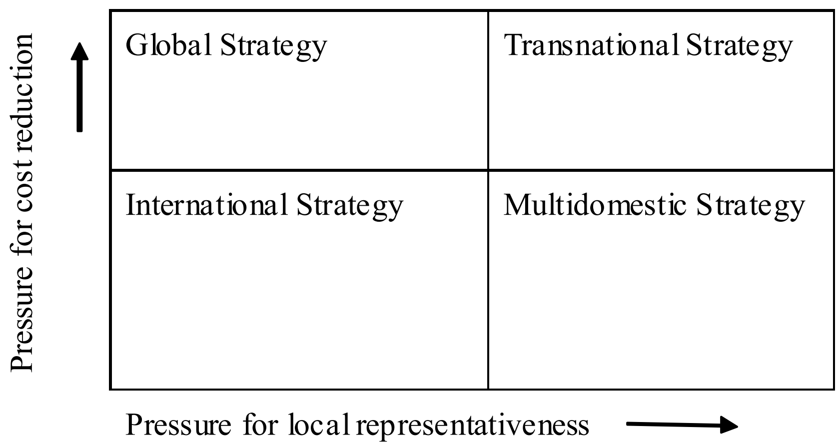

Figure - 7-1 : International Strategies

Source: C.A.Bartlett and S. Ghoshal, Managing Across Borders, Boston, M.A., Harvard Business School Press, 1979.

These four types of international strategies are:

1. **International Strategy** (low pressure for cost reduction and low pressure for local representativeness). It is a simple strategy under which standardised products and services are transferred to various countries.

2. **Global Strategy** (high pressure for cost reduction and low pressure for local representativeness). Under this strategy standardised products and services are transferred with an emphasis on low cost approach. Low cost structure is obtained by concentrating production at few favourable places and offering standardised products and services at competitive prices to various countries. This strategy is more suitable for commodities like steel, petroleum and chemicals where differentiation is low.

3. **Multidomestic Strategy** (low pressure for cost reduction and high pressure for local representativeness). Under which strategy emphasis is on providing differentiated products and services. Firms try to customise their offerings according to local conditions. This strategy is more suitable for firms operating in the clothes, entertainment and food business, for example McDonald and Pizza Hut have *indianised* the food items as per the taste of local customers.

4. **Transnational Strategy** (high pressure for cost reduction and high pressure for local representativeness). This strategy is build upon two contradictory objectives- one is of low cost approach and another is of high customisation. Usually customisation is achieved through incurring additional cost that is why this strategy is somewhat difficult to adopt. Barlett and Ghoshal are ofthe view that a firm's ultimate aim should be to increase their expertise in such a way that they are able to offer customised products with low cost. According to them, this is the only viable strategy in today's competitive world.

International Entry Modes

The organisation can enter into the international market through various modes, for example:

1. **Export Entry Mode**: The firm produces in the home country and market it in the foreign land through export. Export can be *Direct* where an agent/ distributor/ branch/ subsidiary are established overseas for marketing the products and there is no involvement of home country intermediary.

Export can also be *Indirect* where home country intermediary exports the firm's product in overseas market.

2. **Contractual Entry Mode**: A firm can establish an association with a company in the overseas market through various forms of contracts like:

   a.Licensing: a contractual agreement between two parties where one party having some proprietary rights (knowledge, technology, patent etc.) agrees to transfer its rights to another party by charging some fee or royalty.

   b. Franchising: an agreement between franchiser and franchisee where a franchiser receives some form of payment for allowing the franchisee to use its brand name in the overseas market.

3. **Investment Entry Mode:** It involves investment in the ownership of production units in the overseas market in form of Joint Ventures, Strategic Alliances, wholly owned Subsidiary or Independent ventures.

A firm trying to enter international markets has to make decisions regarding which international markets to enter and when. There are a number of markets around the world. Before making an international entry, it is advisable to make a systematic analysis of benefits, costs, risk of market entry and long term profit potential. As far as timing of entry into the international market is considered, the firm can be a first-mover (i.e., the first to provide a product or service in the foreign market), second-mover or rapid follower and late mover (wait-and-see). The above mentioned entry timings have their own advantages and disadvantages. This has been discussed in unit seven under timing tactics.

During the last two decades there have been many examples of Indian pharmaceutical companies adopting international strategy to grow. Asian Paints has adopted this strategy and is among the ten biggest home paint producers in the world. Normally, firms internationalise gradually. They start as exporters and later on go for strategic alliances and wholly owned subsidiaries.

7.3 Digitalisation

In today's world of computerisation and I.T. enabled communication, there are many strategic alternatives available before organisation, which arise from digitisation of information. Digitisation includes:

(i) Computerisation of various functions at all the levels of management in an organisation. This requires installing computers and connecting them through a network.

(ii) Conversion of physical data into electronic data. The data is managed electronically with help of data base management systems and management information system.

Digitalised business or e-business is doing business with help of computers and internet. E business aims at integration of I.T & communication technologies with business processes and management practices. According to Kalakota and Robinson, depending upon the extent of digitalisation adopted, the following strategic alternatives are available to a firm:

1. ***E Channel Pattern*:** chain of relationship between companies and customers and between companies and their resellers. Digitisation can be used to exchange information, reduce channel length, expanding channel reach, and innovating new channels.

2. ***Click and Order Firm:*** these are new types of firms that rely on IT and digitisation for doing their business. These are in contrast to brick and mortar companies and reach there customers and suppliers through internet.

3. ***E Portal Pattern*:** portals are intermediaries offering a group of services for a specific group of users. They are positioned between suppliers and customers. They offer value added services or help in decreasing transaction costs. for example auction portal like e-Bay.
4. ***E Market*:** it is an online intermediary that connects dispersed buyers and sellers, within a common vertical industry for example chemicals and steel. These e-markets help in eliminating channel inefficiencies by matching many buyers/ sellers in an auction.
5. ***Pure E- Digital Products Pattern*:** Many products can be produced, delivered, consumed and licensed electronically. Many products related to entertainment industry like music and games downloads, mobile commerce and outsourcing services are example of this.

Adoption of other corporate strategies like integration, diversification, internationalisation and cooperation require digitalisation. In today's world success of any strategy is difficult to achieve without going digital.

7.4 Retrenchment Strategy

A retrenchment grand strategy is followed when an organization aims at a contraction of its activities through substantial reduction or the elimination of the scope of one or more of its businesses in terms of their respective customer groups, customer functions, or alternative technologies either singly or jointly in order to improve its overall performance. For example, a private hospital decides to focus only on special treatment and realise higher revenues by reducing its commitment to general cases, which is less profitable.

The growth of industries and markets is threatened by various external and internal developments. The external developments like government policies, demand saturation, emergence of substitute products, changing customer needs etc. and internal developments like poor management, inappropriate strategies, poor quality of functional management, etc. make it difficult for the business to continue. In this situation, the industry, the market and the company face the danger of decline and adopt retrenchment strategies. For example fountain pens, manual type writers, tele printers, steam engines, jute and jute products, slide rules, calculators and wooden toys are some products that have either disappeared or face decline due to changing customer needs and emergence of technologically advanced products.

Retrenchment is more appropriate an option in case of decline in business as evident from various symptoms like: declining sales, declining market share, diminishing profitability, rising debt, loss of goodwill, etc.

Retrenchment strategy is adopted because:

- The management no longer wishes to remain in business either partly or wholly due to continuous losses.
- The environment is threatening.
- Stability can be ensured by reallocation of resources from unprofitable to profitable businesses.

There are three types of retrenchment strategies: Turnaround Strategies, Divestment Strategies and Liquidation strategies.

7.4.1 Turnaround Strategies

Turn around means reversing a negative trend. There are certain conditions or indicators which point out that a turnaround is needed for an organization to survive. They are:

- Persistent Negative cash flows

- Negative Profits
- Declining market share
- Deterioration in Physical facilities
- Over manning, high turnover of employees and low morale
- Uncompetitive products or services
- Mismanagement

An organization which faces one or more of these issues is referred to as a 'sick' company.

There are three ways in which turnarounds can be managed:

- The existing chief executive and management team handles the entire turnaround strategy with the advisory support of a external consultant.
- In another case the existing team withdraws temporarily and an executive consultant or turnaround specialist is employed to do the job.
- The last method involves the replacement of the existing team specially the chief executive, or merging the sick organization with a healthy one.
- Before a turn around can be formulated for an Indian company, it has to be first declared as a sick company. The declaration is done on the basis of the Sick Industrial Companies Act (SICA), 1975 which provides for a quasi judicial body called the Board of Industrial and Financial Reconstruction (BIFR) to help companies that fall sick.

Turnaround Management:

The various stages in management of turnaround process are:

1 **Cost Cutting:** A cost cutting program should be taken up after careful analysis. The possibilities are that some departments or projects may need additional funding, while others need modest cuts and still others need drastic cuts or need to be eliminated altogether.

2 **Re-engineering:** Reengineering involves casting aside old assumptions about how an organization's business processes should be done and starting from scratch to design more efficient processes. This may cut costs. This is easiest to see in a manufacturing process, where each step of assembly is scrutinized for improvement or elimination.

3 **Downsizing:** Downsizing means laying-off people. It is a way to cut costs quickly. But unless downsizing is tied to a rational strategy, problems can result. Cutting staff without changing the amount and type of work may result in costs cuts, but product quality and customer service may suffer and if they do, the organization's performance measures will suffer.

7.4.2 Divestment Strategies

A divestment strategy involves the sale or liquidation of a portion of business, or a major division, profit centre or a SBU. Divestment is usually a part of rehabilitation or restructuring plan and is adopted when a turnaround has been attempted but has proved to be unsuccessful.

The various reasons for divestment are as follows:

- The business that has been acquired proves to be a mismatch and cannot be integrated within the company. Similarly a project that proves to be unviable in the long term is divested.

- Persistent negative cash flows from a particular business create financial problems for the whole company, creating a need for the divestment of that business.
- Severity of competition and the inability of a firm to cope with it may cause it to divest.
- Technological up gradation is required if the business is to survive but where it is not possible for the firm to invest in it. A preferable option would be to divest
- Divestment may be done because by selling off a part of a business the company may be in a position to survive
- A better alternative may be available for investment, causing a firm to divest a part of its unprofitable business.
- Divestment by one firm may be a part of merger plan executed with another firm, where mutual exchange of unprofitable divisions may take place.
- Lastly a firm may divest in order not to attract the provisions of the MRTP Act or owing to oversize and the resultant inability to manage a large business.

TATA group is a highly diversified entity with a range of businesses under its fold. They identified their non core businesses for divestment. TOMCO was divested and sold to Hindustan Levers as soaps and a detergent was not considered a core business for the Tatas. Similarly, the pharmaceuticals companies of the Tatas- Merind and Tata Pharma – were divested to Wockhardt. The cosmetics company Lakme was divested and sold to Hindustan Lever, as besides being a non core business, it was found to be a non-competitive and would have required substantial investment to be sustained.

7.4.3 Liquidation Strategies

A retrenchment strategy which is considered to be the most extreme and unattractive is the liquidation strategy, which involves closing down a firm and selling its assets. It is considered as the last resort because it leads to serious consequences such as loss of employment for workers and other employees, termination of opportunities where a firm could pursue any future activities and the stigma of failure.

Reasons for Liquidation include:

- Business becoming unprofitable
- Obsolescence of product/process
- High competition
- Industry overcapacity
- Failure of strategy

Liquidation strategy may be unpleasant as a strategic alternative but makes sense because the real estate owned by a firm may fetch it more money than the actual returns of doing business. The psychological implications associated with liquidation are: the prospects of liquidation create a bad impact on the company's reputation and for many executives who are closely associated firms; liquidation may be a traumatic experience.

Liquidation strategy may be difficult as buyers for the business may be difficult to find. Moreover, the firm may not receive adequate compensation as most assets, being unusable, are considered as scrap.

Legal aspects of liquidation: Under the Companies Act 1956, liquidation is termed as winding up. The Act defines winding up of a company as the process whereby its life is ended and its property administered for the benefit of its creditors and members. The Act provides for a liquidator who takes control of the company to collect its assets, pay its debts, and finally distribute any surplus among the members according to their rights.

7.5 Combination Strategies

Large, diversified organizations commonly use a number of strategies in combination. For example, an organization may simultaneously seek growth through the acquisition of new businesses, employ a stability strategy for some of its existing businesses and divest itself of other businesses. Combination strategy means adopting a mixture of stability, expansion and retrenchment strategy. This may be done at same or different times and for one or a group of business units. Combination strategy is developed after taking into account environmental and organisational factors. Combination strategy is adopted because of the following reasons:

- The organisation is large and faces complex environment.
- The organistion is composed of different businesses belonging to different industry, thus requiring a different approach.

A paint company can follow stability strategy by providing a wider variety to its present customers and expands its product range for that through expansion.

7.6 Corporate Restructuring

Change in the business conditions may necessitate restructuring of the business. Corporate restructuring may involve expansion or contraction of the portfolio or changes in the nature and volume of business.

Restructuring strategies involve divesting some businesses and acquiring other so as to put a whole new face on the company's business line up. Over the past decade corporate restructuring has become a popular strategy at many diversified companies, especially those that had diversified broadly into many different industries and lines of business. Some of the reasons why restructuring seems to be a better option are:

- Businesses in slow-growth, declining, low-margin, or otherwise unattractive industries have to be given up.
- Declining market shares of businesses due to competitive weakness, need to be divested.
- An excessive debt burden with high interest costs that affect profitability.
- Acquisitions that have not turned as profitable as expected.

Restructuring can be of following three types:

- **Portfolio Restructuring:** It refers to change in the portfolio of businesses of the company. The increase in competition has provoked many companies to divest businesses in which they are not competitive and to concentrate on their core businesses in which they tend to grow by setting up new capacity and/or by acquisition.
- **Organizational Restructuring:** Changes in corporate strategy, such as portfolio restructuring sometimes call for organisational restructuring. Generally structural changes follow strategy. Increase or decrease in activity levels, expansion or contraction of portfolio or functions etc. may cause modification of organisational structure. Decentralization, flattening and regrouping of activities are important organizational restructuring measures.
- **Functional Restructuring** : Restructuring of corporate functions (marketing operations, personnel and finance) is also important for success of strategy.

  • **Marketing Function**: restructuring of the marketing function through creating of a product management team, building up sales force, restructuring distribution system etc

- **Financial Function:** modifying of the financial function by improving the financial reporting system.
- **Operations:** Restructuring of operations through re-engineering, technological up gradation, acceptance of total quality management etc.

The various forms of restructuring that can be adopted by an organisation are: Mergers & Acquisitions, Joint Ventures, Divestitures, changes in ownership structure, exchange offers, share repurchases and leveraged buy-outs.

***Changes in Ownership Structure*:** The ownership structure of a firm may be changed due to various reasons. As a firm grows the ownership structure may undergo change. For example, a sole proprietorship may be converted into a partnership, when a partnership firm grows and when more ownership capital needs to be brought in, a private limited company may be formed.

***Exchange Offers*:** Exchange offers involve exchange of debt or preferred stock for common stock, or conversely, of common stock for more senior claims. Several cases of restructuring involve exchange of debt for equity. For example, the government loan to a public or joint sector unit may be converted into equity. Such a measure helps to reduce the interest burden and reduces cash outflow by loan repayment also.

***Share Repurchase*:** Buy-back of shares by a company help change the management control. If the company buys back shares from those who hold substantial shares it could divert the control in favour of the promoters, although the percentage of shares they hold does not increase. Buy back of shares can also guard against take-overs to some extent.

***Buy-Outs*:** Management buy-out involves the purchase of a division of a company or a whole company by a new entity formed specifically for this purpose. When such a purchase is financed by large debt it is referred to as Leveraged buy-out (LBO). LBOs are very risky because of the high interest burden and loan repayment obligation. An LBO move have to be made very cautiously as it can aggravate tax burden.

7.7 Business Portfolio Models

Formulating a consistent organizational strategy in large, diversified companies is very complicated, because a number of different business level strategies need to be coordinated to achieve overall organizational objectives. An organization may simultaneously seek growth through the acquisition of new businesses, employ a stability strategy for some of its existing businesses, and divest itself of other businesses. Business portfolio models are designed to help managers deal with this problem. The portfolio models help a company understand and consider changes in its portfolio of businesses, and also about allocation of resources among the different business elements. The two primary models are the BCG Growth-Share Matrix and the GE Business Screen. These models consider and display on a two-dimensional graph each major SBU (strategic business unit) in terms of some measure of its industry attractiveness and its relative competitive strength.

7.7.1 BCG's Growth - Share Matrix

The Boston Consulting Group, a leading management consulting firm, developed and popularised a strategy formulation approach called the Growth - Share matrix. The basic idea underlying this approach is that a firm should have a balanced portfolio of businesses such that some generate more cash than they use and can thus support other businesses that need cash to develop and become profitable. The role of each business is determined on the basis of two factors: the growth rate of its market and the share of that market that it enjoys.

The vertical axis indicates the market growth rate and it ranges from -20 to + 20. It represents the annual growth percentage of the market (current or forecasted) in which the business operates. The horizontal axis indicates market share dominance or relative marker share. It is computed by dividing the firm's market share (in units) by the market share of the largest competitor. High and low growth combined with high and low market share can be shown with help of four cells. These cells represent particular types of businesses, each of which has a particular role to play in the overall business portfolio. These cells are :

1 **Question Marks** (businesses that operate in a high-growth market but have low relative market share). Most businesses start off as question marks, in that they enter a high - growth market in which there is already a market leader. A question mark generally requires the infusion of a lot of funds. It has to keep adding plant, equipment, and personnel to keep up with the fast growing market, and if it wants to overtake the leader. The term question mark is well chosen, because the organization has to think hard about whether to keep investing funds in the business or to get out.

2 **Stars** (businesses that operate in a high-growth market and have high relative market share). They are question mark businesses that have become successful. Stars are often cash using rather than cash generating, though they are usually profitable over time. The organization has to spend a great deal of money keeping up with the market's rate of growth and fighting off competitors' attacks.

3 **Cash Cows** (businesses that operate in a low growth market but have high relative market share). Businesses in markets whose annual growth rate is less than 10 percent but that still have the largest relative market share are called cash cows. They produce a lot of cash for the organizations. The organization need not invest much in such businesses because the market's growth rate is low. Being the market leader, the business enjoys economies of scale and higher profit margins. The organization uses its cash-cow businesses to support its other businesses.

4 **Dogs** (businesses that operate in a low growth market and have low relative market share). They typically generate low profits or losses, although they may bring in some cash. Such businesses frequently consume more management time than they are worth and need to be phased out. However, an organization may have good reasons to hold onto a dog, such as an expected turnaround in the market growth rate or a new chance at market leadership.

After each of an organization's businesses is plotted on the growth - share matrix, the next step is to evaluate whether the portfolio is healthy and well balanced. A balanced portfolio has a number of stars and cash cows and no too many questions marks or dogs. This balance is important because the organization needs cash not only to maintain existing businesses but also to develop new businesses. Depending on the position of each business, four basic strategies can be formulated:

1 **Build Market Share**: This strategy is appropriate for question marks that must increase their share in order to become stars. For some businesses, short-term profits may have to be forgone to gain market share and future long-term profits.

2 **Hold Market Share**: This strategy is appropriate for cash cows with strong share positions. The cash generated by mature cash cows is critical for supporting other businesses and financing innovations. However, the cost of building share for cash cows is likely to be too high to be a profitable strategy.

3 **Harvest:** Harvesting involves milking as much short-term cash from a business as possible, even allowing market share to decline if necessary. Weak cash cows that do not appear to have a promising future are candidates for harvesting, as are question marks and dogs.

4 **Divest:** Divesting involves selling or liquidating a business because the resources devoted to it can be invested more profitably in other businesses. This strategy is appropriate for those dogs and question marks that are not worth investing in to improve their positions.

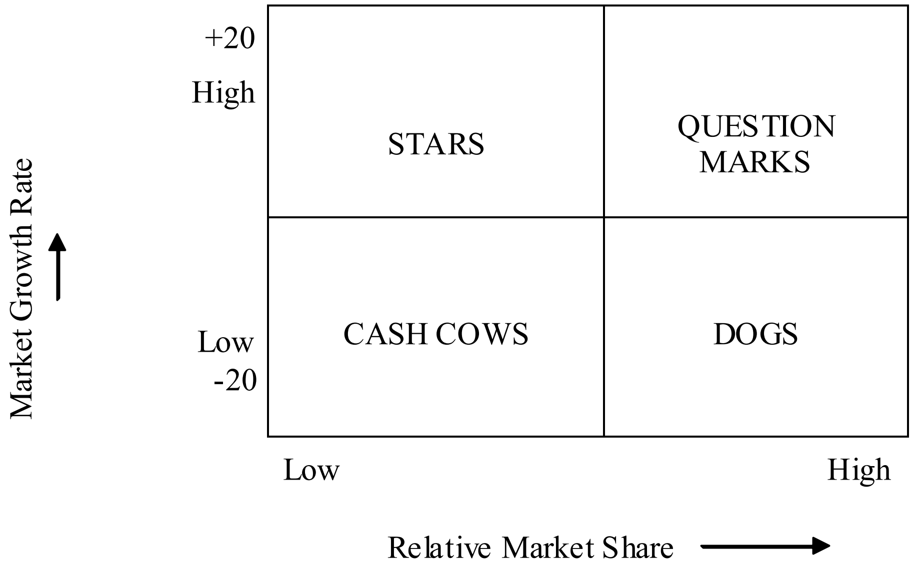

Figure - 2: BCG Growth Share Matrix

7.7.2 GE Multi-factor Port folio matrix

The process for developing this matrix is as follows:

1. Each of an organization's businesses is plotted in the matrix on two dimensions, industry attractiveness and business strength. Each of these two major dimensions is a composite measure of a variety of factors. To use this approach, an organization must determine what factors are most critical for defining industry attractiveness and business strength.

   The factors associated with industry attractiveness are: market size and growth rate, industry profit margin, competitive intensity, seasonality, cyclicality, economies of scale, technology and social environment, environmental and legal impacts.

   The factors associated with business strength are: relative market share, profit margin, ability to compete on price and quality, knowledge of customers and market, competitive strengths and weaknesses, technological capabilities, and calibre of management.

2. Next step is to weight each variable on the basis of its perceived importance relative to the other factors (hence the total of the weight must be 1.0). On a scale of 1 to 5, it has to be indicated that how low or high the business scores are on that factor.

3. Businesses falling in the cells that form a diagonal from lower left to upper right are medium strength businesses that should be invested in only selectively. Businesses in the cells above and to the left of this diagonal are the strongest; they are the ones for which the company should employ an invest and grow strategy. Businesses in the cells below and to the right of the diagonal are low in overall strength and are serious candidates for a harvest or divest strategy.

This approach has several advantages over the growth-share matrix.

· It provides a mechanism for including a host of relevant variables in the process of formulating strategy.

- The two dimensions of industry attractiveness and business strength are good criteria for rating potential business success.
- The approach forces managers to be specific about their evaluations of the impact of particular variables on overall business success.

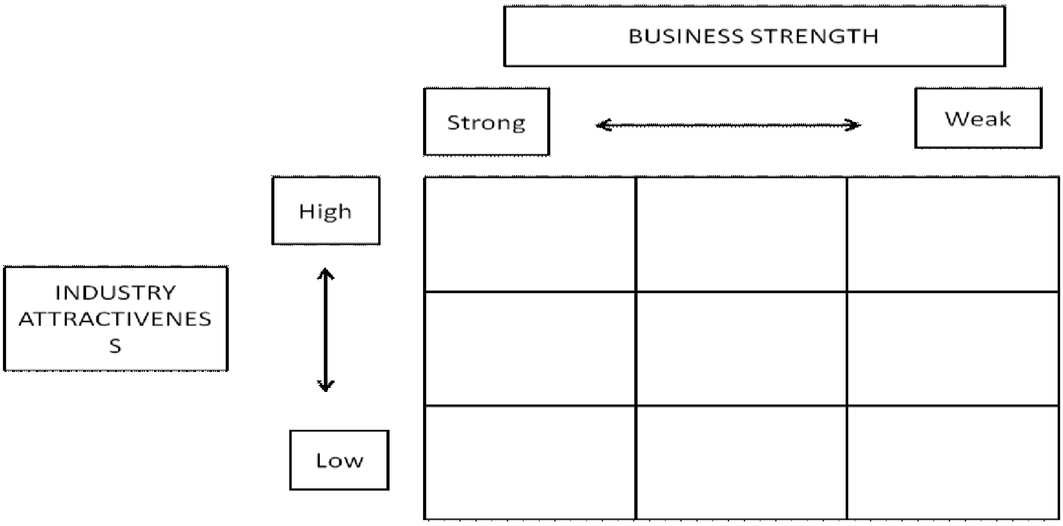

Figure 3: GE Multi-factor Port folio matrix

7.7 Summary

To respond to the dynamism in the business environment and enhance competitiveness, organisations follow various strategies at corporate level like growth or expansion, stability, retrenchment and combination strategies. Growth or extension strategies include concentration, integration, diversification, cooperation, internationalisation and digitalisation strategies.

The four types of international strategies based upon two sets of variables - 'pressure for cost reduction' and 'pressure for local responsiveness' are: international, multi domestic, global and transnational strategy. The organisation can enter into the international market through various modes like: export entry mode, contractual entry mode and investment entry mode. Digitalised business or e-business is doing business with help of computers and internet. E business aims at integration of I.T & communication technologies with business processes and management practices to gain competitive advantage.

A retrenchment grand strategy is followed when an organization aims at a contraction of its activities through substantial reduction in the scope of one or more of its businesses in terms of their respective customer groups, customer functions, or alternative technologies. There are three types of retrenchment strategies: Turnaround Strategies, Divestment Strategies and Liquidation strategies. Turn around strategies involve actions that can reverse a negative trend, like cost cutting, re engineering and downsizing. A divestment strategy involves the sale or liquidation of a portion of business, or a major division, profit centre or a SBU. Liquidation strategy involves closing down a firm and selling its assets. Large, diversified organizations commonly use a number of strategies in combination. Corporate restructuring may involve expansion or contraction of the portfolio or changes in the nature and volume of business. Change in the business conditions may necessitate restructuring of the business.

The second component of corporate level strategy is concerned with making decisions regarding the portfolio of lines of business or strategic business units (SBU's). Portfolio matrix models can be useful in analysing a company's present portfolio and also in allocation of resources among the different business units. The two primary models are the BCG Growth-Share Matrix and the GE Business Screen. These models consider and display on a two-dimensional graph each major SBU in terms of some measure of its industry attractiveness and its relative competitive strength. The BCG matrix enables managers to classify every business as a question mark, a star, a cash cow, or a dog; to ascertain whether the firm's group of businesses is well balanced among the four quadrants; and to determine which strategy is appropriate for each. The GE matrix attempts to quantify the strength of a business and the attractiveness of the industry it operates in. The sum of these two numbers is taken as an indication of whether investing aggressively, investing selectively, or refraining from further investment is the best strategy.

A summarised chart for various corporate level strategies is as follows:

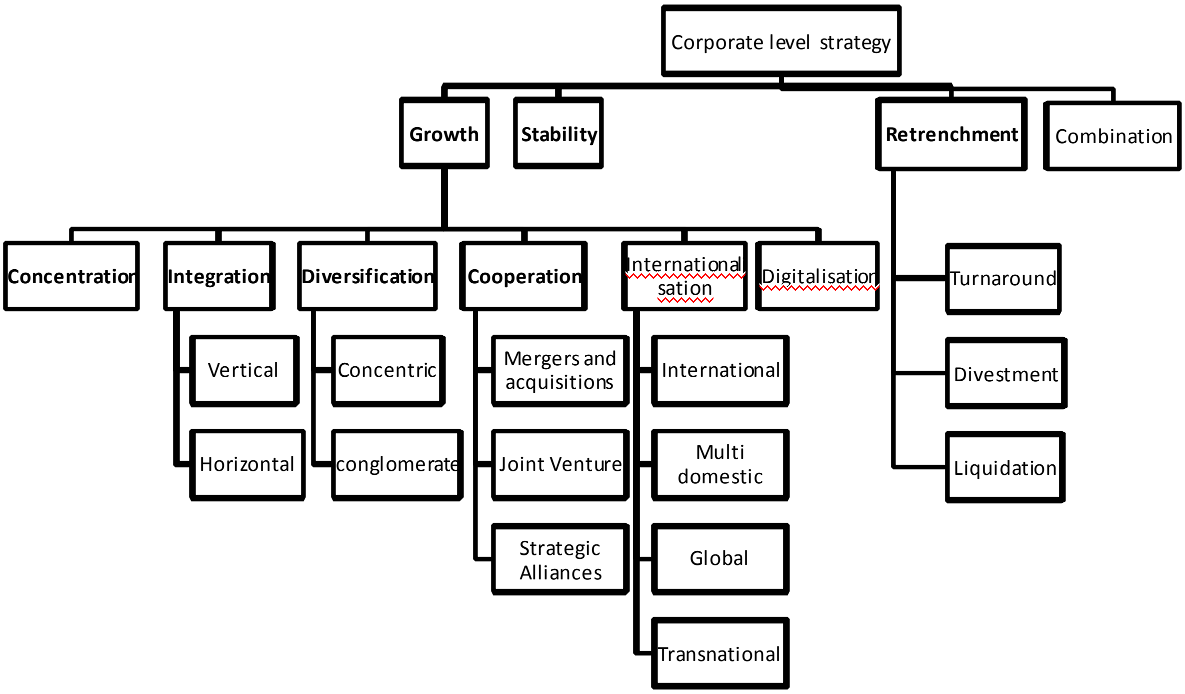

Figure - 4 : Corporate level strategy

7.9 Self Assessment Questions

1. Identify various internationalisation strategies that firms adopt.
2. What all factors should be considered by firms to decide which international market to enter and when?
3. Explain the term digitalisation and write a descriptive note on digitalisation strategies.
4. What are the various factors that can cause a decline in organisations?
5. Explain the various retrenchment strategies with Indian examples.
6. What is retrenchment? Explain why and when it is followed.
7. How can a turnaround be managed?
8. Explain divestment strategy. Also tell how can this strategy be employed?
9. Explain liquidation strategy.
10. What are the characteristics exhibited by sick companies?
11. Write short notes on:

a. cooperate restructuring
b. turnaround process
c. legal aspects of liquidation
d. types of international entry mode.

12. What do you understand by combination strategy?

13. Discuss the different forms of restructuring.

14. Examine the significant of portfolio strategies.

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Unit - 8 : Mergers & Acquisitions

Structure of Unit:

8.0 Objectives

After completing this unit, you would be able to;

- Define merger and acquisition;
- Know various forms of business combinations;
- Explain difference between mergers and acquisitions;
- Discuss need and benefits of mergers and acquisitions;
- Describe strategies of mergers and acquisitions;
- Components of merger agreement
- Mergers and acquisitions advisory and valuation;

8.1 Introduction

Mergers and acquisitions (M&A) and corporate restructuring are a big part of the corporate finance world. M&A transactions bring separate companies together to form larger ones. As a business gets bigger, the growth will be organic or inorganic. Organic growth, also called internal growth, occurs when the company grows from its own business activity using funds from one year to expand the company the following year. Inorganic growth, or external growth, occurs when the company grows by merger or acquisition of another business. Getting involved with another company in this way makes good business sense as it can give a new source of fresh ideas and access to new markets.

Most business enterprises are constantly faced with the challenge of prospering and growing their businesses‘. Growth is generally measured in terms of increased revenue, profits or assets. Businesses can choose to build their in-house competencies, invest to create competitive advantages, differentiate and innovate in the product or service line (Organic Growth) or leverage upon the market, products and revenues of other companies (In-organic Growth).

Microsoft, is a clear case of In-Organic growth as it has successfully completed more than 100 acquisitions since 1886. Apple Inc., on the other hand is probably an excellent example of Organic Growth. Growth at Apple is driven by trend-setting product innovation. Macintosh, iMac, iPod and the latest technological breakthrough pioneered by Apple is the iPhone.

8.2 What is Merger?

Before we understand Merger, First, let's find out the simple meaning of an acquiring company and acquired companies.

1. **Acquiring Company** is a single existing company that purchases the majority of equity shares of one or more companies.
2. **Acquired Companies** are those companies that surrender the majority of their equity shares to an acquiring company.

Definition: Merger is a combination of two companies where one corporation is completely absorbed by another corporation.

A merger happens when two firms, often of about the same size, agree to go forward as a single new company rather than remain separately owned and operated

The less important company loses its identity and becomes part of the more important corporation, which retains its identity. A merger extinguishes the merged corporation, and the surviving corporation assumes all the rights, privileges, and liabilities of the merged corporation.

Merger is a technique of business growth. It is not treated as a business combination. Merger is done on a permanent basis. Generally, it is done between two companies. However, it can also be done among more than two companies.

During Merger, an acquiring company and acquired companies come together to decide and execute a merger agreement between them.

After Merger, acquiring company survives whereas acquired companies do not survive anymore, and they cease (stop) to exist.

- Merger does not result in the formation of a new company. The management of acquiring company continues to lead (direct) the merger.
- Merger is not the same as a consolidation, in which two corporations lose their separate identities and unite to form a completely new corporation.

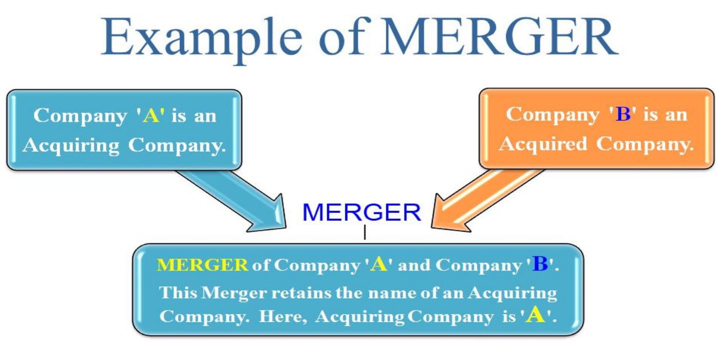

Figure - 8.1

In the above example, Company 'A' and Company 'B' are operating (existing) in the market. Company 'A' is an acquiring company, and Company 'B' is getting acquired by Company 'A'. In other words, Company 'B' gets merged with Company 'A'.

In this example of merger, Company 'A' will purchase the majority of equity shares (ownership shares) of Company 'B'. Company 'A' will take over the assets and liabilities of the Company 'B'. The shareholders of the Company 'B' will be given the shares of Company 'A'. The acquiring Company 'A' will continue to operate (function) by its erstwhile (former) name.

8.2.1 Effects of Merger

a) Unilateral Effect : The merged entity may also have a unilateral incentive to increase the price of one or more of the products sold by the merging firms if a significant proportion of consumers view the two merging firms as their first and second choices. In the premerger equilibrium, firms have chosen their prices to maximize profits, taking into account their perceptions about consumers' willingness to switch to other products.

Thus, a firm would not have an incentive to increase its price independently prior to the merger because it has already determined that the benefit of a higher price would be outweighed by the cost of lost sales to competitors. However, if a large enough proportion of the lost sales by one merging firm would be captured by the other merging firm, then a price increase could be profitable after the merger.

b) Coordinated Effects : It occur when a merger increases the likelihood that competitors will coordinate - either tacitly or expressly - to raise prices. A merger may enhance the ability to coordinate by reducing the number of independent competitors. This is more likely to occur if the existing number of competitors is already relatively small. Many other factors also affect the ability to coordinate. For example, all other things equal, it is easier for competitors to reach and monitor agreements if the products are relatively homogeneous and the pricing by individual competitors is relatively transparent.

8.2.2 Demergers

A demerger is the opposite of a merger, involving the splitting up of one entity into two or more entities. An entity which has more than one business, may decide to 'hive off' or 'spin off' one of its businesses into a new entity. The shareholders of the original entity would generally receive shares of the new entity.

If one of the businesses of a company is financially sick and the other business is financially sound, the sick business may be demerged from the company. This facilitates the restructuring or sale of the sick business, without affecting the assets of the healthy business. Conversely, a demerger may also be undertaken for situating a lucrative business in a separate entity. A demerger, may be completed through a court process under the Merger

8.3 What Is Acquisition?

"An **Acquisition** is the purchase of all or a portion of a corporate asset or target company".

"When one company takes over the other and rules all its business operations, it is known as acquisitions".

Acquisitions are actions through which companies seek economies of scale, efficiencies and enhanced market visibility. All acquisitions involve one firm purchasing another - there is no exchange of stock or consolidation as a new company. Acquisitions are often congenial, and all parties feel satisfied with the deal.

Other times, acquisitions are more hostile.

An acquisition may be only slightly different from a merger. In fact, it may be different in name only. In an acquisition, as in some of the merger deals we discuss above, a company can buy another company with cash, stock or a combination of the two. Another possibility, which is common in smaller deals, is for one company to acquire all the assets of another company.

When a target company is acquired by another company, the target company ceases to exist in a legal sense and becomes part of the purchasing company. Acquisitions are commonly made by using cash or debt to purchase outstanding stock, but companies can also use their own stock by exchanging it for the target firm's stock. Company X buys all of Company Y's assets for cash, which means that Company Y will have only cash (and debt, if they had debt before). Of course, Company Y becomes merely a shell and will eventually liquidate or enter another area of business.

Acquisitions can be either hostile or friendly. For example, Oracle Corporation is very famous for its acquisitions. Oracle acquires companies and not merge with them. Oracle acquired Siebel, BEA, Peoplesoft and more recently SUN through friendly or hostile take overs.

8.3.1 Procedure of Acquisition

Let's assume Company XYZ wants to acquire Company ABC. Company XYZ starts to buy ABC shares on the open market, but once Company XYZ acquires 5% of ABC, it must formally (and publicly) declare to the Securities and Exchange Commission (SEC) how many shares it owns. Company XYZ must also state whether it intends to buy ABC or just hold its existing shares as an investment.

If Company XYZ wants to proceed with the acquisition, it will make a "tender offer" to ABC's board of directors, followed by an announcement to the press. The tender offer will indicate, among other things, how much Company XYZ is willing to pay for ABC and how long ABC shareholders have to accept the offer.

Once the tender offer is made, ABC can accept (1) the terms of the offer, (2) negotiate a different price, (3) use a "poison pill" or other defense to avert the deal, or (4) find another company, who hopefully will pay as much or more as XYZ is offering, to buy them.

If ABC accepts the offer, regulatory bodies then review the transaction to ensure the combination does not create a monopoly or other anti-competitive circumstances within the industries involved. If the regulatory bodies approve the transaction, the parties exchange funds and the deal is closed.

Activity A:

1. What are an acquisition and a merger?
2. What are effects of merger?
3. How do you define Demerger?

8.4 Joint Venture, Strategic Alliance, Corporate M & A and Amalgamation of Companies

8.4.1 Joint Venture

A joint venture is a legal partnership between two (or more) companies where in they both make a new (third) entity for competitive advantage. With a JV you will have something more than simple governance;

you'll have a completely new entity with a board, officers, and an executive team. Effectively a JV is a completely new organization, but owned by the founding participants. The board of directors generally is constructed with representatives of the founding organizations. This new company will "do business" with the founding entities-usually as suppliers e.g. Uninor was a joint venture between Unitech (India) and Telenor (France) and KPIT Cummins is a joint venture between KPIT and Cummins Infosystems. In both the above cases,the resulting company is a new independent company with its own set of executives and even name.

8.4.2 Strategic Alliance

SA is a kind of partnership between two entities in which they take advantage of each other's core strengths like proprietary processes, intellectual capital, research, market penetration, manufacturing and/or distribution capabilities etc. They share their core strengths with each other. They will have an open door relationship with another entity and will mostly retain control. The length of agreement could have a sunset date or could be open-ended with regular performance reviews. However, they simply would want to work with the other organizations on a contractual basis, and not as a legal partnership e.g. HP and Oracle had a strategic alliance wherein HP recommended Oracle as the perfect database for their servers by optimizing their servers as per Oracle and Oracle also did the same.

8.4.3 Corporate M & A

Corporate merger and acquisition is defined as the process of buying, selling, and integrating different corporations with the desire of expansion and accelerated growth opportunities. This kind of association in any form plays an integral role when it comes to business and economy as it results in significant restructuring of a business.

The key objective of corporate mergers and acquisitions is to increase market competition. This can be done in various ways using different methods of merger like horizontal merger, conglomeration merger, market extension merger, and product extension merger. All the types work towards a common goal but behold different characteristics suited to get the best outcome in terms of growth, expansion, and financial performance.

In many significant ways, this kind of restructuring a business proves to be beneficial to the corporate world. It greatly helps to share all resources, skills, talents, and knowledge that eventually increases the wisdom bar within the company. This can further help to combat the competitive challenges existing in the market.

Further to that, elimination of duplicate departments, possibility of cross selling, reduction of tax liability, and exchange of resources are other big time benefits of corporate merger and acquisition. This not only helps to cut the extra cost involved in the operation and gain financial gains but also help to expand across boundaries and enhance credibility. This in the long run help increase revenue and market share, fulfillment of the only desire that drives the growth of M&A.

8.4.4 Amalgamation of Companies

Amalgamation is defined as a simple arrangement or reconstruction of business. It is a process that involves combining of two or more companies as either absorption or as blend. Two or more companies can either be absorbed by an entirely new firm or a subsidiary powered by one of the basic firm. In such cases all the shareholders of the absorbed company automatically become the shareholders of the ruling company as the amalgamating company loses its existence. All the assets and liabilities are also transferred to the new entity.

Amalgamation has given different forms to different actions in due course of the merger taking place. It can either be classified in the nature of merger or in the nature of purchase. If the process takes place in the nature of merger then the all assets, liabilities, and shareholders holding not less than 80% of equity shares are automatically transferred to the new company or the holding company by virtue of the amalgamation.

When amalgamation takes place in nature of purchase then the assets and liabilities of the company are taken over by the ruling company. All the properties and characteristics of amalgamating company should vest with the other company. Even the shareholders holding shares not less than 75% should transfer their shares to the transferee company. In such a case any company does not purchase the business resulting in a takeover, the transferor company does not completely lose its existence.

8.5 Difference between Merger and Acquisition

Merger and acquisition is often known to be a single terminology defined as a process of combining two or more companies together. The fact remains that the so-called single terminologies are different terms used under different situations. Though there is a thin line difference between the two but the impact ofthe kind of completely different in both the cases.

Whether a purchase is considered a merger or an acquisition really depends on whether the purchase is friendly or hostile and how it is announced. In other words, the real difference lies in how the purchase is communicated to and received by the target company's board of directors, employees and shareholders.

Regardless of their category or structure, all mergers and acquisitions have one common goal: they are all meant to create synergy that makes the value of the combined companies greater than the sum of the two parts. The success of a merger or acquisition depends on whether this synergy is achieved.

1	Merger is considered to be a process when two or more companies come together to expand their business operations.	When one company takes over the other and rules all its business operations, it is known as acquisitions.
2	In the pure sense of the term, a merger happens when two firms, often of about the same size, agree to go forward as a single new company rather than remain separately owned and operated. This kind of action is more precisely referred to as a "merger of equals." Both companies' stocks are surrendered and new company stock is issued in its place.	When one company takes over another and clearly established itself as the new owner, the purchase is called an acquisition. From a legal point of view, the target company ceases to exist, the buyer "swallows" the business and the buyer's stock continues to be traded.
3	Two companies of same size combine to increase their strength and financial gains along with breaking the trade barriers	Usually two companies of different sizes come together to combat the challenges of downturn
4	There is a friendly association where both the partners hold the same percentage of ownership and equal profit share	A deal in case of an acquisition is often done in an unfriendly manner, it is more or less a forceful or a helpless association where the powerful company either swallows the operation or a company in loss is forced to sell its entity.

Activity B:

1. Discuss in detail about Corporate M & A
2. How will you differentiate between Joint Venture, Strategic Alliance and Amalgamation of Companies?
3. Explain difference between acquisition and merger with the help of example

8.6 Classifications of Mergers and Acquisitions

1. Horizontal

- A merger in which two firms in the same industry combine in the same geographic area and thereby eliminates competition between the two firms.
- Often in an attempt to achieve economies of scale and/or scope.

2. Vertical

- A merger in which one firm acquires a supplier or another firm that is closer to its existing customers.
- Often in an attempt to control supply or distribution channels.

3. Conglomerate

- A merger in which two firms in unrelated businesses combine.
- Purpose is often to 'diversify' the company by combining uncorrelated assets and income streams
- Conglomerate mergers encompass all other acquisitions, including pure conglomerate transactions where the merging parties have no evident relationship (e.g., when a shoe producer buys an appliance manufacturer), geographic extension mergers, where the buyer makes the same product as the target firm but does so in a different geographic market, and product-extension mergers, where a firm that produces one product buys a firm that makes a different product that requires the application of similar manufacturing or marketing techniques (e.g., when a producer of household detergents buys a producer of liquid bleach).

4. Cross-border (International) M & As

- Cross-border mergers and acquisitions (M&As) those taking place between firms of different national origin or home countries,

8.7 Some Examples of Merger and Acquisition

1. Tata Steel's acquisition of European steel major Corus for $12.2 billion.
2. Vodafone's purchase of 52% stake in Hutch Essar for about $10 billion. Essar group still holds 32% in the Joint venture.
3. Hindalco's (Aditya Birla group) acquisition of Novellis for $6 billion.
4. Ranbaxy's acquisition by Japan's Daiichi for $4.5 billion.
5. ONGC's acquisition of Russia based Imperial Energy for $2.8 billion.
6. NTT DoCoMo-Tata Tele services deal for $2.7 billion.
7. HDFC Bank's acquisition of Centurion Bank of Punjab for $2.4 billion.

8. Tata Motors's acquisition of luxury car maker Jaguar Land Rover for $2.3 billion.

8. Suzlon Energy's acquisition of RePower for $1.7 billion.

10. Reliance Industries taking over Reliance Petroleum Limited (RPL) for 8,500 crore or $1.6 billion

8.8 Need for Mergers & Acquisition

Mergers and acquisitions are more popular form of partnerships which is simpler to understand. Two companies together are more valuable than two separate companies - at least, that's the reasoning behind M&A.

One plus one makes three: this equation is the special alchemy of a merger or an acquisition. The key principle behind buying a company is to create shareholder value over and above that of the sum of the two companies. Two companies together are more valuable than two separate companies - at least, that's the reasoning behind M&A.

This rationale is particularly alluring to companies when times are tough. Strong companies will act to buy other companies to create a more competitive, cost-efficient company. The companies will come together hoping to gain a greater market share or to achieve greater efficiency. Because of these potential benefits, target companies will often agree to be purchased when they know they cannot survive alone

Mergers and acquisitions often result in a number of social benefits. Mergers can bring better management or technical skill to bear on underused assets. They also can produce economies of scale and scope that reduce costs, improve quality, and increase output. The possibility of a takeover can discourage company managers from behaving in ways that fail to maximize profits. A merger can enable a business owner to sell the firm to someone who is already familiar with the industry and who would be in a better position to pay the highest price. The prospect of a lucrative sale induces entrepreneurs to form new firms. Finally, many mergers pose few risks to competition.

Companies acquire target companies as a growth strategy because it can create a bigger, more competitive, and more cost-efficient entity. This synergy — the idea that the two companies together are more valuable to the shareholders than they are apart — is elusive, but it is the idea used to justify most acquisitions. A well-executed acquisition can be the crowning jewel of a CEO's career.

8.9 Benefits of Merger and Acquisition

Merger and acquisition has become the most prominent process in the corporate world. The key factor contributing to the explosion of this innovative form of restructuring is the massive number of advantages it offers to the business world. **Some of the known advantages of merger and acquisition**

- The very first advantage of M&A is synergy that offers a surplus power that enables enhanced performance and cost efficiency. When two or more companies get together and are supported by each other, the resulting business is sure to gain tremendous profit in terms of financial gains and work performance.

- Cost efficiency is another beneficial aspect of merger and acquisition. This is because any kind of merger actually improves the purchasing power as there is more negotiation with bulk orders. Apart from that staff reduction also helps a great deal in cutting cost and increasing profit margins of the company. Apart from this increase in volume of production results in reduced cost of production per unit that eventually leads to raised economies of scale.

- With a merger it is easy to maintain the competitive edge because there are many issues and strategies that can e well understood and acquired by combining the resources and talents of two or more companies.
- A combination of two companies or two businesses certainly enhances and strengthens the business network by improving market reach. This offers new sales opportunities and new areas to explore the possibility of their business.

With all these benefits, a merger and acquisition deal increases the market power of the company which in turn limits the severity of the tough market competition. This enables the merged firm to take advantage of hi-tech technological advancement against obsolescence and price wars.

Activity C:

1. What are horizontal and Vertical Classifications of Merger and **Acquisition ?**
2. What are important benefits of Merger and **Acquisition ?**

8.10 Strategies of Merger and Acquisition

Strategies play an integral role when it comes to merger and acquisition. A sound strategic decision and procedure is very important to ensure success and fulfilling of expected desires. Every company has different cultures and follows different strategies to define their merger. Some take experience from the past associations, some take lessons from the associations of their known businesses, and some hear their own voice and move ahead without wise evaluation and examination.

Some of the most essential strategies of merger and acquisition are:

- The first and foremost thing is to determine business plan drivers. It is very important to convert business strategies to set of drivers or a source of motivation to help the merger succeed in all possible ways.
- There should be a strong understanding of the intended business market, market share, and the technological requirements and geographic location of the business. The company should also understand and evaluate all the risks involved and the relative impact on the business.
- Then there is an important need to assess the market by deciding the growth factors through future market opportunities, recent trends, and customer's feedback.
- The integration process should be taken in line with consent of the management from both the companies venturing into the merger.
- Restructuring plans and future parameters should be decided with exchange of information and knowledge from both ends. This involves considering the work culture, employee selection, and the working environment as well.
- At the end, ensure that all those involved in the merger including management of the merger companies, stakeholders, board members, and investors agree on the defined strategies. Once approved, the merger can be taken forward to finalizing a deal.

8.11 Merger Agreement

Merger agreement is a contract that comprehensively lists down all details governing the merger of one or more companies. It is a main document that is legally binding on all the parties to the contract. To make it enforceable, the agreement has to be approved by and duly signed by the authorized parties. It can be cancelled under circumstances where any party fails to comply with the laid down terms and conditions.

The agreement should take into account all possibilities and lay down the plan of action for the same. The legal terminology should be correctly and carefully used. Moreover, any spelling mistake in the names can nullify the contract.

A number of formats are easily available for drafting a merger agreement. But due to the level of complexity and accountability involved, they are normally drafted by law firms for their clients.

Some of the important components of the agreement are:

- Agreement date - It is the date on which the agreement became enforceable.
- Names of the merging parties - Complete names of all the companies merging their business.
- Type of industry - It refers to the industry in which the merger is taking place. For instance, merger of two drug-making companies belong to the industry Biotechnology & Drugs.
- Type of sector - In the above example, the sector is Healthcare.
- Jurisdiction - It is important to identify the laws governing the jurisdiction
- Other important details like members of the management, valuation of shares, liability of the members, valuation of tangible assets, etc.

8.12 Merger and Acquisition Advisory and Valuation

8.12.1 Merger and Acquisition Advisory

Merging and acquiring business is a cumbersome task. Any loophole or negligence can lead to huge financial losses and in extreme cases even the closure of business is possible. Therefore, many professional firms, known as merger and acquisition (M&A) advisories, provide consulting services only in the area of business consolidation. The advisory team mainly communicates with the top management of its client organization

They are hired by organizations to study the market and give strategic and financial inputs for growing their business. M&A advisory analyze the need of M&A for the organization, the cost involved, the possible benefits, change in the capital structure, and many other effects of the possible consolidation. They also plan, execute, and implement all the phases of a mergers and acquisition process starting from the pre-merger phase to the post-merger integration.

Giving business expansion advice also falls within the domain of such advisories. They suggest the potential new markets, the need for relocating business, new business tactics, etc. on regular basis to their clients.

8.12.2 Merger and Acquisition Valuation

The number as well as the average size of merger and acquisition deals is increasing in India. During post liberalization, increase in domestic competition and competition against cheaper imports have made organizations merge themselves to reap the benefits of a large-sized company. The merger and acquisition valuation is the building block of a proposed deal. It is a technical concept that needs to be estimated carefully.

M&A valuation involves determining the maximum price that a buyer is willing to pay to buy the target company. From the seller's point of view, it means estimating the minimum price he wants to take against his business. If there are many buyers, then each one bids a purchase price based on his valuation. Finally, the seller will give the business to the highest bidder.

The use of different valuation techniques and principles has made valuation a subjective process. Aconflict in the choice of technique is the main reason for the failure of many mergers. For instance, the asset value can be determined both at the market price and the cost price. Therefore, it is important that the merging parties should first discuss and agree upon the methods of valuation.

Calculating the swap ratio is at the core of the valuation process. It is the ratio at which the shares of the acquiring company will be exchanged with the shares of the acquired company. For instance, a swap ratio of 1:2 means that the acquiring company will provide its one share for every two shares of the other company.

Naturally, both sides of an M&A deal will have different ideas about the worth of a target company: its seller will tend to value the company at as high of a price as possible, while the buyer will try to get the lowest price that he can. There are, however, many legitimate ways to value companies. The most common method is to look at comparable companies in an industry, but deal makers employ a variety of other methods and tools when assessing like:

1. **Price-Earnings Ratio (P/E Ratio) -** With the use of this ratio, an acquiring company makes an offer that is a multiple of the earnings of the target company. Looking at the P/E for all the stocks within the same industry group will give the acquiring company good guidance for what the target's P/E multiple should be.
2. **Enterprise-Value-to-Sales Ratio (EV/Sales)** - With this ratio, the acquiring company makes an offer as a multiple of the revenues, again, while being aware of the price-to-sales ratio of other companies in the industry.
3. **Discounted Cash Flow (DCF**) - A key valuation tool in M&A, discounted cash flow analysis determines a company's current value according to its estimated future cash flows. Forecasted free cash flows (net income + depreciation/amortization - capital expenditures - change in working capital) are discounted to a present value using the company's weighted average costs of capital (WACC). Admittedly, DCF is tricky to get right, but few tools can rival this valuation method.
4. **Replacement Cost -** In a few cases, acquisitions are based on the cost of replacing the target company. For simplicity's sake, suppose the value of a company is simply the sum of all its equipment and staffing costs. The acquiring company can literally order the target to sell at that price, or it will create a competitor for the same cost. Naturally, it takes a long time to assemble good management, acquire property and get the right equipment. This method of establishing a price certainly wouldn't make much sense in a service industry where the key assets - people and ideas - are hard to value and develop.

8.13 Summary

One size doesn't fit all. Many companies find that the best way to get ahead is to expand ownership boundaries through mergers and acquisitions. For others, separating the public ownership of a subsidiary or business segment offers more advantages. M&A and corporate restructuring are a big part of the corporate finance world. The basic reason behind mergers and acquisitions is that organizations merge and form a single entity to achieve economies of scale, widen their reach, acquire strategic skills, and gain competitive advantage. In simple terminology, mergers are considered as an important tool by companies for purpose of expanding their operation and increasing their profits, which in façade depends on the kind of companies being merged. The ultimate goal behind a merger and acquisition is to generate synergy values. Good strategic planning is the key to understanding if synergy values do in fact exist.

A merger or acquisition can add considerable value to a business, but making sure that each stage of the transaction process from valuation to negotiation and completion is successful demands advisory. Valuation is also a critical component for decisions in transactions involving M&As, dispute resolutions, tax structuring, corporate restructuring, and accounting and financial reporting.

8.14 Self Assessment Questions

1. Why companies go for acquisition and merger ?
2. Elaborate various forms of business combinations
3. Differentiate between merger and amalgamation
4. What is valuation and advisory of mergers and acquisitions ?

8.15 Reference Books

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Unit - 9 : Strategic Analysis and Strategic Choice

Structure of Unit:

9.0 Objectives

After completing this unit, you would be able to:

- Understand the strategic analysis concept;
- Tools and techniques of strategic analysis;
- Understand customer analysis;
- Understand environment analysis;
- Understand SWOT analysis;
- Understand competitors' analysis.
- Understand the process of strategic choice
- Understand the objective factors of strategic choice
- Understand the subjective factors of strategic choice
- Understand strategic plan

9.1 Introduction

Strategic analysis provides an overview of the key factors which can affect the current and future performance of company. It helps in understanding the company´s strategic position. It is important to analyze environmental changes and find out how they can affect the company and its employees. Strategic analysis aims to create a view of the key factors which can have an impact on the present and future performance of the company. If strategic analysis is carried out in a correct manner then it will help in choosing the right strategy.

9.2 What is Strategic Analysis?

Strategic Analysis is the process of conducting research on the business environment within which an organisation operates and on the organisation itself, in order to formulate strategy. (BNET Business Dictionary)

'A theoretically informed understanding of the environment in which an organisation is operating, together with an understanding of the organization's interaction with its environment in order to improve organizational efficiency and effectiveness by increasing the organization's capacity to deploy and redeploy its resources intelligently.' Professor Les Worrall, Wolverhampton Business.

Definitions of strategic analysis often differ, but the following attributes are commonly associated with it:

1. Identification and evaluation of data relevant to strategy formulation.

2. Definition of the external and internal environment to be analyzed.

3. A range of analytical methods that can be employed in the analysis.

9.3 Tools and Techniques of Strategic Analysis

The final step in the strategy formulation phase of strategic management is strategic analysis and strategic choice. There are several factors that affect the strategic choice which is ultimately made. These factors can further be divided into two classes: objective and subjective factors. Strategic analysis is performed to analyze these factors. Furthermore strategic analysis can be conducted in two phases. First phase is the technique used for corporate level strategies and second phase is the technique used for business level strategies.

Corporate level strategic analysis would focus on techniques for analyzing businesses within a corporate umbrella, while business level strategic analysis would highlight the techniques used to analyze the businesses individually from viewpoint of industry to which they belong and the competitive situation that these face.

9.4 Business Level Strategic Analysis

One of the key skills of a strategic analyst is in understanding which analytical tools or techniques are most appropriate to the objectives of the analysis. Below is an overview of some of the more commonly used business level strategic analysis tools.

1) SWOT Analysis: A SWOT analysis is a simple but widely used tool that helps in understanding the strengths, weaknesses, opportunities and threats involved in a project or business activity. It starts by defining the objective of the project or business activity and identifies the internal and external factors that are important to achieving that objective. strengths and weaknesses are usually internal to the organisation, while opportunities and threats are usually external. Often these are plotted on a simple 2x2 matrix.

When Using SWOT Analysis, it Should Be Ensured That:

- Only specific, verifiable statements are used. An example might be ‘price is £1.50 per unit lower than competition’ rather than ‘good value for money’.
- Internal and external factors are prioritized so that time is spent concentrating on the most significant factors. This should include a risk assessment to ensure that high risk or high impact threats and opportunities are clearly identified and are dealt with in priority order.
- Issues identified are retained for later in the strategy formation process.
- The analysis is pitched at the project or business activity level rather than at a total company level, which may be less actionable.
- It is not used in exclusivity. No one tool is likely to be completely comprehensive, so a mixture of option-generating tools should be used.

2) PEST Analysis: PEST analysis is a scan of the external macro-environment in which an organisation exists. It is a useful tool for understanding the political, economic, socio-cultural and technological environment that an organisation operates in. It can be used for evaluating market growth or decline, and as such the position, potential and direction for a business.

@ **Political Factors**: These include government regulations such as employment laws, environmental regulations and tax policy. Other political factors are trade restrictions and political stability.

@ **Economic Factors:** These affect the cost of capital and purchasing power of an organisation. Economic factors include economic growth, interest rates, inflation and currency exchange rates.

@ **Social Factors**: This impact on the consumer's need and the potential market size for an organization's goods and services. Social factors include population growth, age demographics and attitudes towards health.

@ **Technological Factors**: These influence barriers to entry, make or buy decisions and investment in innovation, such as automation, investment incentives and the rate of technological change.

PEST factors can be classified as opportunities or threats in a SWOT analysis. It is often useful to complete a PEST analysis before completing a SWOT analysis. It is also worth noting that the four paradigms of PEST vary in significance depending on the type of business. For example, social factors are more obviously relevant to consumer businesses or a B2B business near the consumer end of the supply chain. Conversely, political factors are more obviously relevant to a defense contractor or aerospace manufacturer.

3) Porter's Five Forces: Porter's five forces of competitive position analysis was developed in 1979 by Michael E. Porter of Harvard Business School as a simple framework for assessing and evaluating the competitive strength and position of a business organisation. This theory is based on the concept that there are five forces which determine the competitive intensity and attractiveness of a market. Porter's five forces helps to identify where power lies in a business situation. This is useful both in understanding the strength of an organization's current competitive position, and the strength of a position that an organisation may look to move into. Strategic analysts often use Porter's five forces to understand whether new products or services are potentially profitable. By understanding where power lies, the theory can also be used to identify areas of strength, to improve weaknesses and to avoid mistakes.

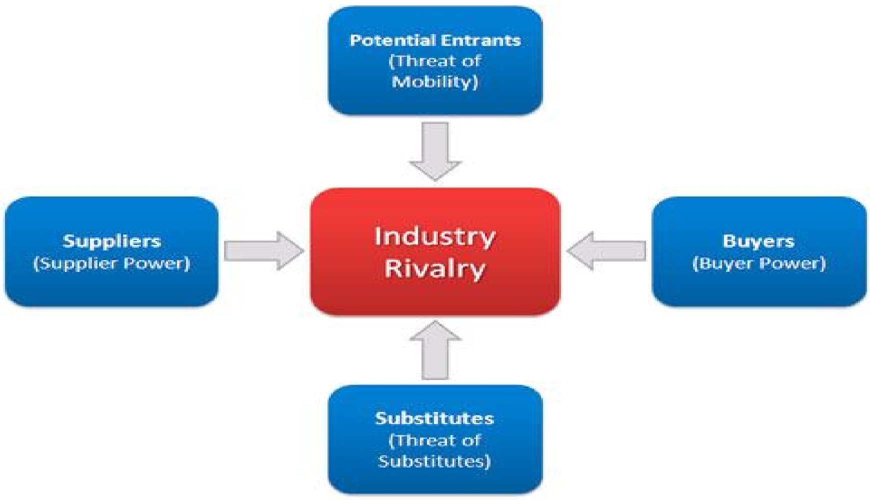

Figure - 9.1

The five forces are:

1. **Supplier Power:** An assessment of how easy it is for suppliers to drive up prices. This is driven by:

- The number of suppliers of each essential input
- The uniqueness of their product or service
- The relative size and strength of the supplier
- The cost of switching from one supplier to another.

2. **Buyer Power:** An assessment of how easy it is for buyers to drive prices down. This is driven by:

- The number of buyers in the market
- The importance of each individual buyer to the organisation
- The cost to the buyer of switching from one supplier to another. If a business has just a few powerful buyers, they are often able to dictate terms.

3. **Competitive Rivalry**: The key driver is the number and capability of competitors in the market. Many competitors, offering undifferentiated products and services, will reduce market attractiveness.

4. **Threat of Substitution**: Where close substitute products exist in a market, it increases the likelihood of customers switching to alternatives in response to price increases. This reduces both the power of suppliers and the attractiveness of the market.

5. **Threat of New Entry**: Profitable markets attract new entrants, which erodes Profitability. Unless incumbents have strong and durable barriers to entry, for Example, patents, economies of scale, capital requirements or government Policies, then profitability will decline to a competitive rate.

4) Value Chain Analysis: Before making a strategic decision, it is important to understand how activities within the organisation create value for customers. One way to do this is to conduct a value chain analysis. Value chain analysis is based on the principle that organizations exist to create value for their customers. In the analysis, the organization's activities are divided into separate sets of activities that add value. The organisation can more effectively evaluate its internal capabilities by identifying and examining each of these activities. Each value adding activity is considered to be a source of competitive advantage. Strategic Analysis Tools.

The Three Steps for Conducting a Value Chain Analysis are:

1. Separate the organization's operations into primary and support activities. Primary activities are those that physically create a product, as well as market the product, deliver the product to the customer and provide after-sales support. Support activities are those that facilitate the primary activities.

2. Allocate cost to each activity. Activity cost information provides managers with valuable insight into the internal capabilities of an organisation.

3. Identify the activities that are critical to customer's satisfaction and market success. There are three important considerations in evaluating the role of each activity in the value chain.
   - **Company Mission:** This influences the choice of activities an organisation undertakes.
   - **Industry Type:** The nature of the industry influences the relative importance of activities.
   - **Value System:** This includes the value chains of an organization's upstream and downstream partners in providing products to end customers.

Value chain analysis is a comprehensive technique for analyzing an organization's source of competitive advantage.

5) Competitor Analysis: deals with the actions and reactions of individual firm within an industry or a strategic group. The four components of competitors analysis are future goals of competitors , its current strategy, the key assumptions that the competitor make about itself and about the industry and its capabilities in terms of strength and weaknesses. It is important because competitive forces shape the strategies adopted by rivals.

9.5 Corporate Level Business Analysis

Corporate level analysis focuses on the question of what should a corporate entity do regarding several businesses that are there in its portfolio. The strategic alternatives here are basically the grand strategies of expansion, stability, retrenchment and combination strategies.

Corporate portfolio analysis could be defined as a set of techniques that help strategist in taking strategic decisions with regard to individual products or businesses in a firm's portfolio. It is primarily used for competitive analysis and corporate strategic planning in multi product and multi business firm. There are number of techniques that could be considered as corporate portfolio analysis techniques discussed as follows:

1) Boston Consulting Group (BCG) Matrix is a four celled matrix (a 2 * 2 matrix) developed by BCG, USA. It is the most renowned corporate portfolio analysis tool. It provides a graphic representation for an organization to examine different businesses in it's portfolio on the basis of their related market share and industry growth rates. It is a two dimensional analysis on management of SBU's (Strategic Business Units). In other words, it is a comparative analysis of business potential and the evaluation of environment. According to this matrix, business could be classified as high or low according to their industry growth rate and relative market share.

Relative Market Share = SBU Sales this year leading competitors sales this year.
Market Growth Rate = Industry sales this year - Industry Sales last year.

BCG matrix has four cells, with the horizontal axis representing relative market share and the vertical axis denoting market growth rate. Resources are allocated to the business units according to their situation on the grid. The four cells of this matrix have been called as stars, cash cows, question marks and dogs. Each of these cells represents a particular type of business

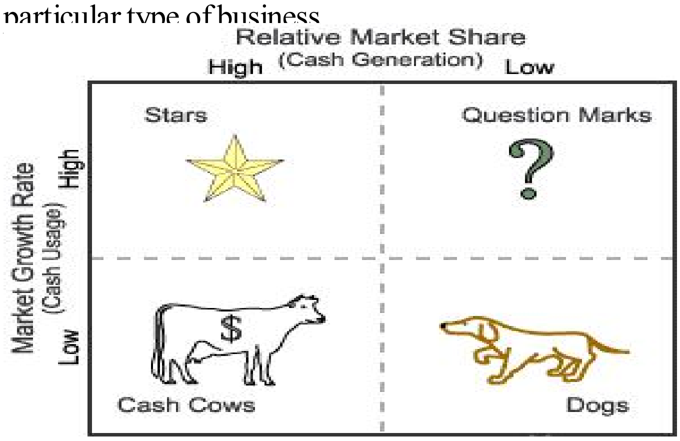

Figure - 9.2 : BCG Matrix

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

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

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

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

2) **GE Nine Cell Matrix:** In 1971 McKinsey and Co developed the business screen for General Electric to differentiate the potential for future profit in each of the 43 strategic business units. This matrix is also known as the industry attractiveness - business strength matrix and the nine-box matrix.

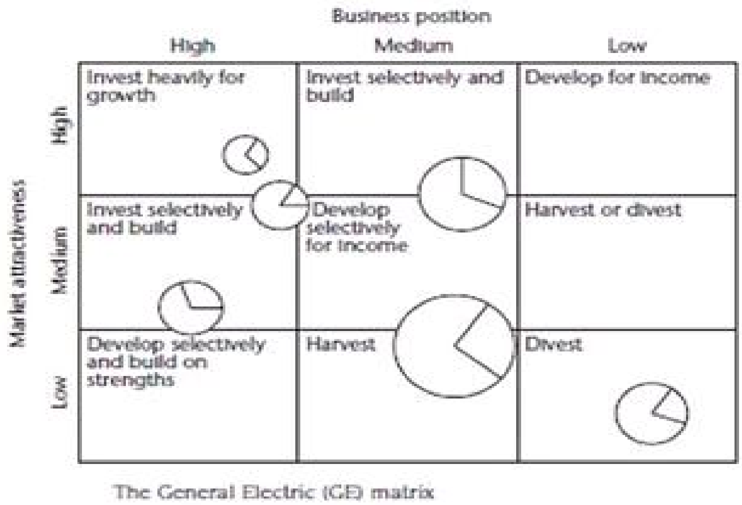

Figure - 9.3

The nine-box matrix provides decision makers with a systematic and effective framework for a decentralized corporation to make better supported investment decisions and for developing strategies for future product development or new market segment entries. Instead of looking solely at each unit's future prospects, a corporation can adopt a multi-dimensional approach based on two components that will indicate how well the unit will perform in the future. The two components used to evaluate businesses, which also serve as the axes of the matrix, are the 'attractiveness' of the relevant industry and the unit's 'competitive strength' within the same industry. Each axis is then divided into Low, Medium and High.

The circles representing SBUs are then placed within the matrix. As a result, the executives of the corporation will have a clear and powerful analytic map for understanding and managing their entire multi-unit business. The units that fall above the diagonal indicate the investment and growth to be pursued; the units along the diagonal require a thorough analysis and individual selection for investment; finally the units below the diagonal might indicate divestments are necessary or otherwise that businesses can be kept only for cash reasons. The placement of the units within the matrix is a necessary first step before the analysis phase that requires human judgment can begin. For example, a strong unit in a weak industry is in a very different situation than a weak unit in a highly attractive industry.

3) **Hofer's Product/Market Evolution Matrix:** Hofer and schendel propose 15 cell matrixes that consider the stages of development of the product or market and the competitive position of different businesses in a company's corporate portfolio. As in the GE nine cell matrix, circles are plotted to represent the size of the industry while the segments denote the business market share.

   Five businesses have been shown with their respective market shares with regard to the industry size. Business A represents a product/ market that have high potential and deserves expansion strategy through large investment. Business B has a strong competitive position but has a product that is entering the shake out stage and therefore need a cautious expansion strategy. Business C is probably a dog while D represents a business which can be used for cash generation that could be diverted to A or B. Business E is a potential loser and may be considered for divestment.

4) **Strategic Position and Action Evaluation (SPACE):** an approach that considers the company's strategic position in tandem with strategic position of the industry. The company's strategic position is determined on the basis of financial strength (ROI, leverage, liquidity etc.) and competitive advantage (market share, product quality etc.). The industry's strategic position is based on industry strength (growth and profit potential etc.). Four strategic postures - aggressive, defensive, conservative and competitive - are based on simple rating system. Understand the concept of strategic choice

9.6 Strategic Choice: Introduction and Process

Strategic choice is the third logical element of the strategy formulation process. Choice is at the centre of strategy formulation. If there are no choices to be made, there can be little value in thinking about strategy at all. On the other hand, there will always, in practice, be limits on the range of possible choices. In general, small enterprises tend to be limited by their resources, whereas large enterprises find it difficult to change quickly and so tend to be constrained by their past. Organizations continuously face the challenge of exercising choice among alternatives. Strategic choice is an inalienable part of the decision making process.

The process of strategic choice is essentially a decision making process. The decision to select from among the grand strategies which will best meet the enterprise's objectives. The decision involves focusing on a few alternatives. Considering the selection factors, evaluating the alternatives against these criteria and making the actual choice. Following are the steps in the strategic choice:

a) **Focusing on the Alternatives:** a decision maker would, in practice, limit the choice to a few alternatives. Focusing on alternative could be done by visualizing the future state and working backwards. This can be done through gap analysis. A company sets objectives for a future period of time, say four to five years, and then work backward to find out where it can reach through the present level of efforts. By analyzing the difference between the projected and the desired performance, a gap could be found. How wide or narrow the gap is, its importance, and the possibility of being reduced influence the focus on alternatives. Where the gap is narrow, stability strategies would seem to be feasible alternative. If the performance GAP is large due to past and expected bad performance then Retrenchment Strategy would be seem to be a feasible alternative.

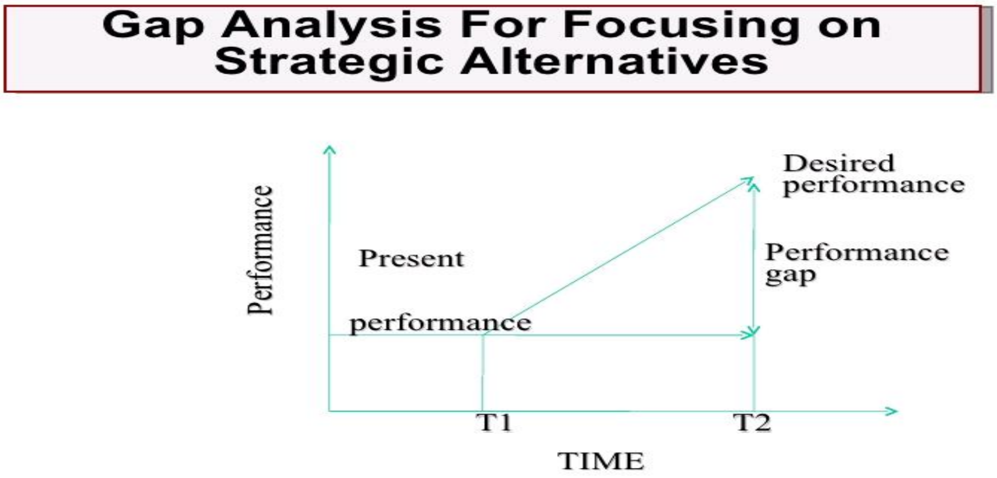

Figure - 9.4

GAP ANALYSIS = Projected Performance - Desired Performance

In the complex scenario, where the multiple reason for the performance GAP then Combination Strategy would be seem to be a feasible alternative.

b) **Considering the Selection Factors:** Selecting the feasible alternative is facilitated by considering the business definition and a thorough GAP analysis. These alternatives have to be subjected to further analysis. Such an analysis has to rely on certain factors. These factors are termed as selection factors. They determine the criteria on which evaluation of strategic alternatives can be based. The selection factors can be classified as objective and subjective factors. Objective factors are based on analytical techniques and are hard facts or data used to facilitate a strategic choice. The Subjective Factors- Based on one's personal judgment, collective or descriptive factors. Thus alternatives that are generated in the first step have to be subjected to analysis on the basis of these selection factors.

Subjective Factors in Strategic Choice: Strategy formulation is not entirely an analytical process but takes into account the non-analytical or subjective factor too. Subjective factor are essentially intuitive and descriptive in nature. Not many 'cut-and-dried' analytical models can be used. But this does not mean that subjective factors are irrational or non-analytical. Rather they attempt to consider many of the issues that cannot, and probably should not, be dealt with in the application of analytical models.

1 Consideration of Government Policy: Strategies within organizations are aware of crucial role that the government plays in setting down policies and priorities. In fact several cases, government policies are the deciding factor: a shift in policies can have a significant impact on the future prospective of companies. Strategic alternatives consider by companies have to be seen in the context of government policies. Expansion, retrenchment, or liquidation types of corporate strategies can only be feasible if the government policies act as a major subjective factor in screening alternatives.

2 Commitment of Past Strategic Action: There, is, another, practical, reason, why, past, stretagic, affect, strategic, choice. strategic, actions, involve, not, only, the, formulation, of, oarticular, strategic, but, also, commitement, in, term, of, resources, and, personnel.

Having made serious commitment In term of resources and person become redundant. Therefore, strategists tend to eliminate the strategic alternative that lead an organization too from its exiting position.

3 Strategist's Decision Style and Attitude to Risk: The crucial variable responsible for the difference between the two approaches is the decision style and the attitude to risk of the respective strategists.

4 Internal Political Considerations: By internal political considerations is meant the strategists interrelationship and power structure and balance. When strategy formulation is viewed as a political process, strategists are viewed as a coalition of interests. A dominant CEO is able to affect strategic choice decisively. Where the CEO is perceived as weak, or invites participation, interest groups or cliques emerge which affect the strategic choice process and try to make the process work in their favor.

5 Timing and Competitor Considerations: The time element and competitor consideration are another set of important subjective factor that influence strategic choice.

Competitor action (and reaction) is also to be considered in strategic choice. It is expected that a particular strategy would elicit an aggressive response, them it should only be chosen if the company is in a position to counteract. The timing of competitor action is also significant.

6 Perception of CSFs and Distinctive Competencies: while considering several strategic alternatives, strategists could be guided by distinctive competencies that the organization possesses, and CSFs that ensure success in an industry. CSF are those few things that must go well to ensure success for a manager or an organization, and, therefore, they represent those managerial or enterprise area, that must be given special and continual attention to bring about high performance. CSFs include issues vital to an organizations current operating activities and to its future success

Distinctive competence of a firm refers to a set of activities or capabilities that a company is able to perform better than its competitors and which gives it an advantage over them. Distinctive competence can lie in different area such as technology, marketing activities, or management capability

c) **Evaluation of Strategic Alternatives:** Evaluation of strategic alternatives basically involves bringing together the results of the analysis carried out on the basis of the objective and subjective factors. There is no set procedure and strategist may use any approach which suits the circumstances. For the proper evaluation both the factors have to be considered together.

d) **Making the Strategic Choice:** the final step in process is making the appropriate choice of strategy. One or more strategies have to be chosen for implementation. Then a blueprint will describe the strategies and conditions under which they would operate. This blueprint is the strategic plan for action.

9.7 Strategic Plan

A strategic plan (also called a corporate, group, or perspective plan), is a document which provides information regarding the different element of strategic management and the manner in which an organization and its strategists propose to put the strategies into action.

A comprehensive strategic plan document could contain the followings information:

1 A clear statement of strategic intent covering the vision, mission, business definition, goals and objectives.

2 Results of environment appraisal, major opportunities and threats, and critical success factors.

3 Results of organization appraisal, major strength and weakness, and core competencies.

4 Strategies chosen and the assumption under which the strategies would be relevant, Contingent strategies to be used under different condition.

5 Strategic budget for the purpose of resources allocation for implementing strategies and the schedule for implementation.

6 Proposed organization structure and the major origination system for strategy implementation, including the top functionaries and their role and responsibility.

7 Functional strategies and the mode of their implementation.

8 Measures to be used to evaluate performance and assess the success of strategy implementation.

Typically, a strategic plan document could run into several pages and be treated as a formal report. Another possibility is that a brief document of three to five pages could briefly cover the points mentioned above. Much would depend on the nature and size of the company and the management policies regarding the preparation of the strategic plan document. It must be remembered, however, that when approved and accepted, a strategic plan document has to be communicated down the line to middle-level managers who will be responsible for its implementation.

9.8 Summary

The strategic choice process is based on strategic decision making which is a highly complex activity. The process of strategic choice is divided into four steps of focusing on alternatives, considering the selection factors, considering the selection factors, evaluation of strategic alternatives and making strategic choice.

Focusing on alternatives involve considering the business definition and analysis of the gap between desired and present performance. The selection factors are divided into two parts objective factors and subjective factors.

Objective factors are based on facts and figures which can be dealt with analytical models. Subjective factors involve the application of managerial intuition and judgment. Strategic plan is the document which provides information regarding the different elements of strategic management and the manner in which an organization and its strategists propose to put the strategies into action.

Strategic choice process is based on strategic decision making which is a highly complex activity. Thus in order to select the best alternative we need to conduct strategic analysis both at corporate level and business level. Corporate and business level strategic analysis can help companies that are running diverse businesses to develop feasible strategic alternatives and to allocate resources among them. Other benefits include a more perceptive understanding of businesses, which leads to better strategic decision making. Thus each tool of strategic analysis should be used as per the environmental and organizational scanning and looking at the market structure and growth prospective. The technique of corporate level analysis includes BCG matrix, GE nine cell matrix, hoofer's product market evolution, SPACE matrix etc.

9.9 Self Assessment Questions

1. What do you mean by strategic choice?
2. Discuss the process of strategic choice.
3. Explain the various subjective factors of strategic choice
4. Write a short note on strategic plan.
5. What do you mean by strategic analysis? Discuss the business level strategic analysis tools.
6. Explain the concept of corporate portfolio analysis.
7. What are the tools for business level strategic analysis and corporate portfolio analysis?

9.10 Reference Books

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Unit - 10 : Strategy Implementation

Structure of Unit:

10.0 Objectives

After completing this unit you will be able to:

- To understand the basic concepts of the strategy implementation;
- To understand the importance of strategy implementation in the organization;
- To understand the nature and differences between the strategy implementation and strategy formulation;
- To evaluate the process of strategy implementation;
- To elaborate the role of the general managers in the strategy implementation process;
- To analyze various issues/barriers from the managerial, marketing, research, financial, information systems and human resource perspectives in relation to the implementation of the strategy across the levels of the organization.

10.1 Strategy Implementation: An Introduction

Transformation of the selected strategies into action is referred to as the Strategy Implementation. Strategy implementation refers to the methods and techniques adopted by the organization to execute management's selected strategy. In other words, strategy implementation process comprises of selection of the most appropriate structure for the chosen strategy, support systems for the resource allocation to the structure, and suitable motivation. By nature itself, strategy implementation is very crucial to the goal accomplishment as the best strategy would not turn out to be effective and efficient strategy in the absence of its accurate implementation. For instance, a strategic marketing plan was implemented by Mercedes- Benz with the objective to increase the percentage of cars produced outside Germany, by expanding its operations not only into new geographical markets but also new market niches, such as sport utility vehicles, minivans, and a subcompact city car. By the implementation of this new strategy, of about 13 per cent increase in U.S. sales by company have been anticipated. Moreover, as the part of its continuation strategy, the company also formed a merger with Chrysler.

Thus, it can be said, in spite of the commitment of the organizations to the strategy implementation, it will remain worthless in the absence of the commitment of all levels of the organization. For the effective implementation of the strategy, the following five key areas have to be addressed. To properly implement a strategy, five key areas must be addressed:

1. The organizational structure must be strategically actionable and include the degree of autonomy to each individual for the respective individual performance;

2. The concurrence of the firms' activities with agreed strategy shall be assured by the implementation systems;

3. Focus of the management style of the organization on leadership, planning, organizing, controlling, communicating, and problem-solving activities;

4. Tuning of the organization's culture in accordance to the strategic process;.

5. Finally, the parity between the strategy and implementation.

In nut shell, planned effort with commitment from all members of the organization, rather than mere management, is inevitable for the successful implementation of the strategy. However, to implement the strategy the management must possess the required tools, support mechanisms, and lines of authority within the organizational structure. Even the most technically perfect strategic plan will serve little purpose if it is not implemented. Many organizations tend to spend an inordinate amount of time, money, and effort on developing the strategic plan, treating the means and circumstances under which it will be implemented as afterthoughts. Change comes through implementation and evaluation, not through the plan. A technically imperfect plan that is implemented well will achieve more than the perfect plan that never gets of the paper on which it is typed.The implementation process of strategic management requires putting strategies action. Successful strategy formulation alone does not guarantee success. If the strategy cannot be translated into action, then the resources and the energies put forth are worthless. Strategy implementation refers to the way a company structures itself in order to execute its strategic plan efficiently and achieve its objectives which becomes easier if the managers and the employees of the firm understand the effectiveness and feel a part of the company, and through involvement in strategy formulation activities have become committed to helping the organization succeed. Without understanding commitment, strategy implementation efforts face major problems.

Activity A:

1. Examine the importance of the strategy implementation in the organization of your choice.

10.2 Nature of Strategy Implementation

As discussed in the above section the successful strategy formulation does not guarantee successful strategy implementation. It is always more difficult to do something, i.e., strategy implementation, than to say you are going to do it, i.e., "Strategy Formulation". Although inextricably linked, strategy implementation differs from the strategy formulation.

Strategy formulation and implementation can be contrasted in the following ways:

Table - 10.1

Sr. No.	Strategy Formulation	Strategy Implementation
01.	It is the positioning of forces before the action	It is managing of the forces during the action
02.	It focuses on effectiveness	It focuses on efficiency
03.	It is primarily an intellectual process	It is primarily an operational process
04.	It requires good intuitive and analytical skills	It requires special motivation and leadership skills
05.	It requires coordination among few individuals	It requires coordination among many individuals

Strategy formulation concepts and tools do not differ greatly for small, large, for-profit and nonprofit organizations. However, strategy implementation varies substantially among different types and sizes of organizations. Implementing strategies requires such actions as:

- Altering sales territories;
- Adding new departments;
- Closing facilities;
- Hiring new employees;
- Changing an organization's pricing strategy;
- Developing financial budgets;
- Developing new employee benefits;
- Establishing cost-control procedures;
- Changing advertising strategies;
- Building new facilities;
- Training new employees;
- Transferring managers among divisions, and
- Building better management information systems.

These types of activities obviously differ greatly between manufacturing, service, and governmental organizations. However, the most common issues and barriers in the strategy implementation of the strategy are as discussed in the following section.

Activity B:

1. Examine the deviations in the strategy formulation and strategy implementation at any of the manufacturing firm in your city and suggest the corrective measures, if at all.

10.3 Issues/ Barriers in the Strategy Implementation

10.3.1 Management Issues central to Strategy Implementation

Undoubtedly, the transition from strategy formulation to strategy implementation demands a shift in the responsibilities from strategists to divisional and functional managers, which naturally raises varied implementation problems and issues. These issues become crucial and intense when the strategy formulation decisions are presented by the organization as the surprise to the middle-and-lower-level managers. On other side, factually the managers and employees are generally motivated more by their perceived self-interests, rather than by the organizational interests. This demands voluntary balancing of the organizational interests with the individuals' perceived self interests which may emerge effortlessly and naturally, if the divisional and functional managers are involved as much as possible to strategy-formulation activities, as well the strategy implementation activities. The strategists' genuine personal commitment to the implementation of the strategy is necessary and the most powerful motivational force for the manager and the employees.

The various strategic management implementation activities involves., establishing annual objectives, devising policies, allocating resources, altering an existing organizational structure, restructuring and reengineering, revising reward and incentive plans, minimizing resistance to change, matching managers with strategy, developing a strategy-supportive culture, adapting production/operations processes, developing an effective human resources functions, and, if necessary, downsizing. Moreover, when the strategic changes to implemented affects the organization in the broader and prolonged manner the implementation of such managerial changes becomes extensive. It goes without saying that strategy implementation directly affects the performance of the plant managers, division managers, department managers, sales managers, staff managers, supervisors, and all employees. However, in few situations, the individuals totally kept isolated during the strategy formulation process, may also appreciate, understand, and accept the assumptions, logic and vision behind the strategy formulation. While, on the other side of the coin, there may even be those managers and employees who may be get convinced and deny the strategy formulation efforts and commitment to the strategy implementation process. Therefore, it is inevitable that the managers and employees throughout an organization should participate early and directly in strategy-implementation decisions based on their involvement in the strategy formulation activities. But in real practice, strategists are too busy to actively support strategy implementation efforts, and lessen their interest in implementation process which affects adversely to the organizations' success.

In order to keep the zeal of strategy implementation live, the rationale for objectives and strategies should be understood and clearly communicated throughout an organization and across the various levels of organization. The crucial components of the competitors' environment, such as, accomplishments, products, plans, actions, and performance should be screened and presented to all the organizational members. Apart from this, the firm needs to develop the competitors' focus at all hierarchical levels by assimilating and widely disseminating the competitive intelligence. All the employees in the firm should be able to benchmark his/her efforts inorder to pose the personal challenge.

Also, the major external environmental scanning contents, opportunities and threats, should be clarified, and the queries of the managers and the organizations to the same shall be addressed. The organization can rely upon the top-down flow of communication which will further result into bottom-up support.

Strategies has to be implemented successfully in organization that do market goods and services well, in firms that can raise needed working capital firms that produce technologically superior products, or in firms that have a strong information system. This can be made possible only after examining the marketing, finance/accounting, R & D, and management information systems (MIS) issues that are central to effective strategy implementation.

Activity C:

1. Identify any five variety of the management barriers to the implementation of strategy in any of the organization in your city of your choice.

10.3.2 Marketing Issues central to the Strategy Implementation:

Strategy implementation affects and is affected by the each and every position in the firm as well as the each of the functional areas of the organization. Some of the various marketing variables, which affects the success or failure of the strategy implementation, which are as given below:

- To use exclusive dealerships or multiple channels of distribution;
- To use heavy, light, or no TV advertising;
- To limit (or not) the share of business done with a single customer;
- To be a price leader or a price follower;
- To offer a complete or limited warranty;
- To reward salespeople based on straight salary, straight commission, or a combination salary/ commission;
- To advertise online or not.

The marketing issue of increasing concern to consumers is the extent to which companies can track individuals' movements on the Internet. Marketing companies such as, Doubleclick, Flycast, AdKnowledge, Adforce, and Real Media have applied sophisticated methods to identify the consumer and the particular interests of the consumers.

Apart from this, the two important marketing variables central to the strategy implementation, namely, market segmentation and product positioning are discussed in detail below:

Market Segmentation: Market segmentation is widely used in implementing strategies, especially for small and specialized firms. Market segmentation can be defined as the subdividing of a market into distinct subsets of customers according to the needs and buying habits. Market segmentation is an important variable in strategy implementation for the following reasons:

- Strategies such as market development, product development, market penetration, and diversification require increased sales through new markets and products, for which new or improved market-segmentation approaches are required;
- Market segmentation allows a firm to operate with limited resources because mass production, mass distribution, and mass advertising are not required;
- Market segmentation decisions directly affect marketing mix variables, such as, product, place, promotion and price.

Product Positioning: Identifying target customer group on whom the marketing efforts shall be focused to meet their needs and wants, is followed by the positioning step. Positioning entails developing schematic sensations that reflect how the products and services of the company compared to the competitors' are important to succeed in the industry, which also used as one of the tool for the effective implementation of strategy. Some rules for using the product positioning as the strategy implementation tool are as given below:

- Look for the hole or vacant niche; as the best strategic opportunity might be an un-served segment;
- Don't squat between segments, as any advantage from squatting is offset by a failure to satisfy one segment;
- Don't serve two segments with the same strategy, a strategy successful with one segment cannot be directly transferred to another segment;
- Don't position yourself in the middle of the map. The middle usually means a strategy that is not clearly perceived to have any distinguishing characteristics;

Thus, an effective positioning strategy meets two criteria:

- Firstly, it exclusively differentiates the company from the competition;
- Secondly, it leads customers to expect slightly less service than a company can deliver.

Hence, the firms should not create expectations that exceed the service the firm can or will deliver. This a constant challenge for marketers. Firms need to inform customers about what to expect and then exceed the promise. Thus, the key is under-promising and over-delivering.

Activity D:

1. Provide the outlineof the major issues in strategy implementation from the context of the strategy implementation.

10.3.3 Financial/Accounting Issues central to the Strategy Implementation:

The several finance/accounting concepts considered to be central to the strategy implementation, acquiring needed capital, developing projected financial statements, preparing financial budgets, and evaluating the worth of a business. Some illustrations of such decisions that may require finance/accounting policies are given below:

- To raise capital with the short-term debt, long-term debt, preferred stock, or common stock;
- To lease or buy fixed assets;
- To determine an appropriate dividend payout ratio;
- To use LIFO (Last-in-First-Out), FIFO (First-in-First-Out), or a market-value (an accounting approach);
- To extend the time of accounts receivable;
- To establish a certain percentage discount on accounts within a specified period of time;
- To determine the amount of cash that should be kept on hand.

Successful implementation of strategies involves various issues from the Accounting/Financial contexts, such as, acquiring capital to implement strategies; projecting of the financial statements; preparation of the financial budgets, evaluating the worth of a business, and deciding on whether to go public or not, which are discussed below:

- **Acquiring Capital to Implement Strategies:** Successful implementation often requires additional capital. Besides net profit from operations and the sale of assets, two basic sources of capital for an organization are debt and equity.

  Determining an appropriate mix of debt and equity in a firm's capital structure can be vital to successful strategy implementation. An Earnings Per Share/Earnings Before Interest and Taxes (EPS/EBIT) analysis is the most widely used techniques for determining whether the debt, stock, or a combination of debt and stock is the best alternative for raising capital to implement strategies. Through this technique the impact of the debt versus stock financing on earnings per share under various assumptions as to EBIT is examined. Theoretically, an enterprise should have enough debt in its capital structure to boost return on investment. While, in during the low earning periods, too much debt in the capital structure on an organization can endanger stockholders' returns and jeoparadise the survival of the organization. Fixed obligations generally must be met regardless of circumstances.

  EPS/EBIT analysis is a valuable tool for making the capital financing decisions needed to implement strategies, but several considerations should be made whenever use this technique, such as, profit levels may be higher for stock or debt alternative when the levels are lower, flexibility of the organizations' capital structure with the future capital needs, performing the controlling function as when additional stock is issued to finance strategy implementation, ownership and control of the enterprise are diluted, which can be a serious concern in today's business environment of hostile takeovers, mergers and acquisitions. When using EPS/EBIT analysis, consideration of timing in relation to movements of stock prices, interest rates, and bond prices also becomes the crucial. However, during the depressed stock prices, debt may prove to be the most suitable alternative form, both a cost and a demand standpoint. However, when cost of capital (interest rates) is high, stock issuances become more attractive.

- **Projected Financial Statements:** Projected financial statement analysis is a central strategy-implementation technique as it enables an organization to examine the expected results of various actions and approaches. This type of analysis can be used to forecast the impact of various implementations decisions. Nearly all financial institutions require at least three years of projected financial statements whenever the business seeks capital. A projected income statement and balance sheet allows an organization to compute the projected financial ratios under various strategy-implementation scenarios. When compared to prior years and to industry averages, financial ratios provide valuable insights for the feasibility of various strategy implementation approaches.

- **Preparation of the Financial Budgets:** The document that details the obtainment and the spending of the funds for specified period of time is called as the financial budget. Fundamentally, financial budgeting is a method for specifying what must be done to complete strategy implementation successfully. Financially budgeting should not be thought of as a tool for controlling expenditure but rather as a method for obtaining the most optimum use of the organization's resources. They are also referred to as the planned allocation of the firms' resources based on the forecasts of the future. Generally, at times of the organizational financial difficulties, budgets guide the strategy implementation.

  There are almost as many different types of financial budgets as there are types of organizations. Some common types of budgets include cash budgets, operating budgets, sales budgets, profit budgets, expense budgets, divisional budgets, variable budgets, flexible budgets and fixed budgets.

  However, financial budgets have some limitations. Firstly, over-budgeting or under-budgeting can cause problems. Secondly, financial budgets can become a substitute for objectives. A budget is tool and not an end in itself. Thirdly, budgets can hide inefficiencies if based solely on precedent rather than on periodic evaluation of circumstances and standards. Finally, budgets are sometimes used as instruments of tyranny, which results in frustration, resentment, absenteeism, and high turnover.

- **Evaluating the worth of the Business:** Evaluating the worth of a business is central to strategic implementation because integrative, intensive, and diversification strategies are often implemented by acquiring other firms. Other strategies, such as retrenchments and divestiture, may result in the sale of a division of an organization or of the firm itself.

  All these various methods for determining a business's worth can be grouped into three main approaches: what a firm owns, what a firm earns, or what a firm will bring in the market. But, as valuation is not an exact science, although the valuation of a firm's worth is based on the financial facts, some degree of common sense and intuitive judgments does enter the process. The assigning of the monetary value to some factors, such as, loyal customer base, a history of growth, legal suits pending, dedicated employees, a favourable lease, a bad credit rating, or good patents becomes difficult practically, due to which they may not be accurately reflected in the firm's financial statements.

  The firms' worth differs on the basis of the varied valuation methods adopted by the firm in its calculation. There is no best prescribed approach for certain situation. Also, evaluating the worth of a business truly requires both qualitative and quantitative skills.

  Business evaluations in various aspects are becoming integral part of the organizations for varied strategic situations. Businesses have many strategy-implementation reasons for determining their worth, in addition to preparation to sell or purchase other companies. Employee plans, taxes, retirement packaged, mergers, acquisitions, expansions plans, banking relationships, death of a principal, divorce, partnership agreements, and audits are other reasons for the periodic valuation. It is just good business to have a reasonable understanding of what your firm is worth. Thus, a good business must have the reasonable understanding of about the firms' worth which will enable the firm to protect the interests of all the stakeholders.

- **Deciding on Whether to Go Public or Not:** Going public means selling off a percentage of your company to others in order to raise capital; consequently, it refers to the diluting of the owners' control of the firm. For the companies with less than $ 10 million in sales, going public is not recommended due to high initial costs experiences by the firm to generate sufficient cash flow in worthwhile going public decision, in addition to the costs and obligations associated with reporting and management in a publicly held firm. However, for firms with more than $10 million in sales, going public can prove to be beneficial, as it enable the firm to raise capital, to develop new products, build products, build plants, expand, grow, and market products and services more effectively.

Activity E:

1. Identify any five financial issues central to the strategy implementation in the small scale company and provide the alternative solutions to the same.

10.3.4 Research and Development (R & D) Issues central to the Strategy Implementation

Research and Development (R & D) personnel can play an integral role in strategy implementation. The research personnel are generally charged with developing new products and improving old products in a way that will allow effective strategy implementation. R & D employees and managers perform tasks that include transferring complex technology adjusting processes to local raw materials, adapting processes to local markets, and altering the products to particular tastes and specifications. Strategies such as product development, market penetration, and related diversification emphasize on the successful development of the new products and significant improvements of the old products. However, the level management support for R & D is often constrained by the resource availability.

Technological improvements that affect the consumer and industrial products and services usually shorten product life cycles. Virtually, the companies in every industry are relying on the development of new products and services to accelerate the profitability and growth, with the help of the varied R & D strategies, which links the organization with the strategic external opportunities to the internal strengths, and thereby the objectives. In other words, the well formulated R & D policies match the market opportunities with the internal capabilities. The Research & Development policies can enhance strategy implementation efforts in the following ways:

- Emphasize the product or process improvements;
- Stress Basic or Applied Research;
- Be leaders or followers in R & D;
- Develop robotics or manual-type processes;
- Spend a high, average, or low amount of money on R & D;
- Perform R & D within the firm or to contract R & D to outside firms;
- Use university researchers or private-sector researchers.

There must be effective interactions between R & D departments and other functional departments in implementing different types of generic business strategies. Conflict between marketing, finance/accounting, R & D, and information systems departments can be minimized with clear policies and objectives by applying the following guidelines:

- When the rate of technical progress is slow, the rate of market growth is moderate, and there are significant barriers to possible new entrants, in-house R & D is the preferred solution, which enables the company to exploit temporary products or processes monopoly;
- When technology is changing rapidly and the market is growing slowly, then it is risky to make major effort in R & D, as it may lead to development of an ultimately obsolete technology or one for which there is no market;
- When technology is changing slowly, the market is growing quickly, and there is generally no enough time for in-house development, obtainment of R & D expertise on an exclusive or nonexclusive basis from an outside firm;
- If both technical progress and market growth are fast, R&D expertise can be obtained through acquisition of the well-established firm in the industry.

In this context, the three major R & D approaches for implementing strategies are available which are as pointed out:

- The first strategy is to be the first firm to market new technological products, i.e, Market Leadership, which is both the attractive and exciting strategy, but at the same time, is also dangerous

  For instance, the Firms such as, 3M and General Electric have been successful with this approach, but many other pioneering firms have fallen, with rival firms seizing the initiative.
- A second approach is to be an "Innovative Imitator" of successful products, enabling the minimization of the risks and costs of start-ups. This approach entails allowing a pioneer firm to develop the first version of the new product and demonstrate that a market exists;
- The third approach is to be laggard firm, by developing the similar product, which demands excellent R&D strategy, requires substantial investment in plant and equipment. However, this approach requires fewer expenditure in R&D strategy as compared to theother discussed approaches.

Activity F:

1. Explain the significance of the Research and Development Issues central to the strategy implementation in any large scale company.

10.3.5 Management Information Systems (MIS) Issues central to the Strategy Implementation

The world has evolved as the concrete composition of the varied information and the linkages of the information sources. It has become essential for any organization to gather, assimilate, and evaluate external and internal information most effectively in order to gain competitive advantage over other firms. Information is, thus, the basis for decision making of the firm, determining its success or failure. The process of strategic management is facilitating intensively to the firms with the effective information systems, with the blend of the technical knowledge of the computer experts and the vision of the senior management.

Thus, recognizing the importance of having an effective Management Information System (MIS) no more exist as the optional decision, but, has emerged as inevitable requirement. Information collection, retrieval, and storage offers varied competitive advantages, such as, cross-selling to customers, monitoring suppliers, keeping managers and employees informed, coordinating activities among divisions, and managing funds.

Information has also now been recognized as a valuable organizational asset that can be controlled and managed. A good information system can allow the firm to reduce costs.

Direct communications between suppliers, manufacturers, marketers, and customers can link together elements of the value chain as though they were one organization. Improved quality and service often result from an improved information system.

The organizational management methods are also getting transformed, with the developing role of the management information systems. In many firms, information technology is doing away with the workplace and allowing employees work at home or anywhere, anytime. The mobile concept of work allows employees to work the traditional 9-to-5 workday across nay of the 24 time zones around the globe.Any manager or employee who travels a lot away from the office is a good candidate for working at home rather than in an office provided by the firm. Salespersons or consultants are good examples, but any person whose job largely involves talking to others or handling information could easily operate at home with the proper computer system and software.

However, the firms are and must be increasingly concerned about the computer hackers and take specific measures to secure and safeguard corporate communications, files, orders, and business conducted over the Internet. Many companies, in the presently, are adversely affected by the computer hackers who include disgruntled employees, competitors, bored teens, sociopaths, thieves and hired agents. Computer vulnerability is a giant, expensive headache.

Activity G:

1. Examining the importance of management information system in the list out the strategy implementation issues in the organization of your choice.

10.4 Strategy Implementation Process

Steps in the Strategy Implementation Process:

The process of the strategy implementation process comprises of six steps:

1. Analyzing Strategic Change
2. Building a Capable Organization
3. Allocating Resources to Match the Strategic Objectives
4. Establishing Organization-wide Commitment to the Strategic Plan.
5. Institutionalizing the Strategy Implementation
6. Operationalizing the Strategy Implementation

The detail understanding of the aforementioned steps is presented as follows:

1. Analyzing Strategic Change: The first step in the implementation process is Analysis of Strategic Change, which can be divided into two areas:

A. Determine Necessary Level of Change for Successful Implementation: For the successful implementation of the strategy, the conducive change in the same becomes essential. Therefore, determining the extent to which the change has to be made is an integral and the foremost step in the process of strategy implementation. However, it is obvious that some strategies require only minimal changes in the organization.

For instance, in case of selecting the market penetration, the marketing efforts such as raise the

advertising and distribution or decrease in prices. This type of strategy will not change the routine operational pattern of the organization, as only few people within the organization are offered new assignments. While in case the organization plans to enter into new businesses, it would require new direction for sales growth and stability, which will demand for the organization to reshape its structure.
B. Classifying Levels for Strategic Change: For strategy implementation purposes, strategic change is divided into the five stages, namely, Continuation Strategy; Routine Strategy Change; Limited Change; Radical Change and Organizational Redirection, which are explained in brief below:

· **A Continuation Strategy:** The same strategy, as applied in the previous planning period, is chosen to be repeated, which is generally based on the stability of the existing environmental factors and the fact that no new skills or unfamiliar tasks are involved. Manager, at this stage, generally monitor the ongoing activities in order to ensure timely accomplishment of the short-run goals. Thus, the cumulative effect of the learning curve on the basis of the past experience will reduce and increase productivity.

· **A Routine Strategy:**This strategy involves normal changes in the appeals of customers' interest. For instance: Redesigning the packaging of the product;Alteration in advertising theme; changes in sales promotion; adopting new pricing tactics, and changing distributors or distribution methods. Positioning and repositioning of the product in the minds of the customers is also the type of the routine strategy, in which the managers' performance in strategy implementation is measured by the indicator of the consumer reactions and responses.

This type of strategy is not only powerful, but also easy to execute, and do not require large changes in the organization. Implementation of this type of strategies is the routine task of the managers' job. Managers' contact certain outside agencies and intermediaries, determines the schedules for each activity, and monitors the proceeding of each activity. In order to ensure proper handling of the messages as well as the collected information, managers shall possess the co-ordinating skills.

· **A Limited Strategy:** It offers new products to new markets within the same general product area. It has been evident from the historical facts that the more successfully diversified companies generally emphasize and introduce the business expansion in the current are of with businesses related to their current area of expertise. This strategy is based on the rationale that the experience and competence gained by the firm in one part of the portfolio will be valuable and beneficial to the other portfolios of the business. Both, synergy and balance are involved in the limited type of strategy. The degree of difference between new products and existing products, determines the degree to which the organization will have to change.

· **A Radical Strategy:** This type of strategy involves reorganization, such as, mergers or acquisitions between two firms in the same industry, which are generally complex as it requires complete integration of two firms.For instance, In food industry, acquisition of Carnation by Nestlé and acquisition of Richardson-Vicks by Procter & Gamble in the consumer products industry.

The quantum of the efforts to be applied by the firms applying this strategy, involves not only obtainment of the new products and markets, but also confronting with the legal problems, the complexities of developing a new organizational structure, and has to reconcile the conflicting organizational values and beliefs. Over and above, it also involves numerous changes in the organizational structure, multiple acquisitions, and sales of subsidiaries.

For instance: When John F. Welch Jr. became chairman of General Electric, GE was regarded as a "GNP company" whose growth and prosperity could never outpace those of the overall economy, who aimed to set the creation of the organization that has the capacity to outperform the economy and could prosper even during the difficult economic times followed the strategy of radical change. For eventually developing the total organization redirection and for accomplishing this objective, the action plan, strategy, comprised of, stripping of the management levels across the corporate hierarchy and shifting of the resources from manufacturing businesses to fast-growing services and high technology; automation of the production facilities and elimination of about 100,000 employees, i.e., of about more than one-fourth of the workforce. Further, in his first 5 years as Chairman, he sold 190 subsidiaries worth nearly US$ 6 Billion and spent US$10 Billion on 70 acquisitions. Clearly, this is a strategy of radical change, which could eventually develop into a total organizational redirection.

Thus, in the radical change strategy the degree of strategic change depends on how different the industries are and on how centralized the management of the new firm is to be. For example, when Philip Morris, a manufacturer of cigarettes and beverages, acquired, General Foods, a food products manufacturer, the redirection consisted primarily of becoming a more diversified organization operating in two similar industries.

· **Organizational Redirection:**Another form of organizational redirection occurs when a firm leaves one industry and enters a new one, which involves the most corn-pled strategy implementation, which also demands change in the firm's mission and new set of skills and technologies. For Example: American Can Company redirected its business from packaging to financial services and retailing during the mid-1980s. Such organizational redirection involves the most corn- pled strategy implementation. It involves changes in the firm's mission and may require an entirely new set of skills and technologies.

2. Building a Capable Organization: The second step in the implementation process is building an organization capable of carrying out the strategic plan. This can be further classified into three sub steps:

A. Matching Structure to Strategy: The choice of structure should be determined on the basis of the firm's strategy, which could be capable of segmenting the key activities and/or strategic operating units to enhance efficiency through specialization, response to competitive environment, and freedom to act. However, at the same times, the structure must also be able to effectively integrate and coordinate these activities and units to accommodate interdependence between the activities and overall control. Thus, the structure selected must be able to reflect the needs of the strategy in terms of the following:

1. Firms' Size;
2. Firms' Product/service diversity;
3. Firms' Competitive Environment and Volatility;
4. Firms' Internal political considerations;
5. Firms' Information and coordination needs of each component of the firm;
6. Firms' Potentials to Grow

Here, the primary determinant of the strategy and the prime source of strategic initiative is philosophy of top management. Thus, an appropriate match of the organizational structure with the organization strategy by the suitable managers makes the aspiration realistic, which also provides a unique ability to the management to overcome one or more special situations.

B. Building Distinctive Competencies: An organization's distinctive competencies, i.e, technical skills, habits, attitudes, and managerial capabilities, have to be thoroughly developed, which may take years.In this context, the superior performance of the firm in few selected subunits can also contribute significantly to the strategic success. For this, the managers of the firm has to take immediate actions to see that the organization is staffed with right number of the right type of people, and are well delegated by the required administrative support for generating the distinctive competence. Consequently, for a distinctive competency to emerge from organization-building actions, strategy implementers have to push aggressively to establish top-notch technical skills and capabilities for subunits. Superior performance of strategically critical tasks can make a real contribution to strategic success. Once distinctive competencies are developed, the strengths and capabilities that are attached to them become logical cornerstones for successful strategy implementation as well as for the actual strategy itself.

C. Assembling a Management Team: Another important task of the strategy implementation is assembling of the capable management team, to bother the recurring administrative issues in addition to finding the right people to fill each slot. The management team sometimes may comprise of the existing management team, i.e., by strengthening the existing management team or by promoting the qualified people from within, or by bringing in skilled managerial talent from the outside. Above all, it is important to assemble a core executive group with the proper composition of backgrounds, experience, knowledge, values, beliefs, styles of man-agile and personalities. Thus, often at this first part of strategy implementation, the company assembles a solid management team. However, until all the key positions are filled with the right people, it is difficult for the strategy implementation to proceed correctly at its highest speed.

3. Allocating Resources to Match Strategic Objectives: In most cases, changes in strategic objectives will require a change in the allocation of the firm's resources. Therefore, the third phase of the strategy implementation process is the allocation of resources to support the organization's strategic objectives. The central role here is played by the general manager, in determining the distribution and reallocation of resources. For this, it is inevitable that the general manager must have knowledge of the types of resources, understand the importance of resource allocation, and effectively distribute these resources is explained below:

Types of Resources, Importance of Resource Allocation and Effective Distribution of the Resources: The resources of the organization can be classified into four types, namely, financial, physical, human, and technological. Financial resources are made up of liquid assets, such as, cash, receivables, and marketable securities; liabilities, such as, bonds and bank notes, and equity, such as, retained earnings and stocks. While, Physical resources include the firm's tangible assets, such as, plants,equipment, land, and inventory. The organization's employees are its human resources, comprising of, engineers, lawyers, and skilled as well as unskilled hourly workers. Technical resources, includes, knowledge, skill methods, and tools of the organization used to carry out its business activities, such as, firm's accounting methods, communication systems, R&D skills, and management information systems.The organizational subunits must have basic resources to carry out the strategic plans, and the general manager is responsible for the allocation of these basis resources.

For example, if a 10 percent increase in sales for a subunit is the strategic objective, the general manager would need to determine advertising and public relations budget changes, manufacturing equipment expansions or improvements, distribution changes, and so forth, to allow the subunit to meet its new goal. In this case, if the general manager allocates too little resources to a strategic area, then it may not be able to achieve its strategic objective. While, if too much is given, waste and inefficiency occurs, and company performance could suffer. However, if the current strategy is only a fine-tuning of the previous strategy, then less reallocation will be needed.

Thus, the step of allocation of the resources comprises four major activities, namely, maintaining flexible organization; overcoming barriers to distribution; utilizing a combination approach and applying the systematic allocation method. For performing this step, the general manager must be strong and determined enough to take risks, to overcome company politics and for allowing the shift of overprotection of resources between the units to allow these shifts to take place; for establishing or maintaining a flexible atmosphere for improving the chance for successful strategy implementation. Undoubtedly, a fluid, flexible approach to reorganization and reallocation of people and budgets is the characteristic of successfully implementing the strategic change.

Thus, since the demand for resources exceeds the supply in most organization, resource allocation should be performed in a systematic manner to achieve optimum results. Thus, the first step, the summary of the available resources, consists of determining what the firm currently has, or what can be made available to it. The second step indicates the areas in which the resources are currently located. The third step then lists the desired resources of these individual areas. The final step is the actual resource allocation process. It starts by comparing the resource requests with the available resources. Resources can then be distributed in the most efficient manner, with any shortages being felt by those areas that have less strategic significance.

4. Establishing Organization-Wide Commitment to the Strategic Plan: The fourth phase in the implementation process is the establishment of an organization-wide commitment to the strategic plan which should be supported by the corporate culture, by developing employees' mind set to work energetically and enthusiastically pursue strategic goals. The key role to be played by the general manger at this stage is, to motivate the firm, todevelop the strategy supportive culture, to create a results orientation, and to link reward and performance.

Here the first step is to motivate the organization to accomplish its strategy. It is critical that the entire organization, from top management down to the line workers, is committed to successfully implementing the strategic plan. To inculcate commitment at this level, the general manager may need to use motivational tools, such as, rewards and incentives, in the form of, praise or company recognition, or can come as salary increases and/or houses, or in the form of inspirational meetings and open communication through memos and letters.

5. Institutionalizing Strategy: It is inevitable, to institutionalize the strategy effectively. An institution refers to the collection of values, norms, roles, and groups that develops to accomplish a certain goal. The institution of education, for example, developed to prepare children to be productive members of society. Similarly, to institutionalize a business strategy, business leaders should also develop a system of values, norms, roles, and groups that enables the accomplishment of strategic goals, i.e, by connecting the strategy to the culture of the organization, quality system, and the other driving forces in the organization. Another drive which has been used by the organization to institutionalize strategy implementation is drive towards TQM, i.e, Total Quality Management; apart from Ethics Development, growing as the another aspect of organizational life. Both of these approaches shift organizational attention from detection and control to coordination and strategic impact, to get the ultimate focused outcome of enhanced quality of work environment for employees and increased quality of products and services for customers.

6. Operationalizing Strategy: If strategies set the general goal and course of action for organizations, operational plans provide the details needed to incorporate strategic plans into the organization's day-to-day operations. The operational are of two types, namely, the Single-use plans and the Standing Plans. The Single-use Plans are designed to be dissolved, on the accomplishment of the specific, nonrecurring goals, while, the standing plans, in contrast, are standardized approaches to handling recurring and predictable situations.

Single-Use Plans: The single-use plans are detailed courses of action which probably will not be repeated in the same form in future. The different types of single-use plan are the Program, Budgets, and Projects. A program is a single-use plan that covers a relatively large set of activities, such as, the major steps required to reach an objective; the organization unit or member responsible for each step; and the order and timing of each step. Projects are smaller, separate portions of programs; with the limited scope and different directives pertaining to the assignments and time. While, the budgets are statements of financial resources set aside for specific activities in a given period of time; used primarily devices to control an organization's activities, and thus are important components of programs and projects.

Standing Plans: In case, the organizational activities comprises of the repeated tasks, standing plans are generally referred to. The standing plans are re-established single decision or set of decisions, which can effectively guide such routine activities. Such types of plans assist managers in saving their valuable time, as similar situations are handled in a predetermined, consistent manner. Standing plans consist of policies, rules, and more detailed procedures.

A policy is a general guideline for decision making, which sets up boundaries around decisions, upon those decisions which can be made and those that cannot be made. Thus, it directs the thinking of the organization members in consistent with the organizational objectives. While, some policies have rules inbuilt, in the form of statements of specific actions to be taken in the given situation. Generally, the policies are accompanied by the detailed procedures, which are called as the standard operating procedures or standard methods, in the form of detailed set of instructions for performing a sequence of actions that occurs often or are routine.Most organizations have some form of policies, rules, and procedures in order assist the implementation of strategy of routine. For example, At Wal-Mart, a discount merchandiser, store procedure requires that one person greet all customers and smile at them.

Thus, the next step ahead in the management of the organization after and for the effective strategy implementation is the appropriate structural selection and implementation.

10.5 Summary

The transformation of the selected strategies into action is called as Strategy Implementation, which involves the methods and techniques adopted by the organization to execute management's selected strategy.Undoubtedly, it is always more difficult to do something, i.e., strategy implementation, than to say you are going to do it, i.e., "Strategy Formulation". Thus, strategy implementation differs from the strategy formulation which has also been described in the section. Strategy formulation concepts and tools do not differ greatly for small, large, for-profit and nonprofit organizations. However, strategy implementation varies substantially among different types and sizes of organizations. The most common issues and barriers in the strategy implementation of the strategy are, Management Issues central to Strategy Implementation, Marketing Issues central to the Strategy Implementation, Financial/Accounting Issues central to the Strategy Implementation, Research and Development (R & D) Issues central to the Strategy Implementation, Management Information Systems (MIS) Issues central to the Strategy Implementation.

The process of the strategy implementation process comprises of six steps, namely, Analyzing Strategic Change; Building a Capable Organization; Allocating Resources to Match the Strategic Objectives; Establishing Organization-wide Commitment to the Strategic Plan; Institutionalizing the Strategy Implementation and Operationalizing the Strategy Implementation.

The first step in the implementation process is Analysis of Strategic Change, provides the discussion coverage of two areas, i.e., Determination of the Necessary Level of Change for Successful Implementation and Classification of Levels of Strategic Change. For strategy implementation purposes, strategic change can be divided into the five stages, namely, Continuation Strategy; Routine Strategy Change; Limited Change; Radical Change and Organizational Redirection. The second step in the implementation process is Building a Capable Organization, which can be classified into three sub steps, Matching Structure to Strategy; Building Distinctive Competencies and Assembling a Management Team. In most cases, changes in strategic objectives will require a change in the allocation of the firm's resources. Therefore, the third phase of the strategy implementation process is the allocation of resources to support the organization's strategic objectives. The central role here is played by the general manager, in determining the distribution and reallocation of resources. For this, it is inevitable that the general manager must have knowledge of the types of resources, understand the importance of resource allocation, and effectively distribute these resources.

The fourth phase in the implementation process is the establishment of an organization-wide commitment to the strategic plan which should be supported by the corporate culture, by developing employees' mind set to work energetically and enthusiastically pursue strategic goals. The key role to be played by the general manger at this stage is, to motivate the firm, todevelop the strategy supportive culture, to create a results orientation, and to link reward and performance.

It is inevitable, to institutionalize the strategy effectively. An institution refers to the collection of values, norms, roles, and groups that develops to accomplish a certain goal. Similarly, to institutionalize a business strategy, business leaders should also develop a system of values, norms, roles, and groups that enables the accomplishment of strategic goals, i.e, by connecting the strategy to the culture of the organization, quality system, ethics development and other driving forces in the organization. If strategies set the general goal and course of action for organizations, operational plans provide the details needed to incorporate strategic plans into the organization's day-to-day operations. The operational are of two types, namely, the Single-use plans and the Standing Plans.

Thus, the next step ahead in the management of the organization after and for the effective strategy implementation is the appropriate structural selection and implementation.

10.6 Self Assessment Questions

1 Define Strategy Implementation. Discuss the nature and importance of Strategy Implementation?

2 Differentiate between Strategy Implementation and Strategy Formulation.

3 Discuss the process of Strategy Implementation.

4 Elaborate on various types of the managerial and marketing Issues and Barriers to the implementation of Strategy with the help of the appropriate examples.

5 Discuss the following issues pertaining to the strategy implementation:

a. Management Information System issues

b. Research and Development issues

6 Fill in the Blanks the following:

1. Transformation of the selected strategies into action is referred to as the Strategy Implementation.
2. Strategy implementation refers to the methods and techniques adopted by the organization to execute management's selected strategy.
3. Strategy implementation process comprises of selection of the most appropriate structure for the chosen strategy, support systems for the resource allocation to the structure, and suitable motivation.
4. Market segmentation can be defined as the subdividing of a market into distinct subsets of customers according to the needs and buying habits.
5. Managers generally monitor the ongoing activities in order to ensure timely accomplishment of the short-run goals in Continuation Strategy.
6. ARoutine Strategy involves normal changes in the appeals of customers' interest.
7. A Limited Strategy offers new products to new markets within the same general product area.
8. A Radical Strategy involve reorganization, such as, mergers or acquisitions between two firms in the same industry, which are generally complex as it requires complete integration of two firms.
9. In Organizational redirectiontype of strategy occurs when a firm leaves one industry and enters a new one, which involves the most corn-pled strategy implementation, which also demands change in the firm's mission and new set of skills and technologies.

10.7 Reference Books

Unit - 11 : Structural Implementation

Structure of Unit:

11.0 Objectives

After completing this unit you will be able to:

- To understand the basic concepts of the organization structure;
- To understand the importance of matching structure with strategy implementation in the organization;
- To understand the nature and differences between the strategy implementation and structural implementation;
- To evaluate the designing of the organization structure;
- To elaborate the stages of the development of the organizational structure;
- To discuss and analyze various types of organization structures for the varied types of the organizational strategies.

11.1 Introduction

When the work is performed by more than one person, i.e., by the group of people, it becomes inevitable to define the role, responsibility and the relationship of the persons in the hierarchy by the managers, which is described in the form of organising. Organising, basically involves the analysis of activities to be performed for achieving organizational objectives, grouping of the activities into various divisions, departments, and sections, which can be assigned to various individuals and delegation them appropriate authority so that they are able to carry on their work effectively.

Organization structure prescribes the relationships among individuals and the positions hold by them. There are different ways in which the relationships are described. Structure, generally is of the permanent nature, which has the provision of incorporating changes whenever required.

The use of term structure independently to denote organization is not used very popular, but it is often being used the with the term organization to mean as organization structure. Organization structure is the basic framework within which the decision making behaviour of the managers takes place. As stated earlier, structure basically deals with relationships and is an important scientific concept.For example, Asbiologists are interested in knowing the structure of cells; the astronomer want to know the structure of the universe; the physicist studies the structure of the atom or molecule, similarly, in management, we need to understand how organizations are structured and how these structures are created and maintained.

In simple words structure is the pattern in which various parts or components are inter-related or interconnected which prescribes the relationships among various organizational activities and positions. As these positions are held by various persons, it can also be referred to as the relationships among the people in the organization.

The organization structure, being abstract, can be inferred from the actual organizational operations and behaviour of the organization, and is not viable in the same way as a biological or mechanical structure, which can be identified even when it is not working due to same anatomy and physiology. Thus, it is the complex pattern, which is difficult to study independently separately from its functioning. Emphasizing on the similar context, Katz and Kahn defines the organizational structure in the following ways:

"A social system is a structuring of events or happenings rather than of physiological parts and it, therefore, has no structure apart from its functioning".

However, the organizational processes do differ from the organizational structure, which also guides the understanding of the concept and design of organization structure. The structure of a system refers to the arrangement of its subsystems and components at a given moment of time, while, the process of the organization refers to the dynamic change in the matter, energy, or information of the system over time. Thus, the concept of structure and process can be viewed as the static and dynamic features, which are related and not contradictory. As organization structure is viewed as the established pattern of relationships among the components of the organization, In large and complex organizations, structure is set forth initially by the design of the major components or subsystems followed by establishing relationships among these subsystems. And, the patterning of these relationships with some degree of permanency is called as the organization structure. Therefore, the issues involved in the design of basic structure are division of the organization work, assignment of the work among various positions, groups, divisions, department, etc. and necessary coordination to accomplish total organizational objectives. Emphasizing of the above aspects Dalton et al have defined organization structure as, "Organizations structure refers to the differentiation and integration of activities and authority, role and relationships in the organization. Differentiation is the difference in cognitive and emotional orientations among managers in different functional departments, and differences in formal structure among these departments. Integration refers to the quality of the state of collaboration that is required to achieve unity of effort by the organization".

Apart from the formal organisation structure, people also create relationships independent of the formal relationships in the organization, called as the informal relationships or organisation. Thus, truly speaking, the organization structure is the totality of both formal and informal relationships. On the other side, the operating mechanism or organizational process, includes factors such as, control procedures, information systems, reward and punishment systems, rules and procedures and so on. These structural variables, both basic structure and operating mechanism, can be used to identify what is required of organizational members to achieve objectives, and encourage them to take collective activities. Thus, in an organization, there does exists formal authority, which is explicit, and informal authority, which is implicit.

11.2 Structure and Strategy

As described in the earlier unit, strategy can be defined as the course of actions through which the organization relates itself with its environment so as to achieve its objectives. However, the strategy of implementation depends largely on the environment, organizations' strengths and weaknesses and other personal factors. There existclose relationship between an organization's strategy and its structure, in order to implement the strategy, the understanding of this relationship is important, and the organizational structure has to be designed accordingly. This relationship between the strategy and structure can be also explained in terms of utilising structure for strategy implementation, as structure is a means to an end in itself. In this context, the most appropriate end is the objectives for which the organization exists as being indicated by the organizational strategy. But, in the absence of coordination between strategy and structure, the obvious outcomes are confusions, misdirection and undivided efforts within the organization.

Research evidence also suggests that structure follows strategy. According to the Chandler, changes in organization's strategy bring about new administrative problems which, in turn, require a new refashioned structure if the new strategy is to be successfully implemented. Chandler has found that structure tends to follow the growth strategy of the organizations but not until inefficiency and internal operating problems provoke a structural adjustment. Thus, organizational actions proceed in a particular sequence, i.e., new strategy creation, emergence of new administrative problems, a decline in profitability and performance, a shift to a more appropriate organization structure, then recovery to improved strategy execution and more profit and performance. However, this sequence can be broken if suitable organization structure is conceived at the starting point of the strategy implementation. Thus, the relationship between strategy and structurecannot be viewed as two-way traffic. The structure should be according to the need of strategy in order to implement it effectively, therefore, recognition of thistwo-way interaction between strategy and structure is inevitable with the help of structural design. Thus, it is obvious that the top management perspective in structural design isnecessary when one understand that such a design is the result of overall strategy, and the success of the strategy depends on the design of the strategy. The interdependence of structure and strategy has been summarised by Cannon, on the basis of his long experience of devising strategies in the consulting firms and organising companies. He observed that, "the experience of McKinsey supports the view that neither the strategy nor structure can be determined independently of the other. If structure cannot stand alone without strategy, it is equally true that strategy can rarely succeed without an appropriate structure. In almost every kind of large-scale enterprise, examples can be found where well-conceived strategic plans were thwarted by an organisation structure that delayed the execution of the plans or gave priority to wrong set of considerations….. good structure is inseparably linked to strategy…."

The relationship between the strategy-structure can be analysed by the study of stages of the organizational growth, because at each stage of the organizational growth, the growth, types of product/market, size of the organization and consequently managerial problems differ. On the basis of the observations from the growth of organizations in US economy, Chandler has concluded that evolution of the organizations follow the following pattern:

- Initial expansion and accumulation of resources;
- Rationalization of the use of resources;
- Expansion into new product and business lines; and
- Development of a new organization structure to enable effective mobilisation and utilisation of resources to meet short-term market demand and long-term market trends.

On the basis of these four phases, the organization structure can be divided into the following four types, namely, **Type I, Type II and Type III, which are as described below:**

- **Type – I:** Type I structure is generally used by entrepreneurial organisation that are characterised by the centralized decision-making, a single-product line, which emphasises on one function—production— more than any other.
- **Type II:** Type II structure is the vertically integrated structure that focuses on the efficiency and

functional coordination with one or a few related products. This type of organization are characterised by the chief executives entrusted with various complex decisions and departmental heads who are entrusted with the departmental managerial responsibilities. However, these departmental heads are too busy, restricted to a single functional area, haverare experience or interest in understanding the needs and problems of other departments or the total organization.

- **Type III:** Type III structure, by its nature, is highly decentralised and divisionalized. The accumulation of resources by successful firm with type-II structure generally leads to the diversification in the varied product lines. However, the alternative of diversification gives rise to many administrative problems, such as, inter-departmental coordination and control. While, various coordination problems which are emerged at the lower levels are to be referred to the departmental heads or even to the chief executive, but it demands lot of time of the higher-level managerial personnel resulting into inefficiency. Thus, the companies are compelled to opt from either to give up the diversification strategy or change the organization structure, i.e., shift from functional structure to some other structure.

Activity A:

1. Examine the above types of structures and explain the same with the help of the depicting the real-life organization structure.

In the similar pattern, many firms have replaced their functional structure by divisional structure by establishing two or more product divisions with functional responsibility assigned to the divisional managers. The role of the Chief Executive, head of the central office, consists of coordination and control to finance apart from performing primary functions like planning and research. By following this type of organization structure, various companies, such as, General Motors, Du Pont, Sears Roebuck, Standard Oils, were able to exploit opportunities in variety of product/market and manage variety of unrelated activities. The extent to which new structures facilitate the development of the strategic approach can be witnessed from the Chandler's study, and derived from the following conclusions about the stages of development of organization, strategy adopted and organization structure designed:

1. The development occurs in three stages—— a small, single-product company (stage – I) develops into a specialized functional company (stage – II) and finally into a multi-product diversified company;
2. Changes in managerial style and organization structure are associated with the growth of the organizations; and
3. There is continuum of structural forms and stages of development; there is a movement away from a simple form towards more complex forms.

Thus, it can be said that, the perfect fit of the organization strategy and organizational structure is the foremost condition for the success of the implementation and execution of the organizational strategy, as the organization strategy outlines the tasks to be performed by the organization and structure coordinates the people who performs these tasks. At the same time, the right type of right number of the people ensures that consistent execution of the tasks with the strategy, in the organization. For this, the division of the varied organizational activities into different divisions or departments is most important aspects of the organizational structure, which is based on the skills and experience of the people as well as the match of the human resources, the task, and the equipment. Another important aspect of the organization structure is take decisions upon creating an environment for the divisions or departments so that they can work efficiently in aggregate, to accomplish the organizational objectives.

The company, firstly, tries to allocate people and resources to the organizational tasks, followed by the authority delegation decisions by the management of the organization.For this, the appropriate number of hierarchical levels and right span of controls has to be determined by the organization. It is also followed by the division of the labour in the organization and its appropriate fit with the organizational tasks. The organizational management also has to decide on the delegation of the authority at the divisional or functional level to varied positions, as well as to divide people and tasks into functions and divisions in order to ensure it ability to create value for the organization. Secondly, an attempt has to be made by the management to obtain an acceptable level of coordination between human resources and their functions to accomplish the required assignment. Hence, the operations of the organizational structure and its assistance to the mechanism of organizational control, is determined by these two aspects of implementation.

Inevitably, both strategy and structure should vary according to the type of organization. In other words, for a single – SBU firm, both strategy and structure might be very simple, while, for the organization with conglomerate operations, the strategy and structure should be able to reflect the complexity of the organizational situation.

Activity B:

1. Examine the development stages of the organization of your choice and relate it with the developmental stages discussed in the chapter.

11.3 Stages of Development of Organization

The managers' preference for the appropriate number of hierarchical levels in the company and the appropriate span of control for the each of the manager is the beginning point of the organizational structuring process. Span of control refers to the number of subordinates to be managed by the manager directly. The primary decision to be taken by the manager is between,the flat structure with few hierarchical levels, i.e., relatively wide span of control, and the tall structure, i.e., many levels forming small span of control. Thus, the type of structure a company chooses depends heavily on the number of employees and the type of business. Generally, majority of the companies have less than nine levels as too many levels in the hierarchy may create some problems. For instance, tall structure proves to be very expensive as it requires more managers, further increasing various expenses, such as, managers' salaries, expenses and other benefits. The greater number of the hierarchical levels also increases the different hierarchical levels and integration becomes difficult, which has to be integrated with the help of the co-ordination and functional methodsof accomplishing the organizational tasks. This further may also lead to the misinterpretation of the messages and slows down the implementation process.

However, the managers in organization with the flat structures have greater autonomy, and therefore, a certain level of accountability is expected. Certain companies have adopted the total quality management, which promotes teamwork and encourages the employees to exercise the meaningful commitment and responsibility to the resources as compared to the companies adopting tall structures. In tall structures, managers with few subordinates have limited authority and responsibility. Hence, it can be said that the appropriate authority in the company is an organizational strength, while, the rigid authority is the weakness, for which proper level of organizational centralization has to be chosen to avoid the difficulties emerging out of it.

When the managers take decision to control all the major decisions, it is called centralization of authority, and, when the authority to make decisions is delegated to other managers and employees in the hierarchy, it is called as the decentralization. There are various benefits of the decentralized structure which may resolves various communications problems, grants responsibility to the operating managers, andtime for strategic decision making to the top level managers, smooth conveying of the information down the hierarchy, which motivates most of the large companies in an international organizations.

11.4 Approaches for Organization Structures

There are different approaches which can be adopted for designing organization structure, on the basis of the performance of the varied types of activities by the organization for the accomplishment of theobjectives. According to Peter Drucker, three types of analyses can be taken into consideration to design the organization structure, namely, activities analysis, decision analysis and relations analysis. Another way of classifying the approaches for organizational design is process approach, result approach, and decision approach, are considered to be appropriate for organizational design, which are as explained below:

Process Approach: Process approach to organization structural design is related to identification of sequence of activities involved and determining varied units of organization, combining various units, and placing them at appropriate places, to ensure the effective and efficient performance of the activities. Here, the emphasis is laid on three important aspects, which are, performance of the necessary activities for the accomplishment of the objectives, no unnecessary duplication of performance of activities and synchronized performance of all necessary activities in the organization, which determines the creation of the organizational units.

Some of the unique advantages of the process approach of organizational design are stated below:

- It improvesthe understanding of dynamism of the operating sequences and requirements of business. In this context, various organizational processes, such as, communication, coordination, delegation of authority, centralisation and decentralization, can be prescribed to meet the needs of the objectives.
- This approach also helps in improving the coordination of organizational functions that across the several departments, such as, planning, budgeting, etc.

However,the basic limitation of this approach is its stable structure. Although, this process worksvery well in comparison to the smaller organizations which emphasize on one or lesser number of related products.

Result Approach: The organization in which strategy innovation is of the foremost importance, the organizational design that focuses on results becomes more effective. The main aspects involved in developing the organizational structure on the basis of the result approach are as stated below:

1. Defining the business on the basis of potential area of market opportunities;
2. Establishing the objectives to be accomplished;
3. Determining the requirements for success and functional skills needed to meet them;
4. Determining the degree of authority in accordance with the degree of centralization for effective decision-making.

However, the organization who want to take advantages of several clusters of uncommon market opportunities, may adopt the structure on the basis of the Strategic Business Units, i.e., SBU. A Strategic Business Unit refers to the cluster of the discrete product/market units on the basis of some important common strategic elements. Here, the central idea is grouping of the organizations' activities on the basis of the strategically relevant criteria rather than size of the span of control. SBU structure provides attractive organising rationale and reviews the strategic performance of diverse operating units, which proves to be unique managerial value.

Decision Approach: The decision approach of organizational design mechanism provides solutions to the following core questions involved in designing of the organization structure:

1. What decisions are needed to obtain results for organizational objectives accomplishment?
2. What is the nature of such decisions?
3. At what levels of the organization, such decisions should be made?
4. What are the activities involved in or affected by such decisions?

The solutions to the above questions, comprises of determining degree of authority in the position, its interaction with other positions, and the placement of the position in organizational hierarchy.

Thus, it can be said that these above three approaches focuses on different sets of importance of various activities in the organization, which are not mutually exclusive, but, rather they can be integrated.

Activity C:

1. Examine the organizational approaches above types of structures and explain the same with the help of the depicting the real-life organization structure.

11.5 Structures for Strategies: Types

The structure of the company has to be selected on the basis of the strategy of the company, and has to be the best fit. Therefore, when the company's strategy changes over, the changes or the modifications have to be made in the existing structure of the company also. The Seven structures, appropriate for seven diverse organizational situations, are explained in brief.The four of the seven structures explained below are credited to Higgins and Vincze, among others:

1. **Simple Structure:** This type of structure is appropriate for the small organizations. This type of structure is generally adopted by such organizations in the early stages of their existence. Usually, such structure involves one person, often the owner, who performs all the required responsibilities to produce and market a product as given in the figure below. However, this structure shall be changed or modified as the company starts expanding its operations.

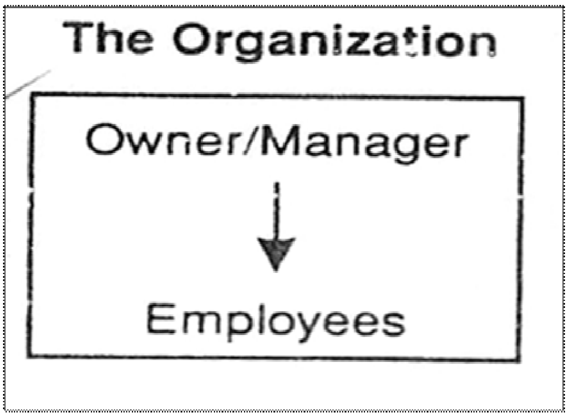

Figure : 11.1

Activity D:

1. What are the advantages of the simple organization structure in any of the small organization/company of your choice.

Economic Functional Structure: When the organization grows, through the marketing of its product, resulting into increase in the supervisory needs and business control, the organization adopts the economic functional type of the organizational structure. It is the complex structure, which is required to meet the newly created positions in the company.Therefore, it requires experienced and expertized people, which are grouped together on the basis of their job responsibilities, or sometimes, on the basis of the use of the similar kind of resources. Thus, it can be said that the functional structure divides the company into various functions or subunits, such as, purchasing, sales, production, finance, engineering, and so on as shown in the figure below:

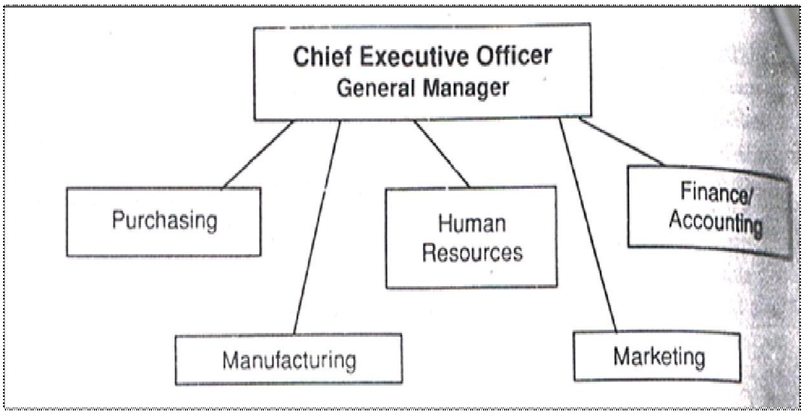

Figure 11.2

Activity E:

1. How the economic functional organization structure can be helpful. Discuss it with the help appropriate example.

Product Structure: Product structural type is adopted by organization when the firm reaches an appropriate size, such as, involves two or more products significantly contributing to the business operations. In this type of the structure, the operations of the company are grouped on the basis of the demand for the company's products. However, sometimes, various functions performed by the organizations are also divided into different product lines on the basis of similarities between the products produced, as shown in the figure below:

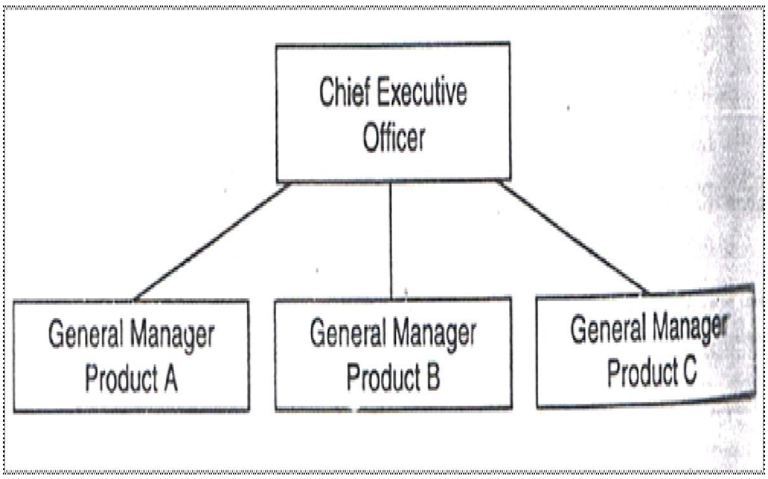

Figure – 11.3

Activity F:

1. How the implementation of the product type structure assist the implementation of strategy in the organization of your choice.

Strategic Business Unit Structure (SBU): In the SBU type of structure, the company sells either one product or a few, and adopted when the organization becomes large, complex, and diversified. In this type of organization structure, the company combines divisions on the basis of their similarities and differences, which will result in a self-contained SBU. Each SBU is managed by its own management team, which acts as a liaison between the corporate management team and the management in each of the different divisions inside the SBU which is shown in the figure below:

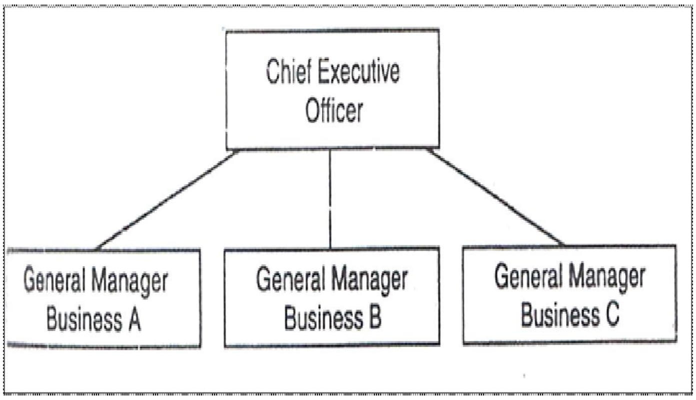

Figure – 11.4

Activity G:

1. Identify two organizations in which strategic business unit type organization structure is being implemented and it facilitate the strategy implementation.

Geographical Structure: The geographical structure is used when certain geographic region is the basis for forming departments within the organization. In this type of organizational structure, each of the product lines are listed under different geographic regions and the activities of the personnel are grouped by geographic rotation. For example, A company can divide its operation into Southern, Northern, Western, Eastern and Central regions. In this type of organizational structure, the regional managers control operations at the regional level, while, the top managers at the centre continue to control the overall activities. This type of structures is extensively used by the large departmental stores.

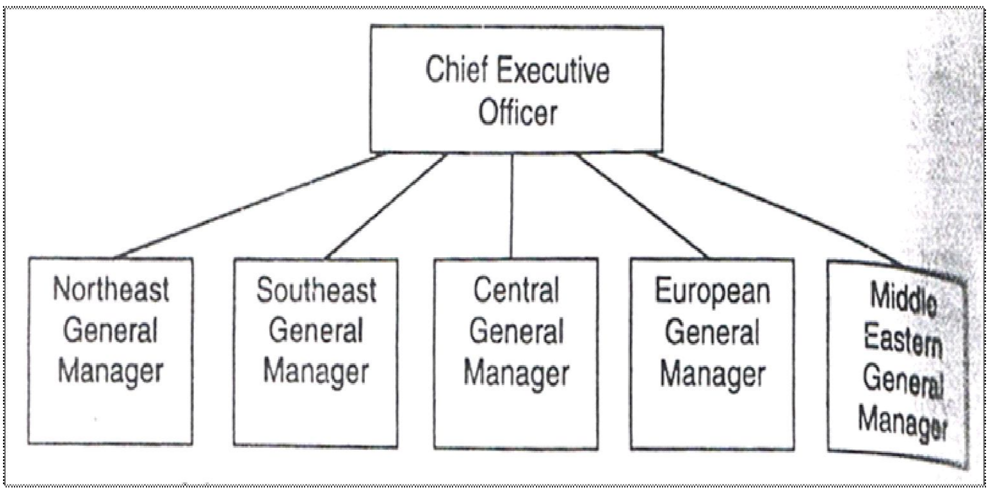

Figure – 11.5

Activity H:

1. Examine the implementation of the Geographic organization structure in the real set up and explain the same.

Matrix Structure: In Matrix Organizational Structure the authority over staff employees is organized by project/product and functional managers at the same time. This type of structure is based on two principles of grouping people and racket sources as given below:

(a) The vertical axis operations are grouped by a functional logic, to get the benefits of the functional organizational structure;

(b) The horizontal axis operations are organized by a product or project logic, to get the benefits from the product structure.

(c) Thus, the result is a complex design of reporting relationships which is exclusively different as compared to all the other structures explained earlier.

The organization with matrix type of structure is explained as in the figure below:

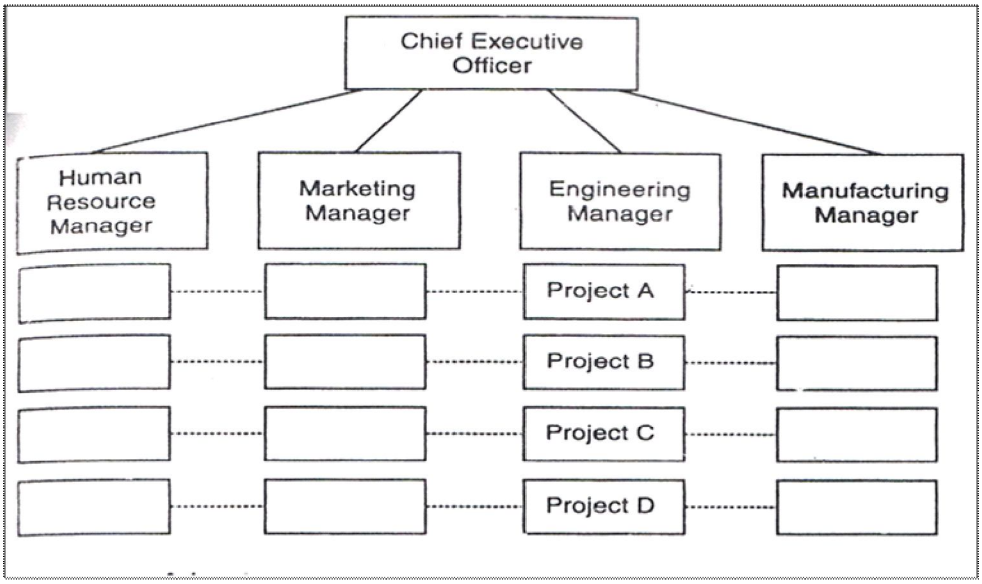

Figure – 11.6

Activity I:

1. How the matrix structure is important and necessary in the event management companies. Discuss on the basis of real life observations.

4. Project Structure: This type of organizational structure is followed by the organization with team management which divides certain projects among different groups, performing the same jobs, such as, marketing, finance, operations, and human resources. Generally, this type of structure is adopted by the companies with small numbers of the large projects, of long-term nature.

Activity J:

1. Observe the company or organization adopting the project type of structure and discuss the merits and demerits of the same as experienced by the company.

11.6 Summary

Structure refers to the pattern inter-related or inter-connected patterns or components, which prescribes the relationships among various organizational activities and positions. The organization structure is abstract in nature, and it can be inferred from the actual organizational operations and behaviour of the organization. However, the organizational processes do differ from the organizational structure, which guides the understanding of the concept and design of organization structure. The structure of a system refers to the arrangement of its subsystems and components at a given moment of time, while, the process of the organization refers to the dynamic change in the matter, energy, or information of the system over time. Thus, the concept of structure and process can be viewed as the static and dynamic features, which are related and not contradictory.

The strategy of implementation depends largely on the environment, organizations' strengths and weaknesses and other personal factors. There exist close relationship between an organization's strategy and its structure, in order to implement the strategy, the understanding of this relationship is important, and the organizational structure has to be designed accordingly, which demands effective and efficient co-ordination. According to the Chandler, changes in organization's strategy bring about new administrative problems which, in turn, require a new refashioned structure if the new strategy is to be successfully implemented. Chandler has found that structure tends to follow the growth strategy of the organizations but not until inefficiency and internal operating problems provoke a structural adjustment. Thus, organizational actions proceed in a particular sequence, i.e., new strategy creation, emergence of new administrative problems, a decline in profitability and performance, a shift to a more appropriate organization structure, then recovery to improved strategy execution and more profit and performance.

However, the relationship between the strategy-structure can be also be analysed by the study of stages of the organizational growth. On the basis of observations of Chandler four phases of development stages, the organization structure can be divided into the following four types, namely, Type I, Type II and Type III, which has been also explained in the chapter above. The type of structure a company chooses depends heavily on the number of employees and the type of business.The managers' preference for the appropriate number of hierarchical levels in the company and the appropriate span of control for the each of the manager is the beginning point of the organizational structuring process.

Generally, majority of the companies have less than nine levels as too many levels in the hierarchy may create some problems.There are different approaches which can be adopted for designing organization structure, on the basis of the performance of the varied types of activities by the organization for the accomplishment of the objectives. According to Peter Drucker, three types of analyses can be taken into consideration to design the organization structure, namely, activities analysis, decision analysis and relations analysis. Another way of classifying the approaches for organizational design is process approach, result approach, and decision approach, are considered to be appropriate for organizational design, which are as discussed in brief in the chapter earlier.

Apart from this this, The Seven structures, appropriate for seven diverse organizational situations, are explained in brief in the chapter, four of these seven structures are credited to Higgins and Vincze. These seven structures discussed in the unit are, simple organization structure, economic functional organizational structure, product, strategic business unit, geographic organization structure, matrix organization structure and project organization structure, which are discussed in the unit with the help of the diagrams, along with the assignment of the activities.

11.7 Self Assessment Questions

1. Explain the concept of organization structure
2. Explain the relationship between structure implementation and strategy implementation
3. Discuss the stages of development of organization structure.
4. Write the short note on the Approaches of Organizational Design.
5. Discuss in detail the importance of the following types of organization structure and implementation of strategy in the organization with respect to the following structure.
   a. Simple organization structure
   b. Economic functional structure
   c. Product Structure
6. Explain in detail Strategic Business Unit. Outline the points of importance and limitations of this type of organization structure.
7. Examine the importance of geographic organization structure in the implementation of strategy.
8. Elaborate the points of difference between Matrix organization structure and Project Organization Structure from the point of view of strategy implementation.

11.8 Reference Books

Unit -12 : Functional Implementation -1

Structure of Unit:

12.0 Objectives

After completing this unit, you would be able to:

- Explain the importance of Annual objectives and Policies in achieving Organisational commitment strategies to be implemented.
- Describe the relationship between production /operation and strategy implementation.
- Explain how a firm can effectively link performance and pay to strategies.
- Describe how to modify an organizational culture to support new strategies.
- How to implement strategies in management Issues
- How to implement strategies in Operation Issues

12.1 Introduction

The strategy-implementation stage of strategic management is revealed in Figure -1. Successful strategy formulation does not guarantee successful strategy implementation. It is always more difficult to do something (strategy implementation) than to say you are going to do it (strategy formulation)! Although inextricably linked, strategy implementa-tion is fundamentally different from strategy formulation. Strategy formulation and imple-mentation can be contrasted in the following ways:

- Strategy formulation is positioning forces before the action.
- Strategy implementation is managing forces during the action.
- Strategy formulation focuses on effectiveness.
- Strategy implementation focuses on efficiency.
- Strategy formulation is primarily an intellectual process.

- Strategy implementation is primarily an operational process.
- Strategy formulation requires good intuitive and analytical skills.
- Strategy implementation requires special motivation and leadership skills.
- Strategy formulation requires coordination among a few individuals.
- Strategy implementation requires coordination among many individuals.

Strategy-formulation concepts and tools do not differ greatly for small, large, for-profit, or nonprofit organizations. However, strategy implementation varies substantially among different types and sizes of organizations. Implementing strategies requires such actions as altering sales territories, adding new departments, closing facilities, hiring new employees, changing an organization's pricing strategy, developing financial budgets, devel-oping new employee benefits, establishing cost-control procedures, changing advertising strategies, building new facilities, training new employees, transferring managers among divisions, and building a better management information system. These types of activities obviously differ greatly between manufacturing, service, and governmental organizations.

12.2 Management Perspective

In all but the smallest organizations, the transition from strategy formulation to strategy imple-mentation requires a shift in responsibility from strategists to divisional and functional man-agers. Implementation problems can arise because of this shift in responsibility, especially if strategy-formulation decisions come as a surprise to middle- and lower-level managers. Managers and employees are motivated more by perceived self-interests than by organiza-tional interests, unless the two coincide. Therefore, it is essential that divisional and functional managers be involved as much as possible in strategy-formulation activities. Of equal impor-tance, strategists should be involved as much as possible in strategy-implementation activities.

As indicated in Table-1, management issues central to strategy implementation include establishing annual objectives, devising policies, allocating resources, altering an existing organizational structure, restructuring and reengineering, revising reward and incentive plans, minimizing resistance to change, matching managers with strategy, developing a strategy-supportive culture, adapting production/operations processes, developing an effective human resources function, and, if necessary, downsizing. Management changes are necessarily more extensive when strategies to be implemented move a firm in a major new direction.

Table -12.1-Some Management Issues Central to Strategy Implementation

Establish annual objectives Devise policies
Allocate resources
Alter an existing organizational structure Restructure and
reengineer
Revise reward and incentive plans
Minimize resistance to change
Match managers with strategy
Develop a strategy-supportive culture
Adapt production/operations processes
Develop an effective human resources function Downsize
and furlough as needed
Link performance and pay to strategies

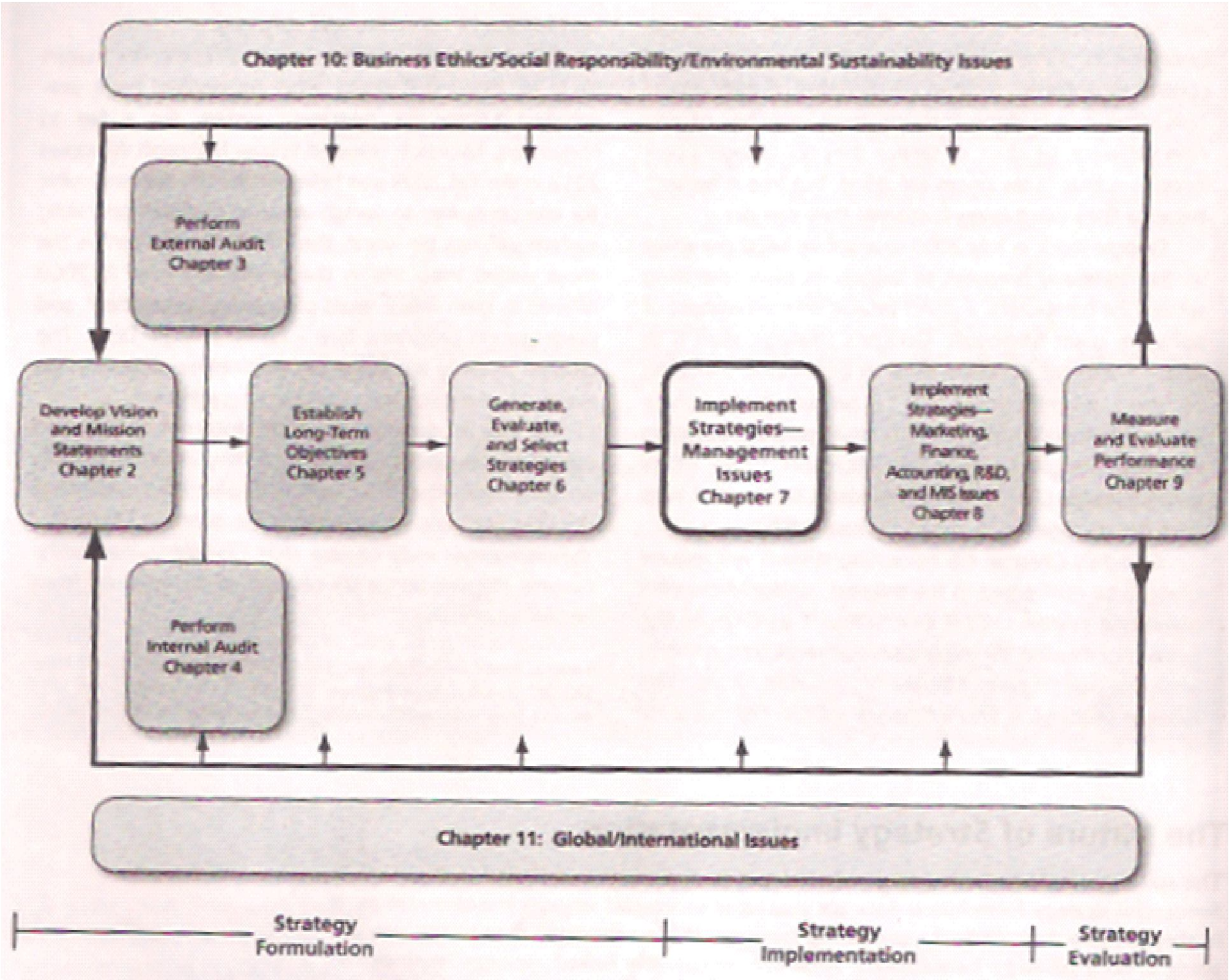

Figure - 12.1 : Comprehensive Strategic-Management Model

Source: Fred R. David, "How Companies Define Their Mission," *Long Range Planning* 22, no. 3 (June 1988): 40.

Managers and employees throughout an organization should participate early and directly in strategy-implementation decisions. Their role in strategy implementation should build upon prior involvement in strategy-formulation activities. Strategists' genuine personal commitment to implementation is a necessary and powerful motivational force for managers and employees. Too often, strategists are too busy to actively support strategy-implementation efforts, and their lack of interest can be detrimental to organizational success. The rationale objectives and strategies should be understood and clearly communicated throughout an organisation. Major competitors' accomplishments, products, plans, actions, and perfor-mance should be apparent to all organizational members. Major external opportunities and threats should be clear, and managers' and employees' questions should be answered. Top-Down -flow of communication is essential for developing bottom-up support.

Firms need to develop a competitor focus at all hierarchical levels by gathering and widely distributing competitive intelligence; every employee should be able to benchmark his or her efforts against best-in-class competitors so that the challenge becomes personal. For example, Starbucks Corp. in 2009-2010 is instituting "lean production/operations" at its 11,000 U.S. stores. This system eliminates idle employee time and unnecessary employee motions, such as walking, reaching, and bending. Starbucks says 30 percent of employees' time is motion and the company wants to reduce that. They say "motion and are two different things."

12.3 Annual Objectives

Establishing annual objectives is a decentralized activity that directly involves all managers in an organization. Active participation in establishing annual objectives can lead to accep-tance and commitment. Annual objectives are essential for strategy implementation because they (1) represent the basis for allocating resources; (2) are a primary mechanism for evaluating managers; (3) are the major instrument for monitoring progress toward achieving long Term objectives; and (4) establish organizational, divisional, and departmental priori-ties.

Considerable time and effort should be devoted to ensuring that annual objectives are well conceived consistent with long-term objectives, and supportive of strategies to be implimented. Approving, revising, or rejecting annual objectives is much more than a rubber-stamp activity. The purpose of annual objectives can be summarized as follows:

Annual Objectives serve as guidelines for action, directing and channeling efforts and activities of organizarion members. They provide a source of legitimacy in an enterprise by justifying activities to stakeholders. They serve as standards of performance.

They serve as an important source of employee motivation and identification. They give incentives for managers and employees to perform. They provide a basis for organizational design.

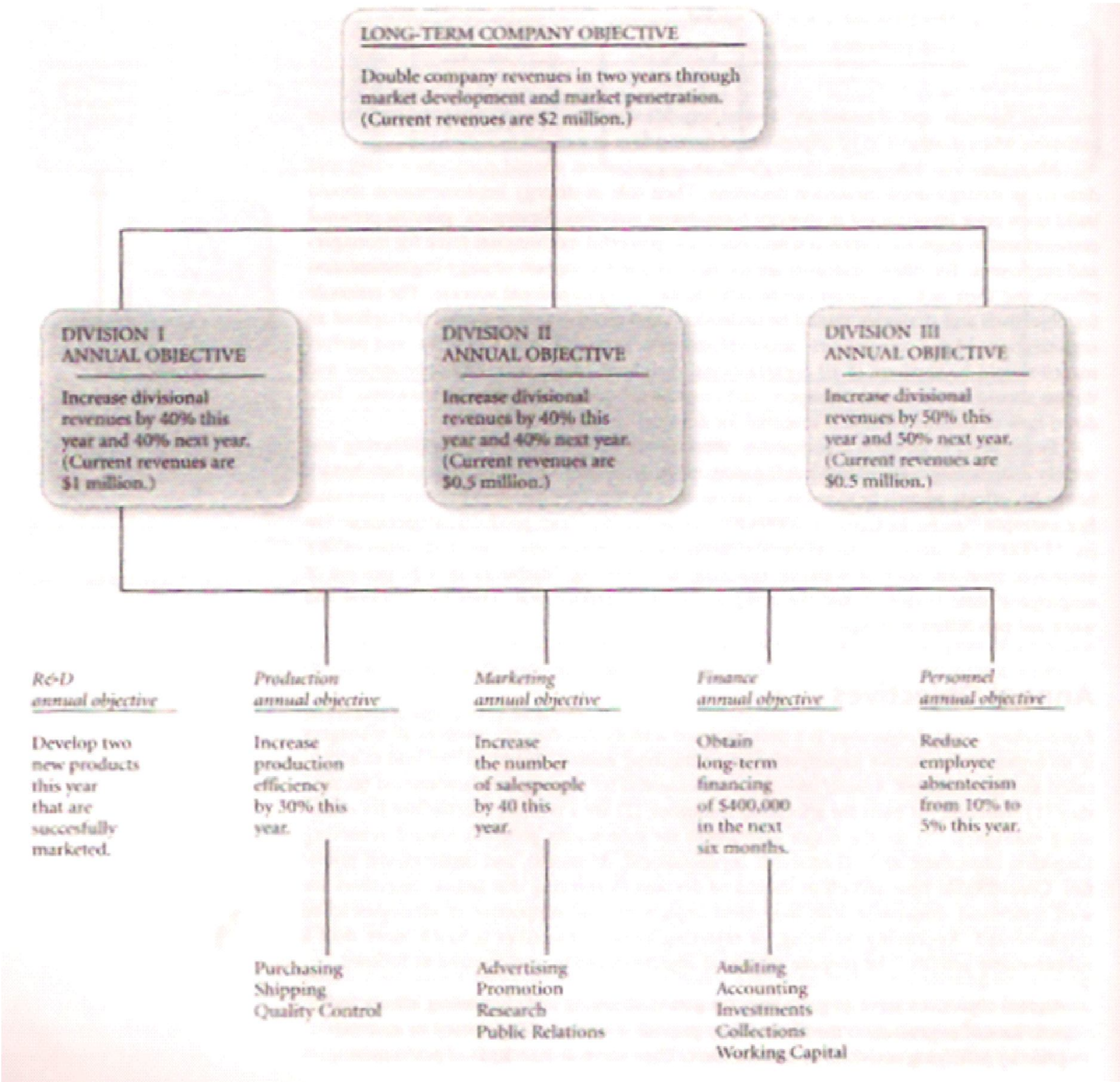

Figure -12.2 : The Stamus Company's Hierarchy of Aims

Table-12.2-The Stamus Company's Revenue Expectations(in Millions)

	2010	2011	2012
Division I Revenues	1.0	1.400	1.960
Division II Revenues	0.5	0.700	0.980
Division IIIRevenues	0.5	0.750	1.125
Total Company Revenues	2.0	2.850	4.065

Clearly stated and communicated objectives are critical to success in all types and sizes of firms. Annual objectives, stated in terms of profitability, growth, and market share by business segment, geographic area, customer groups, and product, are common in organizations.

Figure-12.2 illustrates how the Stamus Company could establish annual objectives based on long-term objectives. Table-12.2 reveals associated revenue figures that correspond to the objectives outlined in Figure-12.2. Note that, according to plan, the Stamus Company will slightly exceed its long-term objective of doubling company revenues between 2010 and 2012.

Figure-12.2 also reflects how a hierarchy of annual objectives can be established based on an organization's structure. Objectives should be consistent across hierarchical levels and form a network of supportive aims. Horizontal consistency of objectives is as impor-tant as vertical consistency of objectives. For instance, it would not be effective for manu-facturing to achieve more than its annual objective of units produced if marketing could not sell the additional units.

Annual objectives should be measurable, consistent, reasonable, challenging, clear, communicated throughout the organization, characterized by an appropriate time dimen-sion, and accompanied by commensurate rewards and sanctions. Too often, objectives are stated in generalities, with little operational usefulness. Annual objectives, such as "to improve communication" or "to improve performance," are not clear, specific, or measur-able. Objectives should state quantity, quality, cost, and time-and also be verifiable. Terms and phrases such as maximize, minimize, as soon as possible, and adequate should be avoided.

Annual objectives should be compatible with employees' and managers' values and should be supported by clearly stated policies. More of something is not always better. Improved quality or reduced cost may, for example, be more important than quantity. It is important to tie rewards and sanctions to annual objectives so that employees and managers understand that achieving objectives is critical to successful strategy implemen-tation. Clear annual objectives do not guarantee successful strategy implementation, but they do increase the likelihood that personal and organizational aims can be accomplished. Overemphasis on achieving objectives can result in undesirable conduct, such as faking the numbers, distorting the records, and letting objectives become ends in themselves. Managers must be alert to these potential problems.

12.4 Policies

Changes in a firm's strategic direction do not occur automatically. On a day-to-day basis, policies are needed to make a strategy work. Policies facilitate solving recurring problems and guide the implementation of strategy. Broadly defined, policy refers to specific guide-lines, methods, procedures, rules, forms, and administrative practices established to support and encourage work toward stated goals. Policies are instruments for strategy implementation. Policies set boundaries, constraints, and limits on the kinds of adminis-trative actions that can be taken to reward and sanction behavior; they clarify what can and cannot be done in pursuit of an organization's objectives.

For example, Carnival's Paradise ship has a no smoking policy anywhere, anytime aboard ship. It is the first cruise ship to ban smoking comprehensively. Another example of corporate policy relates to surfing the Web while at work. About 40 percent of companies today do not have a formal policy preventing employees from surfing the Internet, but software is being marketed now that allows firms to monitor how, when, where, and how long various employees use Internet at work.

Policies let both employees and managers know what is expected of them, thereby increasing the likelihood that strategies will be implemented successfully. They provide a basis for management control, allow coordination across organizational units, and reduce the amount of time, managers spend making decisions. Policies also clarify what work is to be done and by whom. They promote delegation of decision making to appropriate managerial levels where various problems usually arise.

Many organiza-tions have a policy manual that serves to guide and direct behavior. Wal-Mart has a policy that it calls the "10 Foot" Rule, whereby customers can find assistance within 10 feet of anywhere in the store. This is a welcomed policy in Japan, where Wal-Mart is trying to gain a foothold; 58 percent of all retailers in Japan are mom-and-pop stores and consumers historically have had to pay "top yen" rather than "discounted prices" for merchandise.

Policies can apply to all divisions and departments (for example, "We are an equal opportunity employer"). Some policies apply to a single department ("Employees in this department must take at least one training and development course each year"). Whatever their scope and form, policies serve as a mechanism for implementing strate-gies and obtaining objectives. Policies should be stated in writing whenever possible. They represent the means for carrying out strategic decisions. Examples of policies that support a company strategy, a divisional objective, and a departmental objective are given in Table-12.3.

Some example issues that may require a management policy are provided in Table-12.4.

Table-12.3 -A Hierarchy of Policies

Company Strategy

Acquire a chain of retail stores to meet our sales growth and profitability objectives.

Supporting Policies

1. "All stores will be open from 8 A.M. to 8 P.M. Monday through Saturday." (This policy could increase retail sales if stores currently are open only 40 hours a week.)
2. "All stores must submit a Monthly Control Data Report." (This policy could reduce expense-to-sales ratios.)
3. "All stores must support company advertising by contributing 5 percent of their total monthly revenues for this purpose." (This policy could allow the company to establish a national reputation.)
4. "All stores must adhere to the uniform pricing guidelines set forth in the Company Handbook." (This policy could help assure customers that the company offers a consistent product in terms of price and quality in all its stores.)

Divisional Objective: Increase the division's revenues from $10 million in 2009 to $15 million in 2010.
Supporting Policies

1. "Beginning in January 2010, each one of this division's salespersons must file a weekly activity report that includes the number of calls made, the number of miles traveled, the number of units sold, the dollar volume sold, and the number of new accounts opened." (This policy could ensure

that salespersons do not place too great an emphasis in certain areas.)

2. "Beginning in January 2010, this division will retum to its employees 5 percent of its gross revenues in the form of a Christmas bonus." (This policy could increase employee productivity.)
3. "Beginning in January 2010, inventory levels carried in warehouses will be decreased by 30 percent in accordance with a just-in-time (JIT) manufacturing approach." (This policy could reduce production expenses and thus free funds for increased marketing efforts.)

Production Department Objective: Increase production from 20,000 units in 2009 to 30,000 units in 2010.

Supporting Policies

1. "Beginning in January 2010, employees will have the option of working up to 20 hours of overtime per week." (This policy could minimize the need to hire additional employees.)
2. "Beginning in January 2010, perfect attendance awards in the amount of $100 will be given to all employees who do not miss a workday in a given year." (This policy could decrease absenteeism and increase productivity.)
3. "Beginning in January 2010, new equipment must be leased rather than purchased." (This policy could reduce tax liabilities and thus allow more funds to be invested in modernizing production processes.)

Table -12.4: Some Issues That May Require a Management

- To offer extensive or limited management development workshops and seminars
- To centralize or decentralize employee-training activities
- To recruit through employment agencies, college campuses, and/or newspapers
- To promote from within or to hire from the outside
- To promote on the basis of merit or on the basis of seniority
- To tie executive compensation to long-term and/or annual objectives
- To offer numerous or few employee benefits
- To negotiate directly or indirectly with labor unions
- To delegate authority for large expenditures or to centrally retain this authority
- To allow much, some, or no overtime work
- To establish a high- or low-safety stock of inventory
- To use one or more suppliers
- To buy, lease, or rent new production equipment
- To greatly or somewhat stress quality control
- To establish many or only a few production standards
- To operate one, two, or three shifts
- To discourage using insider information for personal gain
- To discourage sexual harassment
- To discourage smoking at work
- To discourage insider trading
- To discourage moonlighting

12.5 Resource Allocation

Resource allocation is a central management activity that allows for strategy execution. In organizations that do not use a strategic-management approach to decision making, resource allocation is often based on political or personal factors. Strategic management enables resources to be allocated according to priorities established by annual objectives.

Nothing could be more detrimental to strategic management and to organizational success than for resources to be allocated in ways not consistent with priorities indicated by approved annual objectives.

All organizations have at least four types of resources that can be used to achieve desired objectives: financial resources, physical resources, human resources, and techno-logical resources.

Allocating resources to particular divisions and departments does not mean that strategies will be successfully implemented. A number of factors commonly prohibit effective resource allocation, including an overprotection of resources, too great an emphasis on short-run financial criteria, organizational politics, vague strategy targets, a reluctance to take risks, and a lack of sufficient knowledge.

Below the corporate level, there often exists an absence of systematic thinking about resources allocated and strategies of the firm. Yavitz and Newman explain why:

Managers normally have many more tasks than they can do. Managers must allocate time and resources among these tasks. Pressure builds up. Expenses are too high. The CEO wants a good financial report for the third quarter. Strategy formulation and implementation activities often get deferred. Today's problems soak up available energies and resources. Scrambled accounts and budgets fail to reveal the shift in allocation away from strategic needs to currently squeaking wheels.

The real value of any resource allocation program lies in the resulting accomplishment of an organization's objectives. Effective resource allocation does not guarantee successful strategy implementation because programs, personnel, controls, and commitment must breathe life into the resources provided. Strategic management itself is sometimes referred to as a "resource allocation process."

Table -12.5- Some Management Trade-Off Decisions Required in Strategy Implementation

- To emphasize short-term profits or long-term growth To emphasize profit margin or market share
- To emphasize market development or market penetration To layoff or furlough
- To seek growth or stability To take high risk or low risk
- To be more socially responsible or more profitable
- To outsource jobs or pay more to keep jobs at home
- To acquire externally or to build internally
- To restructure or reengineer
- To use leverage or equity to raise funds To use part-time or full-time employees

12.6 Managing Conflict

Interdependency of objectives and competition for limited resources often leads to conflict. Conflict can be defined as a disagreement between two or more parties on one or more issues. Establishing annual objectives can lead to conflict because individuals have different expectations and perceptions, schedules create pressure, personalities are incom-patible, and misunderstandings between line managers (such as production supervisors) and staff managers (such as human resource specialists) occur. For example, a collection manager's objective of reducing bad debts by 50 percent in a given year may conflict with a divisional objective to increase sales by 20 percent.

Establishing objectives can lead to conflict because managers and strategists must make trade-offs, such as whether to emphasize short-term profits or long-term growth, profit margin or market share, market penetration or market development, growth or stabil-ity, high risk or low risk, and social responsiveness or profit maximization.

Trade-offs are necessary because no firm has sufficient resources pursue all strategies to would benefit the firm. Table-12.5 reveals some important management trade-off decisions required in strategy implementation.

Conflict is unavoidable in organizations, so it is important that conflict be managed and resolved before dysfunctional consequences affect organizational performance. Conflict is not always bad. An absence of conflict can signal indifference and apathy. Conflict can serve to energize opposing groups into action and may help managers identify problems.

Various approaches for managing and resolving conflict can be classified into three categories: avoidance, defusion, and confrontation. Avoidance includes such actions as ignoring the problem in hopes that the conflict will resolve itself or physically separating the conflicting individuals (or groups). Defusion can include playing down differences between conflicting parties while accentuating similarities and common interests, compro-mising so that there is neither a clear winner nor loser, resorting to majority rule, appealing to a higher authority, or redesigning present positions. Confrontation is exemplified by exchanging members of conflicting parties so that each can gain an appreciation of the other's point of view or holding a meeting at which conflicting parties present their views and work through their differences.

12.7 Matching Structure With Strategy

Changes in strategy often require changes in the way an organization is structured for two major reasons. First, structure largely dictates how objectives and policies will be estab-lished. For example, objectives and policies established under a geographic organizational structure are couched in geographic terms. Objectives and policies are stated largely in terms of products in an organization whose structure is based on product groups. The structural format for developing objectives and policies can significantly impact all other strategy-implementation activities.

The second major reason why changes in strategy often require changes in structure is that structure dictates how resources will be allocated. If an organization's structure is based on customer groups, then resources will be allocated in that manner. Similarly, if an organization 's structure is set up along functional business lines, then resources are allocated by functional areas. Unless new or revised strategies place emphasis in the same areas as old strategies, structural reorientation commonly becomes a part of strategy implementation.

Changes in strategy lead to changes in organizational structure. Structure should be designed to facilitate the strategic pursuit of a firm and, therefore, follow strategy.

Without a strategy or reasons for being (mission), companies find it difficult to design an effective structure. Chandler found a particular structure sequence to be repeated often as organiza-tions grow and change strategy over time; this sequence is depicted in Figure 12.3.

There is no one optimal organizational design or structure for a given strategy or type of organization. What is appropriate for one organization may not be appropriate for a sim-ilar firm, although successful firms in a given industry do tend to organize themselves in a similar way. For example, consumer goods companies tend to emulate the divisional struc-ture-by-product form of organization. Small firms tend to be functionally structured (cen-tralized). Medium-sized firms tend to be divisionally structured (decentralized). Large firms tend to use a strategic business unit (SBU) or matrix structure. As organizations grow, their structures generally change from simple to complex as a result of concatena-tion, or the linking together of several basic strategies.

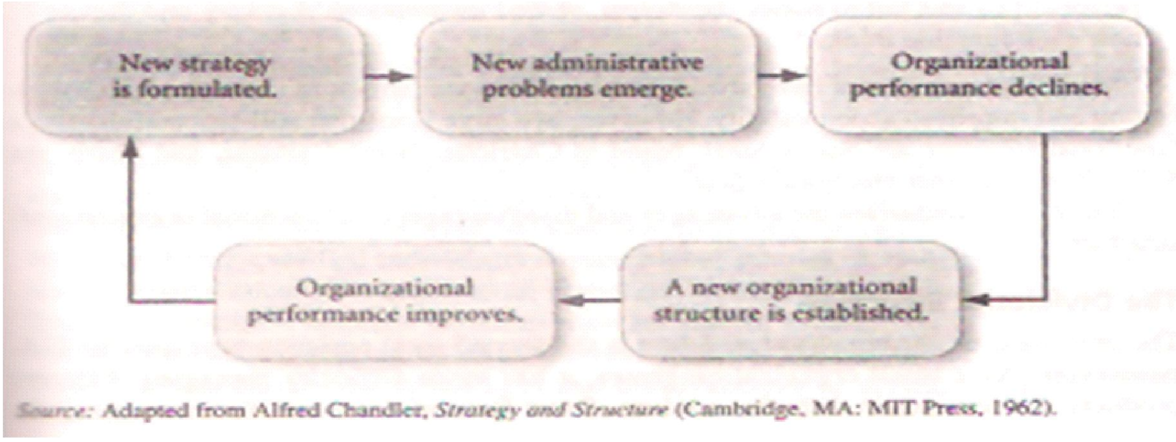

Figure : 12.3 Chandler'S Strategy-Structure Relationship

Numerous external and internal forces affect an organization; no firm could change its structure in response to every one of these forces, because to do so would lead to chaos. However, when a firm changes its strategy, the existing organizational structure may become ineffective. As indicated in Table -6, symptoms of an ineffective organizational structure include too many levels of management, too many meetings attended by too many people, too much attention being directed toward solving interdepartmental con-flicts, too large a span of control, and too many unachieved objectives. Changes in struc-ture can facilitate strategy-implementation efforts, but changes in structure should not be expected to make a bad strategy good, to make bad managers good, or to make bad prod-ucts sell.

Table-12.6

1- Too many levels of Management

2- Too many meetings attended by too many people

3- Too much attention being directed towards solving interdepartmental conflicts

4- Too large a span of control

5- Too many unachieved objectives

6- Declining corporate or business performance

7- Losing ground to rival firms

8- Revenue and/or earnings divided by number of employees and/or number of managers is low compared to rival firms

Structure undeniably can and does influence strategy. Strategies formulated must be workable, so if a certain new strategy required massive structural changes it would not be an attractive choice. In this way, structure can shape the choice of strategies. But a more impor-tant concern is determining what types of structural changes are needed to implement new strategies and how these changes can best be accomplished.

12.8 The Strategic Business Unit (SBU) Structure

As the number, size, and diversity of divisions in an organization increase, controlling and evaluating divisional operations become increasingly difficult for strategists. Increases in sales often are not accompanied by similar increases in profitability. The span of control becomes too large at top levels of the firm.

For example, in a large conglomerate organiza-tion composed of 90 divisions, such as ConAgra, the chief executive officer could have difficulty even remembering the first names of divisional presidents. In multidivisional organizations, an SBU structure can greatly facilitate strategy-implementation efforts. ConAgra has put its many divisions into three primary SBUs: (1) food service (restau-rants), (2) retail (grocery stores), and (3) agricultural products.

The SBU structure groups similar divisions into strategic business units and delegates authority and responsibility for each unit to a senior executive who reports directly to the chief executive officer. This change in structure can facilitate strategy implementation by improving coordination between similar divisions and channeling accountability to distinct business units. In a 100-division conglomerate, the divisions could perhaps regrouped into 10 SBUs according to certain common characteristics, such as competing - the same industry, being located in the same area, or having the same customers.

Two disadvantages of an SBU structure are that it requires an additional layer of management, which increases salary expenses. Also, the role of the group vice president is often ambiguous. However, these limitations often do not outweigh the advantages of improved coordination and accountability. Another advantage of the SBU structure is that es the tasks of planning and control by the corporate office more manageable.

Citigroup in 2009 reorganized the whole company into two SBUs: (1) Citigroup, which includes the retail bank, the corporate and investment bank, the private bank, and transaction services; and (2) Citi Holdings, which includes Citi's asset management consumer finance segments, CitiMortgage, CitiFinancial, and the joint brokerage tions with Morgan Stanley. Citigroup's CEO, Vikram Pandit, says the restructuring allow the company to reduce operating costs and to divest (spin off) Citi Holdings.

12.9 Creating a Strategy-Supportive Culture

Strategists should strive to preserve, emphasize, and build upon aspects of an existing culture that support proposed new strategies. Aspects of an existing culture that are antag-onistic to a proposed strategy should be identified and changed. Substantial research indi-cates that new strategies are often market-driven and dictated by competitive forces. For this reason, changing a firm's culture to fit a new strategy is usually more effective than changing a strategy to fit an existing culture. As indicated in Table-12.7, numerous techniques are available to alter an organization's culture, including recruitment, training, transfer, promotion, restructure of an organization's design, role modeling, positive reinforcement, and mentoring.

Table-12.7 Ways and Means for Altering an Organization's Culture

1. Recruitment
2. Training
3. Transfer
4. Promotion
5. Restructuring
6. Reengineering
7. Role modeling

8. Positive reinforcement
9. Mentoring
10. Revising vision and/or mission
11. Redesigning physical spaces/facades
12. Altering reward system
12. Altering organizational policies/procedures/practices

Schein indicated that the following elements are most useful in linking culture to strategy:

1. Formal statements of organizational philosophy, charters, creeds, materials used for recruitment and selection, and socialization
2. Designing of physical spaces, facades, buildings
3. Deliberate role modeling, teaching, and coaching by leaders
4. Explicit reward and status system, promotion criteria
5. Stories, legends, myths, and parables about key people and events
6. What leaders pay attention to, measure, and control
7. Leader reactions to critical incidents and organizational crises
8. How the organization is designed and structured
9. Organizational systems and procedures
10. Criteria used for recruitment, selection, promotion, leveling off, retirement, and "excommunication" of people"

In the personal and religious side of life, the impact of loss and change is easy to see. Memories of loss and change often haunt individuals and organizations for years. Ibsen wrote, "Rob the average man of his life illusion and you rob him of his happiness at the same stroke."When attachments to a culture are severed in an organization's attempt to change direction, employees and managers often experience deep feelings of grief. This phenomenon commonly occurs when external conditions dictate the need for a new strat-egy. Managers and employees often struggle to find meaning in a situation that changed many years before. Some people find comfort in memories; others find solace in the present. Weak linkages between strategic management and organizational culture can jeopardize performance and success. Deal and Kennedy emphasized that making strategic changes in an organization always threatens a culture:

People form strong attachments to heroes, legends, the rituals of daily life, the hoopla of extravaganza and ceremonies, and all the symbols of the workplace. Change strips relationships and leaves employees confused, insecure, and often angry. Unless something can be done to provide support for transitions from old to new, the force of a culture can neutralize and emasculate strategy changes.

12.10 Production/Operations Concerns When Implementing Strategies

Production/operations capabilities, limitations, and policies can significantly enhance or inhibit the attainment of objectives. Production processes typically constitute more than 70 percent of a firm's total assets. A major part of the strategy-implementation process takes place at the production site. Production-related decisions on plant size, plant location, product design, choice of equipment, kind of tooling, size of inventory, inventory control, quality control, cost control, use of standards, job specialization, employee training, equip-ment and resource utilization, shipping and packaging, and technological innovation can have a dramatic impact on the success or failure of strategy-implementation efforts.

Examples of adjustments in production systems that could be required to implement various strategies are provided in Table-12.8 for both for-profit and nonprofit organiza-tions. For instance, note that when a bank formulates and selects a strategy to add 10 new branches, a production-related implementation concern is site location. The largest bicycle company in the United States, Huffy, recently ended its own production of bikes and now contracts out those services to Asian and Mexican manufacturers. Huffy focuses instead on the design, marketing, and distribution of bikes, but it no longer produces bikes itself. The Dayton, Ohio, company closed its plants in Ohio, Missouri, and Mississippi.

Table -12.8 Production Management and Strategy Implementation

Type of Organization	Strategy Being Implemented	Production System Adjustments
Hospital	Adding a cancer center (product Development)	Purchase specialized equipment and add specialized people
Bank	Adding 10 new branches (Market Development)	Perform site location analysis.
Beer Brewery	Purchasing a barley farm operation (Backward Integration)	Revise the inventory control system.
Steel Manufacturer	Acquiring a fast-food chain (Unrelated Diversification)	Improve the quality control system
Computer Company	Purchasing a retail distribution chain (Forward Integration)	After the shipping, packaging, and transportation systems

Just-in-time (IT) production approaches have withstood the test of time. JIT signifi-cantly reduces the costs of implementing strategies. With JIT, parts and materials are delivered to a production site just as they are needed, rather than being stockpiled as a hedge against later deliveries. Harley-Davidson reports that at one plant alone, JIT freed $22 million previously tied up in inventory and greatly reduced reorder lead time.

Factors that should be studied before locating production facilities include the avail-ability of major resources, the prevailing wage rates in the area, transportation costs related to shipping and receiving, the location of major markets, political risks in the area or country, and the availability of trainable employees.

For high-technology companies, production costs may not be as important as produc-tion flexibility because major product changes can be needed often. Industries such as biogenetics and plastics rely on production systems that must be flexible enough to allow frequent changes and the rapid introduction of new products. An article in the Harvard Business Review explained why some organizations get into trouble:

They too slowly realize that a change in product strategy alters the tasks of a pro-duction system. These tasks, which can be stated in terms of requirements for cost, product flexibility, volume flexibility, product performance, and product consistency, determine which manufacturing policies are appropriate. As strate-gies shift over time, so must production policies covering the location and scale of manufacturing facilities, the choice of manufacturing process, the degree of vertical integration of each manufacturing facility, the use of R&D units, the control of the production system, and the licensing of technology.

A common management practice, cross-training of employees, can facilitate strategy implementation and can yield many benefits. Employees gain a better understanding of the whole business and can contribute better ideas in planning sessions. Cross-training employees can, however, thrust managers into roles that emphasize counseling and coach-ing over directing and enforcing and can necessitate substantial investments in training and incentives.

12.11 Human Resource Concerns When Implementing Strategies

More and more companies are instituting furloughs to cut costs as an alternative to laying off employees. Furloughs are temporary layoffs and even white-collar managers are being given furloughs, once confined to blue-collar workers.

A few organizations furloughing professional workers in 2009 included Gulfstream Aerospace, Media General, Gannett, the University of Maryland, Clemson University, and Spansion. Recent research shows that 11 percent of larger U.S. companies implemented furloughs during the global eco-nomic recession. Winnebago Industries, for example, required all salaried employees to take a week-long furlough, which saved the company $850,000. The Port of Seattle saved $2.9 million by furloughing all of its 800 nonunion workers, mostly professionals, for two weeks. Table-9 lists ways that companies today are reducing labor costs to stay finan-cially sound.

The job of human resource manager is changing rapidly as companies continue to downsize and reorganize. Strategic responsibilities of the human resource manager include assessing the staffing needs and costs for alternative strategies proposed during strategy formulation and developing a staffing plan for effectively implementing strategies. This plan must consider how best to manage spiraling health care insurance costs. Employers' health coverage expenses consume an average 26 percent of firms' net profits, even though most companies now require employees to pay part of their health insurance premiums.The plan must also include how to motivate employees and managers during a time when offs are common and workloads are high.

Table-12.9 Labor Cost·Saving Tactics

Salary freeze
Hiring freeze
Salary reductions
Reduce employee benefits
Raise employee contribution to health-care premiums Reduce employee 401 (k)/403(b) match
Reduce employee workweek
Mandatory furlough
Voluntary furlough
Hire temporary instead of full-time employees
Hire contract employees instead of full-time employees
Volunteer buyouts (Walt Disney is doing this)
Halt production for 3 days a week (Toyota Motor is doing this)
Layoffs
Early retirement
Reducing/eliminating bonuses

Source: Based on Dana Mattioli, "Employers Make Cuts Despite Belief Upturn Is Near," Wall Street Journal (April 23, 2009): B4.

The human resource department must develop performance incentives that clearly link performance and pay to strategies. The process of empowering managers and employees through their involvement in strategic-management activities yields the greatest benefits when all organizational members understand clearly how they will benefit personally if the firm does well. Linking company and personal benefits is a major new strategic responsi-bility of human resource managers. Other new responsibilities for human resource managers may include establishing and administering an employee stock ownership plan (ESOP), instituting an effective child-care policy, and providing leadership for managers and employees in a way that allows them to balance work and family.

A well-designed strategic-management system can fail if insufficient attention is given to the human resource dimension.

Human resource problems that arise when busi-nesses implement strategies can usually be traced to one of three causes: (1) disruption of social and political structures, (2) failure to match individuals' aptitudes with implementa-tion tasks, and (3) inadequate top management support for implementation activities.

Strategy implementation poses a threat to many managers and employees in an orga-nization. New power and status relationships are anticipated and realized. New formal and informal groups' values, beliefs, and priorities may be largely unknown.

Managers and employees may become engaged in resistance behavior as their roles, prerogatives, and power in the firm change. Disruption of social and political structures that accompany strategy execution must be anticipated and considered during strategy formulation and managed during strategy implementation.

A concern in matching managers with strategy is that jobs have specific and relatively static responsibilities, although people are dynamic in their personal development. Commonly used methods that match managers with strategies to be implemented include transferring managers, developing leadership workshops, offering career development activities, promotions, job enlargement, and job enrichment.

A number of other guidelines can help ensure that human relationships facilitate rather than disrupt strategy-implementation efforts. Specifically, managers should do a lot of chatting and informal questioning to stay abreast of how things are progressing and to know when to intervene. Managers can build support for strategy-implementation efforts by giving few orders, announcing few decisions, depending heavily on informal question-ing, and seeking to probe and clarify until a consensus emerges. Key thrusts that succeed should be rewarded generously and visibly.

It is surprising that so often during strategy formulation, individual values, skills, and abilities needed for successful strategy implementation are not considered. It is rare that a firm selecting new strategies or significantly altering existing strategies possesses the right line and staff personnel in the right positions for successful strategy implementation. The need to match individual aptitudes with strategy-implementation tasks should be consid-ered in strategy choice.

Inadequate support from strategists for implementation activities often undermines organizational success. Chief executive officers, small business owners, and government agency heads must be personally committed to strategy implementation and express this commitment in highly visible ways.

Strategists' formal statements about the importance of strategic management must be consistent with actual support and rewards given for activi-ties completed and objectives reached. Otherwise, stress created by inconsistency can cause uncertainty among managers and "employees at all levels.

Perhaps the best method for preventing and overcoming human resource problems in strategic management is to actively involve as many managers and employees as possible in the process. Although time consuming, this approach builds understanding, trust, commitment, and ownership and reduces resentment and hostility. The true potential of strategy formulation and implementation resides in people.

12.11.1 Employee Stock Ownership Plans (ESOPs)

An ESOP is a tax-qualified, defined-contribution, employee-benefit plan whereby employ-ees purchase stock of the company through borrowed money or cash contributions.

ESOPs empower employees to work as owners; this is a primary reason why the number of ESOPs have grown dramatically to more than 10,000 firms covering more than 10 million employ-ees. ESOPs now control more than $600 billion in corporate stock in the United States.

Besides reducing worker alienation and stimulating productivity, ESOPs allow firms other benefits, such as substantial tax savings. Principal, interest, and dividend payments on ESOP-funded debt are tax deductible. Banks lend money to ESOPs at interest rates below prime. This money can be repaid in pretax dollars, lowering the debt service as much as 30 percent in some cases.

"The ownership culture really makes a difference, when management is a facilitator, not a dictator," says Corey Rosen, executive director of the National Center for Employee Ownership.

If an ESOP owns more than 50 percent of the firm, those who lend money to the ESOP are taxed on only 50 percent of the income received on the loans. ESOPs are not for every firm, however, because the initial legal, accounting, actuarial, and appraisal fees to set up 'an ESOP are about $50,000 for a small or midsized firm, with annual administration expenses of about $15,000. Analysts say ESOPs also do not work well in firms that have fluctuating payrolls and profits. Human resource managers in many firms conduct prelim-inary research to determine the desirability of an ESOP, and then they facilitate its estab-lishment and administration if benefits outweigh the costs.

Wyatt Cafeterias, a southwestern United States operator of 120 cafeterias, also adopted the ESOP concept to prevent a hostile takeover. Employee productivity at Wyatt greatly increased since the ESOP began, as illustrated in the following quote:

The key employee in our entire organization is the person serving the customer on the cafeteria line. In the past, because of high employee turnover and entry-level wages for many line jobs, these employees received far less attention and recognition than managers. We now tell the tea cart server, "You own the place. Don't wait for the manager to tell you how to do your job better or how to provide better service. You take care of it." Sure, we're looking for productivity increases, but since we began pushing decisions down to the level of people who deal directly with customers, we've discovered an- awesome side effect- suddenly the work crews have this "happy to be here" attitude that the customers really love.

12.11.2 Balancing Work Life and Home Life

Work/family strategies have become so popular among companies today that the strate-gies now represent a competitive advantage for those firms that offer such benefits as elder care assistance, flexible scheduling, job sharing, adoption benefits, an on-site summer camp, employee help lines, pet care, and even lawn service referrals. New corporate titles such as work/life coordinator and director of diversity are becoming common.

Working Mother magazine annually published its listing of "The 100 Best Companies for Working Mothers" (www.workingmother.com). Three especially impor-tant variables used in the ranking were availability of flextime, advancement opportuni-ties, and equitable distribution of benefits among companies. Other important criteria are compressed weeks, telecommuting, job sharing, childcare facilities, maternity leave for both parents, mentoring, career development, and promotion for women..

Human resource managers need to foster a more effective balancing of professional and private lives because nearly 60 million people in the United States are now part of two-career families. A corporate objective to become more lean and mean must today include consideration for the fact that a good home life contributes immensely to a good work life.

The work/family issue is no longer just a women's issue. Some specific measures that firms are taking to address this issue are providing spouse relocation assistance as an employee benefit; providing company resources for family recreational and educational use; establishing employee country clubs, such as those at

IBM and Bethlehem Steel; and creating family/work interaction opportunities. A study by Joseph Pleck of Wheaton College found that in companies that do not offer paternity leave for fathers as a benefit, most men take short, informal paternity leaves anyway by combining vacation time and sick days.

Some organizations have developed family days, when family members are invited into the workplace, taken on plant or office tours, dined by management, and given a chance to see exactly what other family members do each day. Family days are inexpensive and increase the employee's pride in working for the organization. Flexible working hours during the week are another human resource response to the need for individuals to bal-ance work life and home life. The work/family topic is being made part of the agenda at meetings and 'thus is being discussed in many organizations.

Only 2.6 percent of Fortune 500 firms have a woman CEO. However, recent studies have found that companies with more female executives and directors outperform other firms.24 Judy Rosener at the University of California, Irvine, says, "Brain scans prove that men and women think differently, so companies with a mix of male and female executives will outperform competitors that rely on leadership of a single sex." It is not that women are better than men, Rosener says. It is the mix of thinking styles that is keyto manage-ment effectiveness.

During the first week of 2009, Ellen Kullman replaced Chad Holliday as CEO of DuPont, which brought to 12 the number of female CEOs running the 500 largest public firms in the United States. Thirteen is a record number, but only one more than the total for the prior year. Lynn Elsenhans became CEO of Sunoco in 2008. In 2008, two Fortune 500 women CEOs departed: Meg Whitman at eBay and Paula Reynolds at Safeco.

USA Today tracks the performance of women CEOs versus male CEOs, and their research shows virtually no difference in the two groups.P The year 2008 saw the S&P 500 stocks fall 38.5 percent, its worst year since 1937. The stock of firms that year with women CEOs fell 42.7 percent, but some firms run by women CEOs did much better, such as Kraft Foods, down only 18 percent under Irene Rosenfeld. Two firms doing great under woman CEOs are Avon under Andrea Jung and Reynolds American under Susan Ivey. Those stocks are up 65.4 percent and 20.8 percent, respectively, since those women became CEO.

There is great room for improvement in removing the glass ceiling domestically, espe-cially considering that women make up 47 percent of the U.S. labor force. Glass ceiling refers to the invisible barrier in many firms that bars women and minorities from top-level management positions. The United States leads the world in promoting women and minorities into mid- and top-level managerial positions in business.

Boeing's firing of CEO Harry Stonecipher for having an extramarital affair raised public awareness of office romance. However, just 12 percent of 391 companies surveyed by the American Management Association have written guidelines on office dating. The fact of the matter is that most employers in the United States turn a blind eye to marital cheating. Some employers, such as Southwest Airlines, which employs more than 1,000 married couples, explicitly allow consensual office relationships. Research suggests that more men than women engage in extramarital affairs at work, roughly 22 percent to 15 percent; however, the percentage of women having extramarital affairs is increasing steadily, whereas the percentage of men having affairs with co-workers is holding steady. If an affair is disrupting your work, then "the first step is to go to the offending person privately and try to resolve the matter. If that fails, then go to the human-resources manager seeking assistance."

Filing a discrimination lawsuit based on the affair is recommended only as a last resort because courts generally rule that co-workers' injuries are not perva-sive enough to warrant any damages.

12.11.3 Benefits of a Diverse Workforce

Toyota has committed almost $8 billion over 10 years to diversify its workforce and to use more minority suppliers. Hundreds of other firms, such as Ford Motor Company and Coca-Cola, are also striving to become more diversified in their workforces. TJX Companies, the parent of 1,500 T. J. Maxx and Marshall's stores, has reaped great benefits and is an exemplary company in terms of diversity.

An organization can perhaps be most effective when its workforce mirrors the diver-sity of its customers. For global companies, this goal can be optimistic, but it is a worth-while goal.

12.11.4 Corporate Wellness Programs

A recent Business Week cover story article details how firms are striving to lower the accelerating costs of employees' health-care insurance premiums. Many firms such as Scotts Miracle-Oro Company (based in Marysville, Ohio), IBM, and Microsoft are implementing wellness programs, requiring employees to get healthier or pay higher insurance premiums. Employees that do get healthier win bonuses, free trips, and pay lower premiums; nonconforming employees pay higher premiums and receive no "healthy" benefits. Wellness of employees has become a strategic issue for many firms, Most firms require a health examination as a part of an employment application, and healthiness is more and more becoming a hiring factor. Michael Porter, coauthor of Redefining Health Care, says, "We have this notion that you can gorge on hot dogs, be in a pie-eating contest, and drink every day, and society will take care of you. We can't afford to let individuals drive up company costs because they're not willing to address their own health problems."

Slightly more than 60 percent of companies with 10,000 or more employees had a wellness program in 2008, up from 47 percent in 2005.30 Among firms with wellness pro-grams, the average cost per employee was $7,173. However, in the weak economy of late, companies are cutting back on their wellness programs. Many employees say they are so stressed about work and finances they have little time to eat right and exercise. PepsiCo in 2008 introduced a $600 surcharge for all its employees that smoke; the company has a smoking-cessation program. PepsiCo's smoking quit rate among employees increased to 34 percent in 2008 versus 20 percent in 2007.

Wellness programs provide counseling to employees and seek lifestyle changes to achieve healthier living. For example, trans fats are a major cause of heart disease. Near elimination of trans fats in one's diet will reduce one's risk for heart attack by as much as 19 percent,. according to a recent article. New York City now requires restaurants to inform customers about levels of trans fat being served in prepared foods. Chicago is considering a similar ban on trans fats. Denmark in 2003 became the first country to strictly regulate trans fats.

Restaurant chains are only slowly reducing trans fat levels in served foods because (1) trans fat oils make fried foods crispier, (2) trans fats give baked goods a longer shelf life, (3) trans fat oils can be used multiple times compared to other cooking oils, and (4) trans fat oils taste better.

Three restaurant chains have switched to oils free of trans fat-Chili's, Ruby Tuesday, and Wendy's-but some chains still may use trans fat oils, including Kentucky Fried Chicken, McDonald's, Dunkin' Donuts, Taco Bell, and Burger King. Marriott International in February 2007 eliminated trans fats from the food it serves at its 2,300 North American hotels, becoming the first big hotel chain to do so, although the 18-hotel Lowes luxury chain is close behind. Marriott's change includes its Renaissance, Courtyard, and Residence Inn brands.

Saturated fats are also bad, so one should avoid eating too much red meat and dairy products, which are high in saturated fats. Seven key lifestyle habits listed in Table 7-16 may significantly improve health and longevity.

Table -12.10 The Key to Staying Healthy, Living to 100, and Being a "Well" Employee

1- Eat nutritiously-eat a variety of fruits and vegetables daily because they have ingredients that the body uses to repair and strengthen itself.

2- Stay hydrated-drink plenty of water to aid the body in eliminating toxins and to enable body organs to function efficiently; the body is mostly water.

3- Get plenty of rest-the body repairs itself during rest, so get at least seven hours of sleep nightly, preferably eight hours.

4- Get plenty of exercise-exercise vigorously at least 30 minutes daily so the body can release toxins and strengthen vital organs.

5- Reduce stress-the body's immune system is weakened when one is under stress, making the body vulnerable to many ailments, so keep stress to a minimum.

6- Do not smoke-smoking kills, no doubt about it anymore.

7- Take vitamin supplements—consult your physician, but because it is difficult for diet alone to supply all the nutrients and vitamins needed, supplements can be helpful in achieving good health and longevity.

Source: Based on Lauren Etter. "Trans Fats: Will They Get Shelved?" Wall Street Journal (December 8, 2006): A6; Joel Fuhrman. MD, Eat to Live (Boston: Little, Brown, 2003).

12.12 Summary

Successful strategy formulation does not at all guarantee successful strategy implem-entation. Although inextricably interdependent, strategy formulation and strategy implementation are characteristically different. In a single word, strategy implementatio-n means change. It is widely agreed that "the real work begins after strategies-are forrmulated." Successful strategy implementation requires the support of, as well as discipline and hard work from, motivated managers and employees. It is sometimes frightening to think that a single individual can irreparably sabotage strategy-implementation efforts.

Formulating the right strategies is not enough, because managers and employees must be motivated to implement those strategies. Management issues considered central strategy implementation include matching organizational structure with strategy, linking performance and pay to strategies, creating an organizational climate conducive to change, managing political relationships, creating a strategy-supportive culture, adapting production/operations processes, and managing human resources. Establishing annual objectives, devising policies, and allocating resources are central strategy-- implementation activities common to all organizations.

Depending on the size and type of the organization, other management issues could be equally important to successful strategy implementation.

12.13 Self- Assessment Questions

1. Define and give an example of furloughs as they could apply to your business school.

2. The chapter says strategy formulation focuses on effectiveness, whereas strategy implemen-tation focuses on efficiency. Which is-more important, effectiveness or efficiency? Give an example of each concept.

3. What are four types of resources that all organizations have? List them in order of impor-tance for your university or business school.

4. Considering avoidance, defusion, confrontation, which method of conflict resolution do you prefer most? Why? Which do you prefer least? Why?

5. Explain why Chandler's strategy-structure relationship commonly exists among firms.

6. If you owned and opened three restaurants after you graduated, would you operate from a functional or divisional structure? Why?

7. What are the two major disadvantages of an SBU-type organizational structure? What are the two major advantages? At what point in a firm's growth do you feel the advantages offset the disadvantages? Explain.

8. What are the benefits of establishing an ESOP in a company?

9. List reasons why is it important for an organization not to have a "glass ceiling."

10. Allocating resources can be a political and an ad hoc activity in firms that do not use strategic management. Why is this true? Does adopting strategic management ensure easy resource allocation? Why?

11. Compare strategy formulation with strategy implementation in terms of each being an art or a science.

12. Describe the relationship between annual objectives and policies.

13. Identify a long-term objective and two supporting annual objectives for a familiar organization.

12.14 Reference Books

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- Henry Mintzberg, Joseph Lampel(2005); Strategy Safari: A Guided Tour Through The Wilds of Strategic Mangament;Published by Free Press in 2005 (first published September 1st 2000)

- Tony Morden(2007);Principles of Strategic Management; Ashgate Publishing, Ltd., 01-Apr-2007

Unit -13 : Functional Implementation - II

Structure of Unit:

13.0 Objectives

After completing this unit, you would be able to:

- Explain Market Segmentation and Product Positioning as strategy implementation tools.
- Discuss Procedures for determining the worth of a business.
- Explain why projected financial statement analysis is a central strategy –implementation tool.
- Explain how to evaluate the attractiveness of debt versus stock as a source of capital to implement strategies.
- Discuss the nature and role of research and development in strategy implementation.
- Explain how management information systems can determine the success of strategy implementation efforts.

13.1 Introduction

Strategy implementation directly affects the lives of plant managers, division managers, department managers, sales managers, product managers, project managers, personnel managers, staff managers, supervisors, and all employees. In some situations, individuals may not have participated in the strategy-formulation process at all and may not appreciate, understand, or even accept the work and thought that went into strategy formulation. There may even be foot dragging or resistance on their part. Managers and employees who do not understand the business and are not committed to the business may attempt to sabotage strategy-implementation efforts in hopes that the organization will return to its old ways. The strategy-implementation stage of the strategic-management process is highlighted in Figure 13.1.

13.2 Current Marketing Issues

Countless marketing variables affect the success or failure of strategy implementation, and the scope of this text does not allow us to address all those issues. Some examples of marketing decisions that may require policies are as follows:

1. To use exclusive dealerships or multiple channels of distribution
2. To use heavy, light, or no TV advertising
3. To limit (or not) the share of business done with a single customer
4. To be a price leader or a price follower
5. To offer a complete or limited warranty
6. To reward salespeople based on straight salary, straight commission, or a combination salary/ commission

7. To advertise online or not

A marketing issue of increasing concern to consumers today is the extent to which companies can track individuals' movements on the Internet-and even be able to identify an individual by name and e-mail address. Individuals' wanderings on the Internet are no longer anonymous, as many persons still believe. Marketing companies such as DoubleClick, Flycast, AdKnowledge, AdForce, and Real Media have sophisticated meth-ods to identify who you are and your particular interests. Marketing of late has become more about building a two-way relationship with consumers than just informing consumers about a product or service. Marketers today must get their customers involved in their company Web site and solicit suggestions from customers in terms of product development, customer service, and ideas. The online community is much quicker, cheaper and effective than traditional focus groups & surveys.

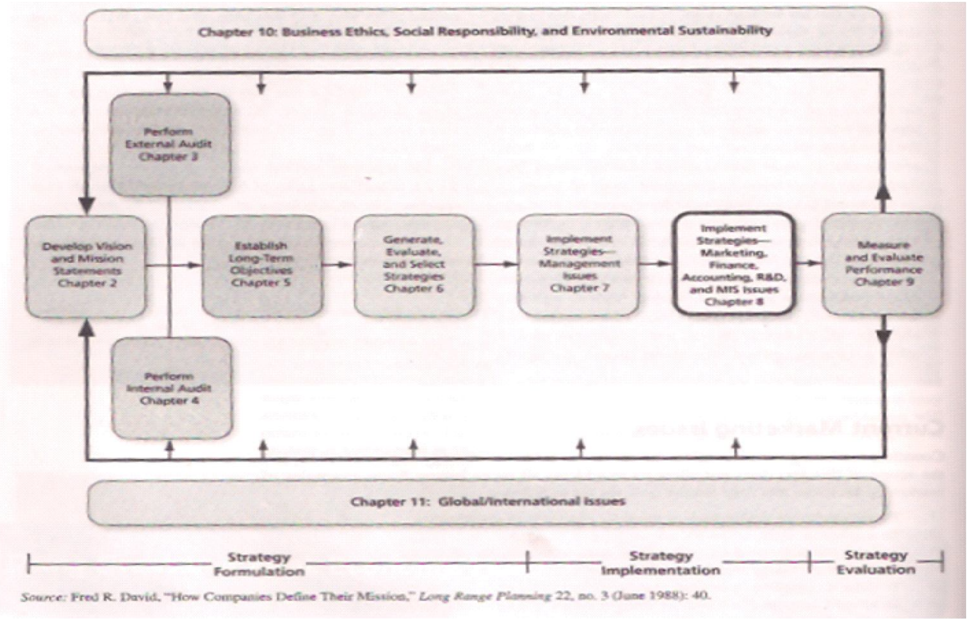

Figure - 13.1: Comprehensive Strategic-Management Model

Companies and organizations should encourage their employees to create wikis-Web sites that allow users to add, delete, and edit content regarding frequently asked questions and information across the firm's whole value chain of activities. The most common wiki is Wikipedia, but think of wikis as user-generated content. Know that anyone can change the content in a wiki but the group and other editors can change the content or changes that you submit.

Firms should provide incentives to consumers to share their thoughts, opinions, and experiences on the company Web site. Encourage consumers to network among them-selves on topics of their choosing on the company Web site. So the company Web site must not be all about the company-it must be all about the customer too. Perhaps offer points or discounts for customers who provide ideas and suggestions. This practice will not only encourage participation but will allow both the company and other customers to interact with "experts."

13.2.1 New Principles of Marketing

Today a business or organization's Web site must provide clear and simple instructions for customers to set up a blog and/or contribute to a wiki. Customers trust each others' opin-ions more than a company's marketing pitch, and the more they talk freely, the more the firm can learn how to improve its product, service, and' marketing. Marketers today monitor blogs daily to determine, evaluate, and influence opinions being formed by cus-tomers. Customers must not feel like they are a captive audience for advertising at a firm's Web site. Table 13.1 provides new principles of marketing according to Parise, Guinan, and Weinberg.

Wells Fargo and Bank of America in 2009 began to tweet customers, meaning they posted messages of 130 characters or less on Twitter.com to describe features of bank products. Some banks are placing marketing videos on YouTube. Discover Financial, American Express, and Citigroup all now have Facebook or MySpace pages. UMB Financial of Kansas City, Missouri, tweets about everything from the bank's financial stability to the industry's prospects. Steve Furman, Discover's director of e-commerce, says the appeal of social networking is that it provides "pure, instant" communication with customers.

When the big three U.S. auto makers were asking lawmakers for bailout funding, all three firms launched extensive Internet marketing campaigns to garner support for their requests and plans for the future. Ford's online marketing campaign was anchored by the Web site www.TheFordStory.com. In addition to a new Web site of its own, Chrysler launched a new marketing YouTube Channel named Grab Democracy and also posted ad information to its blog. GM employed similar marketing tactics to drive visitors to its main Web site.

Although the exponential increase in social networking and business online has created huge opportunities for marketers, it also has produced some severe threats. Perhaps the greatest threat is that any king of negative publicity travels fast online. For example, Dr Pepper recently suffered immensely when an attorney for the rock band Guns N' Roses accused the company of not following through on giving every American a soft drink if they released their album Chinese Democracy. Other examples abound, such as Motrin ads that lightheartedly talked about Mom's back pain from holding babies in slings, and Burger King's Whopper Virgin campaign, which featured a taste test of a Whopper versus a McDonald's Big Mac in remote areas of the world. Even Taco Bell suffered from its ads that featured asking 50 Cent (aka Curtis Jackson) if he would change his name to 79 Cent or 89 Cent for a day in exchange for a $10,000 donation to charity. Seemingly minor ethical and questionable actions can catapult these days into huge public relations problems for companies as a result of the monumental online social and business communications.

For example, Domino's, the nation's largest pizza delivery chain, spent a month in 2009 trying to dispel the video on YouTube and Facebook showing two of its employees doing gross things to a Domino's sub sandwich, including passing gas on salami.

In increasing numbers, people living in underdeveloped and poor nations around the world have cell phones but no computers, so the Internet is rapidly moving to cell phone platforms. This is opening up even larger markets to' online marketing. People in remote parts of Indonesia, Egypt, and Russia represent the fastest growing customer base for Opera Software ASA, a Norwegian maker of Internet browsers for mobile devices. Actually, persons who cannot afford computers live everywhere in every country, and many of these persons will soon be on the Internet on their cell phones. Cell phones are rapidly becoming used for data transfer, not just for phone calls. Companies such as Nokia, AT&T, Purple Labs SA of France, Japan's Access, Vodafone Group PLC, Siemens AG, Research in Motion, and Apple are spurring this transition by developing new and improved Web-capable mobile products every day.

Table 13-1 The New Principles of Marketing

1. Don't just talk at consumers-work with them throughout the marketing process.
2. Give consumers a reason to participate.
3. Listen to-and join-the conversation outside your company's Web site.
4. Resist the temptation to sell, sell, sell. Instead attract, attract, attract.
5. Don't control online conversations; let it flow freely.
6. Find a "marketing technologist," a person who has three excellent skill sets (marketing, technology, and social interaction).

7. Embrace instant messaging and chatting.

Source: Based on Salvatore Parise, Patricia Guinan, and Bruce Weinberg, "The Secrets of Marketing in a Web 2.0 World," Wall Street Journal (December 15, 2008): RJ.

13.2.2 Advertising Media

Recent research by Forrester Research reveals that people ages 18 to 27 spend more time weekly OR the Internet than watching television, listening to the radio, or watching DVDs or VHS tapes. Table 13.2 reveals why companies are rapidly coming to the realization that social networking sites and video sites are better means of reaching their customers than spending so many marketing dollars on traditional yellow pages or television, magazine, radio, or newspaper ads. Note the time that people spend on the Internet. And it is not just the time. Television viewers are passive viewers of ads, whereas Internet users take an active role in choosing what to look at-so customers on the Internet are tougher for marketers to reach."

Table-13.2 Average Amount of Time Spent by 18 to 27 yr Olds

Media	Hours
On the Internet	High-13.0
Watching television	
On their cell phone	Medium-7.0
Listening to the Radio	
Watching DVDs or VHSs	
Playing video games	Low-1.0
Reading magazines	

Source:Based on Ellen Byron, "A New Odd Couple: Google, P&G Swap Workers to Spur Innovation," *Wall Street Journal* (November 19.2008): AI.

New companies such as Autonet Mobile based in San Francisco are selling new technology equipment for cars so the front passenger may conduct an iChat video con-ference while persons in the back each have a laptop and watch a YouTube video or download music or wirelessly transfer pictures from a digital camera. Everyone in the vehicle can be online except, of course, the driver. This technology is now available for installation in nearly all cars and is accelerating the movement from hard media to Web-based media. With this technology also, when the vehicle drives into a new location, you may instantly download information on shows, museums, hotels, and other attractions around you.

Growth of Internet advertising is expected to decline from a 16 percent increase in 2008 to a 5 percent increase in 2009. With this slowdown, companies are changing the restrictions they previously imposed on the categories and formats of advertising. For example, marketers are more and more allowed to create bigger, more intrusive ads that take up more space on the Web page. And Web sites are allowing lengthier ads to run before short video clips play. And blogs are creating more content that doubles also as an ad.

Companies are also waiving minimum ad purchases. Companies are redesigning their Web sites to be much more interactive and are building new sponsorship programs and other enticements on their sites. Editorial content and advertising content are increasingly being mixed on blogs.

In 2009-2011, consumers will act rationally. JC Penney CEO Mike Ullman says, "Consumers now shop for what they 'need' and less for what they 'want.' And they don't need much." Essentials, such as food, health-care products, and beauty aids are selling, but even in those industries, consumers are shifting to less costly brands and stores. There is a need for marketers to convince consumers that their brand will make life eas-ier or better. Consumers now often wait until prices are slashed 75 percent or more to buy. Consumers today are very cautious about how they spend their money. Gone are the days when retailers could convince consumers to buy something they do not need.

JC Penney is among many firms that today have revamped their marketing to be more digital related. Penney's is segmenting its e-mail databases according to customers' shop-ping behaviors and then sending out relevant messages. Penney's corporate director of brand communications recently said, "Tailoring; the e-mail insures that our customers are receiving timely, relevant information."

Expectations for total U.S. advertising spending in 2009 may decline anywhere from 6.2 percent to 3 percent to about $160 billion as the fallout from global financial crises continues to cut into ad spending. Global ad spending is expected to decline about 0.5 percent. One bright spot, however, is online advertising expenditures that are expected to increase 5 percent in 2009 following a 16 percent increase in 2008. Companies are shifting ad dollars from newspaper, magazine, and radio to online media.

13.2.3 Purpose-Based Marketing

The global marketing chief at Procter & Gamble, Jim Stengel, recently started his own LLC business to try to persuade companies that the best way to sell in a weak economy is to "show customers how they can improve their lives" with your product or service. Stengel calls this "purpose-based marketing," and hundreds of firms have now adopted this approach successfully. He says there is need in an ad to build trust and an emotional connection to the customer in order to differentiate your product or service.In a weak economy when consumers are more interested in buying cheaper brands, Stengel acknowledges that ads must promote price, but he says ads must also show the intrinsic value of the product or service to be cost effective.

Stengel contends that ads should do both: promote low price and build emotional equity through "purpose-based appeal."

The Coca-Cola Company is leading the way to another new kind of selling in a weak economy. CEO Muhtar Kent at Coke says marketing today must "employ opti-mism." That is why Coca-Cola launched a new global ad campaign in 2009 appealing to consumers' longing for comfort and optimism. The new campaign features the new slo-gan "Open Happiness," which replaced Coke's prior popular slogan of three years, "The Coke Side of Life." The Coke CEO says marketers must use feel-good messages to counter the fallout from the economic crisis. Firms must today project to customers that their products or services offer a beacon of comfort and optimism. Coke's cola volume declined 4.0 percent in the United States in 2008. Coke Classic's U.S. volume fell about 16 percent from 1998 through 2007 as customers switched to bottled water, enhanced teas, and other alternative drinks.

13.2.4 Market Segmentation

Two variables are of central importance to strategy implementation: market segmentation and product positioning. Market segmentation and product positioning rank as marketing's most important contributions to strategic management.

Market segmentation is widely used in implementing strategies, especially for small and specialized firms. Market segmentation can be defined as the subdividing of a market into distinct subsets of customers according to needs and buying habits.

Market segmentation is an important variable in strategy implementation for at least three major reasons. First, strategies such as market development, product devel-opment, market penetration, and diversification require increased sales through new markets and products. To implement these strategies successfully, new or improved market-segmentation approaches are required. Second, market segmentation allows a firm to operate with limited resources because mass production, mass distribution, and mass advertising are not required. Market segmentation enables a small firm to com-pete successfully with a large firm by maximizing per-unit profits and per-segment sales. Finally, market segmentation decisions directly affect marketing mix variables: product, place, promotion, and price, as indicated in Table 13.3. For example, SnackWells, a pioneer in reduced-fat snacks, has shifted its advertising emphasis from low-fat to great taste as part of its new market-segmentation strategy.

Perhaps the most dramatic new market-segmentation strategy is the targeting 0 regional tastes. Firms from McDonald's to General Motors are increasingly modifying their products to meet different regional preferences within the United States. Campbell's has a spicier version of its nacho cheese soup for the Southwest, and Burger King offe breakfast burritos in New Mexico but not in South Carolina. Geographic and dem graphic bases for segmenting markets are the most commonly employed, as illustrated in Table 13.2.

Evaluating potential market segments requires strategists to determine the characteris-tics and needs of consumers, to analyze consumer similarities and differences, and to develop consumer group profiles. Segmenting consumer markets is generally much simpler and easier than segmenting industrial markets, because industrial products, such as electronic circuits and forklifts, have multiple applications and appeal to diverse customer groups.

Segmentation is a key to matching supply and demand, which is one of the thorniest problems in customer service. Segmentation often reveals that large, random fluctuations in demand actually consist of several small, predictable, and manageable patterns. Matching supply and demand allows factories to produce desirable levels without extra shifts, overtime, and subcontracting. Matching supply and demand also minimizes the number and severity of stock-outs. The demand for hotel rooms, for example, can be dependent on foreign tourists, businesspersons, and vacationers. Focusing separately on these three market segments, however, can allow hotel firms to more effectively predict overall supply and demand.

Banks now are segmenting markets to increase effectiveness. "You're dead in the water if you aren't segmenting the market," says Anne Moore, president of a bank consult-ing firm in Atlanta. The Internet makes market segmentation easier today because consumers naturally form "communities" on the Web.

Table 13.3 The Marketing Mix Component Variables

Product	Place	Promotion	Price
Quality	Distribution channels	Advertising	Level
Features and	Distribution coverage	Personal selling	Discounts &
options	Outlet location	Sales promotion	Allowances
Style	Sales Territories	Publicity	Payments terms
Brand name	Inventory Levels		
Packaging	and Locations		
Product line	Transportation carriers		
Warranty			
Service level			
Other services			

Sources: Jerome McCarthy, *Basic Marketing: A Managerial Approach,* 9th ed. (Homewood, IL: Richard D. Irwin, Inc., 1987): 37-44. Used with permission.

Does the Internet Make Market Segmentation Easier?

Yes. The segments of people whom marketers want to reach online are much more precisely defined than the segments of people reached through traditional forms of media, such as television, radio, and magazines.

For example, Quepasa.com is widely visited by Hispanics. _ larketers aiming to reach college students, who are notoriously difficult to reach via tradi-ional media, focus on sites such as collegec1ub.comand studentadvantage.com. The gay

d lesbian population, which is estimated to comprise about 5 percent of the U.S. popula-on, has always been difficult to reach via traditional media but now can be focused on at - tes such as gay.com. Marketers can reach persons interested in specific topics, such as zavel or fishing, by placing banners on related Web sites.

People all over the world are congregating into virtual communities on the Web by becoming members/customers/visitors of Web sites that focus on an endless range of topics. People in essence segment themselves by nature of the Web sites that comprise their "favorite places," and many of these Web sites sell information regarding their "visitors." Businesses and groups of individuals allover the world pool their purchasing power in Web sites to get volume discounts.

13.2.5 Product Positioning

After markets have been segmented so that the firm can target particular customer groups, the next step is to.find out what customers want and expect. This takes analysis and research. A severe mistake is to assume the firm knows what customers want and expect. Countless research studies reveal large differences between how customers define service and rank the importance of different service activities and how producers view services. Many firms have become successful by filling the gap between what customers and producers see as good service.

Table 13.4 Alternative Bases for Market Segmentation

Variable	Typical Breakdowns
	Geographic
Region	Pacific, Mountain, West North Central, West South Central, East North Central, East South Central, South Atlantic, Middle Atlantic, New England
County Size	A, B, C, D
City Size	Under 5,000; 5,000–20,000; 20,001–50,000; 50,001–100,000; 100,001–250,000; 250,001–500,000; 500,001–1,000,000; 1,000,001–4,000,000; 4,000,001 or over
Density	Urban, suburban, rural
Climate	Northern, southern
	Demographic
Age	Under 6, 6–11, 12–19, 20–34, 35–49, 50–64, 65+
Gender	Male, female
Family Size	1–2, 3–4, 5+
Family Life Cycle	Young, single; young, married, no children; young, married, youngest child under 6; young, married, youngest child 6 or over; older, married, with children; older, married, no children under 18; older, single; other
Income	Under $10,000; $10,001–$15,000; $15,001–$20,000; $20,001–$30,000; $30,001–$50,000; $50,001–$70,000; $70,001–$100,000; over $100,000
Occupation	Professional and technical; managers, officials, and proprietors; clerical and sales; craftspeople; foremen; operatives; farmers; retirees; students; housewives; unemployed
Education	Grade school or less; some high school; high school graduate; some college; college graduate
Religion	Catholic, Protestant, Jewish, Islamic, other
Race	White, Asian, Hispanic, African American
Nationality	American, British, French, German, Scandinavian, Italian, Latin American, Middle Eastern, Japanese
	Psychographic
Social Class	Lower lowers, upper lowers, lower middles, upper middles, lower uppers, upper uppers
Personality	Compulsive, gregarious, authoritarian, ambitious
	Behavioral
Use Occasion	Regular occasion, special occasion
Benefits Sought	Quality, service, economy
User Status	Nonuser, ex-user, potential user, first-time user, regular user
Usage Rate	Light user, medium user, heavy user
Loyalty Status	None, medium, strong, absolute
Readiness Stage	Unaware, aware, informed, interested, desirous, intending to buy
Attitude Toward Product	Enthusiastic, positive, indifferent, negative, hostile

What the customer believes is good service is paramount, not what the producer believes service should be.

Identifying target customers to focus marketing efforts on sets the stage for deciding how to meet the needs and wants of particular consumer groups. Product positioning is widely used for this purpose. Positioning entails developing schematic representations that reflect how your products or services compare to competitors' on dimensions most impor-tant to success in the industry. The following steps are required in product positioning:

Select key criteria that effectively differentiate products or services in the industry.

Diagram a two-dimensional product-positioning map with specified criteria on each axis.

Plot major competitors' products or services in the resultant four-quadrant matrix.

Identify areas in the positioning map where the company's products or services could be most competitive in the given target market. Look for vacant areas (niches).

Develop a marketing plan to position the company's products or services appropriately.

Because just two criteria can be examined on a single product-positioning map, multiple maps are often developed to assess various approaches to strategy implementation. Multidimensional scaling could be used to examine three or more criteria simultaneously, but this technique requires computer assistance and is beyond the scope of this text. Some examples of product-positioning maps are illustrated in Figure 8-2.

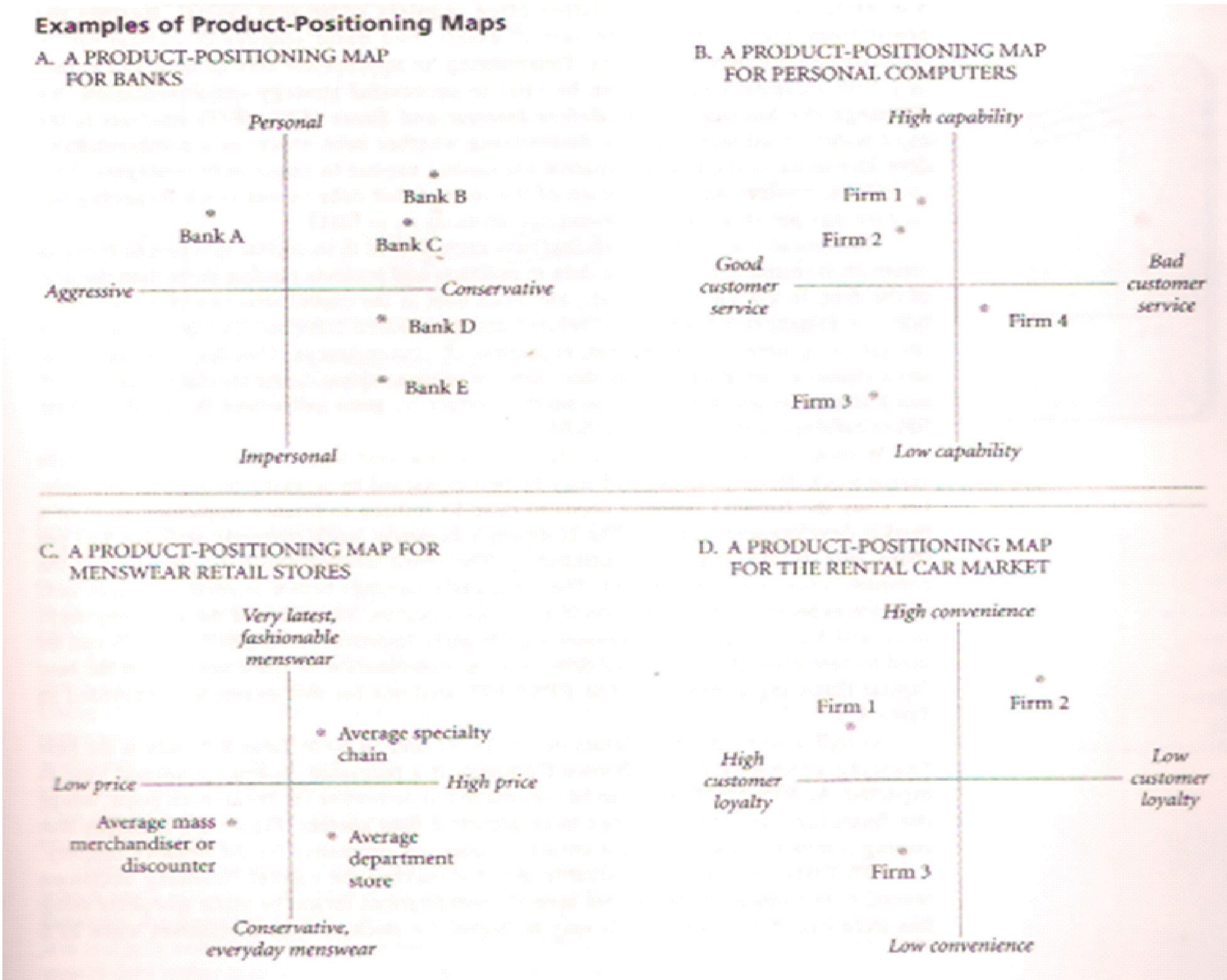

Figure 13.2

Some rules for using product positioning as a strategy-implementation tool are the following:

1. Look for the hole or vacant niche. The best strategic opportunity might be an unserved segment.
2. Don't serve two segments with the same strategy. Usually, a strategy successful with one segment cannot be directly transferred to another segment.
3. Don't position yourself in the middle of the map. The middle usually means a strat-egy that is not clearly perceived to have any distinguishing characteristics. This rule can vary with the number of competitors. For example, when there are only two competitors, as in U.S. presidential elections, the middle becomes the preferred strategic position.'!

An effective product-positioning strategy meets two criteria: (1) it uniquely distin-guishes a company from the competition, and (2) it leads customers to expect slightly less service than a company can deliver. Firms should not create expectations that exceed the service the firm can or will deliver. Network Equipment Technology is an example of a company that keeps customer expectations slightly below perceived performance. This is a constant challenge for marketers. Firms need to inform customers about what to expect and then exceed the promise. Underpromise and then overdeliver is the key!

13.3 Financial Accounting Issues

In this section, we examine several finance/accounting concepts considered to be central to strategy implementation: acquiring needed capital, developing projected financial state-ments, preparing financial budgets, and evaluating the worth of a business. Some examples of decisions that may require finance/accounting policies are these:

1. To raise capital with short-term debt, long-term debt, preferred stock, or common stock
2. To lease or buy fixed assets
3. To determine an appropriate dividend payout ratio
4. To use LIFO (Last-in, First-out), FIFO (First-in, First-out), or a market-value accounting approach
5. To extend the time of accounts receivable
6. To establish a certain percentage discount on accounts within a specified period of time
7. To determine the amount of cash that should be kept on hand

13.3.1 Acquiring Capital to Implement Strategies

Successful strategy implementation often requires additional capital. Besides net profit from operations and the sale of assets, two basic sources of capital for an organization are debt and equity. Determining an appropriate mix of debt and equity in a firm's capital structure can be vital to successful strategy implementation. An Earnings Per Share/Earnings Before Interest and Taxes (EPS/EBIT) analysis is the most widely used technique for determining whether debt, stock, or a combination of debt and stock is the best alternative for raising capital to implement strategies. This technique involves an examination of the impact that debt versus stock financing has on earnings per share under various assumptions as to EBIT.

Theoretically, an enterprise should have enough debt in its capital structure to boost its return on investment by applying debt to products and projects earning more than the cost of the debt. In low earning periods, too much debt in the capital structure of an organiza-tion can endanger stockholders' returns and jeopardize company survival. Fixed debt obligations generally must be met, regardless of circumstances. This does not mean that stock issuances are always better than debt for raising capital. Some special concerns with stock issuances are dilution of ownership, effect on stock price, and the need to share future earnings with all new shareholders.

Without going into detail on other institutional and legal issues related to the debt versus stock decision, EPSIEBIT may be best explained by working through an example. Let's say the Brown Company needs to raise $1 million to finance implementation of a market-development strategy.

The company's common stock currently sells for $50 per share, and 100,000 shares are outstanding. The prime interest rate is 10 percent, and the company's tax rate is 50 percent. The company's earnings before interest and taxes next year are expected to be $2 million if a recession occurs, $4 million if the economy stays as is, and $8 million if the economy significantly improves. EPSIEBIT analysis can be used to determine if all stock, all debt, or some combination of stock and debt is the best capital financing alternative. The EPSIEBIT analysis for this example is provided in Table 13.5.

Table 13.5 EPS/EBIT Analysis for the Brown Company

	Common Stock Financing			Debt Financing			Combination Financing		
	Recession	*Normal*	*Boom*	*Recession*	*Normal*	*Boom*	*Recession*	*Normal*	*Boom*
EBIT	$2.0	$ 4.0	$ 8.0	$2.0	$ 4.0	$ 8.0	$2.0	$ 4.0	$ 8.0
Interest[a]	0	0	0	.10	.10	.10	.05	.05	.05
EBT	2.0	4.0	8.0	1.9	3.9	7.9	1.95	3.95	7.95
Taxes	1.0	2.0	4.0	.95	1.95	3.95	.975	1.975	3.975
EAT	1.0	2.0	4.0	.95	1.95	3.95	.975	1.975	3.975
#Shares[b]	.12	.12	.12	.10	.10	.10	.11	.11	.11
EPS[c]	8.33	16.66	33.33	9.5	19.50	39.50	8.86	17.95	36.14

Source: As indicated by the EPS values of 9.5, 19.50, and 39.50 in Table 8-5, debt is the best financing alternative for the Brown Company if a recession, boom, or normal year is expected. An EPSIEBIT chart can be constructed to determine the break-even point, where one financing alternative becomes more attractive than another.

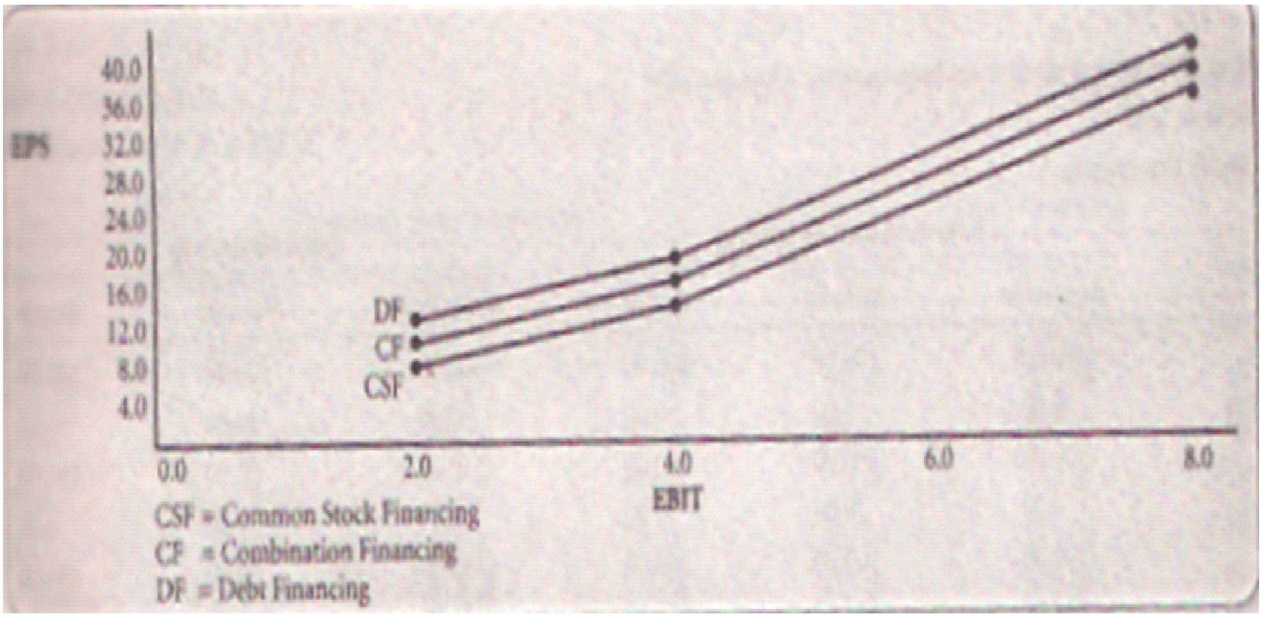

Figure 13.3 : Indicates That Issuing Common Stock is the Least Attractive Financing Alternative for the Brown Company

EPSIEBIT analysis is a valuable tool for making the capital financing decisions needed to implement strategies, but several considerations should be made whenever using this technique. First, profit levels may be higher for stock or debt alternatives when EPS levels are lower. For example, looking only at the earnings after taxes (EAT) values in Table 8-5, you can see that the common stock option is the best alternative, regardless of economic conditions. If the Brown Company's mission includes strict profit maximization, as opposed to the maximization of stockholders' wealth or some other criterion, then stock rather than debt is the best choice of financing.

Another consideration when using EPSIEBIT analysis is flexibility. As an organiza-tion's capital structure changes, so does its flexibility for considering future capital needs. Using all debt or all stock to raise capital in the present may impose fixed obligations, restrictive covenants, or other constraints that could severely reduce a firm's ability to raise additional capital in the future. Control is also a concern. When additional stock is issued to finance strategy implementation, ownership and control of the enterprise are diluted. This can be a serious concern in today's business environment of hostile takeovers, merg-ers, and acquisitions.

Dilution of ownership can be an overriding concern in closely held corporations in which stock issuances affect the decision-making power of majority stockholders. For example, the Smucker family owns 30 percent of the stock in Smucker's, a well-known jam and jelly company. When Smucker's acquired Dickson Family, Inc., the company used mostly debt rather than stock in order not to dilute the family ownership.

When using EPSIEBIT analysis, timing in relation to movements of stock prices, interest rates, and bond prices becomes important. In times of depressed stock prices, debt may prove to be the most suitable alternative from both a cost and a demand stand-point. However, when cost of capital (interest rates) is high, stock issuances become more attractive.

13.3.2 New Source of Funding

Credit unions were not involved in the subprime-loan market, 60 many of them are flush with cash and are making loans, especially to small businesses. Deposits to credit unions were also up when many investors abandoned the stock market. Roughly 27 percent of the 8,137 U.S. credit unions offer business loans.P The amount of businesses loans was up 18 percent in 2008 to $33 billion, and the average loan size was $215,000.

Many credit unions want to give more business loans, but the 1998 federal law (Credit Union Membership Access Act) caps the amount of business loans credit unions can have at 12.25 percent of their assets. Credit unions are trying to get this law changed, but of course banks are lobbying hard to have the law remain in place. Credit unions are chartered as nonprofit cooperative institutions owned by their members. Thus credit unions are tax-exempt organizations. Bankers argue that allowing credit unions to give more business loans would give them an unfair competitive advantage over traditional banks.

13.3.3 Projected Financial Statements

Projected financial statement analysis is a central strategy-implementation technique because it allows an organization to examine the expected results of various actions and approaches. This type of analysis can be used to forecast the impact of various implementation decisions (for example, to increase promotion expenditures by 50 percent to support a market-development strategy, to increase salaries by 25 percent to support a market-penetration strategy, to increase research and development expenditures by 70 percent to support product development, or to

sell $1 million of common stock to raise capital for diversification). Nearly all financial institutions require at least three years of projected financial statements whenever a business seeks capital. A projected income statement and balance sheet allow an organization to compute jected financial ratios under various strategy-implementation scenarios. When compared prior years and to industry averages, financial ratios provide valuable insights into the feasibility of various strategy-implementation approaches.

Primarily as a result of the Enron collapse and accounting scandal and the ensuing Sarbanes-Oxley Act, companies today are being much more diligent in preparing pro-jected financial statements to "reasonably rather than too optimistically" project future expenses and earnings. There is much more care not to mislead shareholders and other constituencies.

There are six steps in performing projected financial analysis:

Prepare the projected income statement before the balance sheet. Start by forecast-ing sales as accurately as possible. Be careful not to blindly push historical percent-ages into the future with regard to revenue (sales) increases. Be mindful of what the firm did to achieve those past sales increases, which may not be appropriate for the future unless the firm takes similar or analogous actions (such as opening a similar number of stores, for example). If dealing with a manufacturing firm, also be mindful that if the firm is operating at 100 percent capacity running three eight-hour shifts per day, then probably new manufacturing facilities (land, plant, and equipment) will be needed to increase sales further.

Use the percentage-of-sales method to project cost of goods sold (CGS) and the expense items in the income statement. For example, if GGS is 70 percent of sales in the prior year (as it is in Table 8-8), then use that same percentage to calculate CGS in the future year-unless there is a reason to use a different percentage. Items such as interest, dividends, and taxes must be treated independently and cannot be forecasted using the percentage-of-sales method.

Calculate the Projected Net Income:

Subtract from the net income any dividends to be paid for that year. This remain-ing net income is retained earnings (RE). Bring this retained earnings amount for that year (N! - DIV = RE) over to the balance sheet by adding it to the prior year's RE shown on the balance sheet. In other words, every year a firm adds its RE for that particular year (from the income statement) to its historical RE total on the balance sheet. Therefore, the RE amount on the balance sheet is a cumula-tive number rather than money available for strategy implementation! Note that RE is the first projected balance sheet item to be entered. Due to this accounting procedure in developing projected financial statements, the RE amount on the balance sheet is usually a large number. However, it also can be a low or even negative number if the firm has been incurring losses. The only way for RE to decrease from one year to the next on the balance sheet is (1) if the firm incurred an earnings loss that year or (2) the firm had positive net income for the year but paid out dividends more than the net income. Be mindful that RE is the key link between a projected income statement and balance sheet, so be careful to make this calculation correctly.

Project the balance sheet items, beginning with retained earnings and then forecast-ing stockholders' equity, long-term liabilities, current liabilities, total liabilities, total assets, fixed assets, and current assets (in that order). Use the cash account as the plug figure-that is, use the cash account to make the assets total the liabilities and net worth. Then make appropriate adjustments. For example, if the cash needed to balance the statements is too small (or too large), make appropriate changes to borrow more (or less) money than planned.

List comments (remarks) on the projected statements. Any time a significant change is made in an item from a prior year to the projected year, an explanation (remark) should be provided. Remarks are essential because otherwise pro formas are meaningless.

Projected Financial Statement Analysis for Mattei, Inc.

Because so many strategic management students have limited experience developing pro-jected financial statements, let's apply the steps outlined on the previous pages to Mattel, the huge toy company headquartered in EI Segundo, California. Mattel designs, manufac-tures, and markets toy products from fashion dolls to children's books. The company Web site is www.mattel.com. MatteI's recent income statements and balance sheets are pro-vided in Table 8-9 and Table 8-10 respectively.

On financial statements, different companies use different terms for various items, such as *revenues* or *sales* used for the same item by different companies. For net income, many firms use the term *earnings,* and many others use the term *profits.*

13.3.4 Financial Budgets

A *financial budget* is a document that details how funds will be obtained and spent for a specified period of time. Annual budgets are most common, although the period of time for a budget can range from one day to more than 10 years. Fundamentally, financial budget ing is a method for specifying what must be done to complete strategy implementation successfully. Financial budgeting should not be thought of as a tool for limiting expendi-tures but rather as a method for obtaining the most productive and profitable use of an organization's resources. Financial budgets can be viewed as the planned allocation of.a firm's resources based on forecasts of the future.

There are almost as many different types of financial budgets as there are types of organizations. Some common types of budgets include cash budgets, operating budgets, sales budgets, profit budgets, factory budgets, capital budgets, expense budgets, divisional budgets, variable budgets, flexible budgets, and fixed budgets. When an organization is experiencing financial difficulties, budgets are especially important in guiding strategy implementation Perhaps the most common type of financial budget is the *cash budget.* The Financial Accounting Standards Board (FASB) has mandated that every publicly held company in

the United States must issue an annual cash-flow statement in addition to the usual finan-cial reports. The statement includes all receipts and disbursements of cash in operations, investments, and financing. It supplements the Statement on Changes in Financial Position formerly included in the annual reports of all publicly held companies.

Financial budgets have some limitations. First, budgetary programs can become so detailed that they are cumbersome and overly expensive. Overbudgeting or underbud-geting can cause problems. Second, financial budgets can become a substitute for objectives. A budget is a tool and not an end in itself. Third, budgets can hide ineffi-ciencies if based solely on precedent rather than on periodic evaluation of circum-stances and standards. Finally, budgets are sometimes used as instruments of tyranny that result in frustration, resentment, absenteeism, and high turnover. To minimize the effect of this last concern, managers should increase the participation of subordinates in preparing budgets.

13.3.5 Evaluating the Worth of a Business

Evaluating the worth of a business is central to strategy implementation because integra-tive, intensive, and diversification strategies are often implemented by acquiring other firms. Other strategies, such as retrenchment and divestiture, may result in the sale of a division of an organization or of the firm itself. Thousands of transactions occur each year in which businesses are bought or sold in the United States. In all these cases, it is necessary to establish the financial worth or cash value of a business to successfully imple-ment strategies.

All the various methods for determining a business's worth can be grouped into three main approaches: what a firm owns, what a firm earns, or what a firm will bring in the market. But it is important to realize that valuation is not an exact science. The valuation of a firm's worth is based on financial facts, but common sense and intuitive judgment· must enter into the process. It is difficult to assign a monetary value to some factors-such as a loyal customer base, a history of growth, legal suits pending, dedicated employees, a favorable lease, a bad credit rating, or good patents-that may not be reflected in a firm's financial statements.

Also, different valuation methods will yield different totals for a firm's worth, and no prescribed approach is best for a certain situation. Evaluating the worth of a business truly requires both qualitative and quantita-tive skills.

The first approach in evaluating the worth of a business is determining its net worth or stockholders' equity. Net worth represents the sum of common stock, additional paid-in capital, and retained earnings. After calculating net worth, add or subtract an appropriate amount for goodwill, overvalued or undervalued assets, and intangibles. Whereas intangi-bles include copyrights, patents, and trademarks, goodwill arises only if a firm acquires another firm and pays more than the book value for that firm.

The second approach to measuring the value of a firm grows out of the belief that the worth of any business should be based largely on the future benefits its owners may derive through net profits. A conservative rule of thumb is to establish a business's worth as five times the firm's current annual profit. A five-year average profit level could also be used.

When using the approach, remember that firms normally suppress earnings in their finan-cial statements to minimize taxes.

The third approach is called the price-earnings ratio method. To use this method, divide the market price of the firm's common stock by the annual earnings per share and multiply this number by the firm's average net income for the past five years.

The fourth method can be called the outstanding shares method. To use this method, simply multiply the number of shares outstanding by the market price per share and add a premium. The premium is simply a per-share dollar amount that a per-son or firm is willing to pay to control (acquire) the other company.

Business evaluations are becoming routine in many situations. Businesses have many strategy-implementation reasons for determining their worth in addition to preparing to be sold or to buy other companies. Employee plans, taxes, retirement packages, mergers, acquisitions, expansion plans, banking relationships, death of a principal, divorce, partner-ship agreements, and IRS audits are other reasons for a periodic valuation. It is just good business to have a reasonable understanding of what your firm is worth. This knowledge protects the interests of all parties involved.

13.3.6 Deciding Whether to Go Public

Going public means selling off a percentage of your company to others in order to raise capital; consequently, it dilutes the owners' control of the firm. Going public is not recom-mended for companies with less than $10 million in sales because the initial costs can be too high for the firm to generate sufficient cash flow to make going public worthwhile. One dollar in four is the average total cost paid to lawyers, accountants, and underwriters when an initial stock issuance is under $1 million; 1 dollar in 20 will go to cover these costs for issuances over $20 million.

In addition to initial costs involved with a stock offering, there are costs and obliga-tions associated with reporting and management in a publicly held firm. For firms with more than $10 million in sales, going public can provide major advantages: It can allow the firm to raise capital to develop new products, build plants, expand, grow, and market products and services more effectively.

13.4 Research and Development (R&D) Issues

Research and development (R&D) personnel can play an integral part in strategy implementation. These individuals are generally charged with developing new products and improving old products in a way that will allow effective strategy implementation.

R&D employees and managers perform tasks that include transferring complex technology, adjusting processes to local raw materials, adapting processes to local mar-kets, and altering products to particular tastes and specifications. Strategies such as product development, market penetration, and related diversification require that new products be successfully developed and that old products be significantly improved. But the level of management support for R&D is often constrained by resource availability.

Technological improvements that affect consumer and industrial products and services shorten product life cycles. Companies in virtually every industry are relying on the development of new products and services to fuel profitability and growth. 15 Surveys suggest that the most successful organizations use an R&D strategy that ties external opportunities to internal strengths and is linked with objectives. Well-formulated R&D policies match market opportunities with internal capabilities. R&D policies can enhance strategy implementation efforts to:

1. Emphasize product or process improvements.
2. Stress basic or applied research.
3. Be leaders or followers in R&D.
4. Develop robotics or manual-type processes.
5. Spend a high, average, or low amount of money on R&D.
6. Perform R&D within the firm or to contract R&D to outside firms.
7. Use university researchers or private-sector researchers.

Pfizer Inc. has only a few new drugs in its pipeline to show for its $7.5 billion R&D budget, so the firm is laying off 5,000 to 8,000 of its researchers and scientists in labs around the world. Cash-strapped consumers are filling fewer prescriptions and are turn-ing more and more to generic drugs. Pfizer is bracing for the 2011 expiration of its patent on cholesterol fighter Lipitor, the world's top-selling drug that alone accounts for aquarter of Pfizer's roughly $48 billion in annual revenue. Pfizer's $7.5 billion R&D budget is the largest of any drug maker. The firm recently scrapped two drugs nearly ready to go to market-insulin spray Exubera and a Lipitor successor drug-after spend-ing billions to develop them. Research areas that Pfizer is exiting include anemia, bone health, gastrointestinal disorders, obesity, liver disease, osteoarthritis, and peripheral artery disease.

There must be effective interactions between R&D departments and other functional departments in implementing different types of generic business strategies. Conflicts between marketing, finance/accounting, R&D, and information systems departments can be minimized with clear policies and objectives.

If technology is changing rapidly and the market is growing slowly, then a major effort in R&D may be very risky, because it may lead to the development of an ultimately obsolete technology or-one for which there is no market.

If technology is changing slowly but the market is growing quickly, there generally is not enough time for in-house development. The prescribed approach is to obtain R&D expertise on an exclusive or nonexclusive basis from an outside firm.

If both technical progress and market growth are fast, R&D expertise should be obtained through acquisition of a well-established firm in the industry.

There are at least three major R&D approaches for implementing strategies. The first strategy is to be the first firm to market new technological products. This is a glamorous and exciting strategy but also a dangerous one. Firms such as 3M and General Electric have been successful with this approach, but many other pioneering firms have fallen, with rival firms seizing the initiative.

A second R&D approach is to be an innovative imitator of successful products, thus minimizing the risks and costs of start-up. This approach entails allowing a pioneer firm to develop the first version of the new product and to demonstrate that a market exists. Then, laggard firms develop a similar product. This strategy requires excellent R&D personnel and an excellent marketing department.

A third R&D strategy is to be a low-cost producer by mass-producing products simi-lar to but less expensive than products recently introduced. As a new product is accepted by customers, price becomes increasingly important in the buying decision. Also, mass marketing replaces personal selling as the dominant selling strategy. This R&D strategy, requires substantial investment in plant and equipment but fewer expenditures in R&D than the two approaches described previously.

R&D activities among U.S. firms need to be more closely aligned to business objectives. There needs to be expanded communication between R&D managers and strategists. Corporations are experimenting with various methods to achieve this improved communication climate, including different roles and reporting arrangements for managers and new methods to reduce the time it takes research ideas to become reality.

Perhaps the most current trend in R&D management has been lifting the veil of secrecy whereby firms, even major competitors, are joining forces to develop new prod-ucts. Collaboration is on the rise due to new competitive pressures, rising research costs, increasing regulatory issues, and accelerated product development schedules. Companies not only are working more closely with each other on R&D, but they are also turning to consortia at universities for their R&D needs. More than 600 research consortia are now in operation in the United States. Lifting of R&D secrecy among many firms through collab-oration has allowed the marketing of new technologies and products even before they are available for sale. For example, some firms are collaborating on the efficient design of solar panels to power homes and businesses.

13.5 Management Information Systems (MIS) Issues

Firms that gather, assimilate, and evaluate external and internal information most effec-tively are gaining competitive advantages over other firms. Having an effective management information system (MIS) may be the most important factor in differentiating successful from unsuccessful firms. The process of strategic management is facilitated immensely in firms that have an effective information system.

Information collection, retrieval, and storage can be used to create competitive advantages in ways such as cross-selling to customers, monitoring suppliers, keeping managers and employees informed, coordinating activities among divisions, and manag-ing funds. Like inventory and human resources, information is now recognized as a valuable organizational asset that can be controlled and managed. Firms that implement strategies using the best information will reap competitive advantages in the twenty-first century.

A good information system can allow a firm to reduce costs. For example, online orders from salespersons to production facilities can shorten materials ordering time and reduce inventory costs. Direct communications between suppliers, manufacturers, mar-keters, and customers can link together elements of the value chain as though they were one organization. Improved quality and service often result from an improved information system.

Firms must increasingly be concerned about computer hackers and take specific measures to secure and safeguard corporate communications, files, orders, and busi-ness conducted over the Internet.

Thousands of companies today are plagued by computer hackers who include disgruntled employees, competitors, bored teens, sociopaths, thieves, spies, and hired agents. Computer vulnerability is a giant, expen-sive headache.

Dun & Bradstreet is an example company that has an excellent information system.

Every D&B customer and client in the world has a separate nine-digit number. The data-base of information associated with each number has become so widely used that it is like a business Social Security number. D&B reaps great competitive advantages from its information system.

In many firms, information technology is doing away with the workplace and allow-ing employees to work at home or anywhere, anytime. The mobile concept of work allows employees to work the traditional 9-to-5 workday across any of the 24 time zones around the globe. Affordable desktop videoconferencing software allows employees to "beam in" whenever needed. Any manager or employee who travels a lot away from the office is a good candidate for working at home rather than in an office provided by the firm. Salespersons or consultants are good examples, but any person whose job largely involves talking to others or handling information could easily operate at home with the proper computer system and software.

Many people see the officeless office trend as leading to a resurgence of family togetherness in U.S. society. Even the design of homes may change from hav-ing large open areas to having more private small areas conducive to getting work done.

13.6 Summary

Successful strategy implementation depends on cooperation among all functional and divisional managers in an organization. Marketing departments are commonly charged with implementing strategies that require significant increases in sales revenues in new areas and with new or improved products. Finance and accounting managers must devise effective strategy-implementation approaches at low cost and minimum risk to that firm. R&D managers have to transfer complex technologies or develop new technologies to successfully implement strategies. Information systems managers are being called upon more and more to provide leadership and training for all individuals in the firm. The nature and role of marketing, finance/ accounting, R&D, and management information systems activities, coupled with the management activities described in this chapter, largely deter-mine organizational success.

13.7 Self-Assessment Questions

1. Describe some marketing, finance/accounting, R&D, and management information systems activities that a small restaurant chain might undertake to expand into a neighboring state.
2. Complete the following EPSIEBIT analysis for a company whose stock price is $20, interest rate on funds is 5 percent, tax rate is 20 percent, number of shares outstanding is 500 million, and EBIT range is $100 million to $300 million. The firm needs to raise $200 million in capital. Use the accompanying table to complete the work.
3. Under what conditions would retained earnings on the balance sheet decrease from one year to the next?
4. In your own words, list all the steps in developing projected financial statements.
5. Why should you be careful not to use historical percentages blindly in developing projected financial statements?

6. Why is it both important and necessary to segment markets and target groups of customers, rather than market to all possible consumers?

7. For companies in general, identify and discuss three opportunities and three threats associated with social networking activities on the Internet.

8. Do you agree or disagree with the following statement? "Television viewers are passive viewers of ads, whereas Internet users take an active role in choosing what to look also customers on the Internet are tougher for marketers to reach." Explain your reasoning.

9. What are the three major R&D approaches to implementing strategies? Which approach would you prefer as owner of a small software company? Why?

10. Discuss the limitations of EPSIEBIT analysis.

11. Explain how marketing, finance/accounting, R&D, and management information systems managers' involvement in strategy formulation can enhance strategy implementation.

13.8 Reference Books

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Unit - 14 : Strategic Evaluation and Control

Structure of Unit:

14.0 Objectives

After completing this unit, you would be able to:

- Understand the relationship between organizations and evaluation;
- Classify the business evaluation process;
- Point out various evaluation techniques affecting business decisions;
- Understand difference between strategic control and operation control.

14.1 Introduction

The markets over the years have experienced disorder in industry and economics plans. In order to change that situation, the organizations can use of external and internal factors that play an improvement role to achieve goals and policies for having a clear vision and perspectives. It is required to have sensitive control for discipline of organization's strategic plan progress and utilizing of resources for the suitable strategy plan of action. Based on those mechanisms, the organization's strategy will improve. Thus, this mechanism is called strategic control. Therefore, an effective managing plan needs a strategy control and map. Planning system with the internal strengths and weaknesses factors as well as external opportunities and threats factors will reach its optimum position when the organization pays attention to monitoring strategies progress with key tactics of organization, simultaneously.

14.2 Importance of Strategic Evaluation

Strategy can neither be formulated nor adjusted to changing circumstances without a process of strategic evaluation. Whether performed by an individual or as a part of organizational preview process, strategy evaluations forms an essential step in the process of guiding an enterprise. Evaluation can be defined as a "careful retrospective assessment of the merit, worth and value of administration, output, and outcomes of governmental interventions, which is intended to play in future, practical action situations" (Vedung, 1997, p. 3). For some strategy evaluation is simply an appraisal of how well a business performs. Has it grown? Is the profit rate normal or better? If the answers to these questions are affirmative, it is argued that the firm's strategy must be sound. But the evaluation process is much more that that. It is the understanding of the long term critical factors that determine the quality of long term results that are often not directly affect the operating results. Thus, strategy evaluation is an attempt to look beyond the obvious facts regarding the short term health of the business and appraise instead those more fundamental factors and trends that govern success in the chosen field of endeavor.

Evaluation, the process of determining a program's utility or direction; is critical to program planning, budgeting, and management. Through evaluation, program planners can ascertain *how well* components of their program are functioning. Evaluation also provides clues as to *why* components may or may not work. Managers often need to determine whether their programs are having the intended effect on participants and the organization. Documenting a program's impact provides valuable information to decision and policy-makers, such as program management and bankers among others. Strategic evaluation can aid long-term strategic planning for managers, leaders, and policy-makers. Carefully documented results from an evaluation provide guidance to those planning similar strategies.

Program managers can use a variety of methods for evaluating programs, which yield different results and have different uses and purposes. Evaluation design and scope dictate the required resources. Several common types of evaluation are:

Process evaluations, which assesses the performance or completion of steps taken to achieve desired outcomes. Process evaluation can occur throughout the project cycle and can guide managers to make changes to maximize effectiveness. Examples of process measures are the number of ads shown in a media campaign.

Output measures, which are commonly used in process evaluations, help gauge a program's processes; they *describe* a project and its functioning (e.g., how well can they launch a new product or effectiveness of the ongoing ad campaign), rather than the ultimate effect of the program (e.g., changes in demand). Output measures allow managers to plan appropriately for clients or classes. Project planners can also use outputs to identify a need to better tailor strategies to a target population (for example, if the ad campaign is not successful) or monitor changes in project outputs.

Outcome evaluations, which consider program goals to determine if desired changes to attitudes, behavior, or knowledge have been attained as a result of the intervention. *Outcome metrics* are usually measured at the beginning *and* end of a project cycle or program. Examples of outcomes include changes in the demand or a quantifiable increase in the sales.

Impact evaluations, which seek to isolate strategy's impact on participants and organization, while filtering out effects from other potential sources. Although impact evaluations require a higher level of technical expertise, they are considered the "gold standard" of evaluation. Impact evaluations (known as "experimental" or "quasi-experimental" studies) compare a strategy group against one that is not.

The General Principal of Strategy Evaluation: The term strategy has been so widely used for different purposes that it has lost any clearly defined meaning. Normally a strategy is a set of objectives, policies and plans that taken together define the scope of an enterprise and its approach to survival and success. Alternatively, it is said that the particular policies, plans and objectives of a business express its strategy for coping with a complex competitive environment.

It is impossible to demonstrate conclusively that a particular business strategy is optimal or guarantee that it will work. Its only the test of critical flaws which could be justifiably applied to a business strategy, most fit within one these board criteria:

- **Consistency:** The strategy must not present mutually inconsistence goals and policies. Gross inconsistency within a strategy seems unlikely until it is realized that many strategies have not been explicitly formulated but have been evolved over time in an adhoc fashion. Even strategies that are the result of formal procedures may easily contain compromise arrangements between opposing power groups.

A key function of strategy is to provide coherence to organizational action. A clear and explicit strategy concept of strategy can foster a climate of implied coordination that is more efficient than most administrative mechanism. A clear consistent strategy, by contrast, allow a managers to negotiate a contract within minimum trade offs.

A final type of consistency that must be sought in strategy is between organizational objectives and the values of the management group. In consistency in this area is more of a problem in strategy formulation than in evaluation of a strategy that has already been implemented. The most frequent source of such conflict is growth. As business expands beyond the scale that allows an easy informal method of operation. While growth can be of course curtailed it will require special attention to a firm's competitive position if survival without growth is desired. The same basic issue arises when other type of personal or social values comes into conflict with existing or apparently necessary policies: the resolution of the conflict normally require an adjustment in the competitive strategy.

- **Consonance:** The strategy must represent an adaptive response to external environment and to the critical changes occurring within it. The way in which a business relates to its environment has two aspects: the business must both match and be adaptive to its environment and it must at the same time compete with other firms that are also trying to adapt. This dual character relationship between the firms and its environment has its analog in two different aspects of strategic choice and two different methods of strategy evaluation.

  The first aspect of fit deals with the basic mission or scope of the business and the second with its special competitive position. Analysis of the first is normally done by looking at the changing social and economic conditions over time. Analysis of the second by contrast typically focuses on the difference across firms at a given time. The first is called *generic* aspect and the second is called *competitive* aspect.

  Generic strategy deals with the creation of social values with the question of weather the products and service being created is worth more that their cost. Competitive strategy by contrast deals with the firm's need to capture some of the social values as profit.

- **Advantage:** The strategy must provide for the creation and /or maintenance of a competitive advantage in the selected area of activity. Competitive strategy, in contrast with generic strategy, focuses on the differences among firms rather than their common missions. The problem it addresses is not so much "how can this function be performed' but "how can we perform it either better than, or at least instead of, our competition?"

  Competitive advantage can normally be traced to one of three roots:

  - Superior Skills
  - Superior Resources
  - Superior Position

  A firm's skills can be a source of advantage if they are based on its own history of learning by doing and if they are rooted in coordinated behavior of many people. Skills are based on generally understood scientific principles, on training that can be purchased by competitors, or which can be analyzed and replicated by others are nit sources of sustained advantage. The skills which compose advantages are usually organizational, rather than individual skills. They involve the adept coordination or collaboration of individual specialists and are built through the interplay of investment, work and learning. Unlike physical assets, skills are enhanced by their use. Skills that are not continually used and improved will deteriorate.

Resources include patents, trademark rights, specialized physical assets and the firm's working relationships with suppliers and distribution channels. Resources that constitute advantages are specialized to firm, are builds up slowly over time through the accumulated exercise of superior skills, or are obtained through being an insightful first mover, or by just plain luck.

A firm's position consists of the products or services it provides, the market segments it sells to, and the degree to which it is isolated from direct competition. In general, the best positions involve supplying very uniquely valuable products to price insensitive buyers, whereas poor positions involve being one of many firms supplying marginally products to very well informed price sensitive buyers.

Positional advantage is the result of foresight, superior skill and resources. Once gained, a good position is defensible. This means that it (i) returns enough value to warrant its continued maintenance and (ii) would be so costly to capture that rivals are deterrent from full scale attacks on the core of the business.

Positional advantages are of two types: (1) first movers advantages and (2) reinforces.

Other position based advantages follow from such factors as:

- The ownership of special raw material sources or advantageous long term supply contracts.
- Being geographically located near key customers in a business involving significant fixed investment and high transport costs.
- Being a leader in a service field that permits or requires the building of a unique experience base while serving clients.
- Being a full line producer in a market with heavy trade up phenomena.
- Having a wide reputation for providing a needed product or service trait reliability and dependability.

- **Feasibility:** The financial resources of a business are the easiest to quantify and are normally the first limitation against which a strategy is tested.

  The less quantifiable but actually more rigid limitation on strategic choice is that imposed by the individual and organizational capabilities that are available.

14.3 Importance of Participants and Barriers to Strategic Evaluation

There are five major types of barriers in evaluation:

The limits of control, difficulties in measurement, resistance to evaluation, tendency to rely on short-term assessment, and relying on efficiency versus effectiveness.

Limits of Control: By its very nature, any control mechanism presents the dilemma of too much versus too little control. It is never an easy task for strategists to decide the limits of control. Too much control may impair the ability of managers, adversely affect initiative and creativity, and create unnecessary impediments to efficient performance. On the other hand, too less control may make the strategic evaluation process ineffective and redundant.

Difficulties in Measurement: The process of evaluation is fraught with the danger of difficulties in measurement. These mainly relate to the reliability and validity of the measurement techniques used for evaluation, lack of quantifiable objectives or performance standards, and the inability of the information system to provide timely and valid information. The control system may be distorted and may not evaluate uniformly or may measure attributes which are not intended to be evaluated.

Resistance to Evaluation: The evaluation process involves controlling the behavior of individuals and, like any other similar organizational mechanism, is likely to be resisted by managers.

Short-termism: Managers often tend to rely on short-term implications of activities and try to measure the immediate results. Often, the long-term impact of performance on strategy and the extended effects of strategy on performance is ignored. This is so as immediate assessment seems to be the easy way out and taking the long-term implications into account may be seen as too tedious.

Relying on Efficiency Versus Effectiveness: It is instructive to remember that efficiency is .doing the things rightly, while effectiveness is .doing the right things. There is often a genuine confusion among managers as to what constitutes effective performance. Measuring the wrong parameters may lead to a situation where the right type of performance does not get rewarded. In fact, sometimes performance that does not really contribute to the achievements of objectives may be rewarded if assessed on the basis of efficiency alone.

How can these barriers be avoided? In this context, it is apt to quote Andrews when he says: .the true function of measurement (or evaluation) is to increase perceptions of the problems limiting achievement.. This is indeed a profound statement. In Andrew's opinion, it is the attitude towards evaluation that is more important than the process of evaluation itself. For instance, bureaucratic control often ends up being control just for the sake of control and not for the real purpose of finding out what is obstructing effective performance. The real worth of evaluation lies in its ability to throw up the problems that are constraining achievement and then doing something about them so that performance can be made effective.

The basic issue in all evaluation should be that control should be dictated by strategy. There needs to be a vertical fit between the strategy requirements, and the evaluation and control exercised over the performance. The guidelines below are suggested in order to make controls effective.

- Control should involve only the minimum amount of information as too much information tends to clutter up the control system and creates confusion.
- Control should monitor only managerial activities and results even if the evaluation is difficult to perform.
- Controls should be timely so that corrective action can be taken quickly.
- Long-term and short-term controls should be used so that a balanced approach to evaluation can be adopted.
- Controls should aim at pinpointing exceptions as nitpicking does not result in effective evaluation. The 80:20 principle, where 20 percent of the activities result in 80 percent of achievement, needs to be emphasized. Getting bogged down with the activities that do not really count for achievement makes the evaluation ineffective.
- Reward for meeting or exceeding standards should be emphasized so that managers are motivated to perform. Unnecessary emphasis on penalties tends to pressurize the managers to rely on efficiency rather than effectiveness.

14.4 Strategic Control

Control of strategy can be characterized as a form of .steering control. Ordinarily, a significant time span occurs between initial implementation of a strategy and achievements of its intended results. During that time, numerous projects are undertaken, investments are made, and actions are undertaken to implement the new strategy. Also during that time, both the environmental situation and the firm's internal situation are developing and evolving. Strategic controls are necessary to steer the firm through these events. They must provide the basis for correcting the actions and directions of the firm in implementing its strategy as developments and changes in its environmental and internal situations take place.

Prudential Insurance Company provides a useful example of the proactive, steering nature of strategic control. Several years ago, Prudential committed to a long-term market development strategy wherein it would seek to attain the top position in the life insurance industry by differentiating its level of service from other competitors in the industry. Prudential decided to establish regional home offices, thus achieving a differential service advantages. Exercising strategic control, prudential managers used the experience at the first regional offices to reproject overall expenses and income associated with this strategy. In fact, the predicted expenses were so high that the location and original schedule for converting other regions had to be modified. Conversion of corporate headquarters was sharply revised on the basic of the other early feedback. Thus the steering control (strategic control) exercised by Prudential managers significantly altered the strategy long before the total plan was in place. In this case, major objectives remained in place while changes were made in the strategy; in other cases, strategic controls may initiate changes in objectives as well. The four basic types of strategic controls are:

1. Premise control
2. Implementation control
3. Strategic surveillance
4. Special alert control.

Premise Control: Every strategy is based on assumed or predicted conditions. These assumptions or predictions are planning premises; a firm's strategy is designed around these predicted conditions. Premise control is designed to check systematically and continuously whether or not the premises set during the planning and implementation process are still valid. If a vital premise is no longer valid, then the strategy may have to be changed. The sooner an invalid premise can be recognized and revised, the better the chances that an acceptable shift in the strategy can be devised.

Premises are primarily concerned with two types of factors: environmental and industry. They are described below.

A company has little or no control over environmental factors, but these factors exercised considerable influence over the success of the strategy. Inflation, technology, interest rates, regulation, and demographic/ social changes are examples of such factors. Strategies are usually based on key premises about these factors. These factors affect the performance of companies in a given industry. They differ among industries, and a company should be aware of the factors that influence success in its particular industry. Competitors, suppliers, substitutes, and barriers to entry are a few such factors about which strategies assumptions are made.

Premises, some major and some minor, are often made about numerous environmental and industry variables. To attempt to track every premise may be unnecessarily expensive and time-consuming. Therefore, managers must select those premises and variables that

(a) are likely to change and
(b) would have a major impact on the company and its strategy if they did.

The key premises should be identified during the planning process. The premises should be recorded, and responsibility for monitoring them should be assigned to the persons or departments who are qualified sources of information. For example, the sales force may be a valuable source for monitoring the expected price policy of major competitors, while the finance department might monitor interest rate trends. All premises should be placed on key success premise so as to avoid information overload. Premises should be update (new predictions) based on update information.

Finally, key areas within the company or key aspects of the strategy that the predicted changes may significant impact should be pre-identified so that adjustments necessitated by a revised premise can be determined and initiated. For example, senior marketing executives should be alerted about changes in competitors pricing policies in order to determine if revised pricing, product repositioning or other strategy adjustments are necessary.

Implementation Control: The action phase of strategic management is located in the series of steps, programs, investments, and moves undertaken over a period of time to implement the strategy. Special programs are undertaken. Functional areas initiate several strategy-related activities. Key people are added or reassigned. Resources are mobilized. In other words, managers convert broad strategic plans into concrete actions and results for specific units and individuals as they go about implementing strategy. And these actions take place incrementally over an extended period of time designed ultimately to enact the planned strategy and achieve long-term objectives. Strategic control can be undertaken within this context. We refer to this type of strategic control as implementation control. Implementation control is designed to assess whether the overall strategy should be changed in light of unfolding events and results associated with incremental steps and actions that implement the overall strategy. The earlier example of Prudential Insurance Company updating cost and revenue projections based on early experiences with regional home offices is an illustration of an implementation control.

The two basic types of implementation control are:

(1) monitoring strategic thrusts (new or key strategic programs) and
(2) milestone reviews.

Implementing broad strategies often involves undertaking several new strategic projects specific narrow undertakings that represent part of what needs to be done if the overall strategy is to be accomplished. These projects or thrusts provide a source of information from which managers can obtain feedback that helps determine whether the overall strategy is progressing as planned and whether it needs to be adjusted or changed.

While strategic thrusts seem a readily apparent type of control, using them as control sources is not always easy to do. Early experience may be difficult to interpret. Clearly identifying and measuring early steps and promptly evaluating the overall strategy in light of this early, isolated experience can be difficult.

Two approaches are useful in enacting implementation controls focused on monitoring strategic thrusts. One way is to agree early in the planning process on which thrusts, or phases of those thrusts, *are critical factors in the success of the strategy or of the thrust***.** Managers responsible for these implementation controls single these out from other activities and observe them frequently.

The second approach for monitoring strategic thrusts is to use stop/go assessments linked to a series of meaningful thresholds (time, costs, research and development, success, etc.) associated with particular thrusts. Days Inns nationwide market development strategy in the early 1980s included a strategic thrust of regional development via company-owned inns in the Rocky Mountain area. Time problems in meeting development targets led company executives to reconsider the overall strategy, ultimately deciding to totally change it and sell the company. Managers often attempt to identify critical milestones that will occur the time period the strategy is being implemented. These milestones may be critical events, major resource allocations, or simply the passage of a certain amount of time. In each case, *a milestone review usually involves a full-scale reassessment of the strategy and the advisability of continuing or refocusing the direction of the company.*

A useful example of strategic implementation control based on milestone review can be found in Boeing's product development strategy to enter the supersonic transport (SST) airplane market. Competition from the joint British/French Concord effort was intense. Boeing had invested millions of dollars and years of scarce engineering talent through phase I of its SST venture. The market was believed large, but the next phase represented a billion-dollar decision for Boeing. This phase was established as a milestone review by Boeing management. Cost estimates were greatly increased; relatively few passengers and predictions of rising fuel costs raised estimated operating costs; the Concord had massive government subsidy, while Boeing did not. All factors led Boeing management to withdraw, in spite of high sunk costs, pride, and patriotism. Only an objective, full-scale strategy reassessment could have led to such a decision. In this example, a major resource allocation decision point provided the appropriate point for a milestone review. Milestone reviews might also occur concurrent with the timing of a new major step in the strategy's implementation or when a key uncertainty is resolved. Sometimes managers may even set an arbitrary time period, say, two years, as a milestone review point. Whatever the basis for selecting the milestone point, the critical purpose of a milestone review is to undertake a thorough review of the firm's strategy so as to control the company's future.

Strategic Surveillance: By their nature, premise control and implementation control are focused control. The third type of strategic control, strategic surveillance, is designed to monitor a broad range of events inside and outside the company that are likely to threaten the course or the firm's strategy. The basic idea behind strategic surveillance is that some form of general monitoring of multiple information sources should be encouraged, with the specific intent being the opportunity to uncover important yet unanticipated information. Strategic surveillance must be kept unfocused as much as possible and should be designed as a loose environmental-scanning activity. Trade magazines, *The Wall Street Journal*, trade conferences, conversations, and intended and unintended observations are all sources of strategic surveillance. While strategic surveillance is loose, its important purpose is to provide an ongoing, broad-based vigilance in all daily operations so as to uncover information that may prove relevant to firm's strategy.

Special Alert Control: Another type of strategic control, really a subset of the other three, is special alert control. A special alert control is the need to thoroughly, and often rapidly, reconsiders the firm's basic strategy based on a sudden, unexpected event. A political coup in the Middle East, an outside firm suddenly acquiring a leading competitor, an unexpected product difficulty like Tylenol's experience with poisoned capsules-all of these represent sudden changes that can drastically alter the company's strategy. Such an occurrence should trigger an immediate and intense reassessment of the company's strategy and its current strategic situation. Many firms have developed crisis teams to handle initial response and coordination when faced with unforeseen occurrences that may have an immediate effect on the firm's strategy. Increasingly, companies are developing contingency plans along with crisis teams to respond to such circumstances.

While each type of strategic control is different, they share a common purpose: to assess whether the strategic direction should be altered in light of unfolding events. Unlike operational control, strategic controls are designed to continuously and proactively question the basic direction of the strategy.

Operations controls are concerned with providing action control. Strategic controls are concerned with steering the company's future direction, Both are needed to manage the strategic process effectively. Strategic controls are useful to top management in monitoring and steering the basic strategic direction of the company. But operating managers also need control methods appropriate to their level of strategy implementation. The primary concern at the operating level is allocation of the company's resources.

14.5 Operational Control

Operational control, however, uses more familiar techniques which have traditionally been used by strategists. The various techniques for operational control are:

Evaluation Techniques for Operational Control: The classification of evaluation techniques in the three parts: internal analysis, comparative *analysis*, and comprehensive analysis.

Internal analysis: Internal analysis, which consists of value-chain analysis, quantitative (financial and non-financial) analysis, and qualitative analysis, deals with the identification of the strengths and weaknesses of a firm in absolute terms.

1. *Value chain analysis* focuses on a set of inter-related activities performed in a value-chain analysis for the purpose of operational evaluation lies in its ability to segregate the total tasks of a firm into identifiable activities which can then be evaluated for effectiveness.

2. *Quantitative analysis* takes up the financial parameters and the non-financial quantitative parameters, such as, physical units or time, in order to assess performance. The obvious benefit of using quantitative factors (either financial or physical parameters) is the ease of evaluation and the verifiability of the assessment done. These are probably the most- used methods for evaluation for operational control. Among the scores of financial techniques described in all standard texts in the area of finance are traditional techniques, such as, ratio analysis, or newer techniques, such as, economic value-added (EVA) and its variations, and activity based costing (ABC). These are proven methods so far as their efficacy for evaluating operational effectiveness is concerned. Apart from the financial quantitative techniques, there are several non-financial quantitative techniques available for the evaluation for operational control, such as: computation of absenteeism, market ranking, rate of advertising recall, total cycle time of production, service call rate, or number of patents registered per period. Many more techniques can be evolved by firms to suit their specific requirement.

3. *Qualitative analysis* supplements the quantitative analysis by including those aspects which is not feasible to measure on the basis of figures and numbers. The methods that could be used for qualitative analysis are based on intuition, judgment, and informed opinion. Techniques like surveys and experimentation can be used for the evaluation of performance for exercising operational control.

Comparative Analysis: This consists of historical analysis, industry norms, and benchmarking. It compares the performance of a firm with its own past performance, or with other firms.

1. *Historical analysis* is a frequently used method for comparing the performance of a firm over a given period of time. This method has the added benefit of enabling a firm to note how the performance has taken place over a period of time and to analyze the trend or pattern. Such an analysis can offer the firm a better perception of its performance as compared to an absolute assessment.

2. *Industry norms* are a comparative method for analyzing performance that has the advantage of making a firm competitive in comparison to its peers in the same industry. Being a comparative assessment, evaluation on the basis of industry norms enables a firm to bring its performance at least up to the level of other firms and then attempt to surpass it.

3. *Benchmarking* is a comparative method where a firm finds practices in an area and then attempts to bring its own performance in that area in line with the best practice. Best practices are the benchmarks that should be adopted by a firm as the standards to exercise operational control. Through this method, performance can be evaluated continually till it reaches the best practice level. In order to excel, a firm shall have to exceed the benchmarks. In this manner, benchmarking offers firms a tangible method to evaluate performance.

Comprehensive analysis: This includes balanced scorecard and key factor rating. This analysis adopts a total approach rather than focusing on one area of activity, or a function or department.

1. *Balanced scorecard* method is based on the identification of four key performance measures of customer perspective, internal business perspective, innovation and learning perspective, and the financial perspective. This method is balanced approaches to performance measurement as a range of parameters are taken into account for evaluation.

2**.** *Key factor rating* is a method that takes into account the key factors in several areas and then sets out to evaluate performance on the basis of these. This is quite a comprehensive method as it takes a holistic view of the performance areas in an organization. Besides the several techniques referred to above, we could mention four other techniques that are used by some companies to assess performance. These are the network techniques, parta system, management by objectives, and the memorandum of understanding.

1. The *parta* system is an indigenous system adopted usually by *Marwari* firms to keep track of daily cash generation. Parta is the pre-determined budget of the net cash inflows from operation before tax and dividend. The parta is decided in between the family group and company head, and actual performance is compared to this budgeted parta on a daily basis, thus making parta an effective operational control device.

2**.** *Network techniques* such as programme evaluation and review technique (PERT), critical path method(CPM), and their variants, are used extensively for the operational controls of scheduling and resource allocation in projects. When network techniques are modified for use as a cost accounting system, they become highly effective operational controls for project costs and performance.

3. Management by Objectives (MBO) is a system, proposed by Drucker, which is based on a regular evaluation of performance against objectives which are decided upon mutually by the superior and the subordinate. By the process of consultation, objective-setting leads to the establishment of a control system that operates on the basis of commitment and self-control. Thus, the scope of MBO to be used as an operational control is quite extensive.

4. *Memorandum of understanding* Just like MBO is a commitment to objectives between individuals, a memorandum of understanding (MoU) is an agreement between a public enterprise and the Government, represented by the administrative ministry in which both parties clearly specify their commitments and responsibilities. Having done that, the enterprises are evaluated on the basis of the MoU. Though an MoU is usually thought of as a technique used solely in the context of public enterprises, its use can be extended to any situation where an external agency is required to evaluate a firm's performance. Thus, a multinational company can set an MoU with its subsidiary and a family business group council can use an MoU to evaluate its constituent companies. With the greater professionalization of private firms, especially in the family business sector, the use of MoU's can be helpful. But in India

the usage of MoU is traditionally confined to the evaluation of performance in a public enterprise. Operational control systems guide, monitor, and evaluate progress in meeting annual objectives. While strategic controls attempt to steer the company over an extended time period (usually five years or more), operational controls provide post-action evaluation and control over short time periods ¾ usually from one month to one year.

To be effective, operational control systems must take four steps common to all post action controls:

1. Set standards of performance.
2. Measure actual performance.
3. Identify deviations from standards.
4. Initiate corrective action or adjustment.

14.6 Techniques of Strategic Evaluation and Control

The essence of strategic control is to continually assess the changing environment to uncover events that may significantly affect the course of an organization's strategy. Techniques for strategic control could be classified into two groups on the basis of the type of environment faced by the organizations. The organizations that operate in a relatively stable environment may use strategic momentum control, while those which face a relatively turbulent environment may find strategic leap control more appropriate.

Strategic Momentum Control: These types of evaluation techniques are aimed at assuring that the assumptions on whose basis strategies were formulated are still valid, and finding out what needs to be done in order to allow the organization to maintain its existing strategic momentum. There are three techniques which could be used to achieve these aims: responsibility control centers, underlying success factors, and generic strategies.

1. Responsibility control centers form the core of management control systems and are of four types: revenue, expense, profit, and investment centers. Each of these centers is designed on the basis of the measurement of inputs and outputs. The study and application of responsibility centers is done under the discipline of management control systems.

2. The underlying success factors enable organizations to focus on the CSFs in order to examine the factors that contribute to the success of strategies. By managing on the basis of the CSFs, the strategists can continually evaluate the strategies to assess whether or not these are helping the organization to achieve its objectives.

3. The generic strategies approach to strategic control is based on the assumption that the strategies adopted by a firm similar to another firm are comparable. Based on such a comparison, a firm can study why and how other firms are implementing strategies and assess whether or not its own strategy is following a similar path. In this context, the concept of strategic group is also relevant. A strategic group is a group or firms that adopt similar strategies with similar resources. Firms within a strategic group, often within the same industry, and sometimes in other industries too, tend to adopt similar strategies.

Strategic Leap Control: Where the environment is relatively unstable, organizations are required to make strategic leaps in order to make significant changes. Strategic leap control can assist such organizations by helping to define the new strategic requirements and to cope with emerging environmental realities. There are four techniques or evaluation used to exercise strategic leap control: *strategic issue management, strategic field analysis, systems modeling and scenarios.*

1. *Strategic issue management* is aimed at identifying one or more strategic issues and assessing their impact on the organization. A strategic issue is a forthcoming development, either inside or the organization, which is likely to have an important impact on the ability of the enterprise to meet its objectives. By managing on the basis of strategic issues', the strategists can avoid being overtaken by surprising environmental changes and design contingency plans to shift strategies whenever required.

2. *Strategic field analysis* is a way of examining the nature and extent of synergies that exist or are lacking between the components of an organization. Whenever synergies exist the strategists can assess the ability of the firm to take advantage of those. Alternatively, the strategists can evaluate the firm's ability to generate synergies where they do not exist.

3. *Systems modeling* is based on computer-based models that simulate the essential features of the organization and its environment. Through systems modeling, organizations may exercise pre-action control by assessing the impact of the environment on organization because of the adoption of a particular strategy.

4. *Scenarios* are perceptions about the likely environment a firm would face in the future. Its use could be extended to evaluation by enabling organizations to focus strategies on the basis of forthcoming developments in the environment.

Several of the above techniques for strategic control with the possible exception of responsibility centers-are or a relatively recent origin. The development of these techniques is an evidence of the expanding body of knowledge in strategic management. As the use and application of strategic management gains approval, it is quite likely that organizations would start using such techniques.

14.7 Summary

Strategic evaluation is the appraisal of plans and the results of plans that centrally concern or affect the basic mission of an enterprise. Its special focus is the separation between obvious current operating results and the factors that underlie success or failure in the chosen domain of activity. Its result is the rejection, modification or ratification of existing strategies and plans.

It is usual to view strategy evaluation as an intellectual task as a problem in data analysis and interpretation that requires both imagination and intelligence. From the point of view, there are four essential tests a strategy must pass. The strategy must (a) be internally consistent, (b) provide for consonance between the firms and its environment, (c) be used on the gaining and maintenance of competitive advantage, and (d) be feasible in the light of existing skills and resource. A strategy which fails one or more of these tests possesses quite serious flaws. While a strategy that passes all four tests cannot be guaranteed to succeed it is without question a better starting place than one that is known to be unsound.

In most medium to large size firms, strategy evaluation is not a purely intellectual task. The issues involved are too important and too closely associated with the distribution of power and authority for either strategy formulation or evaluation to take place in an ivory tower environment. In fact, most firms rarely engage on explicit formal strategy evaluation. Rather, the evaluation of current strategy is a continuing process and one that is difficult to separate from the normal planning, reporting, control and reward systems of the firm. From this point of view, strategy evaluation is not so much an intellectual task as it is an organizational process.

As process, strategy evaluation is the outcome of activities and events that are strongly shaped by the firm's control and reward systems, its structure, its history and particular culture. Thus, its performance is, in practice, tied more directly to the quality of the firm's strategic management than to any particular analytical scheme. In particular, organizing major units around the primary strategic tasks and making the extra effort required to incorporate measures of strategic success in the control system may play a vital roles in facilitating strategy evaluation within the firm,.

Ultimately, a firm's ability to maintain its competitive position in a world of rivalry and change may be best served by managers who can maintain a dual view of strategy and strategy evaluation they must be willing and able to perceive the strategy within the confusion of daily activity and to build and maintain structures and systems that make strategic factors the object of current activity.

14.8 Self Assessment Questions

1. What do you mean by Strategic Evaluation?
2. Why is Strategic Evaluation an important component for the organization's performance?
3. What are the different barriers of strategic evaluation?
4. What is strategic control?
5. What is operational control?
6. What are the various techniques of strategic and operational control?

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Unit - 15 : Reaching Strategic Edge

Structure of Unit:

15.0 Objectives

After completing this unit, you would be able to:

- Understand the different new techniques of strategy;
- Classify the new techniques;
- Point out how these new techniques affect business decisions;
- Understand the concepts of TQM, Kaizen, Six Sigma, Balance Score Card and Outsourcing.

15.1 Introduction

Today manufacturing and business environments are reaching a point where competition for survival and market share is an obligation. Tracking the global economy will show that being good is not enough; therefore each organization is striving for excellence as they want to stay in the market. Every single organization is looking for one single outcome…*PROFIT.*

PROFIT is not a single concept but comes with many important implications:

- P- Process excellence
- R- Resources Management
- O- Oriented to a Goal
- F- Financially Strong
- I- Innovative – to stay ahead of competition
- T- Timely deployment of strategies

In order to be a leader, most companies are realizing that traditional management, manufacturing processes, and other historic approaches, are not enough. More effective methods such as following are needed:

- Business Process Re-engineering.
- Benchmarking.
- Total Quality Management (TQM).
- Kaizen.
- Six Sigma.
- Balance Score Card.

- Business Process Outsourcing.

This chapter will deal in detail with the various new and developing concepts that the organizations in today's competitive environment are adopting to stay ahead of their competitors and command a higher share in their operating markets.

15.2 Business Process Re-engineering

To be a truly world-class organization, the company needs to work as a team and all the functional areas of the business need to be properly integrated, with each understanding the importance of cross functional processes. As the basis of competition changes from cost and quality to flexibility and responsiveness, the value of process management is now being recognized. The role that process management can play in creating sustainable competitive advantage was termed Business Process Reengineering (BPR), and was first introduced by Hammer (1990); Davenport and Short (1990). These authors outlined a new approach to the management of processes, which, it was claimed, was producing radical improvements in performance. The three driving forces behind this radical change were: (a) customers who can now be very diverse, segmented, and are expectant of consultation, (b) competition that has intensified to meet the needs of customers in every niche, and (c) change that has become pervasive, persistent, faster and in some markets a pre-requisite.

Customers, competition, and change have created a New World for business, such that organizations designed to operate in one environment are inadequately equipped to operate well in another. Companies created to thrive on mass production stability, and growth cannot be simply improved to succeed in a world where customers, competition, and change demand flexibility and quick response. In today's marketplaces, it is no longer a question of caveat emptor, but rather caveat factor. Customers today are characterized by their relentless demands in quality, service, and price; by their willingness to act on default of contract and by their disloyalty. In fact, the new power and freedom of the customer has destroyed many of the managerial assumptions of the early Management Revolution. There is no longer unearned brand loyalties, no more complicity among rivals in the same markets; no more passing on of rising wages and benefits in the form of higher prices; no more easy reliance on high entry costs to keep out upstart compete competitors; and reducing protection by national governments. Still, as far as managers are concerned, the most powerful of the new stakeholders is the customer. The reward for managers who can earn their respect is not only repeat business but also willing investors. The aim of reengineering in this environment is to facilitate the match between market opportunities and corporate capabilities, and in so doing, ensure corporate growth.

Internally reengineering functional hierarchies into teams to facilitate work processes will lead to the elimination of most management layers and will teach managers to do far more with much less. Reengineering represents a radical shift away from the tradition in which performance was primarily rewarded by advancement into managerial ranks, that is, the future holds very few "control" positions. In the ideal, hierarchy should disappear from the reengineered company, and be replaced by the idea of purposeful value added interaction. A change of this magnitude raises many challenges for those managers left to develop, motivate, reward, and affirm employees.

The decision to be made is whether to adopt a radical reengineering approach to change or a more gradual continuous improvement approach based on Total Quality Management (TQM). The choice depends on the magnitude of the needed change, the feasibility of it, and the resources required to accomplish it. Both reengineering and TQM approaches share certain principles and adopt a process perspective, so it is possible to make some general propositions on managing change that will enable a company to reinvent it's competitive advantage. They are: (a) strategy that is not only linked to vision, but one that continuously questions what is being done, why it is being done, and how can it be done differently, (b) top management commitment, to vision, strategy and objectives both at the organizational and functional levels, (c) where change is necessary, clear goals, with projects broken down into manageable parts, (d) promotion of cross-functional activities, shared objectives, and externally oriented thinking, and (e) the decentralization of decision making to a point as close to the customer as possible.

Above all it is the value adding processes that enable long-term success for an organization. Achieving these ends requires radical bottom-up redesign input, and effective, unwavering top-down leadership. A TQM methodology has typically delivered discontinuous process improvements on a small scale to several strategic business units within a company. Such an approach while able to keep abreast of technological improvements, competitive pressures and customer requirements, fails in its ability to take into account step changes in technology, or to drive changes across divisional boundaries, and as such is incapable of making significant bottom line improvements. The common theme running through reengineered or breakthrough improvements is technology, in particular information technology (IT). IT represents an all encompassing term for computer workstations linked to computer networks, open systems, client–server architecture, database groupware, and electronic commerce (EC). Together they have opened up the possibilities for the integrated automation of manual-paper based-business processes. The advent of computer assisted software engineering (CASE), and object-oriented programming has helped simplify systems design around office processes, enabling further cost reductions, and the rapid growth of a new industry.

History is full with technological advances such as the steam engine, the internal combustion engine, the telephone, the transistor, and the computer that made possible large step changes in both manufacturing and business processes. So too, IT is enabling both manufacturing and office processes to be automated and fundamentally restructured to take advantage of enormous efficiencies in information gathering, storage, processing, retrieval and presentation. Technology in itself, however, does not offer all the answers, i.e. automation frequently fails to produce the gains expected. The IT intensive banking and insurance industries, widely reported to be going through many major BPR exercises, has been shown to be making very little use of the latest IT solutions. Many companies putting in major new computer systems have achieved only the automation of existing processes. Others have not overhauled their existing IT hardware, but have expected the new systems to integrate with the old.

Studies such as the 1994 CSC Index Survey of US and European companies have confirmed that up to 70 percent of BPR programmes fail because reengineering programmes have been used as a substitute for strategic thinking. That is, companies undertaking BPR have used IT strategy as a substitute for an integrated corporate change strategy. The results are typically disastrous, with different functions within the same organization left with IT systems that are incompatible with each other, and not being used to gain or improve cross structural benefits. Yet it is in the areas of cross functional, cross-divisional, and cross-company processes that the big improvement gains through IT are to be achieved. A strategic overview is thus essential to reengineered process design and the subsequent selection and installation of the hard and soft systems. It is only with this approach that it becomes possible to automate cross structural processes.

- These various tools and techniques used for the purpose of business process reengineering are as following.

***Process Visualization*:** While many authors refer to the need to develop an ideal "end state" for processes to be re-engineered, Barrett (1994) suggests that the key to successful reengineering lies in the development of a vision of the process.

***Process Mapping/Operational Method Study*:** The tools of operational method studies are ideally suited to the reengineering task, but that they are often neglected. Recent evidence suggests that these concepts have been incorporated into tools such as IDEF0 (Integrated Definition Method), DFD (Data Flow Diagrams), OOA (Object Oriented Analysis) (Yu and Wright, 1997), and Prince (Process based Project Management).

- ***Change Management***: Several authors concentrate on the need to take account of the human side of reengineering, in particular the management of organizational change. Some authors suggest that the management of change is the largest task in reengineering. Other authors on the other hand, incorporate the human element of reengineering due to the perceived threat it has on work methods and jobs.
- ***Benchmarking***: Several authors suggest that benchmarking forms an integral part of reengineering, since it allows the visualization and development of processes which are known to be in operation in other organizations.
- ***Process and Customer Focus***: The primary aim of BPR, according to some authors, is to redesign processes with regard to improving performance from the customer's perspective.

This provides a strong link with the process improvement methodologies suggested by authors from the quality field. In some cases, the terminology is almost identical to that used by quality practitioners in the improvement of processes. The major difference, as outlined earlier, appears to be one of scale.

Organizational Redesign Using BPR: BPR is not intended to preserve the status quo, but to fundamentally and radically change what is done; it is dynamic. Therefore, it is essential for a BPR effort to focus on outcomes rather than tasks, and the required outcome will determine the scope of the BPR exercise. The measures used, however, are crucial. At every level of reengineering, a focus on outcome gives direction and measurability; whether it is cost reduction, head count reduction, increase in efficiency, customer focus, identification of core processes and non-value-adding components, or strategic alignment of business processes. Benchmarking is a powerful tool for BPR and is the trigger for many BPR projects, as in Ford's accounts payable process. The value of benchmarking does not lie in what can be copied, but in its ability to identify goals. If used well, benchmarking can shape strategy and identify a potential competitive advantage.

The Redesign Process: Central to BPR is an objective overview of the processes to be redesigned. Whereas information needs to be obtained from the people directly involved in those processes, it is never initiated by them. Even at its lowest level, BPR has a top-down approach. Therefore, most BPR efforts take the form of a project. There are numerous methodologies being proposed, but all share common elements. Typically, the project takes the form of several discrete phases. People need to be equipped to assess, reengineer, and support—with the appropriate technology—the key processes that contribute to customer satisfaction and corporate objectives. Therefore, BPR efforts can involve substantial investment, but they also require considerable top management support and commitment. Critical to the success of the redesign is the make-up of the reengineering team. Most authors suggest that the team should comprise the following:

- Senior Manager as Sponsor
- Steering Committee of Senior Managers to Oversee Overall Reengineering Strategy
- Process Owner
- Team Leader
- Redesign Team

The process owner is someone given the responsibility for the overall reengineering of a specific process. The project approach to BPR suggests a one-off approach. When the project is over, the team is disbanded and business returns to normal, albeit a radically different normal. It is generally recommended that an organization does not attempt to reengineer more than one major process at a time, because of the disruption and stress caused. Therefore, in major reengineering efforts of more than one process, as one team is disbanded, another is formed to redesign yet another process.

Considering that Ford took 5 years to redesign its accounts payable process, BPR on a large scale is a long-term commitment. In a rapidly changing business environment, it is becoming more likely that companies will reengineer one process after another. *Competitive advantage* is a dynamic goal—one that does not stand still.

BPR is often used by companies on the brink of disaster to cut costs and return to profitability. The danger is that during this process the company may slash its capacity for future growth. The example of "Star Vault, Inc.", a mid-sized entertainment company illustrates this conundrum. After BPR, Star Vault returned to short-term profitability by sacrificing its internal production capability to create new products. Senior management soon discovered that the company's library was becoming overexposed and competition for the most attractive product acquisitions more intense. Star Vault was forced to reevaluate its strategic direction. It opted to focus on niche markets. "Instead of simply improving the processes, the company eliminated non-value- added expenses, and evaluated which organizational elements were relevant to the strategy... As a result, the company now has the opportunity to sustain and increase its market share."

To reap lasting benefits, companies must be willing to examine how strategy and reengineering complement each other — by learning to quantify strategy (in terms of cost, milestones, timetables); by accepting ownership of the strategy throughout the organization; by assessing the organizations current capabilities and processes realistically; and by linking strategy to the budgeting process. Otherwise BPR is only a short term efficiency exercise. One of the hazards of BPR is that the company becomes so wrapped up in "fighting its own demons" that it fails to keep up with its competitors in offering new products or services. While American Express tackled a comprehensive reengineering of the credit card business, MasterCard and Visa introduced a new product — the corporate procurement card. American Express lagged a full year behind before offering its customers the same service. Another writer urges consultants not to present BPR as a quick fix program since it "may help you save money tomorrow but will leave you in a worse position next month or next year."

15.3 Benchmarking

"Benchmarking is simply the process of measuring the performance of one's company against the best in the same or another industry". Benchmarking is not a complex concept but it should not be taken too lightly. Benchmarking is basically learning from others. It is using the knowledge and the experience of others to improve the organization. It is analyzing the performance and noting the strengths and weaknesses of the organization and assessing what must be done to improve. The knowledge that is available for comparing operations and processes are vast. "An organization's ability to evaluate its practices against specific business strategies and objectives is critical to leveraging its knowledge capital". Information is there for organizations and it should be evaluated, used, and shared. This is one of the primary goals of benchmarking. It is the process of using all of the knowledge and experience of others to develop new and fresh ideas. This is basic teamwork, which is the way progressive organizations are migrating. Many organizations are realizing how much more can be achieved if there is more collaboration between leaders in an industry.

There are three reasons that benchmarking is becoming more commonly used in industry. They are:

- Benchmarking is a more efficient way to make improvements. Managers can eliminate trial and error process improvements. Practicing benchmarking focuses on tailoring existing processes to fit within the organization.

- Benchmarking speeds up organization's ability to make improvements. In corporate America today, time is of the essence.
- Benchmarking has the ability to bring corporate America's performance up as a whole significantly. If every organization has excellent production and total quality management skills then every company will have world class standards.

Benchmarking is not just making changes and improvements for the sake of making changes, benchmarking are about adding value. No organization should make changes to their products, processes, or their organization if the changes do not bring benefits. When using benchmarking techniques, an organization must look at how processes in the value chain are performed:

1. Identifying a critical process that needs improvement.
2. Identify an organization that excels in the process, preferably the best.
3. Contact the organization that you are benchmarking; visit them, and study the process or activity.
4. Analyze the data.
5. Improve the critical process at your own organization.

All of these things lead to successful benchmarking a product, process, or area within an organization.

Types of Benchmarking: There are three primary types of benchmarking that are in use today. These are process benchmarking, performance benchmarking, and strategic benchmarking. Process benchmarking focuses on the day-to-day operations of the organization. It is the task of improving the way processes performed every day. Some examples of work processes that could utilize process benchmarking are the customer complaint process, the billing process, the order fulfillment process, and the recruitment process. All of these processes are in the lower levels of the organization. By making improvements at this level, performance improvements are quickly realized. This type of benchmarking results in quick improvements to the organization.

Performance benchmarking focuses on assessing competitive positions through comparing the products and services of other competitors. When dealing with performance benchmarking, organizations want to look at where their product or services are in relation to competitors on the basis of things such as reliability, quality, speed, and other product or service characteristics.

Strategic benchmarking deals with top management. It deals with long term results. Strategic benchmarking focuses on how companies compete. This form of benchmarking looks at what strategies the organizations are using to make them successful. This is the type of benchmarking technique that most Japanese firms use. This is due to the fact that the Japanese focus on long term results.

Other types of benchmarking are competitive benchmarking, cooperative benchmarking, collaborative and internal. Competitive benchmarking is the most difficult type of benchmarking to practice. For obvious reasons, organizations are not interested in helping a competitor by sharing information. This form of benchmarking is measuring the performance, products, and services of an organization against its direct or indirect competitors in its own industry. Competitive benchmarking starts as basic reverse engineering and then expands into benchmarking. Reverse engineering is a competitive tool used in benchmarking. It looks at all aspects of the competition's strategy. This does not just include the disassembly and examination of the product but it analyzes the entire customers' path of the organization's competitor. This is a difficult thing to do because this information is not easily obtained. Therefore, it requires extensive research. It is also important to remember when using competitive benchmarking that the goal is to focus on your direct competitors and not the industry as a whole. Cooperative and collaborative benchmarking are the most widely used types of benchmarking because they are relatively easy to practice. These forms of benchmarking are a more accommodating way of getting information. In cooperative benchmarking, organizations invite best in class organizations to meet with their benchmarking team to share knowledge. This is usually done without much controversy because these organizations are not direct competitors. During this process information flows one way. From the "best in class" organization to the benchmarking team organizations. Collaborative benchmarking does the opposite, information flows many ways. With collaborative benchmarking, information is shared between groups of firms. It is a brainstorming session among organizations. It is important to realize that not all collaborative efforts are considered benchmarking. It is sometimes called "data sharing." Data sharing results do not focus on the process but only the end result, while benchmarking focuses on the processes of the organizations. Internal benchmarking is used to identify the best in house practices in the organization and to disseminate these practices throughout the organization. Internal benchmarking allows managers in the organization to be more knowledgeable about the organization as a whole.

Benchmarking Cycle: The overview of the benchmark process is that it consists of the following sub-processes which form a cycle.

PLAN: Before reaching the first stage it is important to understand that business is a process made up of many different processes. Once it is understood, the right process has to be chosen to improve. The organization might want to improve customer service. Select a benchmarking partner that excels in the process known as customer service. Plan by determining how the organization is going to measure the differences between the processes at each business.

DO: The first stage of the "DO" sub-process is to measure the level of customer service in business. Do so with well-designed questionnaires that allow accurate measurement of performance and for customers to provide suggestions on what steps they would like to see taken to improve customer service. Measure the same process of the benchmarking partner's business. One cam adopt the well-designed tools for this purpose designed by the benchmarking partner.

CHECK: The management team now compares the data on customer service between the two organizations, looking for ways the partner's processes are more efficient. Then they try to find what the performance "enablers" are. These are the tools, policies, or work practices that lead to superior customer service. At the same time, performance "inhibitors" of the process should be discovered. These are tools, policies or practices which actually prevent better customer service. It is very helpful to use systems diagrams to describe the processes and see how they balance each other. These diagrams will help the team discover where the levers are to most effectively improve your operation.

ACT: Once team knows how to improve their process, in this example customer service, the key is to act. Adapt, and in some cases improve the processes and performance "enablers" in business. Then continue the process by returning to the plan stage again and continue the cycle of improvement.

Conclusion: Benchmarking can be as complex as re-engineering or as simple as thumbing through the quarterly reports of organizations and making comparisons. Although organizations must use benchmarking with some caution, it can be informative and foster a spirit of openness and cooperation from indirect competitors. It is not enough to benchmark the costs of activities and identify best practices. When an organization looks at benchmarking they must look at all aspects of the business, its products, and its processes. It is crucial for organizations to focus on anything that will impact its performance and quality.

15.4 Total Quality Management (TQM)

TQM is the way of managing for the future, and is far wider in its application than just assuring product or service quality – it is a way of managing people and business processes to ensure complete customer satisfaction at every stage, internally and externally. TQM, combined with effective leadership, results in an organization doing the right things right, first time. The core of TQM is the customer-supplier interfaces, both externally and internally, and at each interface lie a number of processes. This core must be surrounded by commitment to quality, communication of the quality message, and recognition of the need to change the culture of the organization to create total quality. These are the foundations of TQM, and they are supported by the key management functions of people, processes and systems in the organization.

To survive, companies had to make major changes in their quality programs. Many hired consultants and instituted quality training programs for their employees. A new concept of quality was emerging. One result is that quality began to have a strategic meaning. Today, successful companies understand that quality provides a competitive advantage. They put the customer first and define quality as meeting or exceeding customer expectations. Since the 1970s, competition based on quality has grown in importance and has generated tremendous interest, concern, and enthusiasm. Companies in every line of business are focusing on improving quality in order to be more competitive. In many industries quality excellence has become a standard for doing business. Companies that do not meet this standard simply will not survive. The term used for today's new concept of quality is total quality management or TQM. The old concept is reactive, designed to correct quality problems after they occur. The new concept is proactive, designed to build quality into the product and process design.

Features of TQM:

1. **Customer Focus:** The first, and overriding, feature of TQM is the company's focus on its customers. Quality is defined as meeting or exceeding customer expectations. The goal is to first identify and then meet customer needs. TQM recognizes that a perfectly produced product has little value if it is not what the customer wants. Therefore, we can say that quality is *customer driven.* However, it is not always easy to determine what the customer wants, because tastes and preferences change. Also, customer expectations often vary from one customer to the next. For example, in the auto industry trends change relatively quickly, from small cars to sports utility vehicles and back to small cars. The same is true in the retail industry, where styles and fashion are short lived. Companies need to continually gather information by means of focus groups, market surveys, and customer interviews in order to stay in tune with what customers want. They must always remember that they would not be in business if it were not for their customers.

2. **Continuous Improvement:** Another concept of the TQM philosophy is the focus on **continuous improvement.** Traditional systems operated on the assumption that once a company achieved a certain level of quality, it was successful and needed no further improvements. We tend to think of improvement in terms of plateaus that are to be achieved, such as passing a certification test or reducing the number of defects to a certain level.

Traditionally, change for American managers involves large magnitudes, such as major organizational restructuring. The Japanese, on the other hand, believe that the best and most lasting changes come from gradual improvements. Continuous improvement, called kaizen by the Japanese, requires that the company continually strive to be better through learning and problem solving. Because we can never achieve perfection, we must always evaluate our performance and take measures to improve it. The two approaches that can help companies with continuous improvement: the plan –do– study – act (PDSA) cycle and benchmarking.

• **The Plan–Do–Study–Act Cycle:** The plan–do–study–act (PDSA) cycle describes the activities a company needs to perform in order to incorporate continuous improvement in its operation. The circular nature of this cycle shows that continuous improvement is a never-ending process. Let's look at the specific steps in the cycle.

• **Plan:** The first step in the PDSA cycle is to *plan*. Managers must evaluate the current process and make plans based on any problems they find. They need to document all current procedures, collect data, and identify problems. This information should then be studied and used to develop a plan for improvement as well as specific measures to evaluate performance.

• **Do:** The next step in the cycle is implementing the plan (*do*). During the implementation process managers should document all changes made and collect data for evaluation.

• **Study:** The third step is to *study* the data collected in the previous phase. The data are evaluated to see whether the plan is achieving the goals established in the *plan* phase.

• **Act:** The last phase of the cycle is to *act* on the basis of the results of the first three phases. The best way to accomplish this is to communicate the results to other members in the company and then implement the new procedure if it has been successful. Note that this is a cycle; the next step is to plan again. After we have acted, we need to continue evaluating the process, planning, and repeating the cycle again.

• **Benchmarking:** Another way companies' implement continuous improvement is by studying business practices of companies considered "best in class." This is called benchmarking. The ability to learn and study how others do things is an important part of continuous improvement. The benchmark company does not have to be in the same business, as long as it excels at something that the company doing the study wishes to emulate. For example, many companies have used Lands' End to benchmark catalog distribution and order filling, because Lands' End is considered a leader in this area. Similarly, many companies have used American Express to benchmark conflict resolution.

3. **Employee Empowerment:** Part of the TQM philosophy is to empower all employees to seek out quality problems and correct them. With the old concept of quality, employees were afraid to identify problems for fear that they would be reprimanded. Often poor quality was passed on to someone else, in order to make it "someone else's problem." The new concept of quality, TQM, provides incentives for employees to identify quality problems. Employees are rewarded for uncovering quality problems, not punished. In TQM, the role of employees is very different from what it was in traditional systems. Workers are empowered to make decisions relative to quality in the production process. They are considered a vital element of the effort to achieve high quality. Their contributions are highly valued, and their suggestions are implemented. In order to perform this function, employees are given continual and extensive training in quality measurement tools.

   To further stress the role of employees in quality, TQM differentiates between *external* and *internal customers*. *External customers* are those that purchase the company's goods and services. *Internal customers* are employees of the organization who receive goods or services from others in the company. For example, the packaging department of an organization is an internal customer of the assembly department. Just as a defective item would not be passed to an external customer, a defective item should not be passed to an internal customer.

   • **Team Approach:** TQM stresses that quality is an organizational effort. To facilitate the solving of quality problems, it places great emphasis on teamwork. The use of teams is based on the old adage that "two heads are better than one."Using techniques such as brainstorming, discussion, and quality control tools, teams work regularly to correct problems. The contributions of teams are considered vital to the success of the company. For this reason, companies set aside time in the workday for team meetings. Teams vary in their degree of structure and formality, and different types of teams solve different types of problems. One of the most common types of teams is the **quality circle,** a team of volunteer production employees and their supervisors whose purpose is to solve quality problems. The circle is usually composed of eight to ten members, and decisions are made through group consensus. The teams usually meet weekly during work hours in a place designated for this purpose. They follow a preset process for analyzing and solving quality problems. Open discussion is promoted, and criticism is not allowed. Although the functioning of quality circles is friendly and casual, it is serious business. Quality circles are not mere "gab sessions." Rather, they do important work for the company and have been very successful in many firms.

4. **Use of Quality Tools:** You can see that TQM places a great deal of responsibility on all workers. If employees are to identify and correct quality problems, they need proper training. They need to understand how to assess quality by using a variety of quality control tools, how to interpret findings, and how to correct problems. In this section we look at seven different quality tools. These are often called the seven tools of quality control. They are easy to understand, yet extremely useful in identifying and analyzing quality problems. Sometimes workers use only one tool at a time, but often a combination of tools is most helpful.

   • **Cause-and-Effect Diagrams:** Cause-and-effect diagrams are charts that identify potential causes for particular quality problems. They are often called fishbone diagrams because they look like the bones of a fish. The "head" of the fish is the quality problem, such as damaged zippers on a garment or broken valves on a tire. The diagram is drawn so that the "spine" of the fish connects the "head" to the possible cause of the problem. These causes could be related to the machines, workers, measurement, suppliers, materials, and many other aspects of the production process. Each of these possible causes can then have smaller "bones" that address specific issues that relate to each cause. For example, a problem with machines could be due to a need for adjustment, old equipment, or tooling problems. Similarly, a problem with workers could be related to lack of training, poor supervision, or fatigue. Cause-and-effect diagrams are problem-solving tools commonly used by quality control teams. Specific causes of problems can be explored through brainstorming. The development of a cause-and-effect diagram requires the team to think through all the possible causes of poor quality.

   • **Flowcharts:** A flowchart is a schematic diagram of the sequence of steps involved in an operation or process. It provides a visual tool that is easy to use and understand. By seeing the steps involved in an operation or process, everyone develops a clear picture of how the operation works and where problems could arise.

   • **Checklists:** A checklist is a list of common defects and the number of observed occurrences of these defects. It is a simple yet effective fact-finding tool that allows the worker to collect specific information regarding the defects observed. A checklist can also be used to focus on other dimensions, such as location or time. For example, if a defect is being observed frequently, a checklist can be developed that measures the number of occurrences per shift, per machine, or per operator. In this fashion we can isolate the location of the particular defect and then focus on correcting the problem.

- **Control Charts:** Control charts are a very important quality control tool. These charts are used to evaluate whether a process is operating within expectations relative to some measured value such as weight, width, or volume. When the production process is operating within expectations, it is said that it is "in control." To evaluate whether or not a process is in control, a regular measure of the variable of interest is done and is plotted on the control chart. The chart has a line down the center representing the average value of the variable we are measuring. Above and below the center line are two lines, called the upper control limit (UCL) and the lower control limit (LCL). As long as the observed values fall within the upper and lower control limits, the process is in control and there is no problem with quality. When a measured observation falls outside of these limits, there is a problem.

- **Scatter Diagrams:** Scatter diagrams are graphs that show how two variables are related to one another. They are particularly useful in detecting the amount of correlation, or the degree of linear relationship, between two variables. For example, increased production speed and number of defects could be correlated positively; as production speed increases, so does the number of defects. Two variables could also be correlated negatively, so that an increase in one of the variables is associated with a decrease in the other. For example, increased worker training might be associated with a decrease in the number of defects observed. The greater the degrees of correlation, the more linear are the observations in the scatter diagram. On the other hand, the more scattered the observations in the diagram, the less correlation exists between the variables. Of course, other types of relationships can also be observed on a scatter diagram, such as an inverted. This may be the case when one is observing the relationship between two variables such as oven temperature and number of defects, since temperatures below and above the ideal could lead to defects.

- **Pareto Analysis:** Pareto analysis is a technique used to identify quality problems based on their degree of importance. The logic behind Pareto analysis is that only a few quality problems are important, whereas many others are not critical. The technique was named after Vilfredo Pareto, a nineteenth-century Italian economist who determined that only a small percentage of people controlled most of the wealth. This concept has often been called the 80–20 rule and has been extended to many areas. In quality management the logic behind Pareto's principle is that most quality problems are a result of only a few causes. The trick is to identify these causes. One way to use Pareto analysis is to develop a chart that ranks the causes of poor quality in decreasing order based on the percentage of defects each has caused. For example, a tally can be made of the number of defects that result from different causes, such as operator error, defective parts, or inaccurate machine calibrations.

- **Histograms:** A histogram is a chart that shows the frequency distribution of observed values of a variable. It can be seen from the plot what type of distribution a particular variable displays, such as whether it has a normal distribution and whether the distribution is symmetrical.

5. **Product Design Quality Function Deployment:** A critical aspect of building quality into a product is to ensure that the product design meets customer expectations. This typically is not as easy as it seems. Customers often speak in everyday language. For example, a product can be described as "attractive," "strong," or "safe." However, these terms can have very different meaning to different customers. What one person considers tobe strong, another may not. To produce a product that customers want, we need to translate customers' everyday language into specific technical requirements. However, this can often be difficult. A useful tool for translating the voice of the customer into specific technical requirements is **quality function deployment (QFD)**. Quality

function deployment is also useful in enhancing communication between different functions, such as marketing, operations, and engineering. QFD enables us to view the relationships among the variables involved in the design of a product, such as technical versus customer requirements. This can help us analyze the big picture—for example, by running tests to see how changes in certain technical requirements of the product affect customer requirements. An example is an automobile manufacturer evaluating how changes in materials affect customer safety requirements. This type of analysis can be very beneficial in developing a product design that meets customer needs, yet does not create unnecessary technical requirements for production. QFD begins by identifying important customer requirements, which typically come from the marketing department. These requirements are numerically scored based on their importance, and scores are translated into specific product characteristics. Evaluations are then made of how the product compares with its main competitors relative to the identified characteristics. Finally, specific goals are set to address the identified problems.

- **Customer Requirements:** The goal of an organization is to make a product that the customer wants. Therefore, the first thing they need to do is survey customers to find out specifically what they would be looking for in a product. To find out precisely what features would customers like, the marketing department might send representatives to talk to customers, conduct telephone interviews, and maybe conduct focus groups.

- **Competitive Evaluation:** The evaluation of how product compares to those of competitors. In this example there are two competitors, A and B. The evaluation scale is from one to five—the higher the rating, the better. The important thing here is to identify which customer requirements the company should pursue and how they fare relative to our competitors.

- **Product Characteristics:** Specific product characteristics are on top of the relationship matrix. These are technical measures.

- **The Relationship Matrix:** The strength of the relationship between customer requirements and product characteristics is shown in the relationship matrix. A negative relationship means that increase in the desirability of one variable there is decrease in the desirability of the other. A positive relationship means that an increase in desirability of one variable is related to an increase in the desirability of another. This type of information is very important in coordinating the product design.

- **The Trade-off Matrix**: It shows how each product characteristic is related to the others and thus allows the user to see what trade offs is needed.

- **Setting Targets:** The last step is to evaluate competitors' products relative to the specific product characteristics and to set targets for our their product. The bottom row of the chart is the *output* of quality function deployment. These are specific, measurable product characteristics that have been formulated from general customer requirements. The chart of quality has been found to be very useful, it translates everyday terms like "lightweight," "roominess," and "nice looking," into specific product characteristics that can be used in manufacturing the product. These charts of quality can help in the communication between marketing, operations, and design engineering.

- **Reliability:** An important dimension of product design is that the product functions as expected. This is called reliability. **Reliability** is the probability that a product, service, or part will perform as intended for a specified period of time under normal conditions. However, companies know that a high reliability is an important part of customer-oriented quality and try to build this into their product design. Reliability is a probability, likelihood, or a chance.

6. **Process Management:** According to TQM a quality product comes from a quality process. This means that quality should be built into the process. **Quality at the source** is the belief that it is far better to uncover the source of quality problems and correct it than to discard defective items after production. If the source of the problem is not corrected, the problem will continue. It will be far more effective to see where the problem is and correct it. Quality at the source exemplifies the difference between the old and new concepts of quality. The old concept focused on inspecting goods after they were produced or after a particular stage of production. If an inspection revealed defects, the defective products were either discarded or sent back for reworking. All this cost the company money, and these costs were passed on to the customer. The new concept of quality focuses on identifying quality problems at the source and correcting them.

7. **Managing Supplier Quality:** TQM extends the concept of quality to a company's suppliers. Traditionally, companies tended to have numerous suppliers that engaged in competitive price bidding. When materials arrived, an inspection was performed to check their quality. TQM views this practice as contributing to poor quality and wasted time and cost. The philosophy of TQM extends the concept of quality to suppliers and ensures that they engage in the same quality practices. If suppliers meet preset quality standards, materials do not have to be inspected upon arrival. Today, many companies have a representative residing at their supplier's location, thereby involving the supplier in every stage from product design to final production.

15.5 Kaizen

The term *kaizen* has come to be accepted as one of the key concepts of management since its inception in 1986. The success of Toyota Motor Company surpassed General Motors to become the top automotive manufacturer in the world has also let to the awareness of the vital difference played by *kaizen* in Toyota's success.

Today, organizations worldwide from manufacturers, to hospitals, to banks, to software developers, to governments are making a difference by adopting *kaizen* philosophies, mindsets, and methodologies. Even though the names of these strategies may change over the decades from continuous quality improvement and total quality management, to just-in-time and operational excellence, to six sigma and lean manufacturing, the most successful of these strategies are customer-focused, *gemba*-oriented, and *kaizen*-driven.

In Japanese, *kaizen* means "continuous improvement." The word implies improvement that involves everyone—both managers and workers—and entail relatively little expense. The *kaizen* philosophy assumes that our way of life; be it our working life, our social life, or our home life; should focus on constant improvement efforts. This concept is so natural and obvious to many Japanese that they don't even realize they possess it! In my opinion, *kaizen* has contributed greatly to Japan's competitive success.

Although improvements under *kaizen* are small and incremental, the *kaizen* process brings about dramatic results over time. The *kaizen* concept explains why companies cannot remain static for long in Japan. Western management, mean while, worships innovation: major changes in the wake of technological breakthroughs and the latest management concepts or production techniques. Innovation is dramatic, a real attention-getter. *Kaizen*, on the other hand, is often undramatic and subtle. But innovation is one- shot, and its results are often problematic, whereas the *kaizen* process, based on commonsense and low cost approaches, ensures incremental progress that pays off in the long run. *Kaizen* is also a low- risk approach. Managers always can go back to the old way without incurring large costs.

Most "uniquely Japanese" management practices, such as total quality control (TQC) or company wide quality control and quality circles, and style of labor relations can be reduced to one word: *kaizen*. Using the term *kaizen* in place of such buzzwords as *productivity*, *total quality control* (TQC), *zero defects* (ZDs), *just- in- time* (JIT), and the *suggestion system* paints a clearer picture of what has been going on in Japanese industry. *Kaizen* is an umbrella concept for all these practices. However, these practices are not necessarily confined to Japanese management but rather should be regarded as sound principles to be applied by managers everywhere. By following the right steps and applying the processes properly, any company, no matter what its nationality, can benefit from *kaizen*. The widespread acceptance of *kaizen* into management thinking, including the successes of Kaizen Institute clients in more than 50 countries, bears this out.

Major *Kaizen* Concepts: Management must learn to implement certain basic concepts and systems in order to realize *kaizen* strategy:

- *Kaizen* and management
- Process versus result
- Following the plan- do-check-act (PDCA)/standardize-do-check-act (SDCA) cycles
- Putting quality first
- Speak with data.
- The next process is the customer.

Kaizen and Management: In the context of *kaizen*, management has two major functions: maintenance and improvement. *Maintenance* refers to activities directed toward maintaining current technological, managerial, and operating standards and upholding such standards through training and discipline. Under its maintenance function, management performs its assigned tasks so that everybody can follow standard operating procedures (SOPs). *Improvement*, meanwhile, refers to activities directed toward elevating current standards. The Japanese view of management thus boils down to one precept: Maintain and improve standards. Improvement can be classified as either *kaizen* or innovation. *Kaizen* signifies small improvements as a result of ongoing efforts. Innovation involves a drastic improvement as a result of a large investment of resources in new technology or equipment. (Whenever money is a key factor, innovation is expensive.) Because of their fascination with innovation, Western managers tend to be impatient and over look the long -term benefits *kaizen* can bring to a company. *Kaizen*, on the other hand, emphasizes human efforts, morale, communication, training, teamwork, involvement, and self discipline a low cost approach to improvement.

Process versus Result: *Kaizen* fosters process oriented thinking because processes must be improved for results to improve. Failure to achieve planned results indicates a failure in the process. Management must identify and correct such process- based errors. *Kaizen* focuses on human efforts—an orientation that contrasts sharply with the results based thinking in the West. A process-oriented approach also should be applied in the introduction of the various *kaizen* strategies: the plan- do-check-act (PDCA) cycle; the standardize-do-check-act (SDCA) cycle; quality, cost, and delivery (QCD); total quality management (TQM); just-in-time (JIT); and total productive maintenance (TPM). *Kaizen* strategies have failed many companies simply because they ignored process. The most crucial element in the *kaizen* process is the commitment and involvement of top management. It must be demonstrated immediately and consistently to ensure success in the *kaizen* process.

Following the PDCA/SDCA Cycles: The first step in the *kaizen* process establishes the *plan- do-check-act (PDCA) cycle* as a vehicle that ensures the continuity of *kaizen* in pursuing a policy of maintaining and improving standards. It is one of the most important concepts of the process. Plan refers to establishing a target for improvement (since *kaizen* is a way of life, there always should be a target for improvement in any area) and devising action plans to achieve that target. *Do* refers to implementing the plan. *Check* refers to determining whether the implementation remains on track and has brought about the planned improvement. *Act* refers to performing and standardizing the new procedures to prevent recurrence of the original problem or to set goals for the new improvements. The PDCA cycle revolves continuously; no sooner is an improvement made than the resulting status quo becomes the target for further improvement. PDCA means never being satisfied with the status quo. Because employees prefer the status quo and frequently do not have initiative to improve conditions, management must initiate PDCA by establishing continuously challenging goals.

In the beginning, any new work process is unstable. Before one starts working on PDCA, any current process must be stabilized in a process often referred to as the *standardize- do- check- act (SDCA) cycle*. Every time an abnormality occurs in the current process, the following questions must be asked: Did it happen because we did not have a standard? Did it happen because the standard was not followed? Or did it happen because the standard was not adequate? Only after a standard has been established and followed, stabilizing the current process, should one move on to the PDCA cycle.

Thus the SDCA cycle standardizes and stabilizes the current processes, whereas the PDCA cycle improves them. SDCA refers to maintenance, and PDCA refers to improvement; these become the two major responsibilities of management.

Putting Quality First: Of the primary goals of quality, cost, and delivery (QCD), quality always should have the highest priority. No matter how attractive the price and delivery terms offered to a customer, the company will not be able to compete if the product or service lacks quality. Practicing a quality first credo requires management commitment because managers often face the temptation to make compromises in meeting delivery requirements or cutting costs. In so doing, they risk sacrificing not only quality but also the life of the business.

Speak with Data: *Kaizen* is a problem -solving process. In order for a problem to be correctly understood and solved, the problem must be recognized and the relevant data gathered and analyzed. Trying to solve a problem without hard data is akin to resorting to hunches and feelings—not a very scientific or objective approach. Collecting data on the current status helps you to understand where you are now focusing; this serves as a starting point for improvement. Collecting, verifying, and analyzing data for improvement is a theme that recurs throughout this book.

The Next Process is the Customer: All work is a series of processes, and each process has its supplier as well as its customer. A material or a piece of information provided by process A (supplier) is worked on and improved in process B and then sent on to process C. The next process always should be regarded as a customer. The axiom "the next process is the customer" refers to two types of customers: internal (within the company) and external (out in the market).

Most people working in an organization deal with internal customers. This realization should lead to a commitment never to pass on defective parts or inaccurate pieces of information to those in the next process. When everybody in the organization practices this axiom, the external customer in the market receives a high -quality product or service as a result. A real quality- assurance system means that everybody in the organization subscribes to and practices this axiom.

Major *Kaizen* Systems: The following are major systems that should be in place in order to successfully achieve a *kaizen* strategy:

- Total quality control (TQC)/total quality management (TQM)
- A just -in- time (JIT) production system (Toyota Production System)
- Total productive maintenance (TPM)
- Policy deployment
- A suggestion system
- Small -group activities

Total Quality Control/Total Quality Management: One of the principles of Japanese management has been total quality control (TQC), which, in its early development, emphasized control of the quality process. This has evolved into a sys tem encompassing all aspects of management and is now referred to as *total quality management* (TQM), a term used internationally.

Regarding the TQC/TQM movement as a part of *kaizen* strategy gives us a clearer understanding of the Japanese approach. Japanese TQC/TQM should not be regarded strictly as a quality-control activity; TQC/TQM has been developed as a *strategy* to aid management in becoming more competitive and profitable by helping it to improve in all aspects of business. In TQC/TQM, *Q*, meaning "quality," has priority, but there are other goals, too—namely, cost and delivery. The *T* in TQC/TQM signifies "total," meaning that it involves everybody in the organization, from top management through middle managers, supervisors, and shop-floor workers. It further extends to suppliers, dealers, and wholesalers. The *T* also refers to top management's leadership and performance—so essential for successful implementation of TQC/TQM. The *C* refers to "control" or "process control." In TQC/TQM, key processes must be identified, controlled, and improved on continuously in order to improve results. Management's role in TQC/TQM is to set up a plan to check the process against the result in order to improve the process, not to criticize the process on the basis of the result. TQC/TQM in Japan encompasses such activities as policy deployment, building quality-assurance systems, standardization, training and education, cost management, and quality circles.

The Just- in-Time Production System: It originated at Toyota Motor Company, the just- in- time (JIT) production system aims at eliminating non value-adding activities of all kinds and achieving a lean production system that is flexible enough to accommodate fluctuations in customer orders.

This production system is supported by such concepts as *takt* time (the time it takes to produce one unit) versus cycle time, one -piece flow, pull production, *jidoka* ("autorotation"), U-shaped cells, and setup reduction. To realize the ideal JIT production system, a series of *kaizen* activities

must be carried out continuously to eliminate non-value- adding work in *gemba*. JIT dramatically reduces cost, delivers the product in time, and greatly enhances company profits.

Total Productive Maintenance: An increasing number of manufacturing companies now practice *total productive maintenance* (TPM) within as well as outside of Japan. Whereas TQM emphasizes improving overall management performance and quality, TPM focuses on improving equipment quality. TPM seeks to maximize equipment efficiency through a total system of preventive maintenance spanning the lifetime of the equipment.

Just as TQM involves everybody in the company, TPM involves every body at the plant. The five S of housekeeping, another pivotal activity in *gemba*, may be regarded as a prelude to TPM.

However, 5 S activities have registered remarkable achievements in many cases even when carried out separately from TPM.

Policy Deployment: Although *kaizen* strategy aims at making improvements, its impact may be limited if everybody is engaged in *kaizen* for *kaizen*'s sake without any aim. Management should establish clear targets to guide everyone and make certain to provide leadership for all *kaizen* activities directed toward achieving the targets. Real *kaizen* strategy at work requires closely supervised implementation. This process is called Policy Deployment, or in Japanese, *hoshin kanri*.

First, top management must devise a long- term strategy, broken down into medium- term and annual strategies. Top management must have a plan-to-deploy strategy, passing it down through subsequent levels of management until it reaches the shop floor. As the strategy cascades down to the lower echelons, the plan should include increasingly specific action plans and activities. For instance, a policy statement along the lines of "We must reduce our cost by 10 percent to stay competitive" may be translated on the shop floor to such activities as increasing productivity, reducing inventory and rejects, and improving line configurations. *Kaizen* without a target would resemble a trip without a destination. *Kaizen* is most effective when everybody works to achieve a target, and management should set that target.

The Suggestion System: The *suggestion system* functions as an integral part of individual oriented *kaizen* and emphasizes the morale boosting benefits of positive employee participation. Japanese managers see its primary role as that of sparking employee interest in *kaizen* by encouraging them to provide many suggestions, no matter how small. Japanese employees are often encouraged to discuss their suggestions verbally with supervisors and put them into action right away, even before submitting suggestion forms. They do not expect to reap great economic benefits from each suggestion. Developing *kaizen* -minded and self-disciplined employees is the primary goal. This outlook contrasts sharply with that of Western management's emphasis on the economic benefits and financial incentives of suggestion systems.

Small -Group Activities: A *kaizen* strategy includes *small -group activities*—informal, voluntary, intracompany groups organized to carry out specific tasks in a workshop environment. The most popular type of small- group activity is *quality circles*. Designed to address not only quality issues but also such issues as cost, safety, and productivity, quality circles may be regarded as group oriented *kaizen* activities. Quality circles have played an important part in improving product quality and productivity in Japan. However, their role often has been blown out of proportion by overseas observers, who believe that these groups are the mainstay of quality activities in Japan.

Management plays a leading role in realizing quality—in ways that include building quality-assurance systems, providing employee training, establishing and deploying policies, and building cross -functional systems for QCD. Successful quality-circle activities indicate that management plays an invisible but vital role in supporting such activities.

The Ultimate Goal of *Kaizen* Strategy: Since *kaizen* deals with improvement, we must know which aspects of business activities need to be improved most. And the answer to this question is quality, cost, and delivery (QCD). My previous book, *Kaizen: The Key to Japan's Competitive Success*, used the term *quality*, *cost*, and *scheduling* (QCS). Since that time, QCD has replaced QCS as the commonly accepted terminology. *Quality* refers not only to the quality of finished products or services but also to the quality of the processes that go into those products or services. *Cost* refers to the overall cost of designing, producing, selling, and servicing the product or ser vice. *Delivery* means delivering the requested volume on time. When the three conditions defined by the term QCD are met, customers are satisfied.

QCD activities bridge such functional and departmental lines as research and development, engineering, production, sales, and after-sales service. Therefore, cross functional collaborations are necessary, as are collaborations with suppliers and dealers. It is top management's responsibility to review the current position of the company's QCD in the market place and to establish priorities for its QCD improvement policy.

15.6 Six Sigma

Six Sigma is a rigorous, focused, and highly effective implementation of proven quality principles and techniques. Incorporating elements from the work of many quality pioneers, Six Sigma aims for virtually error-free business performance. A company's performance is measured by the sigma level of their business processes. Six Sigma relies on tried and true methods that have been used for decades. By some measures, Six Sigma discards a great deal of the complexity that characterized Total Quality Management (TQM). Six Sigma takes a handful of proven methods and trains a small cadre of in-house technical leaders, known as Six Sigma Black Belts, to a high level of proficiency in the application of these techniques. To be sure, some of the methods Black Belts uses are highly advanced, including up-to-date computer technology. But the tools are applied within a simple performance improvement model known as Define-Measure-Analyze-Improve-Control, or DMAIC. DMAIC is described briefly as follows:

- *D* Define the goals of the improvement activity.
- *M* Measure the existing system.
- *A* Analyze the system to identify ways to eliminate the gap between the current performance of the system or process and the desired goal.
- *I* Improve the system.
- *C* Control the new system.

Quality, defined traditionally as conformance to internal requirements, has little to do with Six Sigma. Six Sigma focuses on helping the organization make more money by improving customer value and efficiency. To link this objective of Six Sigma with quality requires a new definition of quality: the value added by a productive endeavor. This quality may be expressed as potential quality and actual quality. Potential quality is the known maximum possible value added per unit of input. Actual quality is the current value added per unit of input. The difference between potential and actual quality is waste. Six Sigma focuses on improving quality (i.e., reducing waste) by helping organizations produce products and services better, faster, and cheaper. There is a direct correspondence between quality levels and "sigma levels" of performance. Six Sigma focuses on customer requirements, defect prevention, cycle time reduction, and cost savings. Thus, the benefits from Six Sigma go straight to the bottom line. Unlike mindless cost-cutting programs which also reduce value and quality, Six Sigma identifies and eliminates costs which provide no value to customers: waste costs. For non-Six Sigma companies, these costs are often extremely high. Companies operating at three or four sigma typically spend between 25 and 40 percent of their revenues fixing problems. This is known as the cost of quality, or more accurately the cost of poor quality. Companies operating at Six Sigma typically spend less than 5 percent of their revenues fixing problems one reason why costs are directly related to sigma levels is very simple: sigma levels are a measure of error rates, and it costs money to correct errors.

The Six Sigma Philosophy: Six Sigma is the application of the scientific method to the design and operation of management systems and business processes which enable employees to deliver the greatest value to customers and owners. The scientific method works as follows:

1. Observe some important aspect of the marketplace or business.
2. Develop a tentative explanation, or hypothesis, consistent with observations.
3. Based on hypothesis, make predictions.
4. Test predictions by conducting experiments or making further careful observations. Record those observations. Modify the hypothesis based on the new facts. If variation exists, use statistical tools to help you separate signal from noise.

5. Repeat steps 3 and 4 until there are no discrepancies between the hypothesis and the results from experiments or observations.

The Six Sigma philosophy focuses the attention on the stakeholders for whom the enterprise exists. It is a cause-and-effect mentality. Well-designed management systems and business processes operated by happy employees cause customers and owners to be satisfied or delighted. Of course, none of this is new. Most leaders of traditional organizations honestly believe that this is what they already do. What distinguishes the traditional approach from Six Sigma is the degree of rigor and commitment to the core principles.

Implementing Six Sigma: The activities and systems required to successfully implement Six Sigma are well documented.

1. **Leadership:** Leadership's primary role is to create a clear vision for Six Sigma success and to communicate their vision clearly, consistently, and repeatedly throughout the organization. In other words, leadership must lead the effort. Their primary responsibility is to ensure that Six Sigma goals, objectives, and progress are properly aligned with those of the enterprise as a whole. This is done by modifying the organization such that personnel naturally pursue Six Sigma as part of their normal routine. This requires the creation of new positions and departments, and modified reward, recognition, incentive, and compensation systems. These key issues are discussed throughout this chapter. The Six Sigma deployment will begin with senior leadership training in the philosophy, principles, and tools they need to prepare their organization for success.

2. **Infrastructure:** Using their newly acquired knowledge, senior leaders direct the development and training of an infrastructure to manage and support Six Sigma.

3. **Communication and Awareness:** Simultaneously, steps are taken to "soft-wire" the organization and to cultivate a change-capable environment where innovation and creativity can flourish. A top-level DMAIC project is focused on the change initiative and the communication required to build buy-in of the initiative.

4. **Stakeholder Feedback Systems:** Systems are developed for establishing close communication with customers, employees, and suppliers. This includes developing rigorous methods of obtaining and evaluating customer, owner, employee, and supplier input. Baseline studies are conducted to determine the starting point and to identify cultural, policy, and procedural obstacles to success.

5. **Process Feedback Systems:** A framework for continuous process improvement is developed, along with a system of indicators for monitoring progress and success. Six Sigma metrics focus on the organization's strategic goals, drivers, and key business processes.

6. **Project Selection:** Six Sigma projects are proposed for improving business processes by people with process knowledge at various levels of the organization. Six Sigma projects are selected based on established protocol by senior management to achieve business performance objectives linked to measurable financial results

7. **Project Deployment:** Six Sigma projects are conducted by project teams lead by Black Belts (or by Green Belts with the technical assistance of Black Belts).

Timetable: The resulting benefits are dependent on the rate of project deployment and the organization's initial quality levels. A typical goal is an improvement rate of approximately 10 times every two years, measured in terms of errors (or defects) per million opportunities (DPMO). For the typical company starting at three sigma will reach Six Sigma levels of performance after approximately five years from the time they have deployed Six Sigma. The results will begin to appear within a year of starting the deployment. Yet, even when the enterprise reaches a performance level of five or Six Sigma overall, there may still be processes operating at poor sigma levels, demonstrating the fallibility of the DPMO metric, especially when interpreted across an entire organization.

Individual customers judge your organization based on their individual experiences, and customer expectations are a moving target. In the second and subsequent years the benefits outpaced the costs, with the benefit-to-cost ratio improving steadily as costs level out. These results are consistent with those reported by academic research for companies which successfully implemented TQM.

The annual savings achieved by a given organization is largely dependent on their initial quality, as well as their resource commitment. The number of full-time personnel devoted to Six Sigma is a relatively small percentage of the total work force. Mature Six Sigma programs, such as those of General Electric, Johnson & Johnson, AlliedSignal, and others average about 1 percent of their workforce as Black Belts, with considerable variation in that number. There is usually about one Master Black Belt for every 10 Black Belts, or about one Master Black Belt per 1,000 employees. A Black Belt will typically complete 5 to 7 projects per year, usually working with teams. Project teams are led either by Black Belts or in some cases Green Belts, who, unlike Black Belts and Master Black Belts, are not engaged full time in the Six Sigma program. Green Belts usually devote between 5 and 10 percent of their time to Six Sigma project work.

Infrastructure: A successful Six Sigma deployment demands an organizational infrastructure to manage and support the various activities summarized earlier in this chapter. Six Sigma is the primary strategy for enterprise-wide business process improvement; to ensure success it is necessary to institutionalize it as a way of doing business. Six Sigma provides a quasi-standardized set of guidelines for deployment, resulting in a much higher success rate. Although each organization will develop its own unique approach to Six Sigma, it is helpful to review the practices of successful companies.

Most importantly, successful Six Sigma deployment is always a top-down affair. For Six Sigma to have a major impact on overall enterprise performance, it must be fully embraced and actively led by top management. Isolated efforts at division or department levels are doomed from the outset. Like flower gardens in a desert, they may flourish and produce a few beautiful results for a time, but sustaining the results requires immense effort by local heroes in constant conflict with the mainstream culture, placing themselves at risk. Sooner or later, the desert will reclaim the garden. Six Sigma shouldn't require heroic effort—there are never enough heroes to go around. Once top management has accepted its leadership responsibility the organizational transformation process can begin.

The transformation process involves new roles and responsibilities on the part of many individuals in the organization. In addition, new change agent positions must be created. In a Six Sigma organization, improvement and change are the full-time job of a small but critical percentage of the organization's personnel. These full-time change agents are the catalyst that institutionalizes change. Education and training are important means of changing individual perceptions and behaviors. A distinction is made between training and education. *Training* refers to instruction and practice designed to teach a person how to perform one or more tasks. Training focuses on concrete tasks to be completed. *Education* refers to instruction in thinking. Education focuses on integrating abstract concepts into one's knowledge of the world. An educated person will view the world differently after being educated. This is an essential part of the process of change.

Six Sigma training is a sub project of the Six Sigma deployment plan, whose timetables must be tightly linked. Training provided too early or too late is a mistake. When training is provided too early, the recipient will forget much of what he has learned before it is needed. When it is provided too late, the quality of the employee's work will suffer. When it comes to training, just-in-time delivery is the goal.

Champions and Sponsors: Six Sigma champions are high-level individuals who understand Six Sigma and are committed to its success. In larger organizations Six Sigma will be led by a full-time, high-level champion, such as an executive vice president. In all organizations, champions also include informal leaders who use Six Sigma in their day-to-day work and communicate the Six Sigma message at every opportunity. Sponsors are owners of processes and systems who help initiate and coordinate Six Sigma improvement activities in their areas of responsibilities.

Leaders should receive guidance in the art of "visioning." Visioning involves the ability to develop a mental image of the organization at a future time; without a vision, there can be no strategy. The future organization will more closely approximate the ideal organization, where "ideal" is defined as that organization which completely achieves the organization's values.

Leaders need to be masters of communication. When large organizations are involved, communications training should include mass communication media, such as video, radio broadcasts and print media. Communicating with customers, investors, and suppliers differs from communicating with employees and colleagues, and special training is often required. Communicating vision is very different from communicating instructions or concrete ideas. Visions of organizations that embody abstract values are necessarily abstract in nature. To effectively convey the vision, the leader must convert the abstractions to concretes. One way to do this is by living the vision.

Employees who are trying to understand the leader's vision will pay close attention to the behavior of the leader. Another way to communicate abstract ideas is through stories. In organizations there is a constant flow of events involving customers, employees, and suppliers. From time to time an event occurs that captures the essence of the leader's vision. A clerk provides exceptional customer service, an engineer takes a risk and makes a mistake, a supplier keeps the line running through a mighty effort. These are concrete examples of what the leader wants the future organization to become.

Black Belts: Candidates for Black Belt status are technically oriented individuals held in high regard by their peers. They should be actively involved in the process of organizational change and development. As a full-time change agent, the Black Belt needs excellent interpersonal skills. In addition to mastering a body of technical knowledge, Black Belts must

- Communicate effectively verbally and in writing
- Communicate effectively in both public and private forums
- Work effectively in small group settings as both a participant and a leader
- Work effectively in one-on-one settings
- Understand and carry out instructions from leaders and sponsors

Green Belts: Green Belts are Six Sigma project leaders capable of forming and facilitating Six Sigma teams and managing Six Sigma projects from concept to completion. Green Belts are change agents who work part time on process improvement. The bulk of the Green Belt's time is spent performing their normal work duties. Although most experts advocate that the Green Belt spend 10 to 20% of their time on projects, in most cases it is only 2 to 5%. A Green Belt will usually complete one or two major projects per year, usually as a team member rather than a team leader. Since a Green Belt is not trained in all the tools needed in the DMAIC cycle, when they lead projects they must be actively supported by a Black Belt. Few Green Belt projects cover enterprise-wide processes. However, since there are usually more Green Belts than Black Belts, Green Belt projects can have a tremendous impact on the enterprise. Figure 1.10 provides an overview of a process for the selection of Green Belt candidates.

Master Black Belts: This is the highest level of technical and organizational proficiency. Master Black Belts provide technical leadership of the Six Sigma program. They must be thoroughly familiar with the Black Belts Body of Knowledge, as well as additional skills including the mathematical theory that forms the basis of the statistical methods, project management, coaching, teaching, and program organization at the enterprise level. Master

Black Belts must be able to assist Black Belts in applying the methods correctly in unusual situations. Whenever possible, statistical training should be conducted only by for Black Belts and Green Belts to provide training, they should only do so under the guidance of Master Black Belts. Otherwise the familiar "propagation of error" phenomenon will occur; that is., Black Belt trainers pass on errors to Black Belt trainees who pass them on to Green Belts, who pass on greater errors to team members. Because of the nature of the Master's duties, all Master Black Belts must possess excellent communication and teaching skills.

Change Agent Compensation and Retention: Experienced Black Belts and Master Black Belts are in great demand throughout the manufacturing and services sectors.? Given their proven talent for effecting meaningful change in a complex environment, this is no surprise. Since organizations exist in a competitive world, steps must be taken to protect the investment in these skilled change agents, or they will be lured away by other organizations, perhaps even competitors.

There are also numerous nonfinancial and quasi-financial rewards.

Integrating Six Sigma and Related Initiatives: At any given time most companies have numerous activities underway to improve their operations. For example, the company may have functional areas devoted to Lean Implementation, Continuous Improvement, or Business Process Reengineering, to name just a few. Leadership must give careful thought as to how the various overlapping activities can best be organized to optimize their impact on performance and minimize confusion over jurisdiction, resources and authority. An "umbrella concept" often provides the needed guidance to successfully integrate the different but related efforts. One concept that is particularly useful is that of "Process Excellence" (PE). Organizations are typically designed along functional lines, with functions such as engineering, marketing, accounting, and manufacturing assigned responsibility for specific tasks often corresponding closely to university degree programs. Persons with higher education in a specific discipline specialize in the work assigned to that function.

Communications and Awareness: Top-level Six Sigma projects using the DMAIC methodology can be defined to build -buy-in for the change initiative and build awareness through communication, as follows: (Keller, 2005).

Define: DEFINE the scope and objectives for the Six Sigma change initiative, which is usually an enterprise undertaking. Define the key stakeholder groups that will be impacted by the change. The key stakeholders are those groups whose involvement is key to the success of the change initiative, which can include:

- Key customers
- Shareholders or other owners
- Senior leadership
- Middle management
- Six Sigma change agents
- The general employee population
- Suppliers

Define one or more metrics that can be used to track the current organizational culture on quality, which is discussed in the Measure description in the following section.

Measure: Measure the baseline level of buy-in for the change initiative among these key stakeholder groups, as well as the baseline quality culture. Buy-in can be measured according to the following scale, from lowest to highest: Hostility, Dissent, Acceptance, Support, Buy-In. Note that the desired level of buy-in surpasses mere support; enthusiasm is required for complete buy-in. Surveys and focus groups, are often used to measure buy-in as well as perceptions on quality.

Analyze: Analyze the primary causes of buy-in resistance, which can include issues and resolutions such as:

- **Unclear Goals:** Goals need to be clearly communicated throughout the stakeholder groups.
- **No Personal Benefit:** Goals should be stated in terms that provide a clear link to personal benefits for stakeholders, such as decreased hassles or improved working conditions.
- **Predetermined Solutions:** When teams are given the solution without chance for analysis of alternatives, they will likely be skeptical of the result. The root cause of this practice is often management resistance to free thinking or experimentation by process personnel or a lack of customer focus.
- **Lack of Communication:** Analyses and results should be communicated throughout the stakeholder groups.
- **Too Many Priorities:** Teams need to be focused on achievable results.
- **Short-term Focus:** Goals should provide clear benefits over short and longer terms.
- **No Accountability:** Clearly defined Project Sponsors, stakeholders and team members provide accountability.
- **Disagreement on the Definition of Customer:** Clearly defined stakeholder groups are needed for project success. This can also be associated with so-called turf wars between various functional areas within an organization.
- **Low Probability of Implementation:** Formal project sponsorship and approvals provide a clear implementation channel.
- **Insufficient Resources:** Stakeholder groups need to understand that the project is sufficiently funded and resources allocated—Training project teams is essential.
- **Midstream Change in Direction or Scope:** Changes in project scope or direction provide a potential for a loss of buy-in. Changes must be properly communicated to stakeholder groups to prevent this reduction in buy-in.

Improve: Improve buy-in by addressing the causes of resistance. Communication is the primary method of building buy-in, and can be effectively improved by developing and managing a Six Sigma communication plan. The commitment to Six Sigma must be clearly and unambiguously understood throughout the organization. Communicating the Six Sigma message is a multimedia undertaking. The modern organization has numerous communications technologies at its disposal. Keep in mind that communication is a two-way affair; be sure to provide numerous opportunities for upward and lateral as well as downward communication. Here are some suggestions to accomplish the communications mission:

- All-hands launch event, with suitable pomp and circumstance
- Mandatory staff meeting agenda item

- Internal newsletters, magazines, and Web sites, with high profile links to enterprise Six Sigma Web site on home page
- Six Sigma updates in annual report
- Stock analyst updates on publicly announced Six Sigma goals
- Intranet discussion forums
- Two-way mail communications
- Surveys
- Suggestion boxes
- Videotape or DVD presentations
- Closed circuit satellite broadcasts by executives, with questions and answers
- All-hands discussion forums
- Posters
- Logo shirts, gear bags, key chains, coffee mugs, and other accessories
- Speeches and presentations
- Memoranda
- Recognition events
- Lobby displays
- Letters

Control: Control the change effort with a plan to maintain buy-in. Personnel trained as change agents can be placed in strategic positions throughout the organization. This makes it possible for them to assist in the development and implementation (including sponsorship) of future quality improvement projects. Quality improvement of any significance nearly always involves multiple departments and levels in the organization. Change agents help organize an assessment of the organization to identify its strengths and weaknesses. Change is usually undertaken to either reduce areas of weakness, or exploit areas of strength. The assessment is part of the education process. Knowing one's specific strengths and weaknesses is useful in mapping the process for change.

15.7 Balance Score Card

The Balanced Scorecard was first introduced in the early 1990s through the work of Robert Kaplan and David Norton of the Harvard Business School. Since then, the concept has become well known and its various forms widely adopted across the world. By combining financial measures and non-financial measures in a single report, the Balanced Scorecard aims to provide managers with richer and more relevant information about activities they are managing than is provided by financial measures alone. To aid clarity and utility, Kaplan and Norton proposed that the number of measures on a Balanced Scorecard should also be constrained in number, and clustered into four groups. But from the outset it was clear that the selection of measures, both in terms of filtering (organizations typically had access to many more measures than were needed to populate the Balanced Scorecard) and clustering (deciding which measures should appear in which perspectives) would be a key activity. Kaplan and Norton proposed that measure selection should focus on information relevant to the implementation of strategic plans, and that simple attitudinal questions be used to help determine the appropriate allocation of measures to perspectives (Kaplan and Norton, 1992). In essence the Balanced Scorecard has remained unchanged since these early papers, having at its core a limited number of measures clustered into groups, and an underlying strategic focus.

- **1st Generation Balance Scorecard:** Balanced Scorecard was initially described as a simple, "4 box" approach to performance measurement. In addition to financial measures, managers were encouraged to look at measures drawn from three other "perspectives" of the business: Learning and Growth; Internal Business Process; and Customer, chosen to represent the major stakeholders in a business. Definition of what comprised a Balanced Scorecard was sparse and focused on the high level structure of the device. Simple 'causality' between the four perspectives was illustrated but not used for specific purpose. Kaplan and Norton's original paper's focus was on the selection and reporting of a limited number of measures in each of the four perspectives. The paper suggested use of attitudinal questions relating to the vision and goals of the organization to help in the selection of measures to be used, and also encouraged the consideration of 'typical' areas of interest in this process.

Kaplan and Norton's original work makes no specific observations concerning how the Balanced Scorecard might improve the performance of organizations; the implication is that the provision of However, they do imply that the source of these improvements is changes in behavior: "It establishes goals but assumes that people will adopt whatever behaviors and take whatever actions are necessary to arrive at those goals". In the light of this, the basis for selecting the goals represented by the Balanced Scorecard is of some importance. But in their first paper Kaplan and Norton say little about how a Balanced Scorecard could be developed in practice beyond a general assertion that design involved "putting vision and strategy at the centre of the measurement system". Later writing includes increasing amounts of proscription about development methods, concluding with a lengthy description of one such process in their first book on the subject published in 1996.

- **2nd Generation Balance Scorecard:** The practical difficulties associated with the design of 1st Generation Balanced Scorecards are significant, in part because the definition of a Balanced Scorecard was initially vague, allowing for considerable interpretation. Two significant areas of concern were filtering (the process of choosing specific measures to report), and clustering (deciding how to group measures into 'perspectives'). Perhaps the most significant early change translated the attitudinal approach to measure selection proposed initially be Kaplan and Norton (e.g. "To succeed financially, how should we appear to our shareholders?") into a process that yielded a few appropriate key measures of performance in each perspective. A solution was the introduction of the concept of 'strategic objectives'. Initially these were represented as short sentences attached to the four perspectives, and were used to capture the essence of the organization's strategy material to each of the areas: measures were then selected that reflected achievement of these strategic objectives. Although subtle, this approach to measure selection quite different from that initially proposed, since strategic objectives were developed directly from strategy statements based on a corporate vision or a strategic plan. Another key development concerned causality. Causality between the perspectives had been introduced in early '1st Generation' Balanced Scorecard thinking. '2nd Generation' Balanced Scorecard saw the idea of causality developed further. Instead of simply highlighting causal links between perspectives, internal documents from one consulting firm's work in 1993 shows an early attempt to indicate linkages between the measures themselves. The impacts of these changes were characterized by Kaplan and Norton in 1996 as enabling the Balanced Scorecard to evolve from "an improved measurement system to a core management system". Maintaining the focus that Balanced Scorecard was intended to support the management of strategic implementation, Kaplan and Norton further described the use of this development of the Balanced Scorecard as the central element of "a strategic management system". One consequence of this change in emphasis was to increase the pressure on the design process to accurately reflect the organization's strategic goals. Over time the idea of strategic linkage became an increasingly important element of Balanced Scorecard design methodology and began to show graphically linkages between the strategic objectives themselves (rather than the measures) with causality linking across the perspectives toward key objectives relating to financial performance.

- **3rd Generation Balance Scorecard:** The 3rd Generation Balanced Scorecard model is based on a refinement of 2nd Generation design characteristics and mechanisms to give better functionality and more strategic relevance. The origin of the developments stem from the issues relating to target setting and the validation of strategic objective selection outlined above. These triggered the development in the late 1990's of a further design element – the 'Destination Statement' – initially at the end of the design process to 'check' the objectives, measures and targets chosen. The first Destination Statements were created as a final consensus estimate of the consequences at a particular future date (e.g. 'in three years time') of implementing the strategic objectives previously selected for the strategic linkage model. By agreeing in this statement 'how much' of key things would have been achieved by this time (e.g. headcount, revenues, customer satisfaction, quality levels etc.) the hope was it would subsequently be easier (for example) to check for (or set) a consistent set of annual targets. It was quickly found that management teams were able to discuss, create, and relate to the 'Destination Statement' much easily and without reference to the selected objectives. Consequently the design process was 'reversed', with the creation of the 'Destination Statement' being the first design activity, rather than a final one. Further it was found that by working from Destination Statements, the selection of strategic objectives, and articulation of hypotheses of causality was also much easier, and consensus could be achieved within a management team more quickly. We will refer to Balanced Scorecards that incorporate Destination Statements as '3rd Generation Balanced Scorecards'. Key components of a 3rd Generation Balanced Scorecard are:
- **Destination Statement**: In order to make rational decisions about organizational activity and not least set targets for those activities, an enterprise should develop a clear idea about what the organization is trying to achieve. A destination statement describes, ideally in some detail, what the organization is likely to look like at an agreed future date. In many cases this exercise builds on existing plans and documents – but it is rare in practice to find a pre-existing document that offers the necessary clarity and certainty to fully serve this purpose within an enterprise.
- **Strategic Objectives**: The destination statement offers a clear and shared picture of an organization at some point in the future, but it does not provide a suitable focus for management attention between now and then. What needs to be done and achieved in the medium term for the organization to "reach" its destination on time is agreed upon in the form of objectives or priorities. By representing the selected objective on a "strategic linkage model", the design team is encouraged to apply "systems thinking" to identify cause-and-effect relationships between the selected objectives i.e. what do the organization need to do to achieve the results we expect. This approach also helps ensure the objectives chosen are mutually supportive and represent the combined thinking of the team's high-level perception of the business model.
- **Strategic Linkage Model and Perspectives**: The chosen strategic objectives are spread across four zones or 'perspectives'. The lower two perspectives contain objectives relating to the most important activities in terms of business processes, cycle time, productivity etc. (Internal Processes) and what needs to happen for these processes to be sustained and further developed in terms of people, product and process development (Learning & Growth). The two top perspectives house objectives relating to the desired results of the activities undertaken i.e. how we wish external stakeholders (e.g. the general public, partner agencies and organizations to perceive us (External Relations) and how this will ultimately translate into financial results and economic value (Financial).
- **Measures and Initiatives**: Once objectives have been agreed measures can be identified and constructed with the intention to support management's ability to monitor the organization's progress

towards achievement of its goals. Initiatives are special projects with a finite start and end date and are mapped to strategic objectives to give an indication of the projects or actions needed in order to realize the objectives.

Balanced Scorecards, when developed as strategic planning and management systems, can help align an organization behind a shared vision of success, and get people working on the right things and focusing on results. A scorecard is more than a way of keeping score…..it is a system, consisting of people, strategy, processes, and technology. One needs a disciplined framework to build the scorecard system. A balanced scorecard system is using a systematic step-by-step approach. "Balanced Scorecard" means different things to different people. At one extreme, a measurement-based balanced scorecard is simply a performance measurement framework for grouping existing measures into categories, and displaying the measures graphically, usually as a dashboard. The measures in these systems are usually operational, not strategic, and are used primarily to track production, program operations and service delivery (input, output, and process measures). At the other extreme, the balanced scorecard is a robust organization-wide strategic planning, management and communications system. These are strategy-based systems that align the work people do with organization vision and strategy, communicate strategic intent throughout the organization and to external stakeholders, and provide a basis for better aligning strategic objectives with resources. In strategy-based scorecard systems, strategic and operational performance measures (outcomes, outputs, process and inputs) are only one of several important components, and the measures are used to better inform decision making at all levels in the organization. In strategy-based systems, accomplishments and results are the main focus, based on good strategy executed well. A planning and management scorecard system uses strategic and operational performance information to measure and evaluate how well the organization is performing with financial and customer results, operational efficiency, and organization capacity building.

Balanced scorecards built with the goal of "organizing the measures we have" hardly justify the energy it takes to build them. The balanced scorecard journey starts not from performance measures but from the results the organization wants to accomplish. In other words, it starts with the end in mind, not with the measures of what they currently have.

Doing the right things and *doing things right* is a balancing act, and requires the development of good business strategies (*doing the right things*) and efficient processes and operations to deliver the programs, products and services (*doing things right*) that make up the organization's core business. While there are differences in development and implementation of scorecard systems for private, public and nonprofit organizations, the disciplined process of strategic discovery used to develop scorecard systems has more similarities then differences, so the framework applies equally well to different types of organizations, as well as to different size organizations.

Developing a balanced scorecard system is like putting a puzzle together, where different pieces come together to form a complete mosaic. In the balanced scorecard, the "pieces" are strategic components that are built individually, checked for "fit" against other strategic components, and assembled into a complete system. Developing a scorecard system is transformational for an organization….it's about changing hearts and minds. Leaders who are engaged in the discovery process, communication via two-way dialogue, and planning and managing change are important first steps in the process. Organization Mission, Vision, and Values. Critical to an aligned organization are a well defined mission, a shared vision, and organization values that are built on strong personal values. Most organizations have these components, but often there is no connecting tissue among the components that allow employees to "get it" easily. A compelling and clear "picture of the future" (the shared vision) is where the scorecard development process starts……employee buy-in follows as hearts and minds are engaged in creating and executing the organization's strategies.

Organization Pains (Weaknesses) and Enablers (Strengths). An organization environmental scan ("climate survey") will identify internal and external pains and enablers that will drive strategy creation and the approach to achieving future results. Customers and Stakeholders, and the Value Proposition. Effective strategy incorporates a view from the customer and stakeholder perspective, and includes an understanding of customer needs, product and service characteristics, desired relationships and the desired "corporate image" that the organization wants to portray.

- **Perspectives, Strategic Themes, and Strategic Results:** To view strategy through different performance lenses (balanced scorecard perspectives), the organization needs to define strategic perspectives, key strategies and expected results. Key strategies are the main focus areas or "pillars of excellence" that translate business strategy into operations, and make strategy actionable to all employees.
- **Strategic Objectives and Strategy Map:** Strategic objectives are the building blocks of strategy (strategy "DNA"), and objectives linked together in cause-effect relationships create a strategy map that shows how an organization creates value for its customers and stakeholders.
- **Performance Measures, Targets and Thresholds:** Performance measures are linked to objectives and allow the organization to measure what matters and track progress toward desired strategic results. Targets and thresholds provide the basis for visual interpretation of performance data, to transform the data into business intelligence.
- **Strategic Initiatives:** Initiatives translate strategy into operational terms, and provide a basis for prioritizing the budget and identifying the most important projects for the organization to undertake.
- **Performance Information Reporting:** Automated data collection and reporting processes are used to visualize performance information and better inform decision making throughout the organization. Cascade Scorecards to Departments and Individuals. Align the organization through strategy, using the strategy map, performance measures and targets, and initiatives. Scorecards are used to improve accountability through objective and performance measure ownership.
- **Rewards and Recognition:** Incentives are tied to performance to make strategy actionable for people, and help build buy-in for the behavior changes needed to create a high-performance organization.
- **Evaluation:** The results of the organization becoming more strategy-focused are evaluated, and changes in strategy, measures, and initiatives reflect organization learning. Each scorecard component is developed in a logical sequence, using a disciplined framework of discovery and strategic thinking. Each step links to another step until the complete scorecard system is developed. Following development of the strategic components, the scorecard system is assembled and communicated throughout the organization.

The scorecard system includes a strategy map, to show how value is created for members (customers), strategic objectives to describe what needs to be accomplished to produce value, what performance measures will be used to measure progress against targets, and what strategic initiatives have been identified to make strategy actionable and operational. Developing a balanced scorecard is a journey, not a project. The real value of a scorecard system comes from the continuous self-inquiry and in-depth process of discovery and analysis that is at the heart of the process. Start the balanced scorecard with the idea that it is for the long term, and that you will help learn a lot about how organization needs to work to satisfy customers, stakeholders, and employees. How long does it take to build a scorecard system? Depending on the size of the organization, two to four months is typical.

15.8 Business Process Outsourcing

Business process outsourcing (BPO) has emerged as one of the leading business and economic issues. A natural extension of the free-trade movement that has been a dominant force in global economics over the last two decades. The team-based approach to BPO project analysis and management is based on the fact that BPO is a sociotechnical phenomenon. That is, a well-executed outsourcing project must involve both social and technical resources of the organization. BPO is transformational to the organization and requires attention to the social and human impacts that accompany business transformation. At the same time, one of the primary enablers of BPO is the set of technologies that has emerged to connect the world in a global communications network. As a sociotechnical phenomenon, effective BPO management requires a diverse skill set that is not likely to be present in a single individual. It has become clear that BPO provides far more than mere cost savings to firms that use it. BPO has become a strategic business choice that can be leveraged for competitive advantage as well. When a business outsources a process to a vendor whose core competence is centered on that process, the buyer is likely to experience service enhancements that can be turned into competitive advantages over rivals. Furthermore, when the buyer–vendor relationship evolves into a business partnership, both sides will be motivated to look for mutually beneficial ways to leverage the combined asset pool.

BPO Defined: Business process outsourcing (BPO) is defined simply as the movement of business processes from inside the organization to an external service provider. With the global telecommunications infrastructure now well established and consistently reliable, BPO initiatives often include shifting work to international providers.

BPO: A Sociotechnical Innovation: Many executives and managers shy away from BPO because they wrongly believe it to be a technical innovation—one better left for the chief information officer (CIO) or other technology administrators. In part, this belief results from the IT origins of BPO. Many early adopters of outsourcing were those who needed software development expertise or who sought technical expertise to staff help desks and call centers. During the 1990s, the labor pool for such talent, prompting many leading companies to search abroad for the personnel they needed. These organizations turned to international labor markets, where they were able to identify and hire highly skilled technical workers who were far cheaper than their own country based counterparts.

- **BPO Transcends IT Origins:** BPO has evolved far from these IT-specific roots and now encompasses nearly every business process. The point is, nearly every modern business innovation comprises both a technical and a social component. Decision making, strategy setting, service delivery, and virtually every other business activity are now sociotechnical in nature, involving humans interfacing with technical systems. Fundamentally, BPO is a sociotechnical business innovation that provides a rich new source of competitive advantage. By sociotechnical it means that BPO requires skillful management of people and technology (hardware and software). The manager who initiates a BPO strategy must find effective ways to introduce people to technology and vice versa. If left solely in the hands of technical specialists, a BPO initiative is likely to fail for lack of paying attention to the soft issues of human relationships, change management, and organizational culture. If left solely in the hands of nontechnical managers, it is likely to fail for unrealistic expectations about the potential and limitations of the enabling technologies.
- **Human Factors and Technology Issues:** BPO is one of those interdisciplinary workplace innovations that demand a diverse set of skills to be successful. Initiating and implementing a BPO project requires a focus on several human factors, both within the organization initiating the project

and within the outsourcing vendor. These factors cannot be ignored and must be handled correctly in order for the project to succeed. Human factors include:
• Developing various teams to manage the BPO initiative throughout its life cycle
• Reassuring staff of their role in the company
• Training people on the new way of doing business
• Dealing with job loss and/or reassignment
• Keeping morale high throughout the change process
• Encouraging people to participate in decision making
• Understanding cultural differences between the organization and BPO partner.
The initiation and implementation of a BPO project also requires attention to technology issues such as:
• Compatibility of systems between the BPO buyer and vendor
• Data and system security
• Backup and recovery procedures in the case of system failure
• Data interface challenges and strategies
• Software and database compatibility challenges
• Data and knowledge management

- **Driving Factors:** Scholars who study how complex systems change over time are familiar with two types of change:

  1. *Evolutionary*, which are changes a system is likely to produce based on its current design and goals

  2. *Emergent*, which are system features or capabilities that would not have been predicted in advance based on the understood design and goals of the system.

  BPO is revolutionary because it is such an emergent phenomenon and because there is no evidence that anyone set out to design the potential for organizations to use BPO. It grew from a set of driving factors that have unintentionally converged at this particular time to enable the shifting of work to its lowest-cost/highest quality provider regardless of the provider's physical location. BPO is a business innovation that leverages these driving factors and applies them to practical business problems.

These drivers are:

- **Educational Attainment:** The world is catching up quickly in terms of the education. The gap between the developed and the developing nations has increased over time in technical education, which now also translates into fewer students from the developed nations seeking degrees in technical fields. In Asia, for example, far more students are pursuing science and engineering disciplines at the collegiate level than are their counterparts in the United States. Clearly, they recognize that the business world increasingly appreciates and utilizes their new abilities.

- **Broadband Internet:** *Broadband* refers to the growing pipeline capacity of the Internet, allowing larger chunks of information to flow with fewer congestion issues. The term is generally applied to Internet connectivity speeds that are in the range of 2 megabits/second (2 million bits/second). With broadband, workers in different countries can share data—an important factor in BPO—while consumers can surf the Web for the latest bargains.

- **Inexpensive Data Storage:** As file cabinets gave way to floppy disks, punch cards, magnetic tapes, disks, and CDs, storage has gone from scarcity to commodity. Technical advances have driven down costs, and a limitless cyberspace storage capacity now enables files to be retrieved whenever and wherever possible. Individual and organizational learning is literally a keystroke away. This has enabled new ways of thinking about what is possible in the structure and procedures of the workplace. The digitized document storage allows literally infinite distribution of key documents, forms, and plans. In the past, gatekeepers, whose approval was needed to acquire and use company information, managed data access. That barrier has been lifted by precision software based systems that enable rapid access to very specific data sets based on prearranged approval levels. These systems are constantly being upgraded to be more user friendly and can adapt quickly to unique work processes and systems.

- **Analytic Software:** Online analytic processing (OLAP) has created a wide range of new possibilities in workplace structure, including effects on hiring practices, organizational design, and productivity. Although OLAP has enabled some human resources to be eliminated, it has also placed a premium on individuals who can use the sophisticated output and create new value with it. Software that provides humanlike data output has opened the door to the possibility for data and information to seek lower-cost labor in the same way that manufacturing has done. Computational systems range from trend analysis in sales and marketing to workflow optimization on the shop floor.

- **Internet Security:** Internet security refers to the ability to send information and data (including voice) over the Internet without fear of leakage, espionage, or outright loss. It is critical for companies to be certain that their data integrity will be maintained despite its movement around the globe in the servers, routers, and computers that make up the World Wide Web. In the past, many executives were reluctant to conduct any back office business transactions over the Internet or beyond their own four walls because they felt the security risks outweighed the value proposition. However, in today's world of ever-changing technology advancements, most executives are more computer savvy and better understand the security protocols now available. With these new technical breakthroughs, companies can now work within virtual walls with the same level of security they enjoyed within physical walls.

The data protection laws enacted by the United Kingdom and the European Union (EU) are considered to be benchmarks in international privacy laws. Beyond that, several international certifications and standards mitigate security risks. Most BPO providers adhere to one or more of these standards and have received the appropriate certifications. Global and national compliance benchmarks include:

• *BS 7799*. First published in February 1995, BS 7799 is a comprehensive set of controls comprising best practices in information security. It is intended for use by organizations of all sizes and serves as a single reference point for identifying a range of controls needed for most situations where information systems are used in industry and commerce. It was significantly revised and improved in May 1999 and a year or so later published by the International Organization for Standardization (ISO).

• *ISO 17799*. This is an internationally recognized information security management standard that was first published in December 2000.

• *HIPAA*. The Health Insurance Portability and Accountability Act of 1996 (HIPAA) establishes standards for the secure electronic exchange of health data. Health care providers and insurers who transmit data electronically must comply with HIPAA security standards. The new laws governing data protection, organizational policies, and new technologies have converged to create a highly secure—although still imperfect—communications infrastructure. Although hack proof systems have yet to be constructed, the ever-more-complex barriers erected to prevent cyber espionage and cybercrime make them increasingly less attractive projects for weekend hackers and an expensive undertaking for anyone else.

- **Business Specialization:** Since the days of Adam Smith, capitalist economists have touted the benefits of specialization as a key to productive exchange among economic agents. The famous example of the pin factory used by Smith has stood the test of time. His eloquent analysis of the division of labor in the production of pins and the vastly greater output that would occur if people specialized in a part of the process can be applied to nearly any product or service. As it turns out, in a world where business-to-business (B2B) services have become as common to the economy as business-to consumer (B2C) products and services, the basic economic agent can as readily be construed to be a business firm as it could be a person. Business specialization has been urged for several decades. The admonition to focus on core competence, if pursued logically, leads to the idea that a business organization should operate as few nonrevenue- producing units as possible. In the early days of a business, when the firm is small and everyone pitches in to do whatever is necessary for the business to succeed, it is easy to call everything core. However, as a business grows, and as administration and overhead grow with it, there are many things a business does that are expensive but not directly involved in revenue generation. Accounting, legal counsel, payroll administration, human resources, and other processes are all necessary for the business to operate, but they are not tied directly to the top line of the income statement. If a business truly focused only on its core competence, it would not operate those units that do not directly affect serving customers and generating revenue.

As B2B operations have flourished, the potential for firms to shed more and more of their noncore activities has accelerated. The potential for B2B firms to exist and to provide the specific services they do is based entirely on their ability to add value to their clients' businesses. If these firms were unable to provide high-quality, lower-cost services, they would not exist. At the same time, they would not be in business without the relatively new concept of core competence driving management thinking and behavior. .

BPO Types: BPO has usually been discussed in terms of the international relocation of jobs and workplace functions. In reality, there are three types of BPO: (1) offshore, (2) onshore, and (3) near shore, and they differ in both location and function served. Organizations are prone to use any or all of these types, depending on their needs and the BPO initiative being implemented. In some cases, firms use a combination of types to achieve their objectives.

- **Offshore:** Offshore BPO is the most challenging type of this relatively new approach to conducting business, but it is also the most potentially rewarding. It began with movement of factory jobs overseas, the advantages of doing so are numerous as compared to the disadvantages. The complexity of business functions being moved offshore continues to increase. As such, organizations using the offshore approach have developed a variety of models to ensure continuity. Some have utilized a model known as *offshore insourcing,* in which the organization establishes a wholly owned subsidiary in the international market and hires local labor. An extension of this is the so-called build–operate–transfer (BOT) model. Organizations buy offshore companies specializing in a business process, operate them jointly for a year or so, and then transfer the firm to internal control (insource). It is important to note that there is no one-size-fits-all approach to offshore BPO. With the growing list of companies outsourcing at least some business functions to offshore vendors, the range of possible approaches will grow as well. This makes it increasingly likely that the next adopter of offshore BPO will find a model suitable to its needs.

- **Onshore: Outsourcing to U.S.-Based Firms:** Many companies are outsourcing back-office functions to their own country based firms. The cost savings that result from moving back-office processes to low-wage environments is the reason cited most often. However, firms can also use BPO to transfer service functions to best-in-class performers to gain competitive advantage. A firm that outsources customer service functions to a firm that specializes in and provides world-class support in that area will perform at a higher level in that function than its competitors. Moving to a best-in-class provider may actually increase costs in the short run in the interest of developing competitive advantage. Under this rationale, BPO is a strategic investment that is designed to upgrade service levels at a cost, with the intent of increasing revenues through enhanced competitiveness. What matters most is the acquisition of partners that provide market-shifting capabilities for the firm doing the outsourcing.

- **Nearshore: Outsourcing In North America:** *Nearshore outsourcing* is a relatively new term that refers to the practice of outsourcing on the same continent or more so to the neighboring countries. Nearshore outsourcing allows companies to test the BPO waters without the level of risk associated with going offshore. Firms that go with a nearshore strategy are often seeking cost savings, but they are also occasionally able to find best-in-class providers of the services they need.

15.9 Summary

The organizations today are facing a very stiff competition not only from the other domestic organizations but also from the various international organizations. Therefore there is even greater need for them to develop strategies that will help them in gaining a competitive advantage over their competitors and will help them to increase their revenues.

The organizations must adopt the new and much more refined strategies for their business operations. These include strategies like Kaizan, Total Quality Management, Business Process Outsourcing, Balanced Score Card, Sig Sigma and Business Process Outsourcing among others. These strategies are being developed and are used with the specific goals like developing core competencies and competitive advantages within themselves so that these organizations will be able to compete and survive in this environment. It has been seen that the companies which are practicing these strategies are better placed in comparison to the other organizations which have failed to use these techniques of strategic management.

15.10 Self Assessment Questions

1. What are the various new strategies that the companies must adopt for attaining competitive advantage?
2. What is Total Quality Management?
3. Why is Kaizan a very important concept for the organization seeking quality?
4. What is Business Process Outsourcing?
5. How organization using Business Process Outsourcing are better placed that the organizations not using this phenomenon?

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