Chapter One

Notable quote
"Without a strategy, an organization is like a ship without a rudder, going around in a circle"—*Joel Ross and Michael Kami*

Introduction

1.1 Overview of strategy

The term 'strategy' is derived from the Greek word *strategos*, which means generalship – the actual direction of military force, as directed from the policy governing its deployment. Strategy was originally a term applied to warfare; it was defined as 'the art of planning and directing larger military movements and the operations of war.' The term was first used around 360 BC, when the Chinese military strategist Sun Tzu wrote The Art of War, a work which is said to have influenced the thinking of many modern Japanese businesses, and has led to a number of thoughts about how the 'art' can be applied to modern business**.**

1.2. Definition of Strategy?

What is strategy? Is it a plan? Does it refer to how we will obtain the ends we seek? Is it a position taken? Just as military forces might take the high ground prior to engaging the enemy; might a business take the position of low-cost provider? Or does strategy refer to perspective, to the view one takes of matters, and to the purposes, directions, decisions and actions stemming from this view?Strategy is all these—it is perspective, positionand a plan.

Dictionary definition-A **strategy** is a general plan or set of plans intended to achieve something, especially over a long period.

Michael Porter (1996) argues that strategy is about competitive position, about differentiating yourself in the eyes of the customer, about adding value through a mix of activities different from those used by competitors.

According to **Charles W**. and **Gareth L** a **strategy** is a set of related actions that managers take to increase their company's performance.

Alfred D Chandler, defined strategy as: "the determination of basic long-term goals and objectives of an enterprise and the adoption of the courses of action and the allocation of resources necessary for carrying out these goals".

William F. Glueck defines strategy as: "a unified, comprehensive, integrated plan… designed to ensure that the basic objectives of the enterprise are achieved".

Hill and Jones define strategy as it is 'a specific pattern of decisions and actions that managers take to achieve superior organizational performance'.

Definition of strategic management

Fred R. Daviddefined strategic management, as the art and science of formulating, implementing, and evaluating cross-functional decisions that enable an organization to achieve its objectives. As this definition implies, strategic management focuses on integrating management, marketing, finance/accounting, production/operations, research and development, and information systems to achieve organizational success.

According to **David Hunger and Thomas**, Strategic management is that set of managerial decisions and actions that determines the long-run performance of a corporation. It includes environmental scanning (both external and internal), strategy formulation (strategic planning), strategy implementation, and evaluation and control. The study of strategic management therefore, emphasizes the monitoring and evaluating of external opportunities and threats in light of a corporation's strengths and weaknesses in order to generate and implement a new strategic direction for an organization

1.2 Stages of Strategic Management

The *strategic-management process* consists of three stages: strategy formulation, strategy implementation, and strategy evaluation.

1. *Strategy formulation*

Strategy Formulation is the process of developing strategy and the process by which an organization chooses the most appropriate courses of action to achieve its defined goals. **Strategy formulation** is the task of selecting strategies, This process is essential to an organization's success, because it provides a framework for the actions that lead to the anticipated results. Strategy formulationincludes

- Developing a vision and mission
- Identifying an organization's external opportunities and threats
- Determining internal strengths and weaknesses
- Establishing long-term objectives
- Generating alternative strategies, and
- Choosing particular strategies to pursue

Strategy-formulation issues include deciding what new businesses to enter, what businesses to abandon, how to allocate resources, whether to expand operations or diversify, whether to enter international markets.Because no organization has unlimited resources, strategists must decide which alternative strategies will benefit the firm most. Strategy-formulation decisions commit an organization to specific products, markets, resources, and technologies over an extended period of time. Strategies determine long-term competitive advantages. For better or worse, strategic decisions have major multifunctional consequences and enduring effects on an organization. Top managers have the best perspective to understand fully the ramifications of strategy-formulation decisions; they have the authority to commit the resources necessary for implementation.

2. *Strategy implementation*

Developing a strategy is only effective if it is put into practice. Strategy implementation is the process by which strategies and policies are put into action through the development of programs, budgets and procedures. **Strategy implementation** is the task of putting strategies into action, which includes designing, delivering, and supporting products; improving the efficiency and effectiveness of operations; and designing a company's organization structure, control systems, and culture. Paraphrasing the well-known saying that "success is 10% inspiration and 90% perspiration," in the strategic management arena we might say that "success is 10% formulation and 90% implementation."The task of selecting strategies is relatively easy (but requires good analysis and some inspiration); the hard part is putting those strategies into effect. This process might involve changes within the overall culture, structure and/or management system of the entire organization.

Strategy implementation requires a firm to establish annual objectives, devise policies, motivate employees, and allocate resources so that formulated strategies can be executed. Strategy implementation includes developing a strategy-supportive culture, creating an effective organizational structure, redirecting marketing efforts, preparing budgets, developing and utilizing information systems, and linking employee compensation to organizational performance. Strategy implementation often is called the "action stage" of strategic management. Implementing strategy means mobilizing employees and managers to put formulated strategies into action. Often considered to be the most difficult stage in strategic management, strategy implementation requires personal discipline, commitment, and sacrifice. Successful strategy implementation hinges upon managers' ability to motivate employees, which is more an art than a science. Strategies formulated but not implemented serve no useful purpose.

Interpersonal skills are especially critical for successful strategy implementation. Strategy-implementation activities affect all employees and managers in an organization. Every division and department must decide on answers to questions, such as "What must we do to implement our part of the organization's strategy?" and "How best can we get the job done?" The challenge of implementation is to stimulate managers and employees throughout an organization to work with pride and enthusiasm toward achieving stated objectives.

3. *Strategy evaluation and control*

Strategy evaluation and control is the final stage in strategic management. It is the process in which corporate activities and performance results are monitored so that actual performance can be compared with desired performance. Managers at all levels use the resulting information to take corrective action and resolve problems.

Managers desperately need to know when particular strategies are not working well; strategy evaluation is the primary means for obtaining this information. All strategies are subject to future modification because external and internal factors are constantly changing. Three fundamental strategy-evaluation activities are (1) reviewing external and internal factors that are the bases for current strategies, (2) measuring performance, and (3) taking corrective actions. Strategy evaluation is needed because success today is no guarantee of success tomorrow! Success always creates new and different problems; complacent organizations experience demise. Strategy formulation, implementation, and evaluation activities occur at three hierarchical levels in a large organization: corporate, divisional, or strategic business unit, and functional.

By fostering communication and interaction among managers and employees across hierarchical levels, strategic management helps a firm function as a competitive team.

1.3 Key Terms in Strategic Management

Before we further discuss strategic management, we should define nine key terms: competitive advantage, strategists, vision and mission statements, external opportunities and threats, internal strengths and weaknesses, long-term objectives, strategies, annual objectives, and policies.

1. Competitive Advantage

Strategic management is all about gaining and maintaining competitive advantage. This term can be defined as "anything that a firm does especially well compare to rival firm".' When a firm can do something that rival firms cannot do, or owns something that rival firm's desire, that can represent a competitive advantage. Eg. For example, in a global economic recession, simply having ample cash on the firm's balance sheet can provide a major competitive advantage. Having less fixed assets than rival firms also can provide major competitive advantages in a global recession

Getting and keeping competitive advantage is essential for long-term success in an organization. Pursuit of competitive advantage leads to organizational success or failure. Normally, a firm can sustain a competitive advantage for only a certain period due to rival firms imitating and undermining that advantage. Thus, it is not adequate to simply obtaining competitive advantage. A firm must strive to achieve sustained competitive advantage

1) By continually adapting to changes in external trends and events and internal capabilities, competencies, and resources; and
2) By effectively formulating, implementing, and evaluating strategies that capitalizes upon those factors.

Sustainable competitive advantage is an advantage over competitors that cannot easily be imitated.

2. Strategists

Strategists are the individuals who are most responsible for the success or failure of an organization. Strategists have various job titles, such as chief executive officer, president, and owner, chair of the board, executive director, chancellor, dean, or entrepreneur. Writers on organizational behavior say, "All strategists have to be chief learning officers. We are in an extended period of change. If our leaders aren't highly adaptive and great models during this period, then our companies won't adapt either, because ultimately leadership is about being a role model"

Strategists help an organization gather, analyze, and organize information. They track industry and competitive trends, develop forecasting models and scenario analyses, evaluate corporate and divisional performance, spot emerging market opportunities, identify business threats, and develop creative action plans. Strategic planners usually serve in a support or staff role. Usually found in higher levels of management, they typically have considerable authority for decision making in the firm.

The CEO is the most visible and critical strategic manager. Any manager who has responsibility for a unit or division, responsible for profit and loss outcomes, or direct authority over a major piece of the business is a strategic manager (strategist). Strategists differ as much as the organizations themselves and these differences must be considered in the formulation, implementation, and evaluation of strategies. Some strategists will not consider any types of strategies because of their personal philosophies. Strategists differ in their attitudes, values, ethics, willingness to take risks, concern for social responsibility, concern for profitability, concern for short-run versus long-run aims, and management style.

3. Vision and Mission Statements

A **vision** statement answers the question, "What do we want to become?" Vision can be defined as 'a mental image of a possible and desirable future state of the organization'.

A company's **mission** describes what the company does. Mission statements are "enduring statements of purpose that distinguish one business from other similar firms. A mission statement identifies the scope of a firm's operations in product and market term." It addresses the basic question that faces all strategies: "What is our business?"

4. External Opportunities and Threats

Opportunity is a combination of circumstances, time, and place which if accompanied by a certain course of action on the part of the organization, is likely to produce significant benefits. **Threat** is reasonably probable events which if it were to occur, would produce significant damage to the organization.

External opportunities and external threats refer to economic, social, cultural, demographic, environmental, political, legal, governmental, technological, and competitive trends and events that could significantly benefit or harm an organization in the future. Opportunities and threats are largely beyond the control of a single organization-thus the external word. The population shifts, changing work values and attitudes, space exploration, recyclable packages, and increased competition from foreign companies are examples of opportunities or threats for companies. These types of changes are creating a different type of consumer and consequently a need for different types of products, services, and strategies. Many companies in many industries face the severe external threat of online sales, capturing increasing market share in their industry. Other opportunities and threats may include the passage of a law, the introduction of a new product by a competitor, a national catastrophe. A competitor's strength could be a threat. Unrest in the Middle East, rising energy costs, or the war against terrorism could represent an opportunity or a threat. A basic tenet or principle of strategic management is that firms need to formulate strategies to take advantage of external opportunities and to reduce the impact of external threats. For this reason, identifying, monitoring, and evaluating external opportunities and threats is essential for success. This process of conducting research and gathering and assimilating external information is sometimes called environmental scanning or industry analysis.

5. Internal Strengths and Weaknesses

Strengths are internal competencies possessed by the organization in comparison with the competitors. These include structure and policies of the organization, location, and financial soundness, knowledge of personnel, qualities of facilities, ownership of natural resources or a historic reputation for quality and so on.

Weaknesses are attributes of the organization which tend to decrease its competence in comparison to its competitors.

Internal strengths and internal weaknesses are an organization's controllable action that is performed especially well or poorly. They arise in the management, marketing, finance/accounting, production/operations, research and development, and management information systems activities of a business. Identifying and evaluating organizational strengths and weaknesses in the functional areas of a business is an essential strategic-management activity. Organizations strive to pursue strategies that capitalize on internal strengths and eliminate internal weaknesses.

Strengths and weaknesses are determined relative to competitors. Relative deficiency or superiority is important information. Strengths and weaknesses may be determined relative to a firm's own objective.

Internal factors can be determined in a number of ways, including computing ratios, measuring performance, and comparing to past periods and industry averages. Various types of surveys also can be developed and administered to examine internal factors such as employee morale, production efficiency, advertising effectiveness, and customer loyalty.

6. Long-term Objectives

Objectives can be defined as specific results that an organization seeks to achieve in pursuing its mission. Objectives are for organizational success because they state direction; aid in the evaluation; create synergy; reveal priorities; focus, coordination; and provide a basis for effective planning, organizing, motivating, and controlling activities. Objectives should be challenging, measurable, consistent, reasonable, and clear. In a multidimensional firm, objectives should be established for the overall company and for each division.

7. Strategies

Strategies are the means by which long-term objectives will be achieved. Business strategies may include geographic expansion, diversification, acquisition, product development, market penetration, retrenchment, divestiture, liquidation, and joint venture. Strategies are potential actions that require top management decisions and large amounts of the firm's resources. In addition, strategies affect an organization's long-term prosperity, typically for at least five years, and thus are future-oriented. Strategies have multifunctional or multidivisional consequences and require consideration of both the external and internal factors facing the firm.

8. Annual Objectives

Annual objectives are short-term milestones that organizations must achieve to reach long-term objectives. Like long-term objectives, annual objectives should be measurable, quantitative, challenging, realistic, consistent, and prioritized. They should be established at the corporate, divisional, and functional levels in a large organization. Annual objectives should be stated in terms of management, marketing, finance/accounting, production/operations, research and development, and management information systems (MIS) accomplishments. A set of annual objectives is needed for each long-term objective. Annual objectives are especially important in strategy implementation, whereas long-term objectives are particularly important in strategy formulation. Annual objectives represent the basis for allocating resources.

9. Policies

Policies are the means by which annual objectives will be achieved. Policies include guidelines established to support efforts to achieve stated objectives. Policies are guides to decision making and address repetitive or recurring situations. Most policies are often stated in terms of management, marketing, finance/ accounting, production/operations, research and development, and computer information systems activities. Policies can be established at the corporate level and apply to an entire organization at the divisional level and apply to a single division or at the functional level and apply to particular operational activities or departments. Policies, like annual objectives, are especially important in strategy implementation because they outline an organization's expectations of its employees and managers. Policies allow consistency and coordination within and between organizational departments.

1.4 Overview of types of strategy

Strategy making is not just a task for top executives; middle and lower-level managers too must be involved in the strategic-planning process to the extent possible. Strategies could be formulated at different levels of management. The typical business firm usually considers three types of strategy: corporate, business, and functional. First, a firm may choose a corporate strategy and then the business level strategy. Finally, it may work on the details of the functional level strategies in each of its businesses. Below, the strategies that could be adopted at the three levels will be discussed one by one.

1. Corporate level strategies

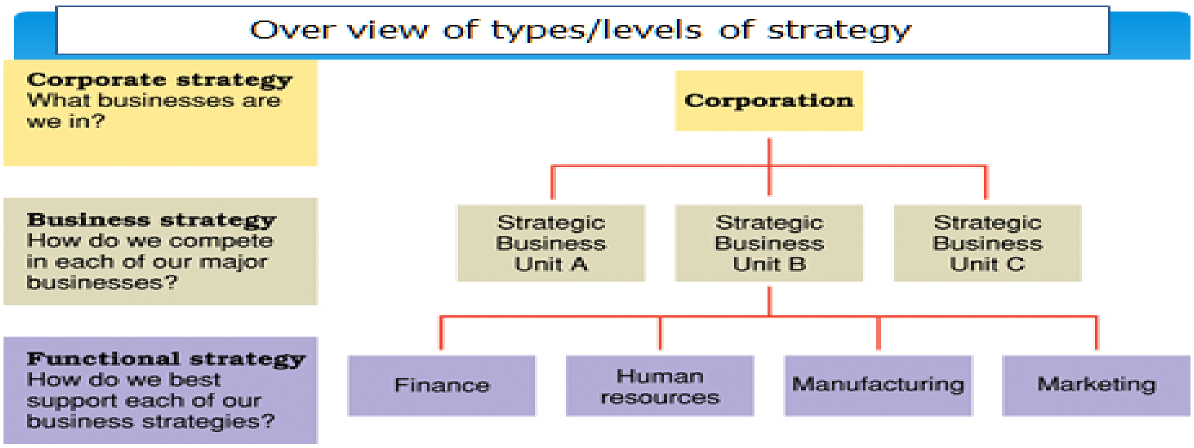
A corporate level strategy specifies actions a firm takes to gain a competitive advantage by selecting and managing a group of different businesses competing in different product markets. Corporate strategy describes a company's overall direction in terms of its general attitude toward growth and the management of its various businesses and product lines. Corporate strategies typically fit within the three main categories of stability, growth, and retrenchment. Corporate level strategies are basically about the choice of direction that a firm adopt in order to achieve its objectives. At the general corporate or headquarters level, basic decisions need to be taken over what business the company is in or should be in.

2. Business Level Strategies

A business-level strategy is an integrated and coordinated set of commitments and actions the firm uses to gain a competitive advantage by exploiting core competencies in specific product markets. This type of strategy usually occurs at the business unit or product level, and it emphasizes the improvement of the competitive position of a corporation's products or services in the specific industry or market segment served by that business unit. Michael E. Porter is credited with extensive pioneering work in the area of business strategies or what he calls, competitive strategies. Companies pursue a business- level strategy to gain a competitive advantage that enables them to outperform rivals and achieve above- average returns. They can choose from three basic generic competitive approaches: cost leadership, differentiation, and focus, although, as we will see, these can be combined in different ways. These strategies are called generic because all businesses or industries can pursue them, regardless of whether they are manufacturing, service, or nonprofit enterprises.

3. Functional Level Strategies

This is the approach taken by a functional area to achieve corporate and business unit objectives and strategies by maximizing resource productivity. It is concerned with developing and nurturing a distinctive competence to provide a company or business unit with a competitive advantage. Functional level strategies are strategies, which are designed by different functions of a company; Finance, Accounting, Research and Development, Personnel, Marketing and Production.



1.5 The strategic management approach/Models of Above-Average Return

Strategic management is the full set of commitments, decisions, and actions required for a firm to create value and earn above average returns. Average returns is returns that are equal to those an investor expects to earn from other investments with a similar amount of risk. Above-Average Returns is returns that are in excess of what an investor expects to earn from other investments with a similar amount of risk. There are different approaches in strategic management that explain how firms can earn above-average returns. But now we will focus only on the resource based view and the industrial organization view.

1.6 Benefits of Strategic management

Strategic management allows an organization to be more proactive than reactive in shaping its own future; it allows an organization to initiate and influence (rather than just respond to) activities and thus to exert control over its own destiny. The principal benefit of strategic management is to help organizations formulate better strategies through the use of a more systematic, logical, and rational approach to strategic choice.

a) Financial Benefits of Strategic Management

Research indicates that organizations using strategic-management concepts are more profitable and successful than those that do not.

- ✓ Improvement in sales, profitability, and productivity compared to firms without systematic planning activities. High-performing firms tend to do systematic planning to prepare for future fluctuations in their external and internal environments.

b) Nonfinancial Benefits

Besides helping firms avoid financial demise, strategic management offers other tangible benefits, such as

- ✓ An enhanced awareness of external threats, an improved understanding of competitors' strategies,
- ✓ Reduced resistance to change, and a clearer understanding of performance–reward relationships.

- ✓ Strategic management enhances the problem-prevention capabilities of organizations because
- ✓ It promotes interaction among managers' at all divisional and functional levels.
- ✓ Strategic management often brings order and discipline to an otherwise floundering firm.
- ✓ It can be the beginning of an efficient and an effective management system.

1.7 Business Ethics and corporate social responsibility

Business ethics is concerned with good and bad or right and wrong behavior and practices that take place in business. Business ethics is the application of ethical values to business behaviour. It concerns how you do all aspects of your business. A branch of philosophical ethics that reflect in what ways do the practices and decisions made within business promote or undermine human well-being?

Good business ethics are a prerequisite for good strategic management; good ethics are just good business! Managers and employees of firms must be careful not to become scapegoats blamed for company environmental wrongdoings. According to Watts et al (1998; 3 cited by Yakovleva, 2005; 12) "Corporate Social Responsibility is the continuing commitment by business to behave ethically and contribute to economic development while improving the quality of life of the workforce and their families as well of the local community and society at large".

Corporate Social Responsibility, thus, reflect the responsibility or accountability of organizations in pro not only of its stakeholders but also of its surrounding environment, taking into consideration the various practices that can affect those.

Harming the natural environment is unethical, illegal, and costly. A new wave of ethical issues related to product safety, employee health, sexual harassment, smoking, affirmative action, waste disposal, foreign business practices, conflicts of interest, employee privacy, security of company records, and layoffs has accented the need for strategists to develop a clear code of business ethics. A code of business ethics can provide a basis on which policies can be devised to guide daily behavior and decisions at the work site. To ensure that the code is read, understood, believed, and remembered, organizations need to conduct periodic ethics workshops to sensitize people to workplace circumstances in which ethical issues may arise. If employees see examples of punishment for violating the code and rewards for upholding the code, this helps reinforce the importance of a firm's code of ethics.

Chapter Two

Strategy Formulation

(The Business Vision, Mission, and Values)

"Notable Quotes"

- "A business is not defined by its name, statutes, or articles of incorporation. The business mission defines it. Only a clear definition of the mission and purpose of the organization makes possible clear and realistic business objectives."**—Peter Drucker**
- "A corporate vision can focus, direct, motivate, unify, and even excite a business into superior performance. The job of a strategist is to identify and project a clear vision."**—John Keane**
- "Where there is no vision, the people perish."**—Proverbs 29:18**

Strategy formulation is the development of long-range plans for the effective management of environmental opportunities and threats, in light of corporate strengths and weaknesses. This chapter focuses on the concepts and tools needed to evaluate and write a business vision and mission statements. A practical frameworkfor developing mission statements is provided. Actual mission statements from large and small organizations and for-profit work for and nonprofit enterprises are presented and critically examined. The process of creating a vision and mission statement is discussed.

Vision statement

Developing a vision statement is often considered the first step in strategic planning, preceding even the development of a mission statement.

- The vision of a company is the desired future state of a company.
- Vision is a picture of what the firm wants to be and, in broad terms, what it wants to ultimately achieve.
- The vision statement answers the question “What do we want to become?”
- A vision statement articulates the ideal description of an organization and gives shape to its intended future.
- Vision statement; is a statement about a company’s long-term direction; hope for the reality to be; keeps an organization moving forward

Vision delineates management’s aspirations for the business, providing apanoramic view of the “where we are going” and a convincing rationale for why this makes good business sense for the company. A strategic vision thus points an organization in a particular direction, charts a strategic path for it to follow in preparing for the future, and molds organizational identity. A clearly articulated strategic vision communicates management’s aspirations to stakeholders and helps steer the energies of company personnel in a common direction.

A clear vision provides the foundation for developing a comprehensive mission statement. A vision statement may apply to an entire company or to a single division of that company. Whether for all or part of an organization, the vision statement answers the question, “Where do we want to go?” Vision statement also answers the question “What do we want to become?” What you are doing when creating a vision statement is articulating your dreams and hopes for your business. It reminds you of what you are trying to build. While a vision statement does not tell you how you are going to get there, it does set the direction for your business planning. That is why it is important when constructing a vision statement to let your imagination go and dare to dream – and why it is important that a vision statement capture your passion.

The vision statement should be short, preferably one sentence, and as many managers as possible should have input into developing the statement. Vision must be compelling, inspiring and make people want to join the organization. It is the banner, around which the organization rallies, since it is the driving force that keeps the organization move towards a feasible by inspired future conditions. If vision is vivid and meaningful enough, people can do outstanding things to bring to realization. However, if it is lacking, no amount of resources will induce people to move forward. VisionStatement is a statement of the future ideal you are working towards. It outlines what the organization wants to be, or how it wants the world in which it operates to be. It provides inspiration and the basis for all the organization is planning. It concentrates on the future and provides clear decision-making criteria.

Features of an effective vision statement include:

1. Brevity

A good vision statement is succinct, which makes it easy for managers, leaders to communicate, and employees to remember. Vision statements are less effective when they are too short or too long (such as a two or three page vision statement). This length seems to be about right for effectively communicating the vision statement to employees. It is long enough to clearly describe the vision but not so long as to be difficult to remember.

2. Clarity

A vision should unite the organization and provide a stable, transcendent goal. The vision should avoid using jargon and buzz words and should use understandable terminology. Writing concise sentences is another way of clarifying a vision statement.

3. Abstract and Challenging

An effective vision statement sets an abstract yet challenging goal. The goal should not be stated too concretely (e.g., “to build a new building”) but rather at a higher level of abstraction (e.g., “to create beautiful living spaces”). This allows it to be relevant to all employees, thus permitting it to guide their daily actions and decisions. Abstractness also provides for flexibility. The following vision statement does a good job at communicating an abstract, challenging goal in a manner that is both clear and succinct:

Our business vision is to make interior environments more beautiful through the valuable, careful, and efficient production of architectural millwork, thereby providing an enriched quality of life to all who view and use our work.

4. Future Focused

Good vision statements are long-term, describing the organization’s desired end-state well into the future. Effective vision statements often describe on-going actions in which the organization will engage. The following is an example of a future-oriented vision statement:

Our goal is to achieve 100% customer satisfaction for every product that we sell. We will be relentless in the pursuit of that goal and will never vary from the principles of customer satisfaction: Quality, Value, and Company Image.

5. Sets a Desirable Goal

A good vision statement inspires followers by setting a desirable goal. It may emphasize:

Fundamental values

We will nurture long-term partnerships with employees, customers, and suppliers built on consideration, trust, open communications, integrity, and professionalism.

A collective identity *We will strive to be the professional team of choice, offering quality engineering and technical services focused on customer satisfaction. We will provide a quality product, on time and within budget, which will exceed our customers’ expectations.*

The organization’s uniqueness (its employees, customers, resources, etc.)

We will be known for the striking beauty of veneer cabinets that we will sell to the nation's most famous hotels.

Employees' worth and efficacy

We are determined to become a university whose people take pride in their accomplishments and their future potential.

Purpose of Vision

- ✓ Shared vision is an initial force that brings people together.
- ✓ Clearly articulated vision can provide energy and strengths to individuals.
- ✓ It inspires stakeholders.
- ✓ It helps to see what you are working towards.

Some examples of vision statements

Woldia University

In 2020, Woldia University aspires to be one of the best universities in Africa that contributes to the sustainable development of the country.

National Bank of Ethiopia

To be one of the strongest and most reputable central banks in Africa.

The General Motors' vision is to be the world leader in transportation products and related services.

Dell's vision is to create a company culture where environmental excellence is second nature.

The Tyson Foods' vision is to be the world's first choice for protein solutions while maximizing shareholder value.

In setting visions, the classical vision example is that of Marthin Luther king, which is partly put as follows:

....I still have a dream. It is a dream deeply rooted in the American dream.

I have a dream that one day this nation will rise up and live out the true meaning of its creed: "We holdthese truths to be self-evident; that all men are created equal."

I have a dream that one day on the red hills of Georgia the sons of the former slaves and the sons of former slaves and the sons of former slave owners will be able to sit down together at the table of brotherhood.

I have a dream that one day even the state of Mississippi, a desert state sweltering with the heat of injustice and oppression, will be transformed into an oasis of freedom and justice.

I have a dream that my four little children will one day live in a nation where they will not be judged by the color of their skin but by the content of their character.

Mission statement

An important first step in the process of formulating a mission is to come up with a definition of the organization's business. Essentially, the definition answers these questions: "What is our business? What will it be? What should it be?" The responses guide the formulation of the mission. To answer the question, "What is our business?" a company should define its business in terms of three dimensions: who is being satisfied (what customer groups), what is being satisfied (what customer needs), and how customers' needs are being satisfied (by what skills, knowledge, or distinctive competencies).

This approach stresses the need for a customer-oriented rather than a product oriented business definition. A product-oriented business definition focuses on the characteristics of the products sold and the markets served, not on which kinds of customer needs the products are satisfying. Such an approach obscures the company's true mission because a product is only the physical manifestation of applying a particular skill to satisfy a particular need for a particular customer group. In practice, that need may be served in many different ways, and a broad customer-oriented business definition that identifies these ways can safeguard companies from being caught unaware by major shifts in demand.

Historically mission is associated with Christian religious groups; indeed, for many years, a missionary was assumed a person on a specifically religious mission. The word "mission" dates from 1598, originally of Jesuits sending "mission", Latin for "act of sending" members abroad.

Mission statement-is an enduring statement of purpose distinguishes one firm from another in the same business. It is a declaration of a firm's reason for existence. The **mission statement** is a declaration of an organization's "reason for being."Mission is a well convincible statement included fundamental and unique purpose, which makes it different from other organization. It identifies the scope of its operation in terms of product offered and market served. The mission also means what we are and what we do. Mission statements sometimes called a creed statement, a statement of purpose, a statement of philosophy, a statement of beliefs, a statement of business principles, or a statement "defining our business. All organizations have a reason for being, even if strategists have not consciously transformed this reason into writing. Mission statements are essential for effectively establishing objectives and formulating strategies.

Mission statements often contain the purpose and aim of the organization; the organization's primary stakeholders; products and services offered. A mission statement is like a flag the organization can hold up that gives the essence of what it is about. Some mission statements are complex, long, and very broad;whereas some mission statements are simple and direct.

Characteristics of a good mission statement

In order to be effective, a mission statement should possess the following **characteristics**. The mission statement should be:

Broad in scope: It usually is broad in scope for at least two major reasons. First, a good mission statement allows for the generation and consideration of a range of feasible alternative objectives and strategies without unduly stifling management creativity. Excess specificity would limit the potential of creative growth for the organization. However, an overly general statement that does not exclude any strategy alternatives could be dysfunctional. Do not include monetary amounts, numbers, percentages, ratios, or objective.An effective mission statement should not be too lengthy; recommended length is less than 250 words. Second, a mission statement needs to be broad to reconcile differences effectively among, and appeal to, an organization's diverse stakeholders, the individuals andgroups of individuals who have a special stake or claim on the company. Thus, a mission statement should be reconciliatory.

Inspiring: an effective mission statement should arouse positive feelings and emotions about an organization; it should be inspiring in the sense that it motivates readers to action. It should be motivating members of the organization or being its customers.

A customer orientation:a good mission statement describes an organization's purpose, customers, products or services, markets, philosophy, and basic technology.A good mission statement reflects the anticipations of customers. Rather than developing a product and then trying to find a market, the operating philosophy of organizations should be to identify customers' needs and then provide a product or service to fulfill those needs

Feasible: a mission should always aim high, but it should not be an impossible statement. In addition, it should be realistic and achievable. Its followers must find it to be credible. However, feasibility depends on the resources available to work towards a mission.

Precise: should not be so narrow to restrict the organization's activities, nor should it be too broad to make itself meaningless.Itshould be clear enough to lead to action

Include nine components: customers, products or services, markets, technology, concern for survival/growth/profits, philosophy, self-concept, concern for public image, concern for employees

A mission statement should be enduring.

Components of a mission statement

Mission statements can and do vary in length, content, format, and specificity. Most practitioners and academicians of strategic management consider an effective statement to exhibit nine characteristics or components. Because a mission statement is often the most visible and public part of the strategic management process, it is important, that it includes all of these essential components. Components and corresponding questions that a mission statement should answer are given here.

Customer: Who are the firm's customers?

Products or services: What are the firm's major products or services?

Markets: Geographically, where does the firm compete?

Technology: Is the firm technologically current?

Concern for survival, growth, and profitability: Is the firm committed to growth and financial soundness?

Philosophy: What are the basic beliefs, values, aspirations, and ethical priorities of the firm?

Self-concept: What is the firm's distinctive competence or a major competitive advantage?

Concern for public image: Is the firm, responsive to social, community, and environmental concerns?

Concern for employees: Are employees a valuable asset of the firm?

Examples:

Woldia University

- The mission of Woldia University is to produce competent and innovative professionals who are well built in knowledge, ethics, and skills who can contribute to the nations people development, conduct problem-solving researches and transfer them to the community service through the active participation of stakeholders

Pepsi

- We aspire to make PepsiCo the world's premier consumer Products Company, focused on convenient foods and beverages. We seek to produce healthy financial rewards for investors as we provide opportunities for growth and enrichment to our employees, our business partners and the communities in which we operate. Moreover, in everything we do, we strive to act with honesty, openness, fairness and integrity. Evaluate, using the elements of the mission statement.

Importance of mission statements

King and Cleland recommended that organizations carefully develop a written mission statement in order to reap the following benefits:

- To ensure unanimity of purpose within the organization
- To provide a basis, or standard, for allocating organizational resources
- To establish a general tone or organizational climate
- To serve as a focal point for individuals to identify with the organization's purpose and direction, and to deter those who cannot from participating further in the organization's activities

- To facilitate the translation of objectives into a work structure involving the assignment of tasks to responsible elements within the organization
- To specify organizational purposes and then to translate these purposes into objectives in such a way that cost, time, and performance parameters can be assessed and controlled

Strategic vision Vs mission

A strategic vision concerns	**A mission statement focuses on**
➢ A firms future business path ➢ Where are we going? ➢ Market to be pursued ➢ Future technology-product-customer focused ➢ Kind of company that management is trying to create	➢ Current business activity ➢ Who we are & what we do. ➢ Current product & service offerings ➢ Customer needs being served ➢ Technological & business capabilities

The Process of Developing Vision and Mission Statements

As indicated in the strategic-management model chapter one, clear vision and mission statements are needed before alternative strategies can be formulated and implemented. As many managers as possible should be involved in the process of developing these statements because, through involvement, people become committed to an organization. A widely used approach to developing a vision and mission statement is

- ✓ First to select several articles about these statements and ask all managers to read these as background information.
- ✓ Then ask managers themselves to prepare a vision and mission statement for the organization.
- ✓ A facilitator or committee of top managers should then merge these statements into a single document and distribute the draft statements to all managers.
- ✓ A request for modifications, additions, and deletions is needed next, along with a meeting to revise the document

To the extent that all managers have input into and support the final documents, organizations can more easily obtain managers' support for other strategy formulation, implementation, and evaluation activities. Thus, the process of developing a vision and mission statement represents a great opportunity for strategists to obtain needed support from all managers in the firm.

During the process of developing vision and mission statements, some organizations use discussion groups of managers to develop and modify existing statements. Some organizations hire an outside consultant or facilitator to manage the process and help draft the language.

Business values

Business values are beliefs that the organization's members hold in common and endeavor/try or attempt/ to put into practice. The values of a company state how managers and employees should conduct themselves, how they should do business, and what kind of organization they should build to help a company achieve its mission. Insofar as they help drive and shape behavior within a company, values are commonly seen as the foundation of a company's organizational culture: the set of norms, and standards that control how employees work to achieve an organization's mission and goals. An organization's culture is often seen as an important source of its competitive advantage.

- ✓ Values guide your organization's members in performing their work.
- ✓ They answer the question --"What are the basic beliefs that we share as an organization?"

- ✓ Values fosters individual and organizational integrity

Core values are the principles and standards at the very center of our character, and from which we will not budge or stray. Core values are extremely stable and change only very slowly over long periods. Core values form the basis for our beliefs about life, us, and those around us, and the human potential of others and ourselves.

<u>Example:Woldia University is guided by the following core values/principles.</u>

- Quality
- Care for the community
- Equity
- Commitment
- Team sprit
- Creativity
- Democratic leadership style
- Unity with diversit

Strategic issues

Oxford English Dictionary defines an issue in a general sense as “a matter the decision of which involves important consequences”. In relation to issue management, Dutton and Duncan (1987: 103) define strategic issues as ”developments, events and trends having the potential to impact an organization’s strategy”.

“Issues are events, developments, and trends that an organization’s members collectively recognize as having some consequence to the organization.” Ansoff (1980)calls the collection of key issues that the company at a given time has as the key strategic issue list. There are two types of strategic issues; external and internal. External strategic issues arise due to factors beyond your control.

Internal strategic issues are ones that your organization faces because of internal factors. Simply put, internal strategic issues are the “big problems” your organization faces that you have direct influence and impact on the performance of the organization..

Setting Goals and Objectives

Objectives: Objectives are organizations performance targets, the results and outcomes it wants to achieve. They function as a yardstick for tracking an organization’s performance and progress. Objectives are the end results of planned activity. They should be stated as action verbs and tell what is to be accomplished by when and quantified if possible. The achievement of corporate objectives should result in the fulfillment of a corporation’s mission. In effect, this is what society gives back to the corporation when the corporation does a good job of fulfilling its mission.

The term goal is often used interchangeably with the term objective. We prefer to differentiate the two terms. In contrast to an objective, we consider a goal as qualitative statement of what one wants to accomplish, with no quantification of what is to be achieved. For example, a simple statement of “increased profitability” is thus a goal, not an objective, because it does not state how much profit the firm wants to make the next year. A good objective should be action-oriented and begin with the word to. An example of an objective is "to increase the firm's profitability in 2015 by 10% over 2014."

Some of the areas in which a corporation might establish its goals and objectives are:

- ✓ Profitability (net profits)
- ✓ Efficiency (low costs, etc.)
- ✓ Growth (increase in total assets, sales, etc.)
- ✓ Shareholder wealth (dividends plus stock price appreciation)
- ✓ Utilization of resources (ROE or ROI)
- ✓ Reputation (being considered a "top" firm)
- ✓ Contributions to employees (employment security, wages, diversity)
- ✓ Contributions to society (taxes paid, participation in charities, providing a needed product or service)
- ✓ Market leadership (market share)
- ✓ Technological leadership (innovations, creativity)
- ✓ Survival (avoiding bankruptcy)

Long-Term Objectives: Long-term objectives represent the results expected from pursuing certain strategies. Strategies represent the actions to be taken to accomplish long-term objectives. The nature of long-term objectives: Objectives should be quantitative, measurable, realistic, understandable, challenging, hierarchical, obtainable, and congruent among organizational units. Each objective should also be associated with a timeline. Objectives are commonly stated in terms such as growth in assets, growth in sales, profitability, market share, degree and nature of diversification, degree and nature of vertical integration, earnings per share, and social responsibility.

Objectives provide a basis for consistent decision making by managers whose values and attitudes differ. Objectives serve as standards by which individuals, groups, departments, divisions, and entire organizations can be evaluated. Long-term objectives are needed at the corporate, divisional, and functional levels of an organization. They are an important measure of managerial performance. Without long-term objectives, an organization would drift aimlessly toward some unknown end. It is hard to imagine an organization or individual being successful without clear objectives. Success only rarely occurs by accident; rather, it is the result of hard work directed toward achieving certain objectives.

The Benefits of Having Clear Objectives

- Provide direction by revealing expectations
- Allow synergy
- Aid in evaluation by serving as standards
- Establish priorities
- Reduce uncertainty
- Minimize conflicts
- Stimulate exertion
- Aid in allocation of resources
- Aid in design of jobs
- Providea basis for consistent decision making

Chapter Three

External Environmental Analysis

3.1 Introduction

For any organization, the environment consists of the set of external conditions and forces that have the potential to influence the organization. Understanding the environment that surrounds an organization is important. There are several reasons for this.

- **First**, the environment provides resources that an organization needs in order to create goods and services. In the seventeenth century, British poet John Donne famously noted, “no man is an island.” Similarly, it is accurate to say that no organization is self-sufficient. As the human body must consume oxygen, food, and water, an organization needs to take in resources such as labor, money, and raw materials from outside its boundaries.
- **Second**, the environment is a source of opportunities and threats to an organization. Opportunities are events and trends that create chances to improve an organization’s performance level. Threats are events and trends that may undermine an organization’s performance. Executives must also realize that virtually any environmental trend or event is likely to create opportunities for some organizations and threats for others. This is true even in extreme cases. In addition to horrible human death and suffering, the March 2011 earthquake and tsunami in Japan devastated many organizations, ranging from small businesses that were simply wiped out to corporate giants such as Toyota whose manufacturing capabilities were undermined. As odd, as it may seem, however, these tragic events also opened up significant opportunities for other organizations. The rebuilding of infrastructure and dwellings requires concrete, steel, and other materials. Japanese concrete manufacturers, steelmakers, and construction companies are likely to be very busy in the years ahead.
- **Third**, the environment shapes the various strategic decisions that executives make as they attempt to lead their organizations to success. The environment often places important constraints on an organization’s goals, for example. A firm that set a goal of increasing annual sales by 50 percent might struggle to achieve this goal during an economic recession or if several new competitors enter its business. Environmental conditions also need to be taken into account when examining whether to start doing business in a new country, whether to acquire another company, and whether to launch an innovative product, to name just a few.

Characteristics of Environment

Some of the important, and obvious, characteristics are briefly described here.

1. **Environment is complex.** 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 entirely new sets of influences. It is difficult to comprehend at once what factors constitute a given environment. Generally, environment is a complex phenomenon relatively easier to understand in parts but difficult to grasp in its totality.
2. **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 change its shape and character continuously.
3. **Environment is multifaceted.** What shape and character an environment will assume depends on the perception of the observer. A particular change in the environment, or a new development, may be viewed differently by different observers.
4. **Environment has a far-reaching impact.** An occurrence in the environment now may have an impact that will stay for long time. The growth and profitability of an organization depend critically on the environment in which it exists.

3.2 The Nature of External Audit

The purpose of an external audit is to develop a finite list of opportunities that could benefit a firm and threats that should be minimized. As the term finite suggests, the external audit is not aimed at developing an exhaustive list of every possible factor that could influence the business; rather, it is aimed at identifying key variables that offer actionable responses. Firms should be able to respond either offensively or defensively to the factors by formulating strategies that take advantage of external opportunities or that minimize the impact of potential threats. Most firms face external environments that are highly turbulent, complex, and global conditions that make interpreting them increasingly difficult. To cope with what are often ambiguous and incomplete environmental data and to increase their understanding of the general environment, firms engage in a process called external environmental analysis.

Components of the External Environment Analysis

Scanning: Identifying early signals of environmental changes and trends**.** Scanningentails the study of all segments in the general environment. Through scanning, firms identify early signals of potential changes in the general environment and detect changes that are already under way.When scanning, the firm often deals withambiguous, incomplete, or unconnected data and information. Environmental scanning is critically important for firms competing in highly volatile environments.In addition,scanning activities must be aligned with the organizational context; a scanning system designed for a volatile environment is inappropriate for a firm in a stable environment.

Monitoring: Detecting meaning through ongoing observations of environmental changes and trends.When monitoring,analysts observe environmental changes to see if an important trend is emerging from among those spotted by scanning.Critical to successful monitoringis the firm's ability to detect meaning in different environmental events and trends. By monitoring trends, firms can be prepared to introduce new goods and services at the appropriate time to take advantage of the opportunities identified trends provides. Effective monitoring requires the firm to identify important stakeholders. Because the importance of different stakeholders can vary over a firm's life cycle, careful attention must be given to the firm's needs and its stakeholder groups across time. Scanning and monitoring is particularly important when a firm competes in an industry with high technological uncertainty. Scanning and monitoring not only can provide the firm with information; they also serve as a means of importing new knowledge about markets and about how to successfully commercialize new technologies that the firm has developed.

Forecasting: Developing projections of anticipated outcomes based on monitored changes and trends. Scanning and monitoring is concerned with events and trends in the general environment at a point in time. When forecasting, analysts develop feasible projections of what might happen, and how quickly, as a result of the changes and trends detected through scanning and monitoring.

Assessing: Determining the timing and importance of environmental changes and trends for firms' strategies and their management.The objective ofassessingis to determine the timing and significance of the effects of environmental changes and trends in the strategic management of the firm.Through scanning, monitoring, and forecasting, analysts are able to understand the general environment. Going a step further, the intent ofthe assessment is to specify the implications of that understanding for the organization. Without assessment, the firm is left with data that may be interesting but are of unknown competitive relevance.

3.3 The Process of Performing an External Audit

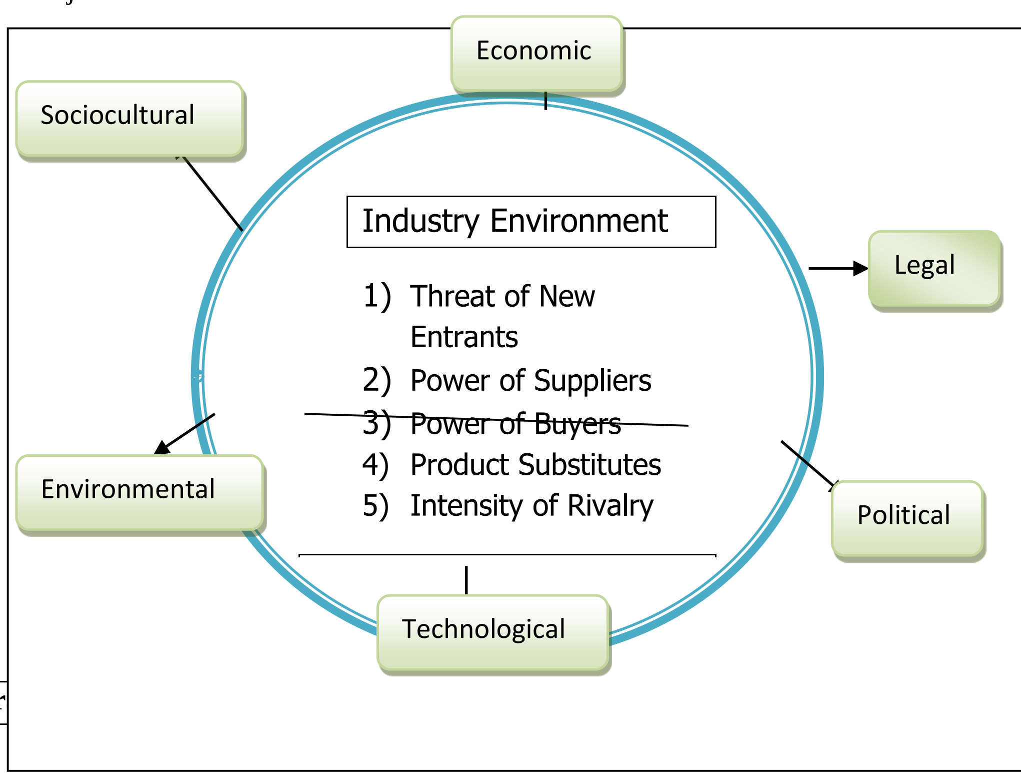
The process of performing an external audit must involve as many managers and employees as possible. As emphasized in earlier chapter, involvement in the strategic-management process can lead to understanding and commitment from organizational members. Individuals appreciate having the opportunity to contribute ideas and to gain a better understanding of their firms' industry, competitors, and markets. To perform an external audit companies may follow the following steps

1. **Gather competitive intelligence and information:**a company gathers competitive intelligence and information about economic, social, cultural, demographic, environmental, political, governmental, legal, and technological trends. Individuals can be asked to monitor various sources of information, such as key magazines, trade journals, and newspapers. These persons can submit periodic scanning reports to a committee of managers charged with performing the external audit. This approach provides a continuous stream of timely strategic information and involves many individuals in the external-audit process. Internet provides another source for gathering strategic information, as do corporate, university, and public libraries. Suppliers, distributors, salespersons, customers, and competitors represent other sources of vital information.
2. **Assimilation and evaluation:** Once information is gathered, it should be assimilated and evaluated. A meeting or series of meetings of managers is needed to collectively identify the most important opportunities and threats facing the firm. These key external factors should be listed on flip charts or a chalkboard. A prioritized list of these factors could be obtained by requesting that all managers rank the factors identified, from the most important opportunity/threat to the least important opportunity/threat. These key external factors can vary over time and by industry. These key external factors should be (a) important to achieving long-term and annual objectives, (b) measurable, (c) applicable to all competing firms, and (d) hierarchical in the sense that some will pertain to the overall company and others will be more narrowly focused on functional or divisional areas.
3. **Communicate and distribute key external factors:** A final list of the most important key external factors should be communicated and distributed widely in the organization. Both opportunities and threats can be key external factors.

3.4 **Analysis of Key External Factors**

An integrated understanding of the external and internal environments is essential for firms to understand the present and predict the future.Firm's external environment is divided into three major areas: the general, industry, and competitor environments.An important objective of studying the external environment is identifying opportunities and threats.

Figure 3.1Three Major Areas External Environment



1. Gener

The general environment is composed of dimensions in the broader society that influence an industry and the firms within it. It aim is to identifying opportunities and threats. An opportunity is a condition in the general environment that, if exploited, helps a company achieves strategic competitiveness. Firms cannot directly control the general environment's segments and elements. Accordingly, successful companies gather the information required to understand each segment and its implications for the selection and implementation of the appropriate strategies.

Segments of the general environment

The general environment is composed of segments that are external to the firm. Although the degree of impact varies, these environmental segments affect each industry and its firms. The challenge to the firm is to scan, monitor, forecast, and assess those elements in each segment that are of the greatest importance. These efforts should result in recognition of environmental changes, trends, opportunities, and threats. PESTEL analysis is one important tool that executives can rely on to organizes factors within the general environment and to identify how these factors influence industries and the firms. PESTEL is an anagram, meaning it is a word that created by using parts of other words. In particular, PESTEL reflects the names of the six segments of the general environment: (1) political, (2) economic, (3) social, (4) technological, (5) environmental, and (6) legal.

1. Political segment

The political segment centers on the role of governments in shaping business. This segment includes elements such as tax policies, changes in trade restrictions and tariffs, the stability of governments and immigration policy. Immigration policy is an aspect of the political segment of the general environment that offers important implications for many different organizations.

2. The Economic Segment

The health of a nation's economy affects individual firms and industries. Because of this, companies study the economic environment to identify changes, trends, and their strategic implications.The **economic environment**refers to the nature and direction of the economy in which a firm competes or may compete. Because nations are interconnected as a result of the global economy, firms must scan, monitor, forecast, and assess the health of economies outside their host nation. For example, many nations throughout the world are affected by the U.S. economy.The economic segment centers on the economic conditions within which organizations operate. It includes elements such as: interest rates, inflation rates, gross domestic product, unemployment rates, levels of disposable income, trade deficits or surpluses, monetary policies , fiscal policies the general growth or decline of the economy. Rising unemployment discouraged consumers from purchasing expensive, nonessential goods such as automobiles and television sets. Bank failures during the economic crisis led to a dramatic tightening of credit markets. This dealt a huge blow to homebuilders, for example, who saw demand for new houses plummet because mortgages were extremely difficult to obtain.

3. Socio-cultural segment

The socio-cultural environment consists of factors related to human relationship within a society; the development, forms and functions of such a relationship; and the learnt and shared behavior of groups of human beings, which have a bearing on the business of an organization. Some of the important elements are demographic characteristics includes population size, ethnic mix, age structure, income distribution, geographic distribution.Socio-culturalattitudes and values: social customs, beliefs, rituals and practices, changing lifestyle patterns and materialism**;** women in the workforce, concerns about the environment**,** workforce diversity **,** shifts in work and career preferences**,** attitudes about the quality and shifts in preferences regarding product and service characteristics

4. Technological segment

The technological environment consists of those factors that are related to the knowledge applied and the materials and machines used in the production of goods and services, which have an impact on the business of an organization. The Internet has changed the nature of opportunities and threats by altering the life cycles of products, increasing the speed of distribution, creating new products and services, erasing limitations of traditional geographic markets, and changing the historical trade-off between production standardization and flexibility.The Internet has lowered entry barriers and redefined the relationship between industries and various suppliers, creditors, customers, and competitors.The technological segment centers on improvements in products and services that are provided by science. Relevant factors include changes in the rate of new product development, increases in automation, product innovations, focus of private and government, applications of knowledge, advancements in service industry delivery.

5. **Environmental segment**

The environmental segment involves the physical conditions within which organizations operate. It includes factors such as:natural disasters, pollution levels, weather patterns, climate change. The threat of pollution, for example, has forced municipalities to treat water supplies with chemicals. These chemicals increase the safety of the water but detract from its taste. This has created opportunities for businesses that provide better-tasting water. Rather than consume cheap but bad-tasting tap water, many consumers purchase bottled water. Changes in temperature can affect many industries including farming, tourism and insurance. With major climate changes, occurring due to global warming and with greater environmental awareness this external factor is becoming a significant issue for firms to consider. The growing desire to protect the environment is having an impact on many industries such as the travel and transportation industries (for example, more taxes being placed on air travel and the success of hybrid cars) and the general move towards more environmentally friendly products and processes is affecting demand patterns and creating business opportunities.

6. **Legal segment**

These are related to the legal environment in which firms operate. The legal segment centers on how the legal issues influence business activity. Business Organizations prefer to operate in a country where there is a sound legal system. Examples of important legal factors include employment laws; health and safety regulations, discrimination laws, antitrust laws. Intellectual property rights are a particularly daunting aspect of the legal segment for many organizations. When a studio such as Adicaproduces a movie, a software firm such as Adobe revises a program, or a video game company such as Activision devises a new game, these firms are creating intellectual property. Such firms attempt to make profits by selling copies of their movies, programs, and games to individuals. Piracy of intellectual property—a process wherein illegal copies are made and sold by others—poses a serious threat to such profits. Law enforcement agencies and courts in many countries, including the United States, provide organizations with the necessary legal mechanisms to protect their intellectual property from piracy.

The introduction of age discrimination and disability discrimination legislation, an increase in the minimum wage and greater requirements for firms to recycle are examples of relatively recent laws that affect an organization’s actions. Legal changes can affect a firm's costs (e.g. if new systems and procedures have to be developed) and demand (e.g. if the law affects the likelihood of customers buying the good or using the service).

I. Industry analysis

Wayne Calloway said: “Nothing focuses the mind better than the constant sight of a competitor that wants to wipe you off the map.” An industry is a group of firms producing products that are close substitutes such as soft drinks or financial services.Industry analysis (popularized by Michael Porter) refers to an in-depth examination of key factors within a corporation’s task environment. In the course of competition, these firms influence one another.

Figure 3.2 The Porter's "Five-Force" competition Model: - A key Analytical Tool

Typically, industries include a rich mix of competitive strategies that companies use in pursuing strategic competitiveness and above-average returns. In part, these strategies are chosen because of the influence of an industry's characteristics. According to porter the intensity of industry competition and an industry's profit potential are functions of five forces of competition: the threats posed by new entrants, the power of suppliers, and the power of buyers, product substitutes, and the intensity of rivalry among competitors.

1. **The Threat of New Entrants to the Industry**

A new entrant into industry represents a competitive threat to existing firms. It adds new production capacity and potential to erode the market share of the existing industry. New entrants into the industry are potential competitors. Potential competitors are organizations that currently are not competing in an industry but have the capability to do so if they choose. Existing (established) organizations try to discourage potential competitors from entering, since the more organizations enter an industry, the more difficult it becomes for established organizations to hold their share of the market and to generate success. Thus, a high risk of entry by potential competitors represents a threat to the profitability of established organizations.On the other hand, if the risk of new entry is low, established organizations could take advantage of this opportunity to raise prices and earn greater returns. The strength of the competitive forces of potential rivals is largely a function of the height of barriers to entry. The concept of barriers to entry implies that there are significant costs in joining an industry.

The greater the costs that potential competitors must bear, the greater are the barriers to entry. High entry barriers keep potential competitors out of an industry even when industry returns are high. Barriers to entry are unique industry characteristics that define the industry. Barriers reduce the rate of entry of new firms, thus maintaining a level of profits for those already in the industry. From a strategic perspective, barriers can be created or exploited to enhance a firm's competitive advantage. **The principal sources of barriers to entry are**:

- ❖ **Economies of scale achieved by existing firms:**Economies of scale are derived from incremental efficiency improvements through experience, as a firm gets larger. Therefore, as the quantity of a product produced during a given period increases the cost of manufacturing each unit declines. Economies of scale can be developed in most business functions, such as marketing, manufacturing, research and development, and purchasing. Increasing economies of scale enhances a firm's flexibility.
- ❖ **Product Differentiation**: Over time, customers may come to believe that a firm's product is unique. This belief can result from the firm's service to the customer, effective advertising campaigns, or being the first to market a good or service. Companies such as Coca-Cola, PepsiCola, and the world's

automobile manufacturers spend a great deal of money on advertising to convince potential customers of their products' distinctiveness. Customers valuing a product's uniqueness tend to become loyal to both the product and the company producing it. Typically, new entrants must allocate many resources over time to overcome existing customer loyalties. To combat the perception of uniqueness, new entrants frequently offer products at lower prices. This decision, however, may result in lower profits or even losses.

- **High capital Requirements:** Competing in a new industry requires a firm to have resourcesto invest. In addition to physical facilities, capital is needed for inventories, marketingactivities, and other critical business functions. Even when competing in a new industryis attractive, the capital required for successful market entry may not be available topursue an apparent market opportunity.
- **High switching Costs:** Switching costs are the one-time costs customers incur when theybuy from a different supplier. In some cases, switching costs are low, such aswhen the consumer switches to a different soft drink. Switching costs can vary as afunction of time. For example, a decision made by manufacturers to produce a new, innovative product creates high switching costs for the finalconsumer. Customer loyalty programs, such as airlines' frequent flier miles, areintended to increase the customer's switching costs.If switching costs are high, a new entrant must offer either a substantially lower price or a much better product to attract buyers. Usually, the more established the relationship between parties, the greater is the cost incurred to switch to an alternative offering.
- **Access to Distribution Channels:** Over time, industry participants typically develop effective means of distributing products. Once a relationship with its distributors has been developed, a firm will nurture it to create switching costs for the distributors. Access to distribution channels can be a strong entry barrier for new entrants, particularly in consumer nondurable goods industries (for example, in grocery stores where shelf space is limited) and in international markets. New entrants have to persuade distributors to carry their products, either in addition to or in place of those currently distributed. Price breaks and cooperative advertising allowances may be used for this purpose; however, those practices reduce the new entrant's profit potential.
- **Government Policy.** Through licensing and permit requirements, governments can also control entry into an industry. Liquor retailing, radio and TV broadcasting, banking, and trucking are examples of industries in which government decisions and actions affect entry possibilities. In addition, governments often restrict entry into some industries because of the need to provide quality service or the need to protect jobs. Some of the most publicized government actions are those involving antitrust
- **Retaliation by established producer:**Firms seeking to enter an industry also anticipate the reactions of firms in the industry. An expectation of swift and vigorous competitive responses reduces the likelihood of entry. Vigorous retaliation can be expected when the existing firm has a major stake in the industry (for example, it has fixed assets with few, if any, alternative uses), when it has substantial resources, and when industry growth is slow or constrained. For example, any firm attempting to enter the auto industry at the current time can expect significant retaliation from existing competitors due to the overcapacity.

2. Rivalry among Established/Existing Firms

It describes the intensity of rivalry among competitors or established organizations within in the industry. Because an industry's firms are mutually dependent, actions taken by one company usually invite competitive responses. In many industries, firms actively compete against one another. Competitive rivalry intensifies when a firm is challenged by a competitor's actions or when a company recognizes an opportunity to improve its market position. Some industries appear "sleepy" because of a low level of rivalry among competitors. On the other hand, some industries are characterized by a high level of competitive activity (example, the brewing industry has many competitors who battle fiercely with each other over market share). If this competitive force is weak, organizations have an opportunity to raise prices and earn grater profits. However, if it is strong, significant price competition, including price wars, may result from the intense rivalry. Price competition limits profitability by reducing the margins that can be earned on sales. Generally, the factors that tend to precipitate intense rivalries in an industry are:

Numerous or equally balanced competitors: Intense rivalries are common in industries with many companies. With multiple competitors, it is common for a few firms to believe that they can act without eliciting a response. However, evidence suggests that other firms generally are aware of competitors' actions, often choosing to respond to them. At the other extreme, industries with only a few firms of equivalent size and power also tend to have strong rivalries. The large and often similar-sized resource bases of these firms permit vigorous actions and responses.

Low rate of industry growth: When a market is growing, firms try to effectively use resources to serve an expanding customer base. Growing markets reduce the pressure to take customers from competitors.However, rivalry in no-growth or slow-growth markets becomes more intense as firms battle to increase their market shares by attracting competitors' customers.

Lack of differentiation or low switching costs: When buyers find a differentiated product that satisfies their needs, they frequently purchase the product loyally over time. Industries with many companies that have successfully differentiated their products have less rivalry, resulting in lower competition for individual firms. Firms that develop and sustain a differentiated product that cannot be easily imitated by competitors often earn higher returns. However, when buyers view products as commodities (that is, as products with few differentiated features or capabilities), rivalry intensifies. In these instances, buyers' purchasing decisions are based primarily on price and, to a lesser degree, service.

The effect of switching costs is identical to the effect of differentiated products. The lower the buyers' switch costs, the easier it is for competitors to attract buyers through pricing and service offerings. High switching costs at least partially insulate the firm from rivals' efforts to attract customers. Interestingly, the switching costs such as pilot and mechanic training—are high in aircraft purchases, yet the rivalry between Boeing and Airbus remains intense because the stakes for both are extremely high.

High Exit Barriers: Sometimes companies continue competing in an industry even though the returns on their invested capital are low or negative. Firms making this choice likely face high exit barriers, which include economic, strategic, and emotional factors causing companies to remain in an industry when the profitability of doing so is questionable. Exit barriers are especially high in the airline industry.

Common exit barriers are:

- ✓ Specialized assets (assets with values linked to a particular business or location).
- ✓ Fixed costs of exit (such as labor agreements).
- ✓ Strategic interrelationships (relationships of mutual dependence, such as those between one business and other parts of a company's operations, including shared facilities and access to financial markets).
- ✓ Emotional barriers (aversion to economically justified business decisions because of fear for one's own career, loyalty to employees, and so forth).
- ✓ Government and social restrictions (these restrictions often are based on government concerns for job losses and regional economic effects).

3. The Bargaining Power of Buyers

Firms seek to maximize the return on their invested capital. Alternatively, buyers (customers of an industry or a firm) want to buy products at the lowest possible price the point at which the industry earns the lowest acceptable rate of return on its invested capital. The bargaining power of buyers refers to the ability of buyers to bargain down prices charged by companies in the industry or to raise the costs of companies in the industry by demanding better product quality and service. To reduce their price, buyers bargain for higher quality, greater levels of service, and lower prices. These outcomes are achieved by encouraging competitive battles among the industry's firms. Customers (buyer groups) are powerful when:

- They purchase a large portion of an industry's total output.
- The sales of the product being purchased account for a significant portion of the seller's annual revenues.
- They could switch to another product at little, if any, cost.
- The industry's products are undifferentiated or standardized, and the buyers pose a credible threat if they were to integrate backward into the sellers' industry.
- The sellers' product is not critical in one way or another to the buyer. If it is critical to the quality, price, appeal, etc,, of an industrial buyer group's finished product, for example, then the sellers will have power over the buyers.
- When buyers can threaten to enter the industry and produce the product themselves and thus supply their own needs, also a tactic for forcing down industry prices.
- When the supply industry depends on the buyers for a large percentage of its total orders.

Armed with greater amounts of information about the manufacturer's costs and the power of the Internet as a shopping and distribution alternative, consumers appear to be increasing their bargaining power in many industries. One reason for this shift is that individual buyers incur virtually zero switching costs when they decide to purchase from one manufacturer rather than another or from one dealer as opposed to a second or third one.

4. The Bargaining Power of Suppliers

The fourth of Porter's five competitive forces is the bargaining power of suppliers the organizations that provide inputs into the industry, such as materials, services, and labor (which may be individuals, organizations such as labor unions, or companies that supply contract labor). The bargaining power of suppliers refers to the ability of suppliers to raise input prices, or to raise the costs of the industry in other ways for example, by providing poor quality inputs or poor service. Powerful suppliers squeeze profits out of an industry by raising the costs of companies in the industry. Thus, powerful suppliers are a threat. Alternatively, if suppliers are weak, companies in the industry have the opportunity to force down input prices and demand higher- quality inputs (e.g., more productive labor). Suppliers are most powerful in the following situations:

- The product that suppliers sell has few substitutes and is vital to the companies in an industry.
- The profitability of suppliers is not significantly affected by the purchases of companies in a particular industry, in other words, when the industry is not an important customer to the suppliers.
- Companies in an industry would experience significant switching costs if they moved to the product of a different supplier because a particular supplier's products are unique or different. In such cases, the company depends on a particular supplier and cannot play suppliers off against each other to reduce price.
- Suppliers can threaten to enter their customers' industry and use their inputs to produce products that would compete directly with those of companies already in the industry.
- Companies in the industry cannot threaten to enter their suppliers' industry and make their own inputs as a tactic for lowering the price of inputs.
- Suppliers' product is differentiated

5. The Threat of Substitute Products

Substitutes are offerings that differ from the goods and services provided by the competitors in an industry but that fill similar needs to what the industry offer. How strong of a threat substitutes are depends on how effective substitutes are in serving an industry's customers. For example, companies in the coffee industry compete indirectly with those in the tea and soft drink industries because all three serve customer needs for nonalcoholic drinks. The existence of close substitutes is a strong competitive threat because this limits the price that companies in one industry can charge for their product, and thus industry profitability. If the price of coffee rises too much relative to that of tea or soft drinks, coffee drinkers may switch to those substitutes.

If an industry's products have few close substitutes, so that substitutes are a weak competitive force, then, other things being equal, companies in the industry have the opportunity to raise prices and earn additional profits. For example, there is no close substitute for microprocessors, which gives companies like Intel and AMD the ability to chargehigher.In general, product substitutes present a strong threat to a firm when customers face few, if any, switching costs and when the substitute product's price is lower or its quality and performance capabilities are equal to or greater than those of the competing product.

Competitor's analysis

An important part of an external audit is identifying rival firms and determining their strengths, weaknesses, capabilities, opportunities, threats, objectives, and strategies.Collecting and evaluating information on competitors is essential for successful strategy formulation. Identifying major competitors is not always easy because many firms have divisions that compete in different industries. Many multidivisional firms do not provide sales and profit information on a divisional basis for competitive reasons. In addition, privately held firms do not publish any financial or marketing information.

Competitor analysis focuses on each company against which a firm directly competes. For example, Coca cola and Pepsi cola, Mesobo Cement, Muger cement and Derba cement, and Boeingand Airbus should be keenly interested in understanding each other's objectives, strategies, assumptions, and capabilities. Furthermore, intense rivalry creates a strong need tounderstand competitors. In a competitor analysis, the firm seeks to understand

- What drives the competitor, as shown by its future objectives
- What the competitor is doing and can do, as revealed by its current strategy.
- What the competitor believes about the industry, as shown by its assumptions.
- What competitor's capabilities are, as shown by its strengths and weaknesses

Information about these four dimensions helps the firm prepare an anticipated response profile for each competitor. The results of an effective competitor analysis help a firm understand, interpret, and predict its competitors' actions and responses. Understanding the actions of competitors clearly contributes to the firm's ability to compete successfully within the industry. Critical to an effective competitor analysis is gathering data and information that can help the firm understand its competitors' intentions and the strategic implications resulting from them. Useful data and information combine to form competitor intelligence: the set of data and information the firm gathers to better understand and better anticipate competitors' objectives, strategies, assumptions, and capabilities. The more information and knowledge a firm can obtain about its competitors, the more likely it is that it can formulate and implement effective strategies. Major competitors' weaknesses can represent external opportunities; major competitors' strengths may represent key threats.

3.5 Sources of external information

A wealth of strategic information is available to organizations from both published and unpublished sources. Unpublished sources include customer surveys, market research, speeches at professional and shareholders' meetings, television programs, interviews, and conversations with stakeholders. Published sources of strategic information include periodicals, journals, reports, government documents, abstracts, books, directories, newspapers, and manuals. The Internet has made it easier for firms to gather, assimilate, and evaluate information.

4.5 Forecasting tools and techniques

Forecasts are educated assumptions about future trends and events. Forecasting is a complex activity because of factors such as technological innovation, cultural changes, new products, improved services, stronger competitors, and shifts in government priorities, changing social values, unstable economic conditions, and unforeseen events.

People eat expecting to be satisfied and nourished in the future. People sleep assuming that in the future they will feel rested. They invest energy, money, and time because they believe their efforts will be rewarded in the future. The truth is we all make implicit forecasts throughout our daily lives. The question, therefore, is not whether we should forecast but rather how we can best forecast to enable us to move beyond our ordinarily unarticulated assumptions about the future. Can we obtain information and then make educated assumptions (forecasts) to better guide our current decisions to achieve a more desirable future state of affairs?

No forecast is perfect, and some forecasts are even wildly inaccurate. This fact accents the need for strategists to devote sufficient time and effort to study the underlying bases for published forecasts and to develop internal forecasts of their own. Key external opportunities and threats can be effectively identified only through good forecasts. Accurate forecasts can provide major competitive advantages for organizations. Forecasting tools can be broadly categorized into two groups: quantitative techniques and qualitative techniques.

1. **Qualitative methods**: These methods rely essentially on the judgment of experts to translate qualitative information into quantitative estimates. Examples in these groups are:

- **Expert opinion method**: this method calls for the pooling of views of group of experts on expected future sales and combining them into a sales estimate. The major advantage of this method is the pooling of expertise knowledge in the forecasting process. However, the accuracy of the forecast will depend on the care and experience of the people providing the inputs. The reliability of this technique is questionable.
- **Delphi method**: this method involves converting the views of a group of experts, who do not interact face-to-face, into a forecast through an iterative process; it is used for eliciting the opinions of a group of experts with the help of a mail survey. The processes may include the following steps:
    - A group of experts is sent a questionnaire by mail and asked to express their view
    - The response received from the experts are summarized without disclosing the identity of the experts, and sent back to the experts, along with a questionnaire meant to probe further the reasons for extreme views expressed in the first round
    - The process may be continued for one or more rounds until a reasonable agreement emerges in the view of the experts.
- **Brainstorming**: is a non-quantitative approach that requires simply the presence of people with some knowledge of the situation to be predicted. The basic ground rule is to propose ideas without first mentally screening them. No criticism is allowed. “Wild” ideas are encouraged. Ideas should build on previous ideas until a consensus is reached. This is a good technique to use with operating managers who have more faith in “gut feel” than in more quantitative number-crunching techniques

2. **Quantitative methods:** uses a formal mathematical method for forecasting. Quantitative forecasts are most appropriate when historical data are available and when the relationships among key variables are expected to remain the same in the future. We can classify as time series analysis and causal forecasting methods.

Time series analysis: some of the examples are;Last Period Demand (LPD): Last Period Demand method simply forecasts for the next period taking the actual demand that occurred in the previous period. Arithmetic Mean (Average): Arithmetic mean method calculates the average of all past actual demand of materials to arrive at a forecast. Moving Average: When demand for a product is neither growing nor declining rapidly, and if it does not have seasonal characteristics, a moving average can be useful in removing the random fluctuations for forecasting.Moving averages are more convenient to use past data to predict the future. These methods calculate the next period's forecast by averaging the actual demand, depending on the predetermined time period, the old states of demand become out of calculation. For example, if we want to forecast June with a five month moving average, we can take the average of January, February, March, April and May. When June passes, the forecast for July would be the average of February, March, April, May and June.

Causal Forecasting Methods: Causal forecasting methods develop a cause and effect model between demand and other variables. For example, the demand for Pepsi cola may be related to population. Data can be collected on these variables and an analysis conducted to determine the validity of the proposed model. Regression and correlation techniques are means of describing association between two or more such variables. The regression method is a forecasting model that establishes a relationship between a dependent variable and one or more independent variables. Knowledge of this relationship helps to forecast the value of the dependent variable Y, from the value of the independent variable X. The dependent variable is the variable to be predicted while the independent variable is the one used for prediction. Simple regression uses only one independent variable. If the data are a time series, the independent variable is the time period, and the dependent variable is usually sales or demand for materials.

CHAPTER FOUR
INTERNAL ENVIRONMENT ASSESSMENT

"Notable Quotes"

- "Like a product or service, the planning process itself must be managed and shaped, if it is to serve executives as a vehicle for strategic decision-making."**—Robert Lenz**
- "Weak leadership can wreck the soundest strategy."**—Sun Tzu**
- "The idea is to concentrate our strength against our competitor's relative weakness." **—Bruce Henderson**

4.1 Introduction

This chapter focuses on identifying and evaluating a firm's strengths and weaknesses in the functional areas of business, including management, marketing, finance, production and operations, research and development (R&D), accounting, information systems (MIS). Internalscanning often referred to as organizational analysis is concerned with identifying and developing an organization's resources and competencies.

4.2 The Nature of an Internal Audit

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. Analysts must look within the corporation itself to identify internal strategic factors critical strengths and weaknesses that are likely to determine whether a firm will be able to take advantage of opportunities while avoiding threats. Ultimately, the fit takes place between the external and the internal environment that enable an organization to formulate its strategy.

Internal environmental analysis is all about identifying strength and weaknesses, which the organization may have. All organizations have strengths and weaknesses in the functional areas of business. No enterprise is equally strong or weak in all areas. Internal strengths and weaknesses, coupled with external opportunities and threats and clear vision and mission statements, provide the basis for establishing objectives and strategies. Objectives and strategies are established with the intention of capitalizing on internal strengths and overcoming weaknesses.

Key Terminology in Internal Environment Analysis

Resources, capabilities, and core competencies provide the foundation of competitive advantage.

1. **Resources**: are an organization's assets thus the basic building blocks of the organization. Resources represent inputs into a firm's production process. Resources are the foundation for strategy and unique

bundles of resources generate competitive advantages leading to wealth creation. A company's resources can be divided into two types: tangible and intangible. **Tangible resources** are physical entities, such as land, buildings, plant, equipment, inventory, and money. **Intangibleresources** are nonphysical entities that are created by managers and other employees, such as brand names; the reputation of the company; the knowledge that employees have gained through experience; and the intellectual property of the company, including intellectual property protected through patents, copyrights, and trademarks.

Resources are particularly valuable when they enable a company to create strong demand for its products and/or to lower its costs. .

2. **Capabilities** refer to a corporation'sability to exploit its resources. They consist of business processes and routines that manage the interaction among resources to turn inputs into outputs. For example, acompany's marketing capability can be based on the interaction among its marketing specialists, distribution channels, and sales people. A capability is functionallybased and is resident in a particular function. Thus, there are marketing capabilities, manufacturing capabilities, and human resource management capabilities. Whenthese capabilities are constantly being updated and reconfigured to make them more adaptive to an uncertain environment, they are called dynamic capabilities.

Functional Areas	Capabilities	Examples of Firms
Distribution	Effective use of logistics management techniques	Wal-Mart, Dell
Human resources	Motivating, empowering, and retaining employees	Microsoft, Dell
Management information systems	Effective and efficient control of inventories through point-of-purchase data collection methods	Wal-Mart, Dell
Marketing	Effective promotion of brand-name products	Procter & Gamble
		Polo Ralph Lauren Corp.
		McKinsey & Co.
	Effective customer service	Nordstrom Inc.
		Norrell Corporation
	Innovative merchandising	Crate & Barrel
Management	Ability to envision the future of clothing	Gap Inc.
	Effective organizational structure	PepsiCo
Manufacturing	Design and production skills yielding reliable products	Komatsu
	Product and design quality	Gap Inc.
	Miniaturization of components and products	Sony
Research &	Innovative technology	Caterpillar
development	Development of sophisticated elevator control solutions	Otis Elevator Co.
	Rapid transformation of technology into new products and processes	Chaparral Steel
	Digital technology	Thomson Consumer Electronics

3. **Competency**: It is a cross-functional integration and coordination of capabilities. For example, a competency in new product development in one division of a corporation may be the consequence of integrating management of information systems (MIS) capabilities, marketing capabilities, R&D capabilities, and production capabilities within the division.
4. **Core competency**: is a collection of competencies that crosses divisional boundaries, is widespread within the corporation. Core competencies are capabilities that serve as a source of competitive advantage for a firm over its rivals. Core competencies distinguish a company competitively and reflect its personality. Thus, new product development is a core competency if it goes beyond one division. Three criteria that distinguishes a core competence from a competence; a core competence must contribute significantly to customer benefit from a product, a core competence should be competitively unique, must be difficult for competitors to imitate and finally, a core competence should provide

potential access to a wide variety of markets. Capabilities are formed by the integration of resources whereas core competencies are formed by the integration of capabilities.

5. **Distinctive competencies:** A firm's strengths that cannot be easily matched or imitated by competitors are called distinctive competencies**.** Building competitive advantages involves taking advantage of distinctive competencies. Strategies are designed in part to improve on a firm's weaknesses, turning them into strengths and maybe even into distinctive competencies. Thismeans all firms should continually strive to improve on their weaknesses, turning them into strengths, and ultimately developing distinctive competencies that can provide the firm with competitive advantages over rival firms.
6. **Sustainable competitive advantage** is an advantage over competitors that cannot easily be imitated.

Four Criteria of Sustainable Competitive Advantage

Core competencies are sources of competitive advantage for the firm over its rivals. Capabilities failing to satisfy the four criteria of sustainable competitive advantage are not core competencies, meaning that although every core competence is a capability, not every capability is a core competence. In slightly different words, for a capability to be a core competence, it must be valuable and unique, from a customer's point of view. For the competitive advantage to be sustainable, the core competence must be inimitable and non-substitutable, from a competitor's point of view. Sustained competitive advantage is achieved only when competitors cannot duplicate the benefits of a firm's strategy or when they lack the resources to attempt imitation. For some period of time, the firm may earn a competitive advantage by using capabilities that are, for example, valuable and rare, but imitable. Sustainable competitive advantage results only when all four criteria are satisfied.

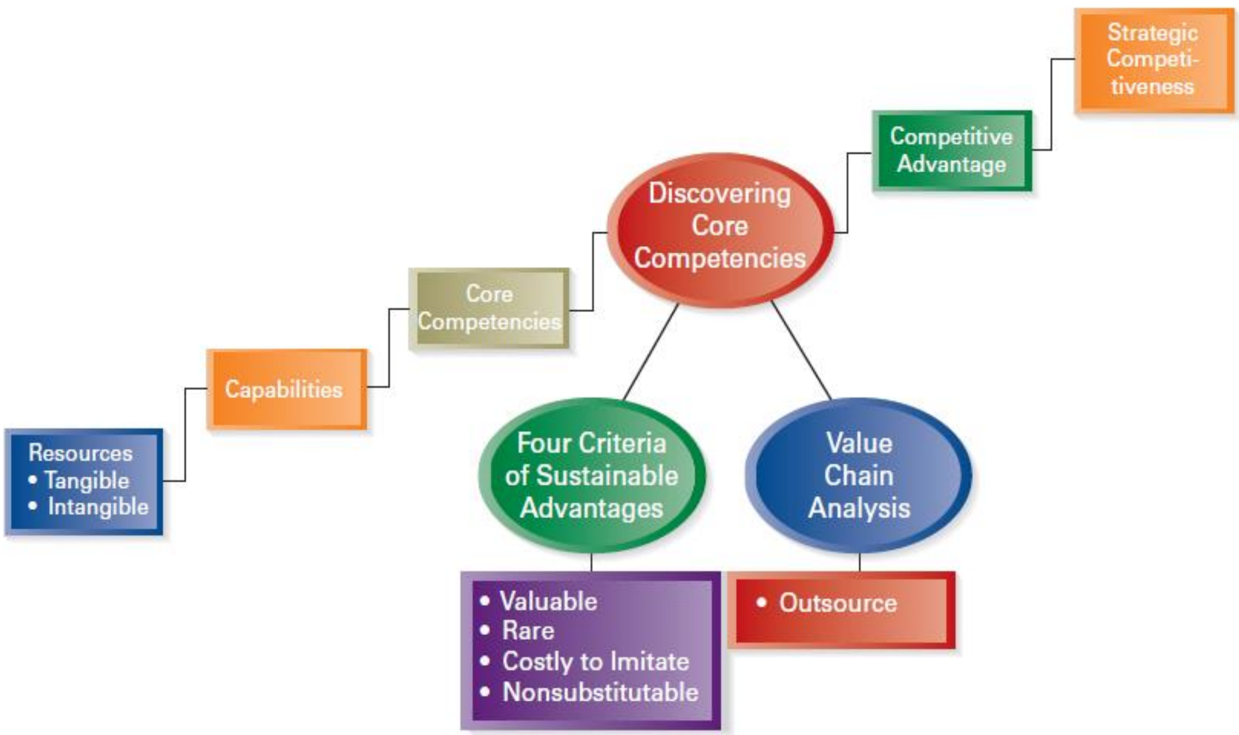
1. **Valuable:** Valuable capabilities allow the firm to exploit opportunities or neutralize threats in its external environment. By effectively using capabilities to exploit opportunities, a firm creates value for customers.
2. **Rare:** Rare capabilities are capabilities that fewcompetitors possess. A key question to be answered when evaluating this criterion is, "How many rival firms possess these valuable capabilities?" Capabilities possessed by many rivals are unlikely to be sources of competitive advantage for any one of them. Instead, valuable but common (i.e., not rare) resources and capabilities are sources of competitive parity. Competitive advantage results only when firms develop and exploit valuable capabilities that differ from those shared with competitors.
3. **Costly to Imitate:** Costly-to-imitate capabilities are capabilities that other firms cannot easily develop. Capabilities that are costly to imitate are created because of one reason or a combination of three reasons.

- First, a firm sometimes is able to develop capabilities because of unique historical conditions. "As firms evolve, they pick up skills, abilities and resources that are unique to them, reflecting their particular path through history." A firm with a unique and valuable organizational culture that emerged in the early stages of the company's history "may have an imperfectly imitable advantage over firms founded in another historical period" one in which less valuable or less competitively useful values and beliefs strongly influenced the development of the firm's culture.
- A second condition of being costly to imitate occurs when the link between the firm's capabilities and its competitive advantage is causally ambiguous. In these instances, competitors cannot clearly understand how a firm uses its capabilities as the foundation for competitive advantage. As a result, firms are uncertain about the capabilities they should develop to duplicate the benefits of a competitor's value-creating strategy.
- Social complexity is the third reason that capabilities can be costly to imitate. Social complexity means that at least some, and frequently many, of the firm's capabilities are the product of complex social phenomena. Interpersonal relationships, trust, friendships among managers and between managers and

employees, and a firm's reputation with suppliers and customers are examples of socially complex capabilities.

4. **Non-substitutable:**non-substitutable capabilities are capabilities that do not have strategic equivalents. This final criterion for a capability to be a source of competitive advantage "is that there must be no strategically equivalent valuable resources that are themselves either not rare or imitable. Two valuable firm resources (or two bundles of firm resources) are strategically equivalent when they each can be separately exploited to implement the same strategies." In general, the strategic value of capabilities increases as they become more difficult to substitute. The invisible capabilities are, the more difficult it is for firms to find substitutes and the greater the challenge is to competitors trying to imitate a firm's value-creating strategy. Firm-specific knowledge and trust-based working relationships between managers and non-managerial personnel are examples of capabilities that are difficult to identify and for which finding a substitute is challenging.

Figure 4.1Components of Internal Analysis Leading to Competitive Advantage and Strategic Competitiveness



4.3 The Process of Performing an Internal Audit

The internal audit requires gathering and assimilating information about the firm's management, marketing, finance/accounting, production/operations, research and development (R&D), and computer information systems operations. To perform an internal audit companies may follow the following steps

4. **Gather information on functional areas:** RepresentativeManagers and employees from throughout the firm need to be involved in determining a firm's strengths and weaknesses. The internal audit requires gathering and assimilating information about the firm's management, marketing, finance/accounting, production/operations, research and development (R&D), and information systems.
5. **Assimilation and evaluation:** Once information is gathered from different functional areas in the organization, it should be assimilated and evaluated. A meeting or series of meetings of functional

managers is needed to collectively identify the most important strength and weakness the firm have. Key factors should be prioritized as so that the firm's most important strengths and weaknesses can be determined collectively

6. **Communicate and distribute key internal strength and weakness:** A final list of the most important key strengths and weakness should be communicated and distributed widely in the organization.

4.4 Relationship among the Functional Areas of Business

Functional Areas of Business

Strategic management is a highly interactive process that requires effective coordination among management, marketing, finance and accounting, production and operations, R&D, and MIS managers. It is not possible in a strategic-management text to review in depth all the material presented in courses such as marketing, finance, accounting, management, management information systems, and production and operations; there are many subareas within these functions, such as customer service, warranties, advertising, packaging, and pricing under marketing. However, strategic planning must include a detailed assessment of how the firm is doing in all internal areas. For different types of organizations, such as hospitals, universities, and government agencies, the functional business areas, of course, differ. In a hospital, for example, functional areas may include cardiology, hematology, nursing, maintenance, physician support, and receivables. Functional areas of a university can include athletic programs, placement services, housing, fund-raising, academic research, counseling, and intramural programs. Within large organizations, each division has certain strengths and weaknesses.

1) Management

The functions of management consist of five basic activities: planning, organizing, staffing, leading, and controlling.

Planning- Planning consists of all those managerial activities related to preparing for the future. Specific tasks include forecasting, establishing objectives, devising strategies, developing policies, and setting goals. Planning is most important at **strategy formulation** stage of strategic-management process.

Organizing- Organizing includes all those managerial activities that result in a structure of task and authority relationships. Organizing is most important at **strategy implementation** stage of strategic-management process.

Staffing- Staffing activities are centered on personnel or human resource management. Staffing is most important at **strategy implementation** stage of strategic-management process

Leading –leading involves efforts directed toward shaping human behavior. Leading is most important at **strategy implementation** stage of strategic-management process

Controlling- Controlling refers to all those managerial activities directed toward ensuring that actual results are consistent with planned results. Controlling is most important at **strategy evaluation** stage of strategic-management process

2) Accounting / Finance

Financial condition is often considered the single best measure of a firm's competitive position and overall attractiveness to investors. Determining an organization's financial strengths and weaknesses is essential to formulating strategies effectively. A firm's liquidity, leverage, working capital, profitability, asset utilization, cash flow, and equity can eliminate some strategies as being feasible alternatives. Financial factors often alter existing strategies and change implementation plans. Financial ratio analysis is the most widely used method for determining an organization's strengths and weaknesses in the investment, financing, and dividend areas. This includes investment decision, capital budgeting, the financing decision and dividend decisions

3) Production/Operations

The production/operations function of a business consists of all those activities that **transform inputs into goods and services.** Production/operations management deals with inputs, transformations, and outputs that vary across industries and markets. A manufacturing operation transforms or converts inputs such as raw materials, labor, capital, machines, and facilities into finished goods and services.

4) Marketing

Marketing can be described as the process of defining, anticipating, creating, and fulfilling customers' needs and wants for products and services. There are seven basic functions of marketing: There are seven basic functions of marketing: (1) customer analysis, (2) selling products/services, (3) product and serviceplanning, (4) pricing, (5) distribution, (6) marketing research, and (7) opportunity analysis. Understanding these functions helps strategists identify and evaluate marketing strengths and weaknesses.

5) Management Information Systems

Billions of bits of information are now “in the cloud.” Information ties all business functions together and provides the basis for all managerial decisions. It is the cornerstone of all organizations. Information represents a major source of competitive management advantage or disadvantage. Assessing a firm’s internal strengths and weaknesses in information systems is a critical dimension of performing an internal audit. A MIS’s purpose is to improve the performance of an enterprise by improving the quality of managerial decisions. An effective information system thus collects, codes, stores, synthesizes, and presents information in such a manner that it answers important operating and strategic questions.

A management information system (MIS) receives raw material from both the external and internal evaluation of an organization. It gathers data about marketing, finance, production, and personnel matters internally, and social, cultural, demographic, environmental, economic, political, governmental, legal, technological, and competitive factors externally. Data are integrated in ways needed to support managerial decision-making. Data becomes information only when it is evaluated, filtered, condensed, analyzed, and organized for a specific purpose, problem, individual, or time.

6) Research and Development

The fifth major area of internal operations that should be examined for specific strengths and weaknesses is research and development (R&D). Many firms today conduct no R&D, and yet many other companies depend on successful R&D activities for survival. Firms pursuing a product development strategy especially need to have a strong R&D orientation. The purpose of research and development are as follows: Development of new products before competition, improving product quality and improving manufacturing processes to reduce costs. Thus, a key to organizational success is effective coordination and understanding among managers from all functional business areas. Through involvement in performing an internal strategic-management audit, managers from different departments and divisions of the firm come to understand the nature and effect of decisions in other functional business areas in their firm. Knowledge of these relationships is critical for effectively establishing objectives and strategies.

7) **Human resource management:** Human resource management (HRM) is an integrative general management that involves identifying the organization’s demand for human resources with particular skills and abilities. As for the introduction of the new products or services, it is necessary for HRM department to know about it. Once the new products or services are introduced, marketing has the responsibility to inform the HRM department punctually and sufficiently. The information for HRM department should be concerned with the new skills and experience needed for the new workers at present.

4.5 The Value Chain Analysis

Value is the extent to which a good or service is perceived by its customer to meet his or her needs or wants, measured by a product’s performance characteristics and by its attributes for which customers are willing to pay. Value is created by a product’s low cost, by its highly differentiated features, or by a combination of low cost and high differentiation, compared with competitors’ offerings.

$$\text{Value} = \frac{\text{Benefits}}{\text{Costs}} = \frac{\text{Functional benefits + emotional benefits}}{\text{Monetary costs + time costs + energy costs + psychic costs}}$$

It commonly depends more on the customer's perception of the worth of the product than on its intrinsic value. Firms must provide value to a customer that is superior to the value provided by competitors in order to create a competitive advantage. Value chain analysis allows the firm to understand the parts of its operations that create value and those that do not. Understanding these issues is important because the firm earns above-average returns only when the value it creates is greater than the costs incurred to create that value.

Value chain is the processes or activities a company performs to design, produce, and market, deliver and support its product. **The value chain analysis** describes the activities the organization performs and links them to the organizations competitive position.Value chain analysis allows the firm to understand the parts of its operations that create value and those that do not. Understanding these issues is important because the firm earns above-average returns only when the value it creates is greater than the costs incurred to create that value. According to Porter, the business of a firm can best be described as a value chain, in which total revenues minus total costs of all activities undertaken to develop and market a product or service yields value

Value chain analysis (VCA) refers to the process whereby a firm determines the costs associated with organizational activities from purchasing raw materials to manufacturing product(s) to marketing those products

The value chain is a template that firms use to understand their cost position and to identify the multiple means that might be used to facilitate implementation of a chosen business-level strategy. As shown in Figure 4.1, a firm’s value chain is segmented into **primary and supportive activities.**

Primary activities: are involved with a product’s physical creation, its sale and distribution to buyers, and its service after the sale. **Supportive activities:** provide the assistance necessary for the primary activities to take place. The value chain shows how a product moves from the raw-material stage to the final customer. For individual firms, the essential idea of the value chain is to create additional value without incurring significant costs while doing so and to capture the value that has been created. In a globally competitive economy, the most valuable links on the chain are people who have knowledge about customers. This locus of value creating possibilities applies just as strongly to retail and service firms as to manufacturers.

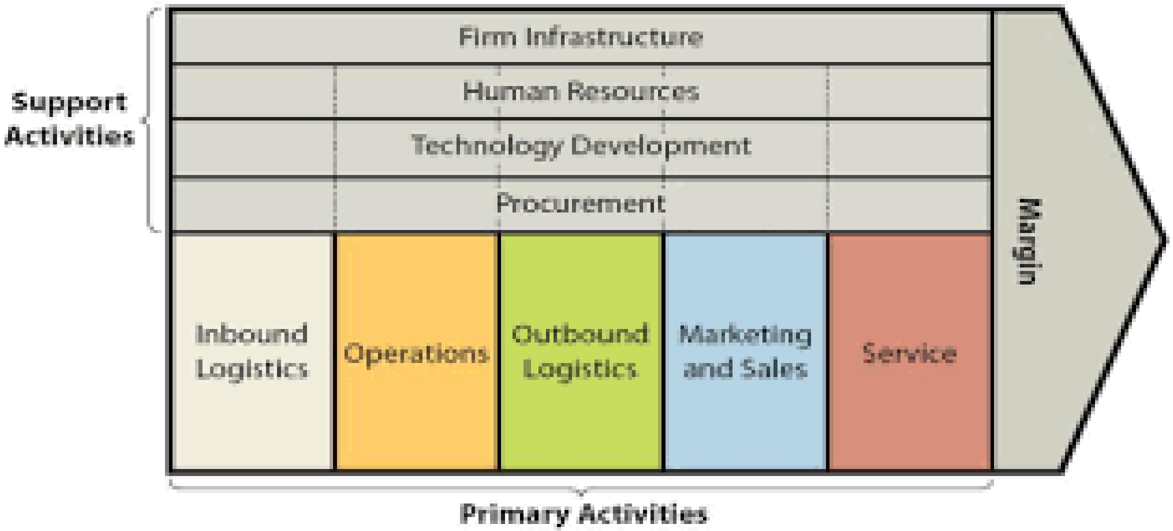


Figure 4.2 the value chain analysis

Moreover, for organizations in all sectors, the effects of e-commerce make it increasingly necessary for companies to develop value-adding knowledge processes to compensate for the value and margin that the Internet strips from physical processes.Table 4.2 lists the items that can be evaluated to determine the value-creating potential of primary activities. In Table 4.3, the items for evaluating support activities are shown. All items in both tables should be evaluated relative to competitors' capabilities. To be a source of competitive advantage, a resource or capability must allow the firm (1) to perform an activity in a manner that provides value superior to that provided by competitors, or (2) to perform a value-creating activity that competitors cannot complete. Only under these conditions does a firm create value for customers and have opportunities to capture that value.

Table 4.1 Examining the Value-Creating Potential of Primary Activities

Inbound Logistics	Activities, such as materials handling, warehousing, and inventory control, used to receive, store, and disseminate inputs to a product.
Operations	Activities necessary to convert the inputs provided by inbound logistics into final product form. Machining, packaging, assembly, and equipment maintenance are examples of operations activities.
Outbound Logistics	Activities involved with collecting, storing, and physically distributing the final product to customers. Examples of these activities include finished goods warehousing, materials handling, and order processing.
Marketing and Sales	Activities completed to provide means through which customers can purchase products and to induce them to do so. To effectively market and sell products, firms develop advertising and promotional campaigns, select appropriate distribution channels, and select, develop, and support their sales force.
Service	Activities designed to enhance or maintain a product's value. Firms engage in a range of service-related activities, including installation, repair, training, and adjustment. Each activity should be examined relative to competitors' abilities. Accordingly, firms rate each activity as superior, equivalent, or inferior.
Each activity should be examined relative to competitors' abilities. Accordingly, firms rate each activity as superior, equivalent, or inferior.	

Table 4.2 Examining the Value-Creating Potential of Support Activities

Procurement	Activities completed to purchase the inputs needed toproduce a firm's products. Purchased inputs include items fully consumed during the manufacture of products (e.g., raw materials and supplies, as well as fixed assets— machinery, laboratory equipment, office equipment, and buildings).
Technological Development	Activities completed to improve a firm's product and the processes used to manufacture it. Technological development takes many forms, such as process equipment, basic research and product design, and servicing procedures.
Human Resource Management	Activities involved with recruiting, hiring, training, developing, and compensating all personnel.
Firm Infrastructure	Firm infrastructure includes activities such as general management, planning, finance, accounting, legal support, and governmental relations that are required to support the work of the entire value chain. Through its infrastructure, the firm strives to effectively and consistently identify external opportunities and threats, identify resources and capabilities, and support core competencies.
Each activity should be examined relative to competitors' abilities. Accordingly, firms rate each activity as superior, equivalent, or inferior.	

Chapter Five
Strategy Formulation
Strategy Analysis and Choice

This chapter focuses on generating and evaluating alternative strategies, as well as selecting strategies to pursue.

"Notable Quotes"

- "The early bird may get the worm, but the second mouse gets the cheese."
- "Tomorrow always arrives. It is always different. And even the mightiest company is in trouble if it has not worked on the future. Being surprised by what happens is a risk that even the largest and richest company cannot afford, and even the smallest business need not run." **—Peter Drucker**

5.1 The Nature of Strategy Analysis and Choice

Increasingly important to firm success, strategy is concerned with making choices among two or more alternatives. When choosing a strategy, the firm decides to pursue one course of action instead of others. The choices made are influenced by opportunities and threats in the firm's external environment as well as the nature and quality of its internal resources, capabilities, and core competencies. The fundamental objective of using any type of strategy is to gain strategic competitiveness and earn above-average returns. Strategies are purposeful, precede the taking of actions to which they apply, and demonstrate a shared under-standing of the firm's vision and mission. Strategy analysis and choice seek to determine alternative courses of action that could best enable the firm to achieve its mission and objectives.Strategy choice is the decision to select from among the alternative strategies, which will best meet the enterprise's objectives Identifying and evaluating alternative strategies should involve many of the managers and employees who earlier assembled the organizational vision and mission statements, performed the external audit, and conducted the internal audit. Representatives from each department and division of the firm should be included in this process, as was the case in previous strategy-formulation activities.

5.2 **Types of strategy**

Strategies can be divided in to three broad categories

1. Corporate strategy: 1) growth strategy, 2) stability strategy, 3) retrenchment strategy.
2. Business unit strategy: 1) cost leadership, 2) differentiation, 3) focus cost leadership, 4) focus differentiation,5) integrated cost leadership/ differentiation.
3. Functional strategy

5.2.1 Corporate level strategy

A corporate-level strategy specifies actions a firm takes to gain a competitive advantage by selecting and managing a group of different businesses competing in different product markets. Corporate-level strategy is concerned with key issues like: in what product markets and businesses the firm should compete and how corporate headquarters should manage those businesses. Corporate strategy deals with three key issues facing the corporation as a whole:

1. The firm's overall orientation toward growth, stability, or retrenchment (directional strategy). This includes question like; should we expand, cut back, or continue our operations unchanged, Should we concentrate our activities within our current industry or should we diversify into other industries? If we want to grow and expand, should we do so through internal development or through external acquisitions, mergers, or strategic alliances?
2. The industries or markets in which the firm competes through its products and business units
3. The manner in which management coordinates activities, transfers resources, and cultivates capabilities among product lines and business units

Corporate level strategies are basically about the choice of direction that a firm adopts in order to achieve its objectives. Corporate-level strategies help companies' select new strategic positions—positions that are expected to increase the firm's value. Corporate level strategies are about decisions related to allocating resources among the different businesses of a firm, transferring resources from one set of businesses to others, and managing and nurturing a portfolio of businesses in such a way that the overall corporate objectives are achieved. An analysis based on business definition provides a set of strategic alternatives that an organization can consider. Major corporate strategies are stability, growth & retrenchment

1. Stabilitystrategy

Stability strategies make no change to the company's current activities. It is adopted by an organization when it attempts to an incremental improvement of its functional performance by marginally changing one or more of its businesses in terms of their respective customer groups, customer functions and alternative technologies either singly or collectively.A corporation may choose stability over growth by continuing its current activities without any significant change in direction.Although sometimes viewed as a lack of strategy, the stability family of corporate strategies can be appropriate for a successful corporation operating in a reasonably predictable environment. They are very popular with small business owners who have found a niche and are happy with their success and the manageable size of their firms. Stability strategies can be very useful in the short run, but they can be dangerous if followed for too long.

2. Growth/Expansion strategies

Growth strategies expand the company's activities. By far the most widely pursued corporate strategies are those designed to achieve growth in **sales**, **assets**, **profits**, or some combination. Companies that do business in expanding industries must grow to survive. Continuing growth means increasing sales and a chance to take advantage of the experience curve to reduce the per-unit cost of products sold, thereby increasing profits.A corporation can grow internally by expanding its operations or it can grow externally through mergers, acquisitions, and strategic alliances.The two basic growth strategies are concentration on the current product line(s) in one industry and diversification into other product lines in other industries.

1. Concentration

If a company's current product lines have real growth potential, concentration of resources on those product lines makes sense as a strategy for growth. It is concentration on the current business. The two basic concentration strategies are vertical growth and horizontal growth. Growing firms in a growing industry tend to choose these strategies before they try diversification.

a) **Vertical Growth.** Vertical growth involves taking over a function previously provided by a supplier or by a distributor. The company, in effect, grows by making its own supplies and/or by distributing its own products. This may be done in order to reduce costs, gain control over a scarce resource, guarantee quality of a key input, or obtain access to potential customers. This growth can be achieved either internally by expanding current operations or externally through acquisitions. Vertical growth can be **backward integration** or **forward integration**. **Backward integration** is a strategy of seeking ownership or increased control of a firm's suppliers.

Seven guidelines for when backward integration may be an especially effective strategy are:

- When an organization's present suppliers are especially expensive, or unreliable, or incapable of meeting the firm's needs for parts, components, assemblies, or raw materials.
- When the number of suppliers is small and the number of competitors is large.
- When an organization competes in an industry that is growing rapidly; this is a factor because integrative-type strategies (forward, backward, and horizontal) reduce an organization's ability to diversify in a declining industry.
- When an organization has both capital and human resources to manage the new business of supplying its own raw materials.
- When the advantages of stable prices are particularly important; this is a factor because an organization can stabilize the cost of its raw materials and the associated price of its product(s) through backward integration.
- When present supplies have high profit margins, which suggests that the business of supplying products or services in the given industry is a worthwhile venture.

- When an organization needs to quickly acquire a needed resource.

Vertical growth results in **vertical integration—**the degree to which a firm operates vertically in multiple locations on an industry's value chain from extracting raw materials to manufacturing to retailing. Forward integration involves gaining ownership or increased control over distributors or retailers.

This strategy can be especially appropriate

- When an organization's present distributors are especially expensive, or unreliable, or incapable of meeting the firm's distribution needs.
- When the availability of quality distributors is so limited as to offer a competitive advantage to those firms that integrate forward.
- When an organization has both the capital and human resources needed to manage the new business of distributing its own products.
- When the advantages of stable production are particularly high; this is a consideration because an organization can increase the predictability of the demand for its output through forward integration.
- When present distributors or retailers have high profit margins; this situation suggests that a company profitably could distribute its own products and price them more competitively by integrating forward.

b) **Horizontal Growth.** Strategy of adding related or similar product/service lines to existing core business, either through acquisition of competitors or through internal development of new products/services Horizontal integration refers to a strategy of seeking ownership of or increased control over a firm's competitors. One of the most significant trends in strategic management today is the increased use of horizontal integration as a growth strategy**.** Mergers, acquisitions, and takeovers among competitors allow for increased economies of scale and enhanced transfer of resources and competencies. Mergers between direct competitors are more likely to create efficiencies than mergers between unrelated businesses, both because there is a greater potential for eliminating duplicate facilities and because the management of the acquiring firm is more likely to understand the business of the target

2. Diversification Strategies

According to strategist Richard Rumelt, companies begin thinking about diversification when their growth has **plateaued** and opportunities for growth in the original business have been **depleted**.This often occurs when an industry consolidates, becomes mature, and most of the surviving firms have reached the limits of growth using vertical and horizontal growth strategies. Unless the competitors are able to expand internationally into less mature markets, they may have no choice but to diversify into different industries if they want to continue growing. Diversification can be either related or unrelated. The key issue here is if the operations of the firm in the new industry share some link in with the firm's existing value chain. Is there some value adding activity that can be shared? For example, is there a production facility, a distribution network, or a marketing competence that both can use?

A. **Concentric (Related) Diversification**. Growth through concentric diversification is expansion into a related industry. Growth through concentric diversification into a related industry may be a very appropriate corporate strategy when a firm has a strong competitive position but industry attractiveness is low.Research indicates that the probability of succeeding by moving into a related business is a function of a company's position in its core business. For companies in leadership positions, the chances for success are nearly three times higher than those for followers.By focusing on thecharacteristics that have given the company its distinctive competence; the company uses those very strengths as its means of diversification. The firm attempts to secure strategic fit in a new industry where the firm's product knowledge, its manufacturing capabilities, and the marketing skills it used so effectively in the original industry can be put to good use.The corporation's products or processes are related in some way: they possess some common thread. The search is for synergy, the concept that two businesses will generate more profits together than they could separately. The point of commonality may be similar technology, customer usage, distribution, managerial skills, or product similarity example, **Johnson and Johnson** engages in products for baby care, skin care, oral care, wound care, and women's health care fields, as well as nutritional products.

B. Conglomerate (Unrelated) Diversification.

Conglomerate diversification is diversifying into an industry unrelated to its current one. Involves diversifying into businesses with No strategic fit, No meaningful value chain relationships and No unifying strategic theme

Rather than maintaining a common thread throughout their organization, strategic managers who adopt this strategy are primarily concerned with financial considerations of cash flow or risk reduction. This is also a good strategy for a firm that is able to transfer its own excellent management system into less-well-managed acquired firms. Examples of unrelated diversification W. R. Grace engage in the production of Chemicals, Coal Mining, Oil and Gas Extraction, Food Manufacturing, Paper Products and Health Service. General Electric and Berkshire Hathaway are examples of companies that have used conglomerate diversification to grow successfully. General electric engaged in the production health care, appliance, financial service, aviation and energy. The emphasis in conglomerate diversification is on sound investment and value-oriented management rather than on the product-market synergy common to concentric diversification.A cash-rich company with few opportunities for growth in its industry might, for example, move into another industry where opportunities are great but cash is hard to find. Another instance of conglomerate diversification might be when a company with a seasonal and,therefore, uneven cash flow purchases a firm in an unrelated industry with complementingseasonal sales that will level out the cash flow.CSX management considered the purchase of a natural gas transmission business (Texas Gas Resources) by CSX Corporation (a railroad dominated transportation company) to be a good fit because most of the gas transmission revenue was realized in the winter months—the lean period in the railroad business.

3. Retrenchment strategies

Retrenchment strategies reduce the company's level of activities. A company may pursue retrenchment strategies when it has a weak competitive position in some or all of its product lines resulting in poor performance—sales are down and profits are becoming losses. These strategies impose a great deal of pressure to improve performance. In an attempt to eliminate the weaknesses that are, dragging the company down, management may follow one of several retrenchment strategies, ranging from turnaround or becoming a captive company to selling out, bankruptcy, or liquidation.

A retrenchment strategy simply means falling back and regrouping. The term retrenchment is sometimes defined rather broadly, similarly to decline strategies. These strategies impose a great deal of pressure to improve performance. This 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.Four types of defensive strategies:

Turnaround strategy- reverses the negative trend. Emphasizes the improvement of operational efficiency and is probably most appropriate when a corporation's problems are pervasive but not yet critical. Research shows that poorly performing firms in mature industries have been able to improve their performance by cutting costs and expenses and by selling off assets. Analogous to a weight reduction diet, the two basic phases of a turnaround strategy are contraction and consolidation.

A captive company strategy involves giving up independence in exchange for security. A company with a weak competitive position may not be able to engage in a full-blown turnaround strategy. The industry may not be sufficiently attractive to justify such an effort from either the current management or investors. Nevertheless, a company in this situation faces poor sales and increasing losses unless it takes some action. Management desperately searches for an "angel" by offering to be a captive company to one of its larger customers in order to guarantee the company has continued existence with a long-term contract.

Sell-Out/Divestment Strategy: If a corporation with a weak competitive position in an industry is unable either to pull itself up by its bootstraps or to find a customer to which it can become a captive company, it may have no choice but to sell out. The sell-out strategy makes sense if management can still obtain a good price for its shareholders and the employees can keep their jobs by selling the entire company to another firm. The hope is that another company will have the necessary resources and determination to return the company to profitability.

Bankruptcy/Liquidation Strategy: When a company finds itself in the worst possible situation with a poor competitive position in an industry with few prospects, management has only a few alternatives—all of them distasteful. Because no one is interested in buying a weak company in an unattractive industry, the firm must pursue a bankruptcy or liquidation strategy. Bankruptcy involves giving up management of the firm to the courts in return for some settlement of the corporation's obligations.

5.2.2 Business Level Strategies

Business level strategies are an integrated and coordinated set of commitments and actions the firm uses to gain a competitive advantage by exploiting core competencies in specific product markets. In the process, the firm uses its competencies to gain, sustain, and enhance its strategic or competitive advantage. Business strategy can be competitive (battling against all competitors for advantage) and/or cooperative (working with one or more companies to gain advantage against other competitors). MichaelPorter is credited with extensive pioneering work in the area of business strategies or what he calls, competitive strategies. Porter's competitive strategies raise the following questions: **Should we compete on the basis of lower cost (and thus price),** or **should we differentiate our products or services on some basis other than cost,** such as quality or service? **Should we compete head to head with our major competitors for the biggest but most sought-after share of the market, or should we focus on a nich**e in which we can satisfy a less sought-after but also profitable segment of the market?

Michael Porter proposes two "generic" competitive strategies for outperforming other corporations in a particular industry: lower cost and differentiation. These strategies are called generic because they can be pursued by any type or size of business firm:
Porter further proposes that a firm's competitive advantage in an industry is determined by its competitive scope, that is, the breadth of the company's or business unit's target market.

Porter's Generic Business Level Strategies

1. Cost leadership
2. Differentiation
3. Focused cost leadership
4. Focuseddifferentiation
5. Integrated cost leadership/differentiation

1. Cost Leadership Business Strategy

A cost leadership strategy is based upon a business organizing and managing its value adding activities to be the lowest cost producer of the product or service in an industry. Value chain analysis is central to identifying where cost savings can be made at various stages in the value chain and its internal and external linkages. A successful cost leadership strategy is likely to rest upon a number of organizational features. Attainment of a position ofcost leadership depends on the arrangement of value chain activities so as to:

- ♣ Reduce unit costs by copying rather than originating designs, using cheaper materials and other cheaper resources, producing products with no frills, reducing labor costs and increasing labor productivity.
- ♣ Achieving economies of scale by high-volume sales perhaps based on advertising and promotion, allowing high fixed costs of investment in modern technology to be spread over a high volume of output
- ♣ Using high volume purchasing to obtain discounts for bulk buying of materials
- ♣ Locating activities in areas where costs are low or government help is available

When the competitive advantage of a firm lies in a lower cost of products or services relative to what the competitors have to offer, it is termed as cost leadership. Customers prefer a lower cost product particularly if it offers the same utility to them as the comparable products available in the market offer. When all firms offer products at comparable price, then the cost leader firm earns a higher profit owing to the low cost of its products. Cost leadership offers a margin of flexibility to the firm to lower price if the competition becomes stiff and yet earn more or less the same level of profit.For companies competing in a price sensitive market, cost leadership is a strategy imperative of the entire organization.

Conditions under Which Cost Leadership is Used

Not every condition under which market operates is conducive to the use of the cost leadership strategy. There are certain conditions that make such usage meaningful. Some of such conditions are mentioned below:

- If the markets for the product/service is price based competition
- If the product/service is standardized and its competition takes place in such a way that differentiation is superfluous
- If the buyers may be numerous and possess a significant bargaining power to negotiate a price reduction from the supplying firm
- If there is lesser customer loyalty and the cost of switching from one seller to another is low.
- If there might be few ways available for differentiation to take place.

Table 5.1 Advantages and disadvantages of cost leadership Strategy

Advantage	**Disadvantage**
✓ Defend market share ✓ Build entry barriers ✓ Increase market share ✓ Enter new markets ✓ Reduce the cost of capital	✓ Competitors may imitate the strategy, thus driving overall industry profits down ✓ Cost advantage is temporary ✓ Cost leadership is obviously not a market friendly approach ✓ Technological shifts are a greater threat to a cost leader as these may change the ground rules on which an industry operates

2. Differentiation Business Strategy

It is a strategy of achieving a competitive advantage by creating a product that is perceived by customers as **unique** in some important way.Using a differentiation strategy means that a firm is competing based on **uniqueness** rather than price and is seeking to attract a broad market.A differentiation strategy is based on persuading customers that a product is superior to that offered by competitors. Differentiation can be based on **premium product features** or simply upon creating consumer perceptions that a product is superior. A differentiation strategy is likely to necessitate emphasis on **innovation**, **design**, **research and development**, **awareness of particular customer needs and marketing.** The firm outperforms its competitors who are not able or willing to offer the special features that it can and does. Customers prefer a differentiated product/service when it offers them a utility that they value, and are willing to pay more for getting such a utility. Profits for the differentiation firm come from the difference in the premium price charged and the additional cost incurred in providing the differentiation. To the extent the firm is able to offer differentiation by maintaining a balance between its price and costs, it succeeds. However, it may fail if the customers are no longer interested in the differentiated features, or not willing to pay extra for such features.

Table 5.2 Advantages and disadvantages of Differentiation Strategy

Advantages	Disadvantages
✓ lessening competitive rivalry ✓ Reduce bargaining power of buyers ✓ Acts as a entry barrier to new entrants ✓ Reduce substitutability	✓ Price premiums to have a limit ✓ customers will not be willing to pay extra to obtain the unique features ✓ if it is not valued by the customers it will fail

3. Focused cost leadership

Focus business strategies essentially rely on either cost leadership or differentiation but cater to a **narrow segment** of the total market. In terms of the market, therefore, focus strategies are **niche strategies**. The more commonly used bases for identifying customer groups are the demographic characteristics (age, gender, income, occupation etc), geographic segmentation (rural/urban), lifestyle (traditional/modern). A focus strategy is aimed at a segment of the market for a product rather than at the whole market or many markets. A particular group of customers is identified on the basis of age, income, life style, sex, geographic location, some other distinguishing segmental characteristic or a combination of these. For the identified market segment a focus firm uses either the lower cost or differentiation strategy.

Focused cost leadership is the first of two focus strategies. A focused cost leadership strategy requires competing based on price to target a narrow market. A firm that follows this strategy does not necessarily charge the lowest prices in the industry. Instead, it charges low prices relative to other firms that compete within the target market.

4. Focused differentiation

Focused differentiation is the second of two focus strategies. A focused differentiation strategy requires offering unique features that fulfill the demands of a narrow market. As with a focused low-cost strategy, narrow markets are defined in different ways in different settings. Some firms using a focused differentiation strategy concentrate their efforts on a particular sales channel, such as selling over the Internet only. Others target particular demographic groups.

Conditions under which a focus strategies are used

1. When the target market niche is large, profitable, and growing.
2. When industry leaders do not consider the niche to be crucial to their own success.
3. When industry leaders consider it too costly or difficult to meet the specialized needs of the target market niche while taking care of their mainstream customers.
4. When the industry has many different niches and segments, thereby allowing a focuser to pick a competitively attractive niche suited to its own resources.
5. When few, if any, other rivals are attempting to specialize in the same target segment
6. When consumers have distinctive preferences or requirements and when rival firms are not attempting to specialize in the same target segment.
7. When the focusing firm has the necessary skills and expertise to serve the niche segment
8. When the focusing firm can guard its territory from other predator firms based on customer relations and the loyalty it has developed and its acknowledged superiority in serving the niche segments.

Table 5.3 Advantage and disadvantage of focus strategy

Advantage	Disadvantage
✓ It allows specialization and greater knowledge ✓ lower investment in resources ✓ It makes entry to a new market less costly and simpler	✓ Serving niche markets requires the development of distinctive competencies to serve those markets ✓ commitment to a narrow marker segment ✓ High cost

5. Integrated Cost Leadership/Differentiation Strategy

Most consumers have high expectations when purchasing a good or service. In general, it seems that most consumers want to pay a low price for products with somewhat highly differentiated features. Because of these customer expectations, a number of firms engage in primary and support activities that allow them to simultaneously pursue low cost and differentiation. Firm seeking to do this use the integrated cost leadership/differentiation strategy.The objective of using this strategy is to efficiently produce products with some differentiated features.Efficient production is the source of maintaining low costs while differentiation is the source of creating unique value.Firms that successfully use the integrated cost leadership/differentiation strategy usually adapt quickly to new technologies and rapid changes in their external environments.

Thisrisky of strategy is risky because firms find it difficult to perform primary and support activities in ways that allow them to produce relatively inexpensive products with levels of differentiation that create value for the target customer. Moreover, to properly use this strategy across time, firms must be able to simultaneously reduce costs incurred to produce products (as required by the cost leadership strategy) while increasing products' differentiation (as required by the differentiation strategy).They may got the problem of "stuck in the middle. Being stuck in the middle means that the firm's cost structure is not low enough to allow it to attractively price its products and that its products are not sufficiently differentiated to create value for the target customer.

5.2.3. Functional Level Strategy (Reading Assignment)

5.3 A comprehensive strategy formulation framework

Important strategy-formulation techniques can be integrated into a three-stage decision-making framework, (input stage, matching stage and the decision stage). The tools presented in this framework are applicable to all sizes and types of organizations and can help strategists identify, evaluate, and select

Stage one (The Input Stage)

Input stage of the formulation framework consists of the external factors evaluation (EFE), internal factors evaluation Matrix (IFE) and Competitive Profile Matrix (CPM). **Stage 1 is called the Input Stage**; stage 1 summarizes the basic input information needed to formulate strategies.

The input tools require strategists to quantify subjectivity during early stages of the strategy-formulation process. Making small decisions in the input matrices regarding the relative importance of external and internal factors allows strategists to more effectively generate and evaluate alternative strategies. Good intuitive judgment is always needed in determining appropriate weights and ratings. Let us see **External Factor Evaluation (EFE) Matrix and the competitive profile matrix (CPM). The internal factor evaluation matrix** discussed in chapter 4.

External Factor Evaluation (EFE) Matrix

An External Factor Evaluation (EFE) Matrix allows strategists to summarize and evaluate economic, social, cultural, demographic, environmental, political, governmental, legal, technological, and competitive information. The EFE Matrix can be developed in five steps:

1. List key external factors as identified in the external-audit process. Include a total of 15 to 20 factors, including both opportunities and threats that affect the firm and its industry. List the opportunities first and then the threats. Be as specific as possible, using percentages, ratios, and comparative numbers whenever possible.
2. Assign to each factor a weight that ranges from 0.0 (not important) to 1.0 (very important). The weight indicates the relative importance of that factor to being successful in the firm's industry. Opportunities often receive higher weights than threats, but threats can receive high weights if they are especially severe or threatening. Appropriate weights can be determined by comparing successful with unsuccessful competitors or by discussing the factor and reaching a group consensus. The sum of all weights assigned to the factors must equal 1.0.
3. Assign a rating between 1 and 4 to each key external factor to indicate how effectively the firm's current strategies respond to the factor, where 4 = the response is superior, 3 = the response is above average, 2 = the response is average and 1 = the response is poor. Ratings are based on effectiveness of the firm's strategies. Ratings are thus company-based, whereas the weights in Step 2 are industry-based. It is important to note that both threats and opportunities can receive a 1, 2, 3, or 4.
4. Multiply each factor's weight by its rating to determine a weighted score.

5. Sum the weighted scores for each variable to determine the total weighted score for the organization.

Regardless of the number of key opportunities and threats included in an EFE Matrix, the highest possible total weighted score for an organization is 4.0 and the lowest possible total weighted score is 1.0. The average total weighted score is 2.5. A total weighted score of 4.0 indicates that an organization is responding in an outstanding way to existing opportunities and threats in its industry. In other words, the firm's strategies effectively take advantage of existing opportunities and minimize the potential adverse effects of external threats. A total score of 1.0 indicates that the firm's strategies are not capitalizing on opportunities or avoiding external threats.

Table 5.4 External Factor Evaluation (EFE) Matrix - Example

Factor		Weight	Rating	Weighted Score
Opportunities				
1	High-end in-home entertainment sales are growing nationally	0.15	4	0.60
2	Forecast for continued growth of expensive housing in Dade & Broward counties	0.16	4	0.64
3	Wealthy foreigners buy expensive entertainment equipment for their homes in South Florida	0.07	3	0.21
4	Current customers refer new prospects with little prompting	0.12	3	0.36
5	Direct mailing lists are available by household income	0.06	3	0.18
Threats				
1	Large chains could expand upward into their niche	0.13	1	0.13
2	New technologies such as satellite broadcast compete with current technologies	0.10	1	0.10
3	Declining incomes in South Florida versus the U.S.	0.08	2	0.16
4	South Florida highly dependent on trade with Latin America	0.07	1	0.07
5	Economy depends on air transport, a volatile industry	0.06	2	0.12
Total		1.00		2.57

Note that the total weighted score of 2.57 is above the average (midpoint) of 2.5, so this cinema business is doing pretty well, taking advantage of the external opportunities and avoiding the threats facing the firm.

The Competitive Profile Matrix (CPM)

The Competitive Profile Matrix (CPM) identifies a firm's major competitors and its particular strengths and weaknesses in relation to a sample firm's strategic position. The weights and total weighted scores in both a CPM and an EFE have the same meaning. However, critical success factors in a CPM include both internal and external issues. In a CPM, the ratings and total weighted scores for rival firms can be compared to the sample firm. This comparative analysis provides important internal strategic information.

The first step is to find the critical success factors for the company and attach weight to those factors according to their relative importance. In the next step, company need to identify its major competitors and rate each competitors including company itself on each of the critical success factors. critical success factors include both internal and external issues and different ratings have been given from 1 to 4 considering their relative importance to the organization where 1 stands for **major weakness**, 2 stands for **minor weakness**, 3 stands for **minor strength,** and 4 stands for **major strength**. Same method has been applied when rating to the critical success factors of competitors. Lastly, company has to multiply the weight by the rating for each factor to get a weighted score and then adds up each competitor's weighted scores to get a total weighted score.

Table 5.5. The Competitive Profile Matrix (CPM) example

Key Success Factors	Weight	Company A		Competitor 1		Competitor 2	
		Score	Weighted Score	Score	Weighted Score	Score	Weighted Score
Innovation	0.25	4	1.00	4	1.00	3	0.75
Advertising	0.20	2	0.40	3	0.60	4	0.80
Brand Name	0.20	1	0.20	4	0.80	2	0.40
Product Quality	0.15	4	0.60	2	0.30	2	0.30
Customer Service	0.10	3	0.30	2	0.20	1	0.10
Price Competitiveness	0.05	3	0.15	3	0.15	4	0.20
Technological Competence	0.05	3	0.15	1	0.05	2	0.10
Total	**1**		**2.80**		**3.10**		**2.65**

This table portrays the competitive scenarios of the company and its competitors in the industry. From this table, it is found that the company A scores better (strengths) in innovation and product quality, and assumes minor strength in customer service, price competitiveness, and in technological competence. Albeit, company has minor weakness in advertising and major weakness is in brand name. As a whole, its total score is 2.80 and on the other hand, its competitor A's and competitor B's total scores are 3.10, and 2.65 respectively. From this competitive profile matrix, it is revealed that competitor 1 enjoys more competitive advantages by 0.30 than the company itself while competitor 2 is lagging behind by 0.15.

Stage 2 (The Matching Stage)

Strategy is sometimes defined as the match an organization makes between its internal resources and skills and the opportunities and risks created by its external factors. The matching stage of the strategy-formulation framework consists of five techniques that can be used in any sequence: the Strengths-Weaknesses-Opportunities-Threats (SWOT) Matrix, the Strategic Position and Action Evaluation (SPACE) Matrix, the Boston Consulting Group (BCG) Matrix, the Internal-External (IE) Matrix, and the Grand Strategy Matrix. These tools rely upon information derived from the input stage to match external opportunities and threats with internal strengths and weaknesses. Matching external and internal critical success factors is the key to effectively generating feasible alternative strategies.

The basic concept of matching is illustrated in Table 5-6. Any organization, whether military, product-oriented, service-oriented, governmental, or even athletic, must develop and execute good strategies to win. A good offense without a good defense, or vice versa, usually leads to defeat. Developing strategies that use strengths to capitalize on opportunities could be considered an offense, whereas strategies designed to improve upon weaknesses while avoiding threats could be termed defensive. Every organization has some external opportunities threats and internal strengths and weaknesses that can be aligned to formulate feasible alternative strategies.

Table 5.6 Matching Key External and Internal Factors to Formulate Alternative Strategies

Key Internal Factor	Key External Factor	Resultant Strategy
Excess working capital (an internal strength	+ 20 percent annual growth in the cell phone industry (an external opportunity)	Acquire Cellfone, Inc.
Insufficient capacity (an internal weakness)	+ Exit of two major foreign competitors from the industry (an external opportunity)	Pursue horizontal integration by buying competitors' facilities
Strong R&D expertise (an internal strength)	+ Decreasing numbers of younger adults (an external threat)	Develop new products for older adults
Poor employee morale (an internal weakness)	+ Rising healthcare costs (an external threat)	Develop a new wellness program

The Strengths-Weaknesses-Opportunities-Threats (SWOT) Matrix

The Strengths-Weaknesses-Opportunities-Threats (SWOT) Matrix is an important matching tool that helps managers develop four types of strategies: SO (strengths-opportunities) Strategies, WO (weaknesses-opportunities) Strategies, ST (strengths-threats) Strategies, and WT (weaknesses-threats) Strategies.

Matching key external and internal factors is the most difficult part of developing a SWOT Matrix and requires good judgment—and there is no one best set of matches. Note in Table 6-1 that the first, second, third, and fourth strategies are SO, WO, ST, and WT strategies, respectively.

- **SO Strategies** use a firm's internal strengths to take advantage of external opportunities. All managers would like their organizations to be in a position in which internal strengths can be used to take advantage of external trends and events. For example, a firm with excess working capital (an internal strength) could take advantage of the cell phone industry's 20 percent annual growth rate (an external opportunity) by acquiring Cellfone, Inc., a firm in the cell phone industry. Organizations generally will pursue WO, ST, or WT strategies to get into a situation in which they can apply SO Strategies. When a firm has major weaknesses, it will strive to overcome them and make them strengths. When an organization faces major threats, it will seek to avoid them to concentrate on opportunities.
- **WO Strategies** aim at improving internal weaknesses by taking advantage of external opportunities. Sometimes key external opportunities exist, but a firm has internal weaknesses that prevent it from exploiting those opportunities. For example, there may be a high demand for electronic devices to control the amount and timing of fuel injection in automobile engines (opportunity), but a certain auto parts manufacturer may lack the technology required for producing these devices (weakness). One possible WO Strategy would be to acquire this technology by forming a joint venture with a firm having competency in this area. An alternative WO Strategy would be to hire and train people with the required technical capabilities.

- **ST Strategies** use a firm's strengths to avoid or reduce the impact of external threats. This does not mean that a strong organization should always meet threats in the external environment head-on.
- **WT Strategies** are defensive tactics directed at reducing internal weakness and avoiding external threats. An organization faced with numerous external threats and internal weaknesses may indeed be in a precarious position. In fact, such a firm may have to fight for its survival, merge, retrench, declare bankruptcy, or choose liquidation.

The Strategic Position and Action Evaluation (SPACE) Matrix

The Strategic Position and Action Evaluation (SPACE) Matrix, another important Stage 2 matching tool. Its four-quadrant framework indicates whether aggressive, conservative, defensive, or competitive strategies are most appropriate for a given organization. The axes of the SPACE Matrix represent two internal dimensions (financial position [FP] and competitive position [CP]) and two external dimensions (stability position [SP] and industry position [IP]).

Internal Strategic Position	External Strategic Position
Financial Position (FP)	*Stability Position (SP)*
Return on investment	Technological changes
Leverage	Rate of inflation
Liquidity	Demand variability
Working capital	Price range of competing products
Cash flow	Barriers to entry into market
Inventory turnover	Competitive pressure
Earnings per share	Ease of exit from market
Price earnings ratio	Price elasticity of demand
	Risk involved in business
Competitive Position (CP)	*Industry Position (IP)*
Market share	Growth potential
Product quality	Profit potential
Product life cycle	Financial stability
Customer loyalty	Extent leveraged
Capacity utilization	Resource utilization
Technological know-how	Ease of entry into market
Control over suppliers and distributors	Productivity, capacity utilization

These four factors are perhaps the most important determinants of an organization's overall strategic position. Depending on the type of organization, numerous variables could make up each of the dimensions represented on the axes of the SPACE Matrix. Factors that were included earlier in the firm's EFE and IFE Matrices should be considered in developing a SPACE

The steps required to develop a SPACE Matrix are as follows:

1. Select a set of variables to define financial position (FP), competitive position (CP), Stability position (SP), and industry position (IP).
2. Assign a numerical value ranging from +1 (worst) to +7 (best) to each of the variables that make up the FP and IP dimensions. Assign a numerical value ranging from -1 (best) to -7 (worst) to each of the variables that make up the SP and CP dimensions. On the FP and CP axes, make comparison to competitors. On the IP and SP axes, make comparison to other industries.
3. Compute an average score for FP, CP, IP, and SP by summing the values given to the variables of each dimension and then by dividing by the number of variables included in the respective dimension.
4. Plot the average scores for FP, IP, SP, and CP on the appropriate axis in the SPACE Matrix.
5. Add the two scores on the x-axis and plot the resultant point on X. Add the two scores on the y-axis and plot the resultant point on Y. Plot the intersection of the new xy point.

6. Draw a directional vector from the origin of the SPACE Matrix through the new intersection point. This vector reveals the type of strategies recommended for the organization: aggressive, competitive, defensive, or conservative.

The SPACE Matrix

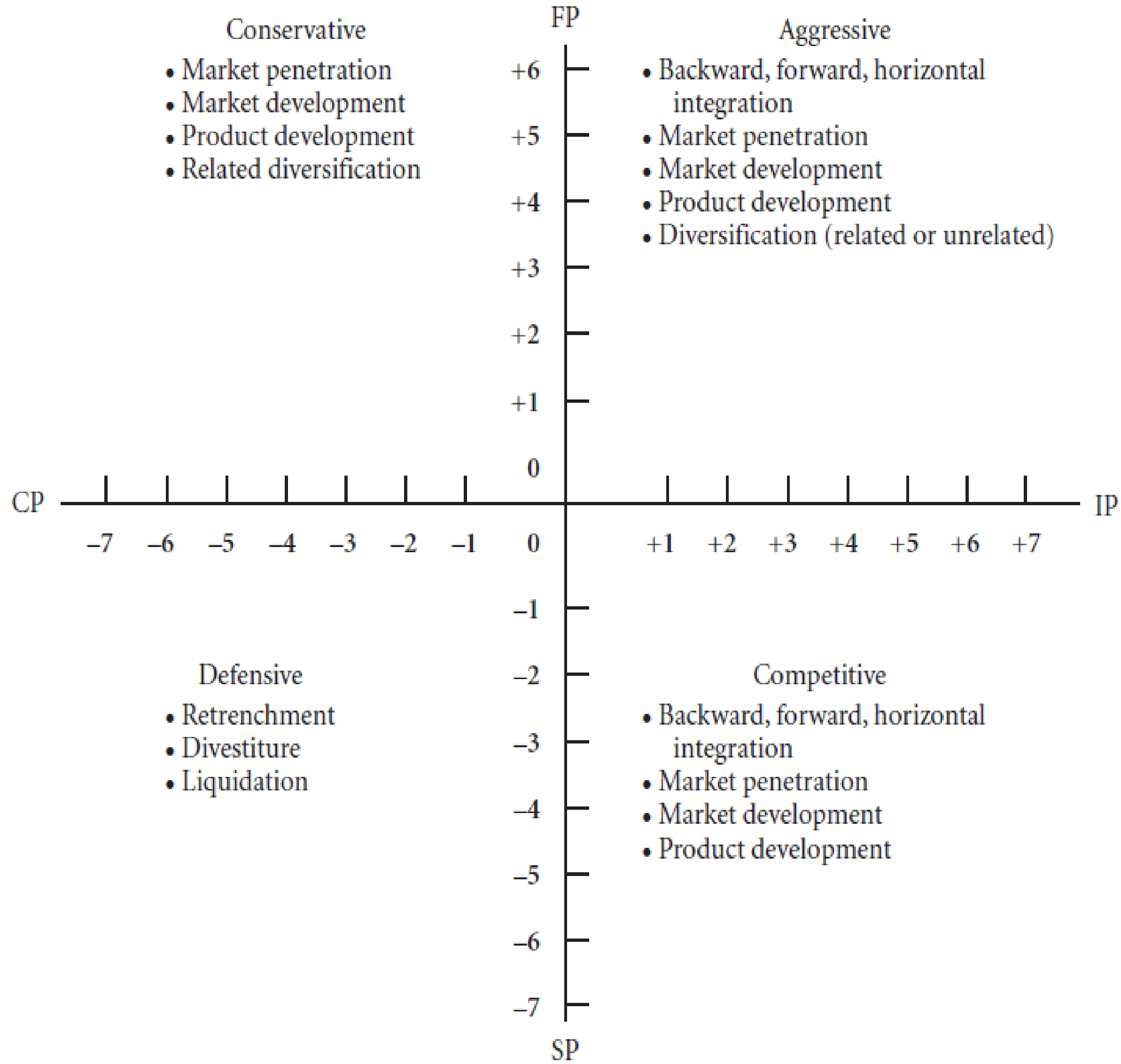


TABLE 6-3 A SPACE Matrix for a Bank

Financial Position (FP)	Ratings
The bank's primary capital ratio is 7.23 percent, which is 1.23 percentage points over the generally required ratio of 6 percent.	1.0
The bank's return on assets is negative 0.77, compared to a bank industry average ratio of positive 0.70.	1.0
The bank's net income was $183 million, down 9 percent from a year earlier.	3.0
The bank's revenues increased 7 percent to $3.46 billion.	4.0
	9.0
Industry Position (IP)	
Deregulation provides geographic and product freedom.	4.0
Deregulation increases competition in the banking industry.	2.0
Pennsylvania's interstate banking law allows the bank to acquire other banks in New Jersey, Ohio, Kentucky, the District of Columbia, and West Virginia.	4.0
	10.0
Stability Position (SP)	
Less-developed countries are experiencing high inflation and political instability.	−4.0
Headquartered in Pittsburgh, the bank historically has been heavily dependent on the steel, oil, and gas industries. These industries are depressed.	−5.0
Banking deregulation has created instability throughout the industry.	−4.0
	−13.0
Competitive Position (CP)	
The bank provides data processing services for more than 450 institutions in 38 states.	−2.0
Superregional banks, international banks, and nonbanks are becoming increasingly competitive.	−5.0
The bank has a large customer base.	−2.0
	−9.0

Conclusion

SP Average is −13.0 ÷ 3 = −4.33 IP Average is +10.0 ÷ 3 = 3.33

CP Average is −9.0 ÷ 3 = −3.00 FP Average is +9.0 ÷ 4 = 2.25

Directional Vector Coordinates: x-axis: −3.00 + (+3.33) = +0.33

y-axis: −4.33 + (+2.25) = −2.08

The bank should pursue Competitive Strategies.

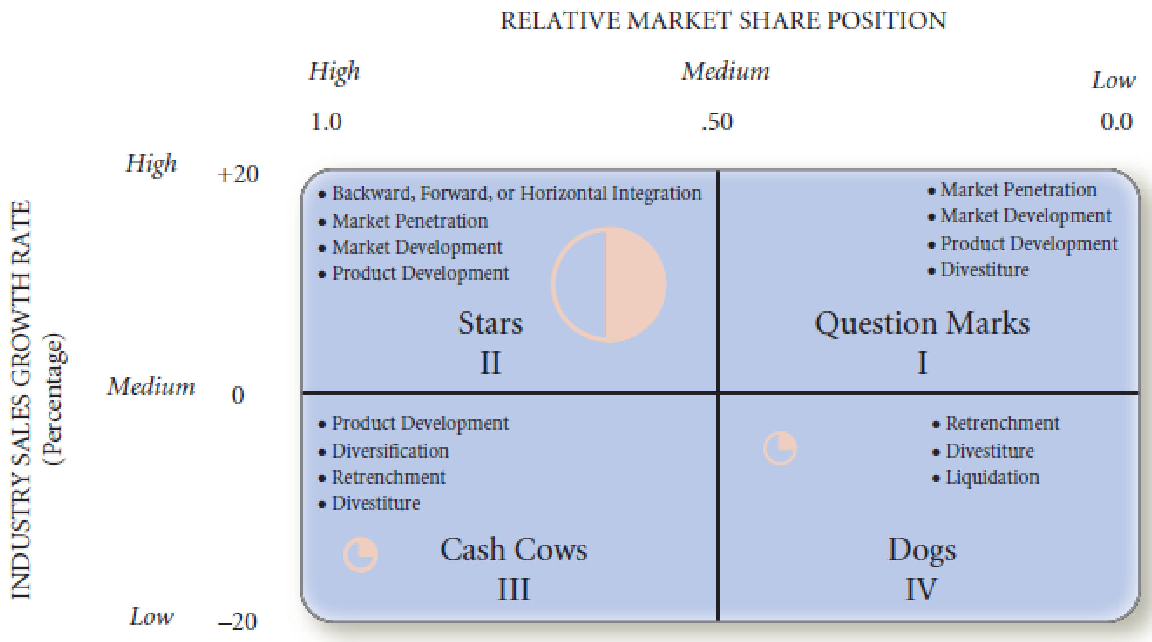
The Boston Consulting Group (BCG) Matrix

Autonomous (independent) divisions (or profit centers) of an organization make up what is called a business portfolio. When a firm's divisions compete in different industries, a separate strategy often must be developed for each business. The Boston Consulting Group (BCG) Matrix designed specifically to enhance a multidivisional firm's efforts to formulate strategies (BCG is a private management-consulting firm based in Boston).

The BCG Matrix graphically portrays differences among divisions in terms of relative market share position and industry growth rate. The BCG Matrix allows a multidivisional organization to manage its portfolio of businesses by examining the relative market share position and the industry growth rate of each division relative to all other divisions in the organization. Relative market share position is defined as the ratio of a division's own market share (or revenues) in a particular industry to the market share (or revenues) held by the largest rival firm in that industry.

Relative market share position is given on the x-axis of the BCG Matrix. The midpoint on the x-axis usually is set at .50, corresponding to a division that has half the market share of the leading firm in the industry. The y-axis represents the industry growth rate in sales, measured in percentage terms. The growth rate percentages on the y-axis could range from -20 to +20 percent, with 0.0 being the midpoint. The average annual increase in revenues for several leading firms in the industry would be a good estimate of the value.
Divisions located in Quadrant I of the BCG Matrix are called "Question Marks," those located in Quadrant II are called "Stars," those located in Quadrant III are called "Cash Cows," and those divisions located in Quadrant IV are called "Dogs."

The BCG Matrix



1. **Question Marks**—Divisions in Quadrant I have a low relative market share position, yet they compete in a high-growth industry. Generally, these firms' cash needs are high and their cash generation is low. These businesses are called Question Marks because the organization must decide whether to strengthen them by pursuing an intensive strategy (market penetration, market development, or product development) or to sell them.
2. **Stars**: Quadrant II businesses (Stars) represent the organization's best long-run opportunities for growth and profitability. Divisions with a high relative market share and a high industry growth rate should receive substantial investment to maintain or strengthen their dominant positions. Forward, backward and horizontal integration; market penetration; market development; and product development are appropriate strategies for these divisions.
3. **Cash Cows**: Divisions positioned in Quadrant III have a high relative market share position but compete in a low-growth industry. Called Cash Cows because they generate cash in excess of their needs, they are often milked. Many of today's Cash Cows were yesterday's Stars. Cash Cow divisions should be managed to maintain their strong position for as long as possible. Product development or diversification may be attractive strategies for strong Cash Cows. However, as a Cash Cow, division becomes weak, retrenchment or divestiture can become more appropriate.

4. **Dogs**: Quadrant IV divisions of the organization have a low relative market share position and compete in a slow- or no-market-growth industry; they are Dogs in thefirm's portfolio. Because of their weak internal and external position, these businesses are often liquidated, divested, or trimmed down through retrenchment. When a division first becomes a Dog, retrenchment can be the best strategy to pursue because many Dogs have bounced back, after strenuous asset and cost reduction, to become viable, profitable divisions.

The major benefit of the BCG Matrix is that it draws attention to the cash flow, investment characteristics, and needs of an organization's various divisions. The divisions of many firms evolve over time: Dogs become Question Marks, Question Marks become Stars, Stars become Cash Cows, and Cash Cows become Dogs in an ongoing counterclockwise motion. Less frequently, Stars become Question Marks, Question Marks become Dogs, Dogs become Cash Cows, and Cash Cows become Stars (in a clockwise motion). In some organizations, no cyclical motion is apparent. Over time, organizations should strive to achieve a portfolio of divisions that are Stars.

Stage three (The decision stage)

Stage 3, called the decision stage, and involves a single technique, the Quantitative Strategic Planning Matrix (QSPM). A QSPM uses input information from Stage 1 to objectively evaluate feasible alternative strategies identified in Stage 2. A QSPM reveals the relative attractiveness of alternative strategies and thus provides objective basis for selecting specific strategies. This technique objectively indicates which alternative strategies are best. The QSPM uses input from Stage 1 analyses and matching results from Stage 2 analyses to decide objectively among alternative strategies. That is, the EFE Matrix, IFE Matrix, and Competitive Profile Matrix that make up Stage 1, coupled with the SWOT Matrix, SPACE Matrix, BCG Matrix, IE Matrix, and Grand Strategy Matrix that make up Stage 2, provide the needed information for setting up the QSPM (Stage 3). The QSPM is a tool that allows strategists to evaluate alternative strategies objectively, based on previously identified external and internal critical success factors. Like other strategy-formulation analytical tools, the QSPM requires good intuitive judgment. Six steps required to develop a QSPM are discussed:

Step 1 Make a list of the firm's key external opportunities/threats and internal strengths/weaknesses in the left column of the QSPM. This information should be taken directly from the EFE Matrix and IFE Matrix. A minimum of 10 external key success factors and 10 internal key success factors should be included in the QSPM.

Step 2 Assign weights to each key external and internal factor. These weights are identical to those in the EFE Matrix and the IFE Matrix. The weights are presented in a straight column just to the right of the external and internal critical success factors.

Step 3 Examine the Stage 2 (matching) matrices, and identify alternative strategies that the organization should consider implementing. Record these strategies in the top row of the QSPM. Group the strategies into mutually exclusive sets if possible.

Step 4 Determine the Attractiveness Scores (AS) defined as numerical values that indicate the relative attractiveness of each strategy in a given set of alternatives.

Attractiveness Scores (AS) are determined by examining each key external or internal factor, one at a time, and asking the question "Does this factor affect the choice of strategies being made?" If the answer to this question is yes, then the strategies should be compared relative to that key factor. Specifically, Attractiveness Scores should be assigned to each strategy to indicate the relative attractiveness of one strategy over others, considering the particular factor. The range for Attractiveness Scores is 1 = not attractive, 2 = somewhat attractive, 3 = reasonably attractive, and 4 = highly attractive. By attractive, we mean the extent that one strategy, compared to others, enables the firm to either capitalize on the strength, improve on the weakness, exploit the opportunity, or avoid the threat. Work row by row in developing a QSPM. If the answer to the previous question is no, indicating that the respective key factor has no effect upon the specific choice being made, then do not assign Attractiveness Scores to the strategies in that set. Use a dash to indicate that the key factor does not affect the choice being made. Note: If you assign an

AS score to one strategy, then assign AS score(s) to the other. In other words, if one strategy receives a dash, then all others must receive a dash in a given row.

Step 5 Compute the Total Attractiveness Scores. Total Attractiveness Scores (TAS) are defined as the product of multiplying the weights (Step 2) by the Attractiveness Scores (Step 4) in each row. The Total Attractiveness Scores indicate the relative attractiveness of each alternative strategy, considering only the impact of the adjacent external or internal critical success factor. ***The higher the Total Attractiveness Score, the more attractive the strategic alternative (considering only the adjacent critical success factor).***

Step 6 Compute the Sum Total Attractiveness Score. Add Total Attractiveness Scores in each strategy column of the QSPM. The Sum Total Attractiveness Scores (STAS) reveal which strategy is most attractive in each set of alternatives. Higher scores indicate more attractive strategies, considering all the relevant external and internal factors that could affect the strategic decisions. The magnitude of the difference between the Sum Total Attractiveness Scores in a given set of strategic alternatives indicates the relative desirability of one strategy over another.

		STRATEGIC ALTERNATIVES			
		1		2	
		Buy New Land and Build New Larger Store		Fully Renovate Existing Store	
Key Factors	*Weight*	*AS*	*TAS*	*AS*	*TAS*
Opportunities					
1. Population of city growing 10%	0.10	4	0.40	2	0.20
2. Rival computer store opening 1 mile away	0.10	2	0.20	4	0.40
3. Vehicle traffic passing store up 12%	0.08	1	0.08	4	0.32
4. Vendors average six new products/year	0.05	—		—	
5. Senior citizen use of computers up 8%	0.05	—		—	
6. Small business growth in area up 10%	0.10	—		—	
7. Desire for Web sites up 18% by Realtors	0.06	—		—	
8. Desire for Web sites up 12% by small firms	0.06	—		—	
Threats					
1. Best Buy opening new store nearby in 1 year	0.15	4	0.60	3	0.45
2. Local university offers computer repair	0.08	—		—	
3. New bypass for Hwy 34 in 1 year will divert traffic	0.12	4	0.48	1	0.12
4. New mall being built nearby	0.08	2	0.16	4	0.32
5. Gas prices up 14%	0.04	—		—	
6. Vendors raising prices 8%	0.03	—		—	
	1.00				
Strengths					
1. Inventory turnover increased from 5.8 to 6.7	0.05	—		—	
2. Average customer purchase increased from $97 to $128	0.07	2	0.14	4	0.28
3. Employee morale is excellent	0.10	—		—	
4. In-store promotions resulted in 20% increase in sales	0.05	—		—	
5. Newspaper advertising expenditures increased 10%	0.02	—		—	
6. Revenues from repair/service segment of store up 16%	0.15	4	0.60	3	0.45
7. In-store technical support personnel have MIS college degrees	0.05	—		—	
8. Store's debt-to-total assets ratio declined to 34%	0.03	4	0.12	2	0.06
9. Revenues per employee up 19%	0.02	—		—	
Weaknesses					
1. Revenues from software segment of store down 12%	0.10	—		—	
2. Location of store negatively impacted by new Hwy 34	0.15	4	0.60	1	0.15
3. Carpet and paint in store somewhat in disrepair	0.02	1	0.02	4	0.08
4. Bathroom in store needs refurbishing	0.02	1	0.02	4	0.08
5. Revenues from businesses down 8%	0.04	3	0.12	4	0.16
6. Store has no Web site	0.05	—		—	
7. Supplier on-time delivery increased to 2.4 days	0.03	—		—	
8. Often customers have to wait to check out	0.05	2	0.10	4	0.20
Total	1.00		4.36		3.27

In the above table, two alternative strategies (1) buy new land and build new larger store and (2) fully renovate existing store are being considered by a computer retail store. Note by sum total attractiveness scores of 4.63 versus 3.27 that the analysis indicates the business should buy new land and build a new larger store.

5.6 The Balanced Scorecard (BSC)

Traditional financial reporting systems provide an indication of how a firm has performed in the past, but offer little information about how it might perform in the future. For example, a firm might reduce its level of customer service in order to boost current earnings, but then future earnings might be negatively impacted due to reduced customer satisfaction. To deal with this problem, Robert Kaplan and David Norton developed the **Balanced Scorecard**, a performance measurement system that considers not only financial measures, but also customer, business process, and learning measures. **BSC** provide a **"balance" between financial measures and other measures that are important for understanding organizational activities that lead to sustained, long-term performance.**
The balanced scorecard translates the organization's strategy into four perspectives, with a *balance* between the following:

- Between internal and external measures
- Between objective measures and subjective measures
- Between performance results and the drivers of future results

Balanced Scorecard Perspectives

In the industrial age, most of the assets of a firm were in property, plant, and equipment and the financial accounting system performed an adequate job of valuing those assets. In the information age, much of the value of the firm is embedded in innovative processes, customer relationships, and human resources. The financial accounting system is not so good at valuing such assets. The Balanced Scorecard goes beyond standard financial measures to include the following additional perspectives: the customer perspective, the internal process perspective, and the learning and growth perspective.

- **Financial perspective** - includes measures such as operating income, return on capital employed, and economic value added.
- **Customer perspective** - includes measures such as customer satisfaction, customer retention, and market share in target segments.
- **Business process perspective** - includes measures such as cost, throughput, and quality. These are for business processes such as procurement, production, and order fulfillment.
- **Learning & growth perspective** - includes measures such as employee satisfaction, employee retention, skill sets, etc.

These four realms are not simply a collection of independent perspectives. Rather, there is a logical connection between them - learning and growth lead to better business processes, which in turn lead to increased value to the customer, which finally leads to improved financial performance.

Balanced Scorecard as a Strategic Management System

The Balanced Scorecard originally was conceived as an improved performance measurement system. However, it soon became evident that it could be used as a management system to implement strategy at all levels of the organization by facilitating the following functions:

1. **Clarifying strategy** - the translation of strategic objectives into quantifiable measures clarifies the management team's understanding of the strategy and helps to develop a coherent consensus.

2. **Communicating strategic objectives** - the Balanced Scorecard can serve to translate high level objectives into operational objectives and communicate the strategy effectively throughout the organization.
3. **Planning, setting targets, and aligning strategic initiatives** - ambitious but achievable targets are set for each perspective and initiatives are developed to align efforts to reach the targets.
4. **Strategic feedback and learning** - executives receive feedback on whether the strategy implementation is proceeding according to plan and on whether the strategy itself is successful ("double-loop learning").

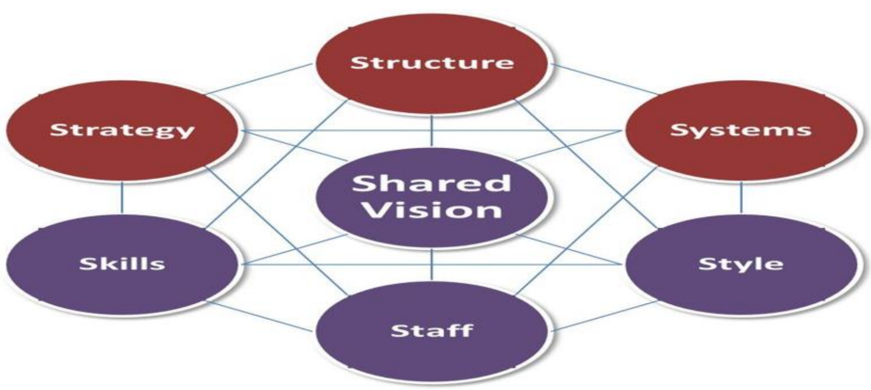
5.7 The 7'S Model

How do you go about analyzing how well your organization is positioned to achieve its intended objective? This is a question that has been asked for many years, and there are many different answers.Some approaches look at internal factors, others look at external ones, some combine these perspectives, and others look for congruence between various aspects of the organization being studied. Ultimately, the issue comes down to which factors to study.While some models of organizational effectiveness go in and out of fashion; one that has persisted is the McKinsey 7's framework. Developed in the early 1980s by Tom Peters and Robert Waterman, two consultants working at the McKinsey & Company consulting firm, the basic premise of the model is that there are seven internal aspects of an organization that need to be aligned if it is to be successful.The model can be applied to elements of a team or a project as well. The alignment issues apply, regardless of how you decide to define the scope of the areas you study.

The Seven S Elements

The McKinsey 7's model involves seven interdependent factors which are categorized as either "hard" or "soft" elements:

Hard Elements	Soft Elements
Strategy Structure Systems	Shared Values Skills Style Staff



The Hard S's

The hard elements (strategy, structure and system) are easier to define or identify and management can directly influence them. They can be found in strategy statements, corporate plans, organizational charts and other documentations.

- **Strategy**: Actions a company plans in response to or anticipation of changes in itsexternal environment.

- ♣ **Structure**:Basis for specializationand co-ordination influenced primarily by strategy and by organization size and diversity.
- ♣ **Systems**: Formal and informal procedures that support the strategy and structure. (Systems are more powerful thanthey are given credit)

The Soft S's

The four soft s's however, are hardly feasible. They are difficult to describe since capabilities, values and elements of corporate culture are continuously developing and changing. They are highly determined by the people at work in the organization. Therefore, it is much more difficult to plan or to influence the characteristics of the soft elements. Although the soft factors are below the surface, they can have a great impact of the hard structures, strategies and systems of the organization.

Style: Management Style; more a matter of what managers do than what they say; How do a company'smanagers spend their time? What are they focusing attention on? Symbolism –the creation and maintenance (or sometimes deconstruction) of meaning is a fundamental responsibility of managers.

Staff: The people/human resource management – processes used to develop managers, socialization processes, ways of shaping basic values of management cadre, ways of introducing youngrecruits to the company, ways of helping to manage the careers of employees.

Skills:The distinctive competences –what the company does best, ways ofexpanding or shifting competences

Shared Values/Superordinate Goals:Guiding concepts, fundamental ideas around which a business is built –must besimple, usually stated at abstract level, have great meaning inside the organization even though outsiders may not see or understandthem.

How to Use the Model?

Now you know what the model covers, how can you use it?

The model is based on the theory that, for an organization to perform well, these seven elements need to be aligned and mutually reinforcing. So, the model can be used to help identify what needs to be realigned to improve performance, or to maintain alignment (and performance) during other types of change.Whatever the type of change – restructuring, new processes, organizational merger, new systems, change of leadership, and so on – the model can be used to understand how the organizational elements are interrelated, and so ensure that the wider impact of changes made in one area is taken into consideration.

CHAPTER SIX
STRATEGY IMPLEMENTATION

"Notable Quotes"

"Objectives can be compared to a compass bearing by which a ship navigates. A compass bearing is firm, but "in actual navigation, a ship may veer off its course for many miles. Without a compass bearing, a ship would neither find its port nor be able to estimate the time required to get there."—**Peter Drucker**

6.1 Introduction

Strategy implementation is the sum total of the activities and choices required for the execution of a strategic plan. It is the process by which objectives, strategies, and policies are put into action through the development of programs, budgets, and procedures. Strategy formulation and strategy implementation should thus be considered as two sides of the same coin. To begin the implementation process, strategy makers must consider three questions:

- Who are the people who will carry out the strategic plan?
- What must be done?
- How are they going to do what is needed?

Management should have addressed these questions and similar ones initially when they analyzed the pros and cons of strategic alternatives, but the questions must be addressed again before management can make appropriate implementation plans. Unless top management can answer these basic questions satisfactorily, even the best-planned strategy is unlikely to provide the desired outcome.

6.2 The nature of strategy implementation

The strategic management process does not end when the firm decides what strategies to pursue. There must be a translation of strategy thought into strategic action. Translation requires support of all managers and employees of the business. Implementing strategy affects an organization from top to bottom; it affects all the functional and divisional areas of a business. Successful strategy formulation does not guarantee successful strategy implementation. *The greatest strategy is doomed if it is implemented badly.* 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, developing 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.

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 implementation is fundamentally different from strategy formulation. Strategy formulation and implementation can be contrasted in the following ways:

Strategy Formulation	Strategy Implementation
➢ Is positioning forces before the action	➢ Is managing forces during the action.

➢ Focuses on effectiveness.	➢ Focuses on efficiency.
➢ Is primarily an intellectual process.	➢ Is primarily an operational process.
➢ Requires good intuitive and analytical skills.	➢ Requires special motivation and leadership skills.
➢ Requires coordination among a few individuals.	➢ Requires coordination among many individuals.

6.3 Management Issues Central to Strategy Implementation

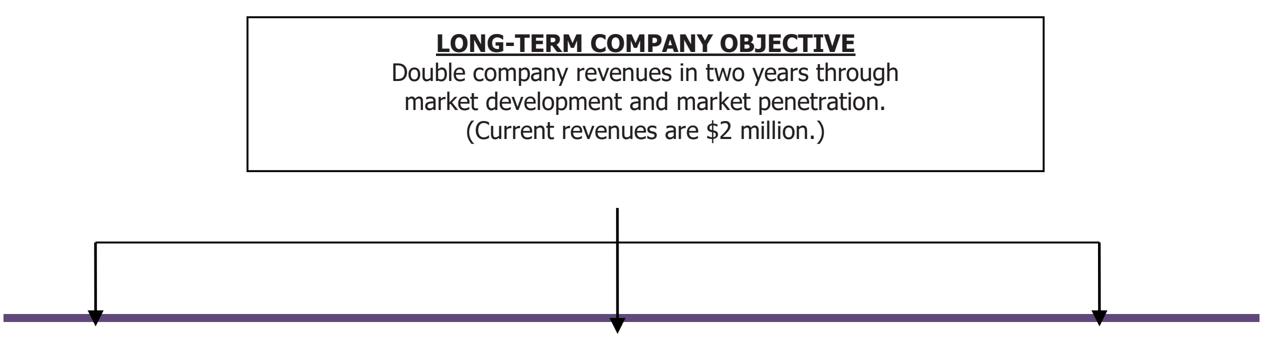
The management issues central to strategy implementation include establishing annual objectives, devising policies, allocating resources, altering an existing organizational structure, restructuring and reengineering, revising reward and incentive plans, minimizing resistance to change, matching managers with strategy, developing a strategy supportive culture, adapting production/operations processes, developing an effective human resources function, and, if necessary, downsizing.

1. Establishing Annual Objectives

Annual objectives are short-term milestones that organizations must achieve to reach long-term objectives. Annual objectives should be stated in terms of functional areas. A set of annual objectives is needed for each long-term objective. 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 priorities. 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 implemented. Annual objectives should be compatible with employees' and managers' values and should be supported by clearly stated policies. Annual objectives should be measurable, consistent, reasonable, challenging, clear, communicated throughout the organization, characterized by an appropriate time dimension, and accompanied by commensurate rewards and sanctions. Annual objectives should be compatible with employees and managers' values and should be supported by clearly stated policies.

The purpose of annual objectives can be summarized as follows:

- Annual objectives serve as guidelines for action, directing and channeling efforts and activities of organization members. They provide a source of legitimacy in an enterprise by justifying activities to stakeholders. They serve as standards of performance.
-



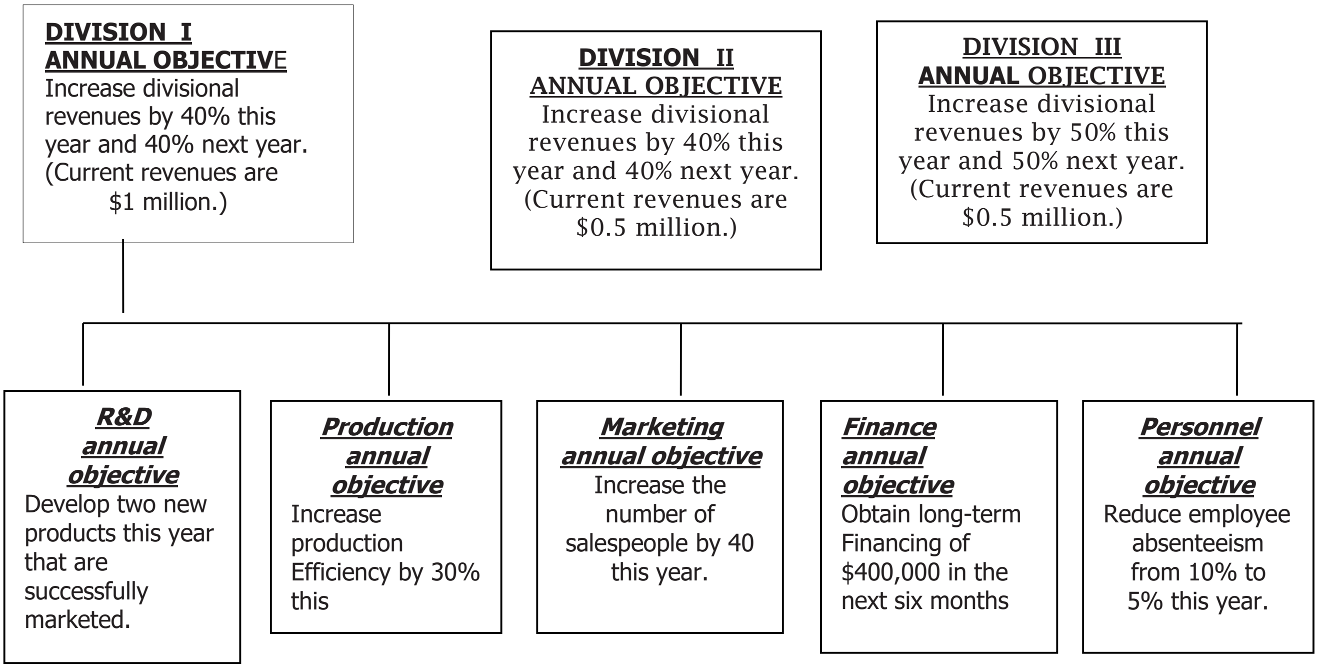


Figure 6.1 hierarchy of objectives

2. Devise Policies

Policies facilitate solving recurring problems and guide the implementation of strategy. Broadly defined, *policy* refers to specific guidelines, 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 administrative 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. 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 organizations have a policy manual that serves to guide and direct behavior.

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 strategies and obtaining objectives. Policies should be stated in writing whenever possible. They represent the means for carrying out strategic decisions.

3. Allocate Resource

Resource allocationis 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 technological 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: overprotection of resources, too great emphasis on short-run financial criteria, organizational politics, vague strategy targets, reluctance to take risks and lack of sufficient knowledge.

4. 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 incompatible, 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 stability, 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.

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:

1. **Avoidance**: includes such actions as ignoring the problem in hopes that the conflict will resolve itself or physically separating the conflicting individuals (or groups).
2. **Defusion**: can include playing down differences between conflicting parties while emphasizing on similarities and common interests, compromising so that there is neither a clear winner nor a loser, resorting to majority rule, appealing to a higher authority, or redesigning present positions.
3. **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.

4. 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 established. 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.
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 important concern is determining what types of structural changes are needed to implement new strategies and how these changes can best be accomplished.

5. Restructuring and Reengineering

Restructuring

Restructuring—also called downsizing, rightsizing, or delayering—involves reducing the size of the firm in terms of number of employees, number of divisions or units, and number of hierarchical levels in the firm's organizational structure. This reduction in size is intended to improve both efficiency and effectiveness. Restructuring is concerned primarily with shareholder well-being rather than employee well-being.
Firms often employ restructuring when various ratios appear out of line with competitors as determined through benchmarking exercises. Recall that benchmarking simply involves comparing a firm against the best firms in the industry on a wide variety of performance related criteria. Some benchmarking ratios commonly used in rationalizing the need for restructuring are headcount-to-sales-volume, or corporate-staff-to-operating-employees,or span-of-control figures. The primary benefit sought from restructuring is cost reduction. For some highly bureaucratic firms, restructuring can actually rescue the firm from global competition and demise. However, the downside of restructuring can be reduced employee commitment, creativity, and innovation that accompanies the uncertainty and trauma associated with pending and actual employee layoffs.

Reengineering

Reengineering—also called process management, process innovation, or process redesign—involves reconfiguring or redesigning work, and processes for the purpose of improving cost, quality, service, and speed. Reengineering is concerned more with employee and customer wellbeing than shareholder well-being. Reengineering does not usually affect the organizational structure or chart, nor does it imply job loss or employee layoffs. Whereas restructuring is concerned with eliminating or establishing, shrinking or enlarging, and moving organizational departments and divisions, the focus of reengineering is changing the way work is actually carried out.
In reengineering, a firm uses information technology to break down functional barriers and create a work system based on business processes, products, or outputs rather than on functions or inputs.

Cornerstones of reengineering are decentralization, reciprocal interdependence, and information sharing. Reengineering is characterized by many tactical (short-term, business-function-specific) decisions, whereas restructuring is characterized by strategic (long-term, affecting all business functions) decisions.

A benefit of reengineering is that it offers employees the opportunity to see more clearly how their particular jobs affect the final product or service being marketed by the firm. However, reengineering can also raise manager and employee anxiety, which, unless calmed, can lead to corporate trauma.

6. Minimize Resistance to Change

Resistance to change is refusal to accept changes that will be implemented in organizations.No organization or individual can escape from change. However, the thought of change raises anxieties because people fear economic loss, inconvenience, uncertainty, and a break in normal social patterns. Almost any change in structure, technology, people, or strategies has the potential to disrupt comfortable interaction patterns. For this reason, people resist change. The strategic-management process itself can impose major changes on individuals and processes. Reorienting an organization to get people to think and act strategically is not an easy task.

Resistance to change can be considered the single greatest threat to successful strategy implementation. Resistance regularly occurs in organizations in the form of sabotaging production machines, absenteeism, filing unfounded grievances, and an unwillingness to cooperate. People often resist strategy implementation because they do not understand what is happening or why changes are taking place. In that case, employees may simply need accurate information. Successful strategy implementation hinges upon managers' ability to develop an organizational climate conducive to change. Change must be viewed as an opportunity rather than as a threat by managers and employees. Because of diverse external and internal forces, change is a fact of life in organizations. The rate, speed, magnitude, and direction of changes vary over time by industry and organization.

Organizational change should be viewed today as a continuous process rather than as a project or event. The most successful organizations today continuously adapt to changes in the competitive environment, which themselves continue to change at an accelerating rate. It is not sufficient today to simply react to change. Managers need to anticipate change and ideally be the creator of change. Viewing change as a continuous process is in stark contrast to an old management doctrine regarding change, which was to unfreeze behavior, change the behavior, and then refreeze the new behavior.

Resistance to change can emerge at any stage or level of the strategy-implementation process. Although there are various approaches for implementing changes, three commonly used strategies are:

1. **Force change strategy:** involves giving orders and enforcing those orders; this strategy has the advantage of being fast, but it is plagued by low commitment and high resistance.
2. **Educative change strategy:**is one that presents information to convince people of the need for change; the disadvantage of an educative change strategy is that implementation becomes slow and difficult. However, this type of strategy evokes greater commitment and less resistance than does the force change strategy.
3. **Rational or self-interest change strategy:** is one that attempts to convince individuals that the change is to their personal advantage. When this appeal is successful, strategy

implementation can be relatively easy. However, implementation changes are seldom to everyone's advantage.The rational change strategy is the most desirable, so this approach is examined a bit further. Managers can improve the likelihood of successfully implementing change by carefully designing change efforts.

7. 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 antagonistic to a proposed strategy should be identified and changed. Changing a firm's culture to fit a new strategy is usually more effective than changing a strategy to fit an existing culture. 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.

The following elements are most useful in linking culture to strategy:

- Formal statements of organizational philosophy, charters, creeds, materials used for recruitment and selection, and socialization
- Designing of physical spaces, facades, buildings
- Deliberate role modeling, teaching, and coaching by leaders
- Explicit reward and status system, promotion criteria
- Stories, legends, myths, and parables about key people and events
- What leaders pay attention to, measure, and control?
- Leader reactions to critical incidents and organizational crises
- How the organization is designed and structured
- Organizational systems and procedures
- Criteria used for recruitment, selection, promotion, leveling off, retirement, and "excommunication" of people

8. Linking performance and pay to strategies

How can an organization's reward system be more closely linked to strategic performance? How can decisions on salary increases, promotions, merit pay, and bonuses be more closely aligned to support the long-term strategic objectives of the organization? There are no widely accepted answers to these questions, but a dual bonus system based on both annual objectives and long-term objectives is becoming common. The percentage of a manager's annual bonus attributable to short-term versus long-term results should vary by hierarchical level in the organization. A chief executive officer's annual bonus could, for example, be determined on a 75 percent shortterm and 25 percent long-term basis. It is important that bonuses not be based solely on short-term results because such a system ignores long-term company strategies and objectives.

9. Adapt Production/Operations processes

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, equipment and resource utilization, shipping and packaging, and technological innovation can have a dramatic impact on the success or failure of strategy-implementation efforts.

10. Develop an Effective Human Resource Function

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. The plan must also include how to motivate employees and managers during a time when layoffs are common and workloads are high. Linking company and personal benefits is a major new strategic responsibility 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 businesses 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 implementation tasks, and (3) inadequate top management support for implementation activities. Strategy implementation poses a threat to many managers and employees in an organization. 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.

Factors causing unsuccessful implementation of strategy

1. **Unsuccessful coupling of the strategy to and actions:** Unsuccessful coupling of strategy with the actions necessary to implement it, both within the organization and in the external decision situations with which it is concerned may cause unsuccessful implementation of strategy. This can be resulted from a number of causes and conditions. For example, the unsatisfactory coupling of the new strategy may be due to lack of explicit decoupling from previous strategy and commitment within the organization itself. The decoupling may be caused by the existence of a sizable group of people in the organization who are convinced that the new strategy is not practical and that the previous ways and activities are best. Another factor for unsatisfactory coupling may be misperceptions by the strategist of the impact of the newly proposed initiatives for the organization and its people. It is sometimes assumed that the new initiative will be accepted by the organization with a minimum time and effort from all those who are involved.
2. **Insufficient attention-** another major factor causing unsuccessful implementation of the strategy is insufficient attention to the negotiation of outcomes in the external decision situation. It is the tendency to assume once the strategy is formulated; that all is necessary to the success of the organization is the aggressive pursuit of the strategy. However, the assumption holds well only as long as there is no change in the decision situation. If these situations change, there should be a corresponding change in the strategy also.

3. **Defective strategy**- Sometimes there may be a strategy, whichcannot be implemented within the context of present and future organizational resources. The strategic choice should always be related with organizational capability to implement it.

CHAPTER SEVEN
STRATEGY EVALUATION AND CONTROL

"Notable Quotes"
"Strategy evaluation must make it as easy as possible for managers to revise their plans and reach quick agreement on the changes."—Dale McConkey

7.1The Nature of Strategy Evaluation

The best formulated and best implemented strategies become obsolete as a firm's external and internal environments change. It is essential, therefore, that strategists systematically review, evaluate, and control the execution of strategies. The strategic-management process results in decisions that can have significant, long-lasting consequences. Erroneous strategic decisions can cause severe penalties and can be exceedingly difficult, if not impossible, to reverse. Most strategists agree, therefore, that strategy evaluation is vital to an organization's well-being; timely evaluations can alert management to problems or potential problems before a situation becomes critical. Strategy evaluation includes three basic activities:

1) Examining the underlying bases of a firm's strategy,
2) Comparing expected results with actual results,
3) Taking corrective actions to ensure that performance conforms to plans.

Adequate and timely feedback is the cornerstone of effective strategy evaluation. Strategy evaluation can be no better than the information on which it is based. Too much pressure from top managers may result in lower managers contriving numbers they think will be satisfactory.Strategy evaluation can be a complex and sensitive undertaking. Too much emphasis on evaluating strategies may be expensive and counterproductive. Strategy evaluation is essential to ensure that stated objectives are being achieved. In many organizations, strategy evaluation is simply an appraisal of how well an organization has performed. **Have the firm's assets increased? Has there been an increase in profitability? Have sales increased? Have productivity levels increased? Have profit margin, return on investment, and earnings-per-share ratios increased?** Some firms argue that their strategy must have been correct if the answers to these types of questions are affirmative. Well, the strategy or strategies may have been correct, but this type of reasoning can be misleading because strategy evaluation must have both a long-run and short-run focus. Strategies often do not affect short-term operating results until it is too late to make needed changes. It is impossible to demonstrate conclusively that a particular strategy is optimal or even to guarantee that it will work. One can, however, evaluate it for critical flaws.

Criteria for Evaluating Strategies

There are four criteria that could be used to evaluate a strategy: consistency, consonance, feasibility, and advantage. *Consonance* and *advantage* are mostly based on a firm's external assessment, whereas *consistency* and *feasibility* are largely based on an internal assessment. Strategy evaluation is important because organizations face dynamic environments in which key external and internal factors often change quickly and dramatically. Success today is no guarantee of success tomorrow! An organization should never be lulled into complacency with success.

Consistency

A strategy should not present inconsistent goals and policies. Organizational conflict and interdepartmental bickering are often symptoms of managerial disorder, but these problems may also be a sign of strategic inconsistency. Three guidelines help determine if organizational problems are due to inconsistencies in strategy:

- ✓ If managerial problems continue despite changes in personnel and if they tend to be issue-based rather than people-based, then strategies may be inconsistent.
- ✓ If success for one organizational department means, or is interpreted to mean, failure for another department, then strategies may be inconsistent.
- ✓ If policy problems and issues continue to be brought to the top for resolution, then strategies may be inconsistent.

Consonance

Consonance refers to the need for strategists to examine *sets of trends*, as well as individual trends, in evaluating strategies. A strategy must represent an adaptive response to the external environment and to the critical changes occurring within it. One difficulty in matching a firm's key internal and external factors in the formulation of strategy is that most trends are the result of interactions among other trends.

For example, the day-care explosion came about as a combined result of many trends that included a rise in the average level of education, increased inflation, and an increase in women in the workforce. Although single economic or demographic trends might appear steady for many years, there are waves of change going on at the interaction level.

Advantage

A strategy must provide for the creation and/or maintenance of a competitive advantage in a selected area of activity. Competitive advantages normally are the result of superiority in one of three areas: **(1) resources, (2) skills, or (3) position.** Positional advantage tends to be self-sustaining as long as the key internal and environmental factors that underlie it remain stable. This is why entrenched firms can be almost impossible to unseat, even if their raw skill levels are only average. Although not all positional advantages are associated with size, it is true that larger organizations tend to operate in markets and use procedures that turn their size into advantage, while smaller firms seek product/market positions that exploit other types of advantage. The principal characteristic of good position is that it permits the firm to obtain advantage from policies that would not similarly benefit rivals without the same position. Therefore, in evaluating strategy, organizations should examine the nature of positional advantages associated with a given strategy.

Feasibility

A strategy must neither overtax available resources nor create unsolvable sub problems. The final broad test of strategy is its feasibility; that is, can the strategy be attempted within the physical, human, and financial resources of the enterprise? The financial resources of a business are the easiest to quantify and are normally the first limitation against which strategy is evaluated. In evaluating a strategy, it is important to examine whether an organization has demonstrated in the past that it possesses the abilities, competencies, skills, and talents needed to carry out a given strategy.

7.2 A strategy evaluation framework

Strategy-evaluation frameworkshows how the evaluation of strategy flows. The framework depicted activates in terms of key questions that should be addressed, alternative answers to those questions, and appropriate actions for an organization to take. Notice that corrective actions are almost always needed except when (1) external and internal factors have not significantly changed and (2) the firm is progressing satisfactorily toward achieving stated objectives. There are three basic activities to be performed in evaluating strategy. These are:

I. Reviewing Bases of Strategy

Reviewing the underlying bases of an organization’s strategy could be approached by developing a revised EFE Matrix and IFE Matrix. A revised IFE Matrix should focus on changes in the organization’s management, marketing, finance/accounting,production/operations, R&D, and management information systems strengths and weaknesses. A revised EFE Matrix should indicate how effective a firm’s strategies have been in response to key opportunities and threats. This analysis could also address such questions as the following.

- ❖ How have competitors reacted to our strategies?
- ❖ How have competitors' strategies changed?
- ❖ Have major competitor's strengths and weaknesses changed?
- ❖ Why are competitors making certain strategic changes?
- ❖ Why are some competitor's strategies more successful than others?
- ❖ How satisfied are our competitors with their present market positions and profitability?
- ❖ How far can our major competitors be pushed before retaliating?
- ❖ How could we more effectively cooperate with our competitors?

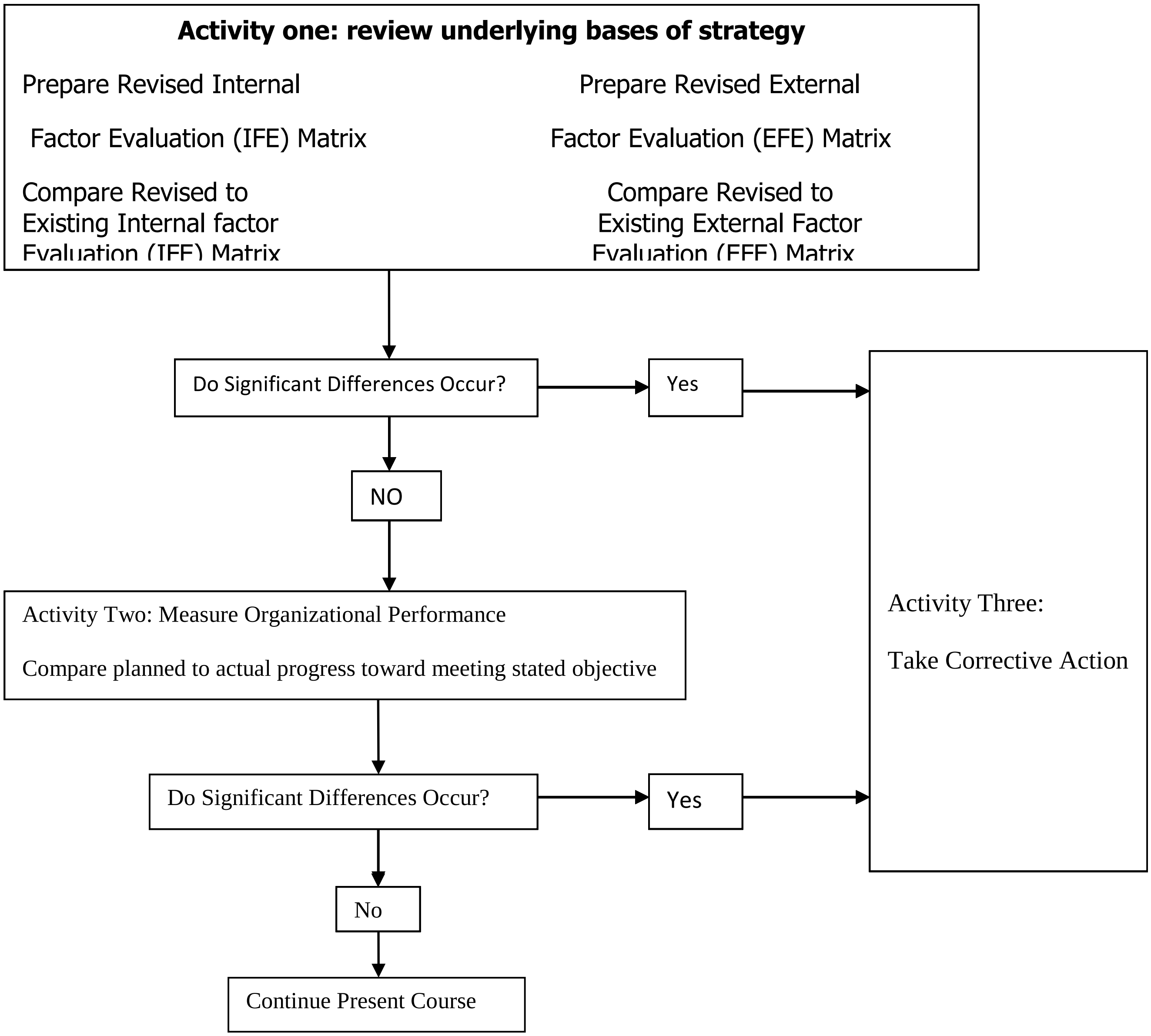
Numerous external and internal factors can prevent firms from achieving long-term and annual objectives. Externally, actions by competitors, changes in demand, changes in technology, economic changes, demographic shifts, and governmental actions may prevent objectives from being accomplished. Internally, ineffective strategies may have been chosen or implementation activities may have been poor. Objectives may have been too optimistic. Thus, failure to achieve objectives may not be the result of unsatisfactory work by managers and employees. All organizational members need to know this to encourage their support for strategy-evaluation activities. Organizations desperately need to know as soon as possible when their strategies are not effective.

External opportunities and threats and internal strengths and weaknesses that represent the bases of current strategies should continually be monitored for change. It is not really a question of whether these factors will change but rather when they will change and in whatways.Here are some key questions to address in evaluating strategies:

- ✓ Are our internal strengths still strengths?
- ✓ Have we added other internal strengths? If so, what are they?
- ✓ Are our internal weaknesses still weaknesses.
- ✓ Do we now have other internal weaknesses? If so, what are they?
- ✓ Are our external opportunities still opportunities?
- ✓ Are there now other external opportunities? If so, what are they?

- ✓ Are our external threats still threats?
- ✓ Are there now other external threats? If so, what are they?
- ✓ Are we vulnerable to a hostile takeover?

Fig 7.1 A Strategy-Evaluation Framework



7.3 Characteristics of An effective evaluation system

Strategy evaluation must meet several basic requirements to be effective. First, strategyevaluation activities must be:

- **Economical**: too much information can be just as bad as too little information; and too many controls can do more harm than good.
- **Meaningful:** They should specifically relate to a firm's objectives.
- **Provide useful information**: They should provide managers with useful information about tasks over which they have control and influence.
- **Provide timely information**: Strategy-evaluation activities should provide timely information; on occasion and in some areas, managers may daily need information. For example, when a firm has diversified by acquiring another firm, evaluative information may be needed frequently. However, in an R&D department, daily or even weekly evaluative

information could be dysfunctional. Approximate information that is timely is generally more desirable s a basis for strategy evaluation than accurate information that does not depict the present. Frequent measurement and rapid reporting may frustrate control rather than give better control. The time dimension of control must coincide with the time span of the event being measured.

- **Provide a true picture of what is happening**: Strategy evaluation should be designed to provide a true picture of what is happening. For example, in a severe economic downturn, productivity and profitability ratios may drop alarmingly; although employees and managers are actually working harder.Strategy evaluations should fairly portray this type of situation. Information derived from the strategy-evaluation process should facilitate action and should be directed to those individuals in the organization who need to take action based on it. Managers commonly ignore evaluative reports that are provided only for informational purposes; not all managers need to receive all reports. Controls need to be action-oriented rather than information-oriented.
- **Should not dominate decisions**: The strategy-evaluation process should not dominate decisions; it should foster mutual understanding, trust, and common sense. No department should fail to cooperate with another in evaluating strategies.
- **Simple**: Strategy evaluations should be simple, not too cumbersome, and not too restrictive. Complex strategy-evaluation systems often confuse people and accomplish little. The test of an effective evaluation system is its usefulness, not its complexity.

7.4. Strategic Control: Control Process

In strategic controlling we will follow certain steps. Hereare the five stage processes of control.

1. **Determine what to measure**: Top managers and operational managers need to specify what implementation processes and results will be monitored and evaluated. The processes and results must be capable of being measured in a reasonably objective and consistent manner. The focus should be on the most significant elements in a process—the ones that account for the highest proportion of expense or the greatest number of problems. Measurements must be found for all important areas, regardless of difficulty.
2. **Establish standards of performance:** Standards used to measure performance are detailed expressions of strategic objectives. They are measures of acceptable performance results. Each standard usually includes a tolerance range, which defines acceptable deviations. Standards can be set not only for final output but also for intermediate stages of production output.
3. **Measure actual performance:** Measurements must be made at predetermined times.
4. **Compare actual performance with the standard:** If actual performance results are within the desired tolerance range, the measurement process stops here.
5. **Take corrective action:** If actual results fall outside the desired tolerance range, action must be taken to correct the deviation. The following questions must be answered:
    - Is the deviation only a chance fluctuation?
    - Are the processes being carried out incorrectly?
    - Are the processes appropriate to the achievement of the desired standard? Action must be taken that will not only correct the deviation but also prevent its happening again.
    - Who is the best person to take corrective action?

Top management is often better at the first two steps of the control model than it is at the last two follow-through steps. It tends to establish a control system and then delegate the implementation to others. This can have unfortunate results. Nucor is unusual in its ability to deal with the entire evaluation and control process.

Types of Control

Control can focus on events before, during, or after a process. For example, a local automobile dealer can focus on activities before, during, or after sales of new cars. Careful inspection of new cars and cautious selection of sales employees are ways to ensure high quality or profitable sales even before those sales take place. Monitoring how salespeople act with customers is a control during the sales task. Counting the number of new cars sold during the month and telephoning buyers about their satisfaction with sales transactions are controls after sales have occurred. These types of controls are formally calledfeed forward, concurrent, and feedback, respectively.

- **Preventive /Preliminary / Input Control** attempt to identify and prevent deviations in the standards before they occur. Preventive controls focus on human, material, and financial resources within the organization. These controls are evident in the selection and hiring of new employees. For example, organizations attempt to improve the likelihood that employees will perform up to standards by identifying the necessary job skills andby using tests and other screening devices to hire people with those skills.
- **Concurrent controls**: monitor ongoing employee activity to ensureconsistency with quality standards. These controls rely on performance standards, rules, and regulations for guiding employee tasks and behaviors. Their purpose is to ensure that work activities produce the desired results. As an example, many manufacturing operations include devices that measure whether the items being produced meet quality standards. Employees monitor the measurements; if they see that standards are not being met in some area, they make a correction themselves or let a manager know that a problem is occurring.
- **Feedback controls:** involve reviewing information to determinewhether performance meets established standards. For example, suppose that an organization establishes a goal of increasing its profit by 12 percent next year. To ensure that this goal is reached, the organization must monitor its profit on a monthly basis. After three months, if profit has increased by 3 percent, management might assume that plans are going according to schedule.

Control Techniques

Control techniques provide managers with the type and amount of information they need to measure and monitor performance. The information from various controls must be tailoredto a specific management level, department, unit, or operation.

To ensure complete and consistent information, organizations often use standardized documents such as financial, status, and project reports. Each area within an organization, however, uses its own specific control techniques:

- ✓ Financial controls
- ✓ Budget controls
- ✓ Marketing controls
- ✓ Human resource controls
- ✓ Computers and information controls