

**WOLLO UNIVERSITY**  
**COLLEGE OF BUSINESS AND ECONOMICS**  
**DEPARTMENT OF MANAGEMENT**

**Course Name: Strategic Management**

**course code: MGMT3201**

**Credit hours: Three**

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**2020**

## CHAPTER ONE: OVERVIEW OF STRATEGIC MANAGEMENT

### Chapter Objectives

Up on completion of this unit, the learner is expected to:

- *Defining strategic management*
- *Identify the Stages of strategic management*
- *Describe the Key terms in strategic management*
- *Explain the strategic management model*
- *Describe the Benefits of strategic management*
- *Discus the relation between Business ethics and strategic management*

### 1.1. Defining strategic management

The Word ‘strategy’ is derived from the Greek term *strategos*, meaning a carefully formulated military style plan of campaign.

Strategy-a firm's strategy is defined as its theory about how to gain competitive advantages

A strategy can be thought of in either of two ways: (1) **as a pattern that emerges in a sequence of decisions over time**, or (2) as an organizational plan of action that is intended to move a company toward the achievement of its shorter - term goals and, ultimately, its fundamental purposes

In most (large) corporations there are several levels of management. Strategic management is the highest of these levels in the sense that it is the broadest - applying to all parts of the firm - while also incorporating the **longest time horizon**. It gives **direction to corporate values, corporate culture, corporate goals, and corporate missions**.

Strategic Management can be defined as “the art and science of formulating, implementing and evaluating cross-functional decisions that enable an organization to achieve its objective.” Strategic Management is “The on-going process of formulating, implementing and controlling broad plans guide the organizational in achieving the strategic goods given its internal and external environment”.

**Interpretation:**

1. *On-going process*: Strategic management is on-going process which is in existence throughout the life of organization.
2. *Shaping broad plans*: First, it is an on-going process in which broad plans are firstly formulated than implementing and finally controlled.
3. *Strategic goals*: Strategic goals are those which are set by top management. The broad plans are made in achieving the goals.
4. *Internal and external environment*: Internal and external environment generally set the goals. Simply external environment forced internal environment to set the goals and guide them that how to achieve the goals?

Strategic management is a field that deals with the major intended and emergent initiatives taken by general managers on behalf of owners, involving utilization of resources, to enhance the performance of firms in their external environments.

It entails specifying the organization's mission, vision and objectives, developing policies and plans, often in terms of projects and programs, which are designed to achieve these objectives, and then allocating resources to implement the policies and plans, projects and programs

**Strategic management** is a 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 or long-range 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.

? Dear learners, would you discuss on the above definitions and define Strategic management in your words?

## 1.2. Stages of strategic management

The strategic management process consists of three stages:

- ✓ Strategy Formulation (strategy planning)
- ✓ Strategy Implementations
- ✓ Strategy Evaluation

### Strategic Formulation:

It is the development of long-range plans for the effective management of environmental opportunities and threats, in light of corporate strengths and weaknesses (SWOT). It includes defining the corporate mission, specifying achievable objectives, developing strategies, and setting policy guidelines.

Strategic formulation means a strategy formulate to execute the business activities. Strategy formulation includes developing:-

- **Vision and Mission** (The target of the business)
- **Strength and weakness** (Strong points of business and also weaknesses)
- **Opportunities and threats** (These are related with external environment for the business)

Strategy formulation is also concerned with setting **long term goals and objectives**, generating alternative strategies to achieve that long term goals and choosing particular strategy to pursue.

The considerations for the best strategy formulation should be as follows:

- Allocation of resources
- Business to enter or retain
- Business to divest or liquidate
- Joint ventures or mergers
- Whether to expand or not
- Moving into foreign markets

### **Strategy Implementation**

It is a process by which strategies and policies are put into action through the development of programs, budgets, and procedures. 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, motivating employees and allocate resources so that formulated strategies can be executed. Strategy implementation includes developing strategy supportive culture, creating an effective organizational structure, redirecting marketing efforts, preparing budgets, developing and utilizing information system and linking employee compensation to organizational performance.

Strategy implementation is often called the action stage of strategic management. Implementing means mobilizing employees and managers in order to put formulated strategies into action. It is often considered to be most difficult stage of strategic management. It requires personal discipline, commitment and sacrifice.

Strategy formulation results in a plan of action for the company and its various levels, whereas strategy implementation represents a pattern of decisions and actions that are intended to carry out the plan. Strategy implementation involves managing stakeholder relationships and organizational resources in a manner that moves the business toward the successful execution of its strategies, consistent with its strategic direction.

### **Strategy evaluation:**

It is a 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. Although evaluation and control is the final major element of strategic management, it can also pinpoint weaknesses in previously implemented strategic plans and thus stimulate the entire process to begin again.

? Dear learner, can you mention and explain the stages of strategic management process?

### 1.3. Key terms in strategic management

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

#### ***Competitive Advantage***

The term can be defined as anything that a firm does especially well compared to rival firms. When a firm can do something that rival firms cannot do, or owns something that rival firms desire, that can represent a competitive advantage.

#### **Strategists**

*Strategists* are individuals who are most responsible for the success or failure of an organization. *Strategists* are individuals who form strategies. Strategists have various job titles, such as chief executive officer, president, and owner, chair of the board, executive director, chancellor, dean, or entrepreneur.

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, responsibility for profit and loss outcomes, or direct authority over a major piece of the business is a strategic manager (strategist).

**Vision Statements**

Many organizations today develop a "vision statement" which answers the question, what do we want to become? Developing a vision statement is often considered the first step in strategic planning, preceding even development of a mission statement. Many vision statements are a single sentence.

**Mission Statements**

*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 terms. It addresses the basic question that faces all strategists: What is our business? A clear mission statement describes the values and priorities of an organization. Developing a mission statement compels strategists to think about the nature and scope of present operations and to assess the potential attractiveness of future markets and activities. A mission statement broadly charts the future direction of an organization.

**External Opportunities and Threats**

*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 term *external*. The computer revolution, biotechnology, 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.

A basic tenet of strategic management is that firms need to formulate strategies to take advantage of external opportunities and to avoid or reduce the impact of external threats. For this reason, identifying, monitoring, and evaluating external opportunities and threats are essential for success.

**Internal Strengths and Weaknesses/Internal assessments**

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*"The prime task is to think through the overall mission of a business". (Peter Drucker)*

*Internal strengths* and *internal weaknesses* are an organization's controllable activities that are performed especially well or poorly. They arise in the management, marketing, finance/accounting, production/operations, research and development, and computer 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 improve on internal weaknesses.

Strengths and weaknesses are determined relative to competitors. *Relative* deficiency or superiority is important information and also Strengths and weaknesses may be determined relative to a firm's own objectives. For example, high levels of inventory turnover may not be strength to a firm that seeks never to stock-out.

### **Long-Term Objectives**

*Objectives* can be defined as specific results that an organization seeks to achieve in pursuing its basic mission. *Long-term objectives* represent the results expected from pursuing certain strategies. Strategies represent the actions to be taken to accomplish long-term objectives. The time frame for objectives and strategies should be consistent, usually from two to five years.

Objectives are essential for organizational success because they state direction; aid in 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.

### **Strategies**

*Strategies* are the means by which long-term objectives will be achieved. 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.

### **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 information systems 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.

### **Policies**

*Policies* are the means by which annual objectives will be achieved. Policies include guidelines, rules, and procedures established to support efforts to achieve stated objectives. Policies are guides to decision making and address repetitive or recurring situations.

A **policy** is a broad guideline for decision making that links the formulation of strategy with its implementation.

Companies use policies to make sure that the employees throughout the firm make decisions and take actions that support the corporation's mission, its objectives and its strategies. Policy **implies a decision** as to *what shall be done and how, when and where*.

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.

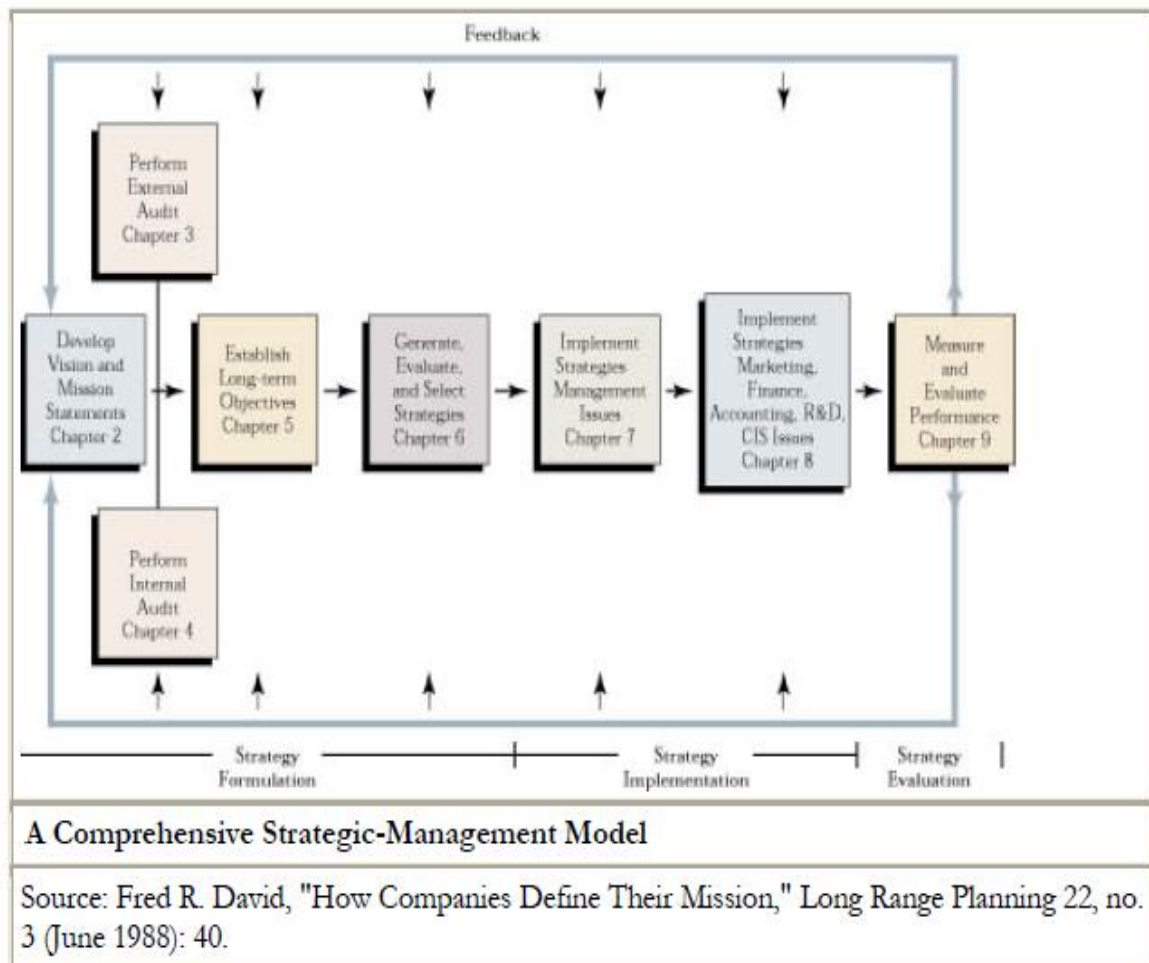
Policies, like annual objectives, are especially important in strategy implementation because they outline an organization's expectations of its employees and managers.

? Dear learner, can you mention some of the Key terms in strategic management?

### **1.4. The Strategic-Management Model**

The strategic-management process best can be studied and applied using a model. Every model represents some kind of process. The framework illustrated in the below Figure is a widely accepted, comprehensive model of the strategic-management process. This model does not guarantee success, but it does represent a clear and practical approach for formulating,

implementing, and evaluating strategies. Relationships among major components of the strategic-management process are shown in the model.



Identifying an organization's existing vision, mission, objectives, and strategies is the logical starting point for strategic management because a firm's present situation and condition may preclude certain strategies and may even dictate a particular course of action. Every organization has a vision, mission, objectives, and strategy, even if these elements are not consciously designed, written, or communicated. The answer to where an organization is going can be determined largely by where the organization has been.

The strategic-management process is dynamic and continuous. A change in any one of the major components in the model can necessitate a change in any or all of the other components. For instance, a shift in the economy could represent a major opportunity and require a change in

long-term objectives and strategies; a failure to accomplish annual objectives could require a change in policy; or a major competitor's change in strategy could require a change in the firm's mission. Therefore, strategy formulation, implementation, and evaluation activities should be performed on a continual basis, not just at the end of the year or semi-annually. The strategic-management process never really ends.

? Dear learner, do you think that the above the Strategic-Management Model guarantee for success? Support your response with evidence.

### 1.5 Benefits of strategic management

**Greenly stated** that strategic management offers the following benefits:

- It allows for identification, prioritization, and exploitation of opportunities.
- It provides an objective view of management problems.
- It represents a framework for improved coordination and control of activities.
- It minimizes the effects of adverse conditions and changes.
- It allows major decisions to better support established objectives.
- It allows more effective allocation of time and resources to identified opportunities.
- It allows fewer resources and less time to be devoted to correcting erroneous or ad hoc decisions.
- It creates a framework for internal communication among personnel.
- It helps integrate the behavior of individuals into a total effort.
- It provides a basis for clarifying individual responsibilities.
- It encourages forward thinking.
- It provides a cooperative, integrated, and enthusiastic approach to tackling problems and opportunities.
- It encourages a favorable attitude toward change.

? Dear learner, can you list the Benefits of strategic management?

### 1.6 Business ethics and strategic management

The term **ethics** refers to accepted principles of right or wrong that govern the conduct of a person, the behavior of members of a profession, or the actions of an organization.

**Business ethics** are the accepted principles of right or wrong governing the conduct of businesspeople and also it can be defined as principles of conduct within organizations that guide decision making and behavior. Ethical decisions are those that are in accordance with accepted principles of right and wrong, whereas an unethical decision is one that violates accepted principles. Good business ethics is a prerequisite for good strategic management; good ethics is just good business.

Strategists are the individuals primarily responsible for ensuring that high ethical principles are espoused and practiced in an organization. All strategy formulation, implementation, and evaluation decisions have ethical ramifications.

A new wave of ethics issues related to product safety, employee health, sexual harassment, AIDS in the workplace, smoking, acid rain, affirmative action, waste disposal, foreign business practices, cover-ups, takeover tactics, conflicts of interest, employee privacy, inappropriate gifts, security of company records, and layoffs has accentuated 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.

Merely having a code of ethics, however, is not sufficient to ensure ethical business behavior. A code of ethics can be viewed as a public relations gimmick, a set of platitudes, or window dressing. 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 ethics 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.

? Dear learner, take the case of Human resource unit at Wollo university. Identify and define the **A code of business ethics**



### Activity

1. Why do we need to lay so much stress on strategic management?

## CHAPTER TWO: THE BUSINESS MISSION, VISION AND VALUES

### Chapter Objectives

At the end of this unit, students will be able to:

- Define the concept of vision, mission and values of a business
- Able to develop vision and mission statements;
- Describe the importance of mission, vision and values
- Explain the nature of business mission
- Illustrate components of mission statement
- Describe strategic issues
- Able to set goals and objectives

### 2.1. INTRODUCTION

It expresses the essential characteristics of the organization, the reasons for its existence, the nature of its business, the groups who are served by the company (its corporate responsibilities), and the principles/values under which it operates. It becomes the definition of the company, the declaration of its corporate identity. It is the reference for defining the scope of the company's business (its product-market strategy - its strategic business units - or its basic strategy).

An organization's **mission** is the purpose or reason for the organization's existence. It tells what the company is providing to society—either a service such as housecleaning or a product such as automobiles. A well-conceived mission statement defines the fundamental, unique purpose that sets a company apart from other firms of its type and identifies the scope or domain of the company's operations in terms of products (including services) offered and markets served.

- A mission statement focuses on current business activities --“who we are and what we do”

- Current product and service offerings
- Customer needs being served
- Technological and business capabilities

**Mission statement:** ANSWER FOR:

- What do we believe in?
- What are our values?
- How do we do it?
- For whom do we do this?
- For what purpose do we do this?
- To what do we dedicate ourselves?
- What are we?

Mission Statements are essential for effectively establishing objectives and formulating strategies

- An enduring statement of purpose
- Distinguishes one firm from another in the same business
- A declaration of a firm's reason for existence

*Mission Statements are also known as:*

- Creed statement
- Statement of purpose
- Statement of philosophy
- Statement of business principles

Mission statement Example 1:

- 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. And in everything we do, we strive to act with honesty, openness, fairness and integrity.

Mission statement Example 2:

- Dell's mission is to be the most successful computer company in the world at delivering the best customer experience in markets we serve. In doing so, Dell will meet consumer

expectations of highest quality; leading technology; competitive pricing; individual and company accountability; best-in-class service and support; flexible customization capability; superior corporate citizenship; financial stability.

### **Vision:**

Vision is a picture of the future cast in the present, it can only be created when your business connects the dots between the environments in which:

- 1) It presently operates,
- 2) Scenarios of possible future environments, and
- 3) Its *desired* future environment based on its values and core competencies.

VISION STATEMENT should answer:

“What do we want to become?”

- How will we do it?
- For whom will we do this?
- What makes us different?
- What do we wish to become in the future?
- What and how do we want to be?

A **vision statement** is sometimes called a picture of your company in the future but it's so much more than that. Your vision statement is your inspiration, the framework for all your strategic planning. It is critically essential that management and executive agree on the basic vision, which the organization endeavors to accomplish over a period of time

A lucid and clear vision lays down a foundation on which a sound mission statement can be built. 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 doesn't tell you how you're going to get there, it does set the direction for your business planning. That's why it's important when crafting a vision statement to let your



imagination go and dare to dream – and why it’s important that a vision statement captures your passion.

Unlike the mission statement, a vision statement is for you and the other members of your company, not for your customers or clients.

### **Vision Statement Examples 1:**

General Motors’ vision is to be the world leader in transportation products and related services. Tyson Foods’ vision is to be the world’s first choice for protein solutions while maximizing shareholder value.

### **Vision Statement Examples 2:**

PepsiCo’s responsibility is to continually improve all aspects of the world in which we operate – environment, social, economic – creating a better tomorrow than today.

### **Example of Wollo University’s mission statement:**

**Wollo** University’s mission is to produce competent entrepreneurial graduates, provide need based community services and demand driven/problem solving research outputs through relevant and quality education, research, training and consultancy service to foster socio-economic development in the country.

### **Example of Wollo University’s vision statement**

**Wollo** University aspires to be one of the top five societal problem solving universities in the country by 2020.

? Dear learners, would you discuss the concepts of vision in your words?

## **2.2. The importance of a clear mission**

- ➡ Unanimity of purpose within the organization
- ➡ Basis for allocating resources

- ➡ Better financial results
- ➡ Establish organizational climate
- ➡ Focal point for direction
- ➡ Translate objectives into work structure
- ➡ Cost, time and performance parameters assessed and controlled
- ➡ Basis of assessment and control

? Dear learners, would you discuss the importance of a clear mission?

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### 2.3. Characteristics of good Mission Statements

*Effective mission statements should be:*

- ➡ Broad in scope
- ➡ Generate range of feasible strategic alternatives
- ➡ Not excessively specific
- ➡ Reconcile interests among diverse stakeholders
- ➡ Finely balanced between specificity & generality
- ➡ Arouse positive feelings and emotions
- ➡ Motivate readers to action
- ➡ Generate the impression that firm is successful, has direction, and is worthy of time, support, and investment
- ➡ Reflect judgments : future growth
- ➡ Provide criteria for selecting strategies
- ➡ Basis for generating & screening strategic options
- ➡ Are dynamic in orientation

? Dear learners, would you list the Characteristics of good Mission Statements?

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## 2.4. 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 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 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?

? Dear learners, would you list the Components of a mission statement?

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## 2.5. Business Values

Company values, also known as corporate values or core values, are the fundamental beliefs upon which your business and its behavior are based. They are the guiding principles that your business uses to manage its internal affairs as well as its relationship with customers. It is also defined as the core principles or standards that guide the way you do business.

### **Business values can be:**

The principles you stand for personally - for example, integrity, perseverance, determination, innovation, respect, passion and fair-mindedness. The beliefs and attitudes you and your staff have in common in the workplace - how people should behave, the way managers should act, how work should be done, how staff should treat each other at work.

Your organization's standards of behavior - what is acceptable business practice? From a customer viewpoint, values are the kind of service they can expect to get when they deal with your business.

## 2.6. Components of Business Value

**Shareholder Value:** For a publicly traded company, shareholder value is the part of its capitalization that is equity as opposed to long-term debt. In the case of only one type of stock, this would roughly be the number of outstanding shares times current share price. Things like dividends augment shareholder value while issuing of shares (stock options) lower it. This shareholder value added should be compared to average/required increase in value, also known as cost of capital.

**Customer Value:** Customer value is the value received by the end-customer of a product or service. End-customer can include a single individual (consumer) or an organization with various individuals playing different roles in the buying/consumption processes. Customer value is conceived variously as utility, quality, benefits, and customer satisfaction.

**Employee knowledge:** This is often an undervalued asset in companies and also the area where there is the most discord in reporting. Employees are the most valuable asset companies possess and the one we expect the most from, but often the one that receives the short end of the stick when it comes to values applied to them.

**Channel Partner Value:** The value a business underpins on partner relationships in the business. Partner value here stresses that it can be critical to a firm's functioning. It ceases to exist or carry out business activities if partner value is diminished or lost.

**Managerial Value:** Follow the people-oriented principle; Follow the principle of system value; Follow the liability principle of value;

**Societal Value:** The social environment also wants that the firm follows or adopts several values towards the society. These social values relate to the provision of hospitals, charity, schools, parks, wildlife protection etc.

? Dear learners, would you list and explain the components of business value?

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## 2.7. Setting Goals and Objectives

Once you have developed your vision, mission and core values, you can then develop the goals and objectives needed to achieve your vision.

**Goals -** Goals are general statements of what you want to achieve. So they need to be integrated with your vision. They also need to be integrated with your mission of how you are going to achieve your vision. Examples of company goals are:

- ✓ To improve profitability
- ✓ To increase efficiency
- ✓ To capture a bigger market share
- ✓ To provide better customer service
- ✓ To improve employee training
- ✓ To reduce carbon emissions

A goal should meet the following criteria:

Suitable: Does it fit with the vision and mission?

Acceptable: Does it fit with the values of the company and the employees? •

Understandable: Is it stated simply and easy to understand?

Flexible: Can it be adapted and changed as needed?

Make sure the goals are focused on the important properties of the business. Be careful not to set too many goals. You run the risk of losing focus. Also, design your goals so that they don't contradict and interfere with each other.

Objectives - Objectives are specific, quantifiable, time-sensitive statements of what is going to be achieved and when it will be achieved. They are milestones along the path of achieving your goals. Examples of company objectives are:

- To earn at least a 20 percent after-tax rate of return on our net investment during the next fiscal year
- To increase market share by 10 percent over the next three years.
- To lower operating costs by 15 percent over the next two years by improving the efficiency of the manufacturing process.
- To reduce the call-back time of customers inquiries and questions to no more than four hours.



### Activity

1. Outline the core elements of a mission statement?
2. What is the difference between goals and objectives?
3. Take a look at the website of your college or university. What is the organization's vision and mission? Were they easy or hard to find?

## CHAPTER THREE: EXTERNAL ENVIRONMENTAL ANALYSIS

*“It is not the strongest species that survive, nor the most intelligent, but the one most responsive to change” Charles Darwin*

### Chapter Objectives

At the end of this chapter students will be able to:

- Understand the nature of external audit.
- Explain sources of external information.
- Describe forecasting tools and techniques.
- Distinguish the differences between the Porter’s five forces model

### INTRODUCTION

The environment of an organization consists of the conditions, circumstances, and influences that affect the firm's ability to achieve its objectives. Every organization exists in an environment that has both external and internal components. Organizations are affected by conditions originated from the external environment and/or internal environment. The environment that exists outside the organization, the external environment (also called as general or remote environment).

The external analysis is the first stage of the auditing process. It creates the information and analysis necessary for an organization to begin to identify the key issues it will need to address in order to develop a successful strategy. The chapter explores the process of PEST analysis, industry analysis, competitor analysis and market analysis.

External environment impact on the organization accounted as opportunities or threats to the organization. Opportunities arise when an organization can take advantage of conditions in its external environment to formulate and implement strategies that enable it to improve

performance Whereas, threats arise when conditions in the external environment endanger the integrity of the organization's activities.

An analysis of the external environment is undertaken in order to discover the opportunities and threats that are evolving and that need to be addressed by the organization.

Opportunities and 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. Therefore, a basic tenet of strategic management is that firms need to formulate strategies to take advantage of external opportunities and to avoid or reduce the impact of external threats.

? Dear learner, can you define the concepts of external environments in your own word?

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### 3.1. *The nature of external audit*

An *external audit* focuses on identifying and evaluating trends and events beyond the control of a single firm, such as increased foreign competition, population shifts to the Sunbelt, an aging society, information technology, and the computer revolution. An external audit reveals key opportunities and threats confronting an organization so that managers can formulate strategies to take advantage of the opportunities and avoid or reduce the impact of threats.

The purpose of an external audit is to develop a finite list of opportunities that could benefit a firm and threats that should be avoided. 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

An analysis of the external environment can be broken down into three key steps each becoming more specific to the organization. The first step is an analysis of the macro-environmental



influences that the organisation faces. This is followed by an examination of the competitive (micro) environment the organisation operates within. Finally a specific competitive analysis is undertaken.

The typical process of external environment analysis includes four activities:

- i. Scanning - identifying early signals of external environment changes and trends
- ii. Monitoring - detecting meaning through ongoing observations of external environmental changes and trends.
- iii. Forecasting - developing projections of anticipated outcomes based on monitored changes and trends
- iv. Assessing - determining the importance of macro environmental changes and trends for the organization's strategic plans.

### ***Key External Forces***

*External forces can be divided into five broad categories:*

- 1. Economic forces;*
- 2. Social, cultural, demographic, and environmental forces;*
- 3. Political, governmental, and legal forces;*
- 4. Technological forces; and*
- 5. Competitive forces.*

#### **1. Economic Forces**

Economic factors have a direct impact on the potential attractiveness of various strategies. For example, as interest rates rise, then funds needed for capital expansion become more costly or unavailable. Also, as interest rates rise, discretionary income declines, and the demand for discretionary goods falls. As stock prices increase, the desirability of equity as a source of capital for market development increases. Also, as the market rises, consumer and business wealth expands. Price fluctuation refers to general price fluctuation. They affect the economic factors and affect the customers buying behaviors. The customers are more conscious about the

economic changes and responds according to the changes in key variable factors. So, any change in the price affects the customer buying trend directly.

Monetary policies and Fiscal policies are changed every year. The person or businesses engaged in business for profit making or nonprofit organizations always have to keep an eye on the economic structure of the countries.

As far as the tax rates are concerned, government also changes the tax rate with the passage of time. So it affects the economic forces.

*It is important to monitor key economic factors such as:*

- ➡ Foreign countries' economic conditions
- ➡ Import/export factors
- ➡ Demand shifts for goods/services
- ➡ Income differences by region/customer
- ➡ Price fluctuations
- ➡ Exportation of labor & capital
- ➡ Monetary policies
- ➡ Fiscal policies
- ➡ Tax rates etc.

## **2. Social, Cultural, Demographic, and Environmental Forces**

Social, cultural, demographic, and environmental changes have a major impact upon virtually all products (Preferences change), services, markets, and customers. Small, large, for-profit, and nonprofit organizations in all industries are being staggered and challenged by the opportunities and threats arising from changes in social, cultural, demographic, and environmental variables. We may use the following analysis in understanding the Social, Cultural, Demographic, and Environmental Forces:

- ➡ Population growing older
- ➡ Increase in younger population
- ➡ Ethnic balance changing

- ➡ Gap between rich and poor widening

*Ethnic balance changes* due to the migration of the people from different areas to different areas. This affects the ethical behavior very much. As the traditions and norms are very much different in different areas, therefore the behavior of the migrated people also have a major affect on the behavior of the resident people. Due to the *increased gap between rich and the poor*, there is a tremendous change in the social behavior of the people.

### 3. Competitive Forces

“Collection and evaluation of information on competitors is essential for successful strategy formulation” Competition in virtually all industries can be described as intense.

- ➡ Identifying rival firms: Strengths, Weaknesses, Capabilities, Opportunities, Threats, Objectives and Strategies

Key Questions about Competitors:

- ➡ Their strengths
- ➡ Their weaknesses
- ➡ Their objectives and strategies
- ➡ Their responses to all external variables (e.g. social, political, demographic, etc.)
- ➡ Their vulnerability to our alternative strategies
- ➡ Our vulnerability to successful strategic counterattack Our product and service positioning relative to competitors

Entry and exit of firms in the industry

- ✓ Key factors for our current position in industry
- ✓ Sales and profit rankings of competitors over time
- ✓ Nature of supplier and distributor relationships
- ✓ The threat of substitute products or services

### Competitive Intelligence Programs

*Systematic and ethical process for gathering and analyzing information about the competition's activities and general business trends to further a business' own goals.*

Every organization must have an intelligence programmed. It should be ethical and systematic for gathering and analyzing the information about competitor activities and activities involve in general business

#### **4. Political, Governmental, and Legal Forces**

Change in government regulations which create opportunities and threats. For example, antitrust legislation where there is an effort to ban the monopolies. Some organizations think that monopolies should be banned. Similarly, tax rates and lobbying efforts for special, lobbying entries are those efforts which are made in order to pass special resolution laws of their own choice. Patents law and intellectual are also relates to the same stories.

Federal, state, local, and foreign governments are major regulators, deregulators, subsidizers, employers, and customers of organizations. Political, governmental, and legal factors, therefore, can represent key opportunities or threats for both small and large organizations. For industries and firms that depend heavily on government contracts or subsidies, political forecasts can be the most important part of an external audit. Changes in patent laws, antitrust legislation, tax rates, and lobbying activities can affect firms significantly.

*Impact of political variables on government regulations:*

- ➡ Government regulation/deregulation
- ➡ Tax law changes
- ➡ Special tariffs
- ➡ Political Action Committees (PACs)
- ➡ Voter participation rates
- ➡ Number of patents
- ➡ Changes in patent laws

#### **5. Technological forces**

Technological forces represent major opportunities and threats that must be considered in formulating strategies. Technological advancements dramatically can affect organizations' products, services, markets, suppliers, distributors, competitors, customers, manufacturing processes, marketing practices, and competitive position. Technological advancements can create

new markets, result in a proliferation of new and improved products, change the relative competitive cost positions in an industry, and render existing products and services obsolete. Technological changes can reduce or eliminate cost barriers between businesses, create shorter production runs, create shortages in technical skills, and result in changing values and expectations of employees, managers, and customers. Technological advancements can create new *competitive advantages* that are more powerful than existing advantages. No company or industry today is insulated against emerging technological developments. In high-tech industries identification and evaluation of key technological opportunities and threats can be the most important part of the external strategic management audit.

Organizations that traditionally have limited technology expenditures to what they can fund after meeting marketing and financial requirements urgently need a reversal in thinking. The pace of technological change is increasing and literally wiping out businesses every day. An emerging consensus holds that technology management is one of the key responsibilities of strategists. Firms should pursue strategies that take advantage of technological opportunities to achieve sustainable, competitive advantages in the marketplace.

? Dear learner, can you give some of the examples of each external environment forces?

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### 3.2. 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, and speech at professionals and shareholders' meetings, Television programs, interviews, and conversations and stakeholders. Published sources of strategic information include periodicals, journals, reports, government documents, abstracts, books, directories, newspapers and manual. The 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.

? Dear learner, can you give some of the examples of sources of external information?

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### 3.3. 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, social values, unstable economic conditions, and unforeseen events. Managers often must rely upon published forecasts to identify key external opportunities and threats effectively.

Forecasting tools can be broadly categorized in to two groups: Quantitative techniques and qualitative techniques. 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.

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. Forecasts are vital to the strategic-management process and to the success of organizations.

? Dear learner, can you explain the two groups forecasting tools?

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### 3.4. Competitive analysis: Porter's five forces model (Industry analysis)

Economists define an industry as a group of firms that supplies a market. Thus, industry analysis looks from the supply side while market analysis looks from the demand side.

Industry analysis is a process of reviewing the profitability of an industry at the moment and in the future to explain why one industry is very profitable and why another industry has much lower profit, which in turn helps to position a business in the most advantageous way.

An organization has to understand the nature of the relationship within its industry, in order to allow the enterprise to develop strategies to gain advantage of the current relationships.

A useful framework, that can be utilized when undertaking this analysis, is Porter's 'five forces' model of establishing industry attractiveness for a business. Porter's Five Forces Framework is a method for analyzing competition of a business. It draws from industrial organization (IO) economics to derive five forces that determine the competitive intensity and, therefore, the attractiveness (or lack of it) of an industry in terms of its profitability.

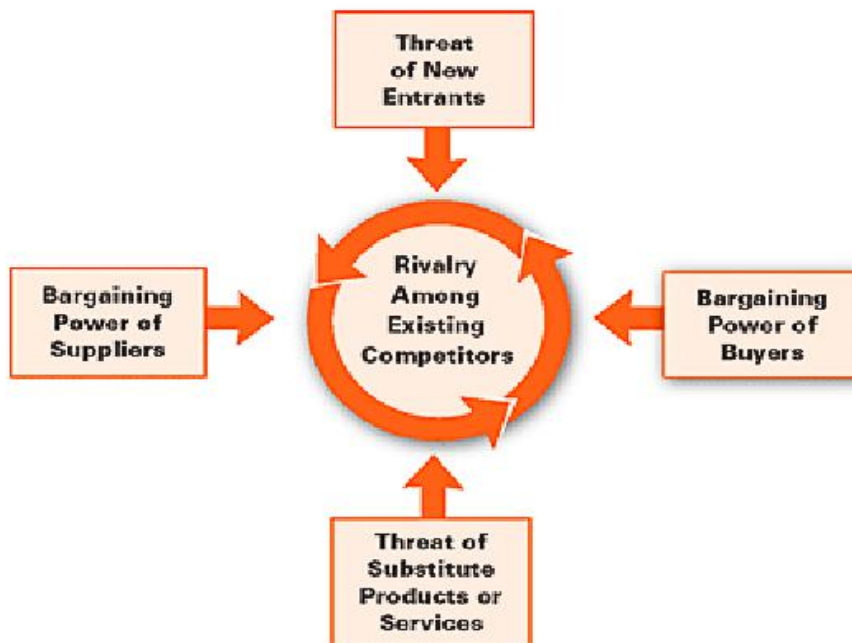
Porter refers to these forces as the microenvironment, to contrast it with the more general term macro environment. They consist of those forces close to a company that affect its ability to serve its customers and make a profit.

Industry analysis helps to answer the following questions of business strategy:

- Is this industry a source of superior profits?" - for potential investors
- How can we make sure that we perform better than our competitors?" -for actual investors

To determine the intensity of competition and the level of profitability in an industry Porter's five forces of competition framework applied; the five forces of competition are:

- The threat of the entry of new competitors
- The threat of substitute products or services
- The intensity of competitive rivalry
- The bargaining power of suppliers and
- The bargaining power of customers (buyers).
- The threat of the entry of new competitors (figure )



### A. The threat of the entry of new competitors

Profitable industries that yield high returns will attract new entities. New entrants eventually will decrease profitability for other firms in the industry. Unless the entry of new firms can be made more difficult by incumbents, abnormal profitability will fall towards zero (perfect competition), which is the minimum level of profitability required to keep an industry in business.

The following factors can have an effect on how much of a threat new entrants may pose:

- ✓ The existence of barriers to entry (patents, rights, etc.). The most attractive segment is one in which entry barriers are high and exit barriers are low. It's worth noting, however, that high barriers to entry almost always make exit more difficult.
- ✓ Government policy such as sanctioned monopolies, legal franchise requirements, or regulatory requirements.



- ✓ Capital requirements - clearly the Internet has influenced this factor dramatically. Web sites and apps can be launched cheaply and easily as opposed to the brick and mortar industries of the past.
- ✓ Absolute cost
- ✓ Cost advantage independent of size
- ✓ Economies of scale
- ✓ Product differentiation
- ✓ Brand equity
- ✓ Switching costs are well illustrated by structural market characteristics such as supply chain integration but also can be created by firms. Airline frequent flyer programs are an example.
- ✓ Expected retaliation - For example, specific characteristics of oligopoly markets is that prices generally settle at equilibrium because any price rises or cuts are easily matched by the competition.
- ✓ Access to distribution channels
- ✓ Customer loyalty to established brands. This can be accompanied by large brand advertising expenditures or similar mechanisms of maintained brand equity.
- ✓ Industry profitability (the more profitable the industry, the more attractive it will be to new competitors).

### **B. The bargaining power of suppliers**

The bargaining power of suppliers is also described as the market of inputs. Suppliers of raw materials, components, labor, and services (such as expertise) to the firm can be a source of power over the firm when there are few substitutes. If you are making biscuits and there is only one person who sells flour, you have no alternative but to buy it from them. Suppliers may refuse to work with the firm or charge excessively high prices for unique resources.

Potential factors are:

- Supplier switching costs relative to firm switching costs

- Degree of differentiation of inputs
- Impact of inputs on cost and differentiation
- Presence of substitute inputs
- Strength of distribution channel
- Supplier concentration to firm concentration ratio
- Employee solidarity (e.g. labor unions)
- Supplier competition: the ability to forward vertically integrate and cut out the buyer.

Suppliers to the company can be a source of power over the firm when:

- ✓ There are very few suppliers of a particular product or service, there are no substitutes, switching to another (competitive) product are very costly, the product is extremely important to buyers - can't do without it, and the supplying industry has a higher profitability than the buying industry.
- ✓ The pressure suppliers can place on a particular business can be limited if;
- ✓ there is many competitive suppliers - (tire industry relationship to automobile manufacturers),
- ✓ purchase commodity products
- ✓ backward integration threat by purchasers (timber producers relationship to paper companies),
- ✓ concentrated purchasers (garment industry relationship to major department stores), and
- ✓ customers weak (travel agents' relationship to airlines)

### **C. The bargaining power of buyers**

The bargaining power of customers is also described as the market of outputs: the ability of customers to put the firm under pressure, which also affects the customer's sensitivity to price changes. Firms can take measures to reduce buyer power, such as implementing a loyalty program. Buyers' power is high if buyers have many alternatives. It is low if they have few choices.

Potential factors:

- Degree of dependency upon existing channels of distribution
- Bargaining leverage, particularly in industries with high fixed costs
- Buyer switching costs
- Buyer information availability
- Availability of existing substitute products
- Buyer price sensitivity
- Differential advantage (uniqueness) of industry products

Some of the reasons enable buyers to have a large enough impact to affect a company's margins and volumes are:

- Size and concentration of buyers relative to suppliers –
- Buyers purchase a significant proportion of output
- Buyers possess a credible backward integration
- Buyer Information
- ❑ While, buyers' pressure can be weak if:
  - Producers threaten forward integration - producer can take over own distribution/retailing
  - Buyer switching costs -products not standardized and buyer cannot easily switch to another product
  - Buyers are fragmented (many, different)
  - Producers supply critical portions of buyers' input - distribution of purchases (Intel's relationship with PC manufacturers)

#### **D. The threat of substitute products or services**

The price customers are willing to pay for a product depends, in part, on the availability of substitute products, products in other industries. Thus, the absence of close substitutes for a product means that consumers are comparatively insensitive to price - demand is inelastic with respect to price. The existence of close substitutes means that customers will switch to

substitutes in response to price increases for the product (i.e., demand is elastic with respect to price). However, the extent to which substitutes limit prices and profits depends on; the propensity of buyers to substitute between alternatives and relative price/performance relationship of substitutes.

A substitute product uses a different technology to try to solve the same economic need. Examples of substitutes are meat, poultry, and fish; landlines and cellular telephones; airlines, automobiles, trains, and ships; beer and wine; and so on. For example, tap water is a substitute for Coke, but Pepsi is a product that uses the same technology (albeit different ingredients) to compete head-to-head with Coke, so it is not a substitute. Increased marketing for drinking tap water might "shrink the pie" for both Coke and Pepsi, whereas increased Pepsi advertising would likely "grow the pie" (increase consumption of all soft drinks), while giving Pepsi a larger market share at Coke's expense.

Potential factors:

- ✓ Buyer propensity to substitute. This aspect incorporated both tangible and intangible factors. Brand loyalty can be very important as in the Coke and Pepsi example above; however contractual and legal barriers are also effective.
- ✓ Relative price performance of substitute
- ✓ Buyer's switching costs. This factor is well illustrated by the mobility industry. Uber and its many competitors took advantage of the incumbent taxi industry's dependence on legal barriers to entry and when those fell away, it was trivial for customers to switch. There were no costs as every transaction was atomic, with no incentive for customers not to try another product.
- ✓ Perceived level of product differentiation which is classic Michael Porter in the sense that there are only two basic mechanisms for competition - lowest price or differentiation. Developing multiple products for niche markets is one way to mitigate this factor.
- ✓ Number of substitute products available in the market
- ✓ Ease of substitution
- ✓ Availability of close substitute

### **E. The intensity of competitive rivalry**

For most industries the intensity of competitive rivalry is the major determinant of the competitiveness of the industry. Having an understanding of industry rivals is vital to successfully marketing a product. Positioning pertains to how the public perceives a product and distinguishes it from competitors'. An organization must be aware of its competitors' marketing strategies and pricing and also be reactive to any changes made.

Potential factors:

- Sustainable competitive advantage through innovation
  - Competition between online and offline organizations
  - Level of advertising expense
  - Powerful competitive strategy which could potentially be realized by adhering to Porter's work on low cost versus differentiation.
  - Firm concentration ratio
- 
- ☐ Industry competitiveness can take the form of price wars, advertising campaigns, new product introductions, or expanded service offerings.
  - ☐ The intensity of competition tends to increase when an industry is characterized by
    - a number of well-balanced competitors and concentration,
    - a slow rate of industry growth (firms are able to improve revenues simply because of fight for market share),
    - fixed costs conditions (scale economies and the ratio of fixed to variable costs),
    - a lack of differentiation between products.

## Activity

1.

## CHAPTER FOUR: THE INTERNAL ENVIRONMENT ASSESSMENT

### Chapter Objectives

At the end of this unit students will be able to:

- ✓ Define the internal environment.
- ✓ Explain the nature of internal audit.
- ✓ Evaluate the relationship among the functional areas of business.

### 4.1. The Nature of an Internal Audit

All organizations have strengths and weaknesses in the functional areas of business. No enterprise is equally strong or weak in all areas. Internal strengths/weaknesses, coupled with External opportunities/threats and Clear statement of mission, provide the basis for establishing objectives and strategies. Objectives and strategies are established with the intention of capitalizing upon internal strengths and overcoming weaknesses.

**Internal Audit** is Parallels process of external audit. It gathers & assimilates information from:

- Management
- Marketing
- Finance/accounting
- Production/operations
- Research & development
- Management information systems

*Involvement in performing an internal strategic-management audit provides vehicle for understanding nature and effect of decisions in other functional business areas of the firm.*

### Key Internal Forces

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*“The prime task is to think through the overall mission of a business”. (Peter Drucker )*

It is not possible in a business policy text to review in depth all the material presented in courses such as marketing, finance, accounting, management, computer information systems, and production/operations; there are many sub areas within these functions, such as customer service, warranties, advertising, packaging, and pricing under marketing.

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.

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. For example, 3M exploits its distinctive competence in research and development by producing a wide range of innovative products. Strategies are designed in part to improve on a firm's weaknesses, turning them into strengths, and maybe even into distinctive competencies. Some researchers emphasize the importance of the internal audit part of the strategic-management process by comparing it to the external audit.

- ▶ *A Firm's Tangible & Intangible Resources combine with Firm's Capabilities to create Distinctive Competencies*
- ▶ *Distinctive Competencies – those activities that a firm performs better than any competing firm*
- ▶ *Sustained Competitive Advantage – firms that possess and exploit costly to imitate, rare, and valuable resources & capabilities in choosing and implementing their strategies may enjoy a period of sustained competitive advantage and above normal economic profit.*

**Tangible Resources:**

- ▶ Dow Chemical's research laboratory and facilities
- ▶ Intel's semiconductor fabrication facilities
- ▶ AT&T's network of wire, cable, and satellites...

**Intangible Resources:**



- ❑ Toyota's well-known and trusted brand names,
- ❑ New Season's good reputation,
- ❑ Intel's knowledgeable and creative workforce,
- ❑ Sun Microsystems' unifying corporate culture,
- ❑ Subway's international experience with different country's regulations on franchising,
- ❑ Norm Thompson Outfitters' visionary leader with strong motivation and communications skills,...

### Capabilities

- Emerge over time through complex interaction between and among tangible and intangible resources.
- Become stronger and more valuable strategically through repetition and practice.
- Skills and knowledge of firm's employees, including functional expertise (human capital)

Examples:

- Toyota's efficient distribution systems - Just-in-time (JIT) delivery, strong supplier relationships, and well-trained inventory specialists.
- L.L. Bean's customer segmentation procedures and systems - database management systems, effective market research efforts and strong supplier relationships.
- Nike's new product development procedures – creative workforce and innovation-driven culture, strong leadership, and effective market research.

### ▪ Distinctive Competencies: The VRIO Framework

🌀 *Question of Value:* Do a firm's resources and capabilities enable the firm to respond to neutralize external threats and/or capitalize on external opportunities?

Example: Are InFocus' engineers and marketing staff able to develop and sell home-based projector systems before its competitors?

🌀 *Question of Rarity:* Is a resource or capability currently controlled by only a small number of competing firms?

ø Example: Does InFocus have the technical expertise and market access that other firms do not have to innovate and sell home-based projector systems?

❁ *Question of Inimitability:* Do firms without the resource or capability face a cost disadvantage in obtaining or developing it?

ð Example: Is it quite expensive for Toshiba to internally develop the expertise to manufacture home-based projector systems?

❁ *Question of Organization:* Are a firm's other policies and procedures organized to support the use of its valuable, rare, and costly to imitate resources and/or capabilities?

Example: Are InFocus' organizational structure and compensation policies appropriate to support its efforts to develop, manufacture and distribute home-based projector systems?

? Dear learner, can you mention the VRIO Framework of distinctive competencies?

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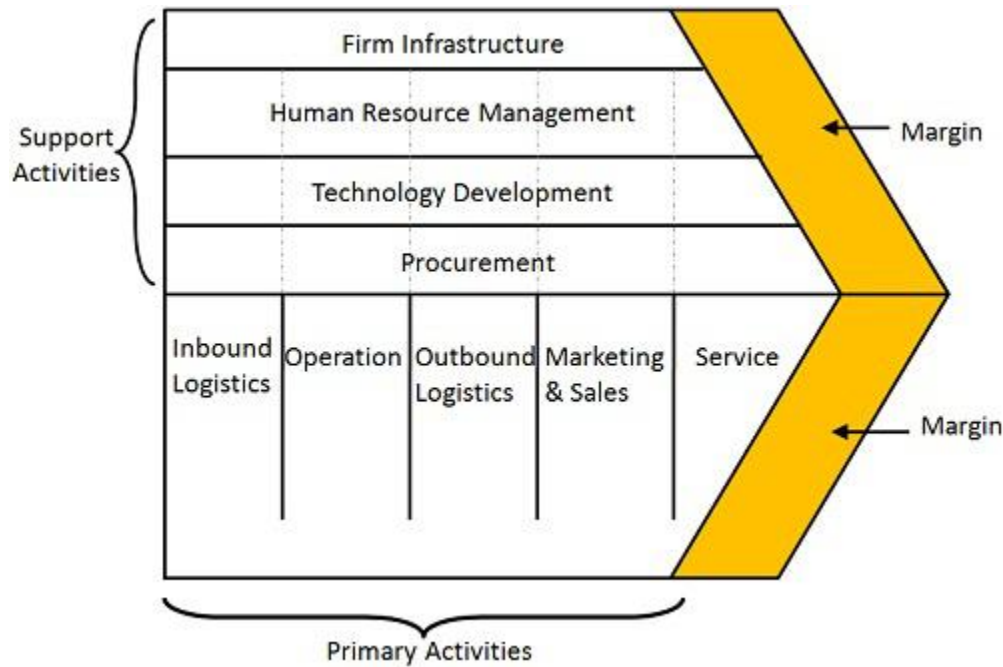
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## 4.2. Value Chain Analysis

Value chain analysis is a strategy tool used to analyze internal firm activities. Its goal is to recognize, which activities are the most valuable (i.e. are the source of cost or differentiation advantage) to the firm and which ones could be improved to provide competitive advantage.

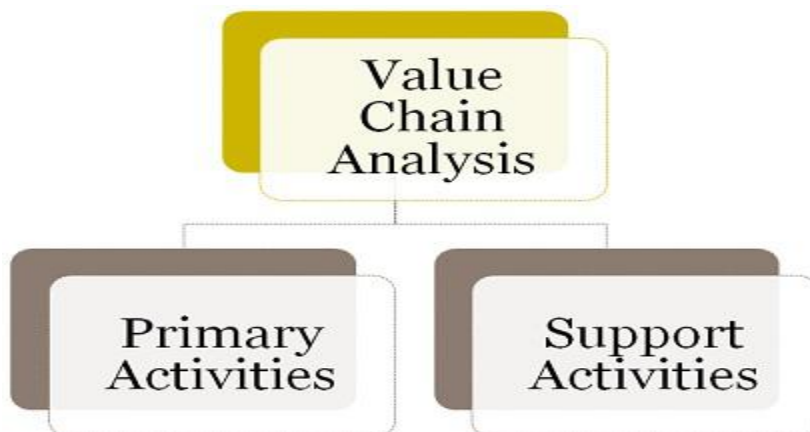
Value chain analysis is a way to visually analyze a company's business activities to see how the company can create a competitive advantage for itself. Value chain analysis helps a company understands how it adds value to something and subsequently how it can sell its product or service for more than the cost of adding the value, thereby generating a profit margin. In other words, if they are run efficiently the value obtained should exceed the costs of running them i.e. customers should return to the organisation and transact freely and willingly.

Originated in the 1980s by Michael Porter, value chain analysis is the conceptual notion of value-added in the form of a value chain. He suggested that an organisation is split into 'primary activities' and 'support activities'. The figure below divides activities into primary and support activities as suggested by Porter's Value Chain Analysis model:



### Classification of Value Chain Analysis

Value Chain Analysis is grouped into primary or line activities, and support activities discussed as under:



1. **Primary Activities:** The functions which are directly concerned with the conversion of input into output and distribution activities are called primary activities. It includes:
  - **Inbound Logistics:** It includes a range of activities like receiving, storing, distributing, etc. which make available goods and services for operational processes. Some of those activities are material handling, transportation, stock control, etc.
  - **Operations:** The activity of transforming input raw material to final product ready for sale, is termed as operation. Machining, assembling, packaging are the activities covered under operations.
  - **Outbound Logistics:** As the name suggests, the activities that help in collecting, storage and delivering the product to the customer is outbound logistics.
  - **Marketing and Sales:** All the activities like advertising, promotion, sales, marketing research, public relations, etc. performed to make the customer aware of the product or service and create demand for it, comes under marketing.
  - **Service:** Service means service provided to the customer so as to improve or maintain the value of the product. It includes financing service, after-sales service and so on.
2. **Support Activities:** Those activities which assist primary activities in accomplishment, are support activities. These are:
  - **Procurement:** This activity serves the organization, by supplying all the necessary inputs like material, machinery or other consumable items, that required by the organization for performing primary activities.
  - **Technology Development:** At present, technology development requires heavy investment, which takes years for research and development. However, its benefits can be enjoyed for several years and by a multitude of users in the organization.
  - **Human Resource Management:** It is the most common plus important activity which excel all primary activities of the organization. It encompasses overseeing the selection, retention, promotion, transfer, appraisal and dismissal of staff.

- **Infrastructure:** This is the management system, which provides, its services to the whole organization and includes planning, finance, information management, quality control, legal, government affairs, etc.

? Dear learner, can you mention the Classification of value chain analysis?

### 4.3. Relationship among the functional areas of business

**Functional relationships** refer to the Number and complexity increases relative to organization size. The process of performing an *internal audit* closely parallels the process of performing an external audit. Representative Managers 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 computer information systems operations.

Compared to the external audit, the process of performing an internal audit provides more opportunity for participants to understand how their jobs, departments, and divisions fit into the whole organization. This is a great benefit because managers and employees perform better when they understand how their work affects other areas and activities of the firm. For example, when marketing and manufacturing managers jointly discuss issues related to internal strengths and weaknesses, they gain a better appreciation of issues, problems, concerns, and needs in all the functional areas. In organizations that do not use strategic management, marketing, finance, and manufacturing managers often do not interact with each other in significant ways. Performing an internal audit, thus, is an excellent vehicle or forum for improving the process of communication in the organization. *Communication* may be the most important word in management.

Performing an internal audit requires gathering, assimilating, and evaluating information about the firm's operations.

Strategic management is a highly interactive process that requires effective coordination among management, marketing, finance/accounting, production/operations, R&D, and computer information systems managers. Although the strategic-management process is overseen by strategists, success requires that managers and employees from all functional areas work together to provide ideas and information.

Financial managers, for example, may need to restrict the number of feasible options available to operations managers, or R&D managers may develop such good products that marketing managers need to set higher objectives. 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.

A failure to recognize and understand relationships among the functional areas of business can be detrimental to strategic management, and the number of those relationships that must be managed increases dramatically with a firm's size, diversity, geographic dispersion, and the number of products or services offered. Governmental and nonprofit enterprises traditionally have not placed sufficient emphasis on relationships among the business functions. For example, some state governments, utilities, universities, and hospitals only recently have begun to establish marketing objectives and policies that are consistent with their financial capabilities and limitations. Some firms place too great an emphasis on one function at the expense of others.

## **Checkpoint**

## CHAPTER FIVE: STRATEGY ANALYSIS AND CHOICE

### Chapter Objectives

At the end of this lesson students will be able to:

- ✓ Explain the nature of strategy analysis and choice.
- ✓ Describe long-term objectives.
- ✓ Assess a comprehensive strategy formulation
- ✓ Explain the decision stage of strategy.
- ✓ Elucidate the BSC model.
- ✓ Explain the 7'S model

### INTRODUCTION

Without strategy, an organisation is like a ship without a rudder. It may know where it wants to go but has no means of getting there. On the other hand, if it does not know where it wants to go – rudder or no rudder – any route (that is, any strategy) would do: it is pointless worrying over what route to take if you do not know where you are going! From our previous modules, we have learnt that the mission sets the broad guidelines of where the organisation would like to be in the future, while strategic objectives are the performance standards, the targets if you like, that are needed to realise the mission. Strategies and strategic objectives are closely intertwined. Objectives tell us what is to be achieved: strategies, how this can be done. In this module, we shall focus on various strategy alternatives and ways and means of evaluating and selecting the right ones for the job.

Strategy analysis and choice focuses on generating and evaluating alternative strategies, as well as on selecting strategies to pursue. Strategy analysis and choice seeks to determine alternative courses of action that could best enable the firm to achieve its mission and objectives.

Choosing appropriate strategies is the one area in strategic management where you must attempt to muster your most creative talents. There is plenty of research to demonstrate that no matter how good your mission, goals and objectives are, it is your choice of strategy that really determines success or failure.

In most corporations there are several levels of strategies. These levels are Corporate-level Strategy, which refers to the overarching strategy of the diversified firm, such a corporate strategy answers the questions of "which businesses should we be in?" and "how does being in these businesses create synergy and/or add to the competitive advantage of the corporation as a whole?" Business strategy refers to the aggregated strategies of single business firm or a strategic business unit (SBU) in a diversified corporation. According to Michael Porter, a firm must formulate a business strategy that incorporates either cost leadership, differentiation, or focus to achieve a sustainable competitive advantage and long-term success.

## 5.1. Types of Corporate-level strategies

### *1. Integration Strategies*

Integration strategy: focuses on moving to different industry level, different product & technology but the basic market remains the same

***There are three types of integrative growths; Forward*** integration, backward integration, and horizontal integration are sometimes collectively referred to as *vertical integration* strategies. Vertical integration strategies allow a firm to gain control over distributors, suppliers, and/or competitors.

- Exists when a firm produces its own inputs (backward integration) or owns channels of distribution of outputs (forward integration)
- A firm pursuing vertical integration usually is motivated to strengthen its position in its core business by gaining market power over competitors

### ***Benefits of vertical integration strategy***



Allow a firm to gain control over:

- ➡ Distributors (forward integration)
- ➡ Suppliers (backward integration)
- ➡ Competitors (horizontal integration)

### ***Types of Integration Strategies***

#### **A. Forward integration**

*Forward integration* involves gaining ownership or increased control over distributors or retailers. It also refers to the transactions between the customers and firm.

#### **Guidelines for the use of integration strategies:**

*Six guidelines* when forward integration may be an especially effective strategy are:

- ➡ 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 competes in an industry that is growing and is expected to continue to grow markedly; this is a factor because forward integration reduces an organization's ability to diversify if its basic industry falters
- ➡ 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. Backward Integration***

*Backward integration* is a strategy of seeking ownership or increased control of a firm's suppliers. This strategy can be especially appropriate when a firm's current suppliers are unreliable, too costly, or cannot meet the firm's needs.

### ***Guidelines for Backward Integration***

Seven guidelines 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 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 acquire a needed resource quickly

### ***C. Horizontal Integration***

*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.

Increased control over competitors means that you have to look for new opportunities either by the purchase of the new firm or hostile take over the other firm. One organization gains control

of other which functioning within the same industry. It should be done that every firm wants to increase its area of influence, market share and business.

**Horizontal integration** refers to the acquisition of **similar products & services**

✓ The two **corporate tools** to achieve integrative growth are:

- **Acquisition**
- **Internal development**

### ***Guidelines for Horizontal Integration***

*Four guidelines* when horizontal integration may be an especially effective strategy are:

- ➡ When an organization can gain monopolistic characteristics in a particular area or region without being challenged by the federal government for "tending substantially" to reduce competition
- ➡ When an organization competes in a growing industry
- ➡ When increased economies of scale provide major competitive advantages
- ➡ When competitors are faltering due to a lack of managerial expertise or a need for particular resources that an organization possesses; note that horizontal integration would not be appropriate if competitors are doing poorly because overall industry sales are declining

### ***1. Intensive Strategies***

Market penetration, market development, and product development are sometimes referred to as *intensive strategies* because they require intensive efforts to improve a firm's competitive position with existing products.

#### ***Types of Intensive Strategies***

##### ***A. Market Penetration***

A *market-penetration* strategy seeks to increase market share for present products or services in present markets through greater marketing efforts. This strategy is widely used alone and in combination with other strategies. Market penetration includes increasing the number of

salespersons, increasing advertising expenditures, offering extensive sales promotion items, or increasing publicity efforts.

### ***Guidelines for Market Penetration***

*Four guidelines* when market penetration may be an especially effective strategy are:

- ➡ Current markets not saturated
- ➡ Usage rate of present customers can be increased significantly
- ➡ Market shares of competitors declining while total industry sales increasing
- ➡ Increased economies of scale provide major competitive advantages

***There are two aspects of market penetration:***

***Rapid market penetration:*** based on two assumptions, to lower the price and promotional activities can be increased.

***Slow market penetration:*** also based on two assumptions, to lower the price but promotional activities are not changed.

### ***B. Market Development***

*Market development* involves introducing present products or services into new geographic areas. It is selling present products in new markets – additional regional, national & international expansions.

- Attracting other market segments through:
  - Developing product versions to appeal to other segments
  - Entering other channels of distribution
  - Advertising in other media

### ***Guidelines for Market Development***

Six guidelines when market development may be an especially effective strategy are:

- ➡ New channels of distribution that are reliable, inexpensive, and good quality
- ➡ Firm is very successful at what it does
- ➡ Untapped or unsaturated markets
- ➡ Capital and human resources necessary to manage expanded operations

- ➡ Excess production capacity
- ➡ Basic industry rapidly becoming global

### ***C. Product Development***

*Product development* is a strategy that seeks increased sales by improving or modifying present products or services. Product development usually entails large research and development expenditures.

- **Product development:** is developing new products for present markets. This involves:
  - Developing new product features:
    - Modifying (change color, form, shape, etc.)
    - Magnify & minify
    - Rearrange (layout, patterns, etc.)
  - Developing additional models & sizes (product proliferation)
- Thus, it involves substantial modification of existing products or creation of new but related items that can be marketed to current customers through established channels
- The idea is to attract satisfied customers to new products as a result of their positive experience with company's initial offering
- The product development strategy is often adopted either to prolong the life cycle of current products or to take advantage of favorable reputation & brand name

Examples of **product development** can be:

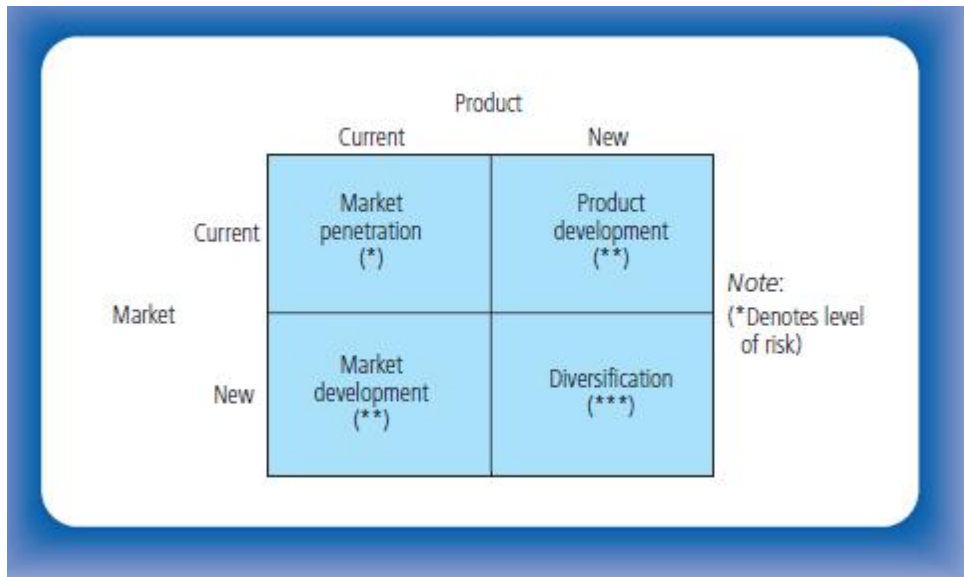
- A revised edition of a college textbook
- A new car style
- A second formula of shampoo for oily air etc

### ***Guidelines for Product Development***

Five guidelines when product development may be an especially effective strategy to pursue are:

- ➡ Products in maturity stage of life cycle
- ➡ Competes in industry characterized by rapid technological developments
- ➡ Major competitors offer better-quality products at comparable prices
- ➡ Compete in high-growth industry
- ➡ Strong research and development capabilities

○ *Summarizing of Types of Intensive Strategies*



## **2. Diversification Strategies**

*Diversification growth strategy: refers to an attempt to change the characteristics of the business through either of new products, markets & technology or all the three.*

There are three general types of *diversification strategies*: concentric, horizontal, and conglomerate. Over all, diversification strategies are becoming less popular as organizations are finding it more difficult to manage diverse business activities. In the 1960s and 1970s, the trend was to diversify so as not to be dependent on any single industry, but the 1980s saw a general reversal of that thinking. Diversification is now on the retreat.

### **A. Concentric Diversification**

Adding new, but related, products or services is widely called *concentric diversification*

**Concentric:** seeking growth with new market & product having meaningful synergy or fit with existing business (tapes into discs, ski sports into summer sporting) – **Related Diversification.**

### ***Guidelines for Concentric Diversification***

Five guidelines when concentric diversification may be an effective strategy are provided below:

- ➡ Competes in no- or slow-growth industry
- ➡ Adding new & related products increases sales of current products
- ➡ New & related products offered at competitive prices
- ➡ Current products are in decline stage of the product life cycle
- ➡ Strong management team

### ***B. Conglomerate Diversification***

Adding new, unrelated products or services is called *conglomerate diversification*. Some firms pursue conglomerate diversification based in part on an expectation of profits from breaking up acquired firms and selling divisions piecemeal.

**Conglomerate:** seeking growth by appealing to new markets with new product that have no technology relationships to current product – **Unrelated Diversification.**

- Most of the acquisitions are principally done on profit considerations
- Example: Virgin Group, MIDROC Ethiopia, West farmers, etc.

### ***Guidelines for Conglomerate Diversification***

Four guidelines when conglomerate diversification may be an effective strategy are provided below:

- ➡ Declining annual sales and profits
- ➡ Capital and managerial talent to compete successfully in a new industry
- ➡ Financial synergy between the acquired and acquiring firms
- ➡ Exiting markets for present products are saturated

### ***C. Horizontal Diversification***

Adding new, unrelated products or services for present customers is called *horizontal diversification*. This strategy is not as risky as conglomerate diversification because a firm already should be familiar with its present customers.

**Horizontal:** seeking growth by appealing to current market, with new products that are technologically unrelated to present products (hotels & tour operators) .

### ***Guidelines for Horizontal Diversification***

Four guidelines when horizontal diversification may be an especially effective strategy are:

- ➡ Revenues from current products/services would increase significantly by adding the new unrelated products
- ➡ Highly competitive and/or no-growth industry w/low margins and returns
- ➡ Present distribution channels can be used to market new products to current customers
- ➡ New products have counter cyclical sales patterns compared to existing products

### **3. Defensive Strategies**

- ✓ It can be used as a short-term solution to:
  - Reverse a negative trend
  - Overcome a crisis or problem situation
- Reasons:
  - The company faced financial problems – certain parts of the organization are doing poorly
  - The company forecasts hard times ahead related to:
    - Challenges from new competitors & products
    - Changes in government regulations

So, Owners are tired of the business or have to have an opportunity to profit substantially by selling. Therefore, in addition to integrative, intensive, and diversification strategies, organizations also could pursue retrenchment, divestiture, or liquidation.



### **A. Retrenchment**

*Retrenchment* occurs when an organization regroups through cost and asset reduction to reverse declining sales and profits. Sometimes called a turnaround or reorganization strategy, retrenchment is designed to fortify an organization's basic distinctive competence.

**Retrenchment** strategy will be used when the company wants to reduce its operations – primarily, by reducing product lines

- The main purpose of retrenchment is economizing through cutting production costs

During retrenchment, strategists work with limited resources and face pressure from shareholders, employees, and the media. Retrenchment can entail selling off land and buildings to raise needed cash, pruning product lines, closing marginal businesses, closing obsolete factories, automating processes, reducing the number of employees, and instituting expense control systems.

#### **Guidelines for Retrenchment**

Four guidelines when retrenchment may be an especially effective strategy to pursue are as follows:

- ➡ Firm has failed to meet its objectives and goals consistently over time but has distinctive competencies
- ➡ Firm is one of the weaker competitors
- ➡ Inefficiency, low profitability, poor employee morale and pressure from stockholders to improve performance.
- ➡ when an organization's strategic managers have failed

### **B. Divestiture**

Selling a division or part of an organization is called *divestiture*. Divestiture often is used to raise capital for further strategic acquisitions or investments.

Divestiture strategy occurs when an organization sells or divests itself of a business or part of a business – previous diversification is not successful (weak growth prospects & poor profitability)

- Moreover, when the firm is highly indebted – it might prefer to survive by selling some of its businesses by raising sufficient capital to:
  - Increase the performance of the remaining businesses
  - Settle its debt – liquidity

Divestiture can be part of an overall retrenchment strategy to rid an organization of businesses that are unprofitable, that require too much capital, or that do not fit well with the firm's other activities.

Divestiture has become a very popular strategy as firms try to focus on their core strengths, lessening their level of diversification.

### **Guidelines for Divestiture**

Five guidelines when divestiture may be an especially effective strategy to pursue are listed below:

- ➡ When firm has pursued retrenchment but failed to attain needed improvements
- ➡ When a division needs more resources than the firm can provide
- ➡ When a division is responsible for the firm's overall poor performance
- ➡ When a division is a misfit with the organization
- ➡ When a large amount of cash is needed and cannot be obtained from other sources.

### ***C. Liquidation***

Selling all of a company's assets, in parts, for their tangible worth is called liquidation.

**Liquidation** occurs when an **entire company** is either sold or dissolved either by **choice** or **force**

- When by choice, it can be because the owners are tired of the business or near retirement; the organization's future prospect is not good and sell at this time.
- When by force, the decision often occurs because of a deteriorated financial condition:
  - Such circumstances leave the seller in a weak bargaining position
  - It is the last resort measure & generally is forced by financial institutions

Liquidation is recognition of defeat and, consequently, can be an emotionally difficult strategy. However, it may be better to cease operating than to continue losing large sums of money.

### **Guidelines for Liquidation**

Three guidelines when liquidation may be an especially effective strategy to pursue are:

- ➡ When both retrenchment and divestiture have been pursued unsuccessfully
- ➡ If the only alternative is bankruptcy, liquidation is an orderly alternative
- ➡ When stockholders can minimize their losses by selling the firm's assets

**? Dear learner, can you mention types of strategies?**

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**Profile:*****Chelsea versus Manchester United, the global game***

Chelsea FC have recently launched a Mandarin language version of the football club's website, Working in partnership with Sina, China's largest Internet portal provider, the club aims to access a market in excess of 100 million. Sina will convert Chelsea's Internet content into Mandarin and will examine football from a local viewpoint. Given the growth potential of the Chinese market, it is not surprising to find other 'giants' of European football – Manchester United, Real Madrid, etc. – actively targeting the South East Asian market. Chelsea view the web development, coupled with support for football at a local level, as a key element in gaining market share. The strategy differs from Manchester United, who has endeavored to open themed outlets.

Chelsea team manager, Jose Mourinho, welcomed Chinese fans to the new website in the following statement:

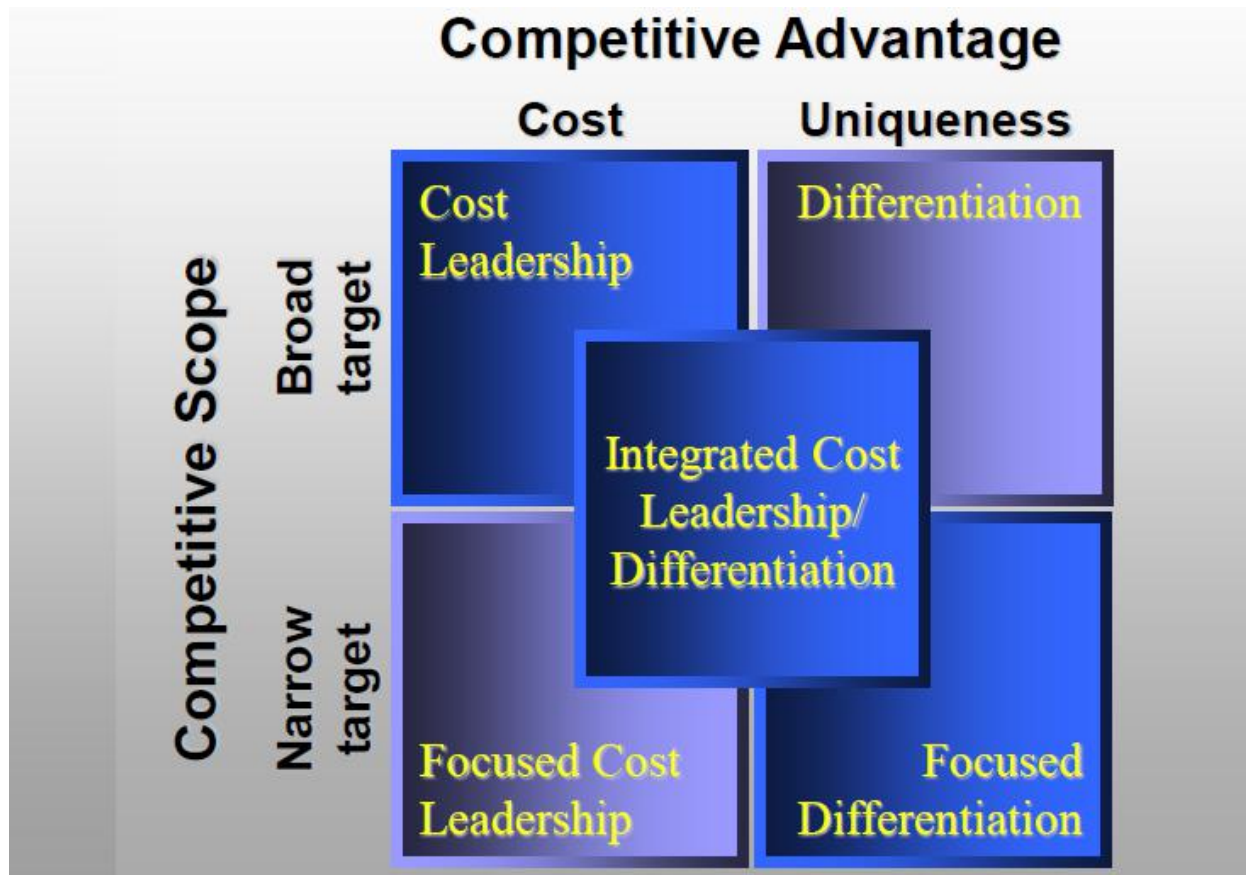
*'Hello to all our fans in China. I know that you pay close attention to our performances and today on behalf of everyone at Chelsea I want to thank you for your support, we do appreciate it very much. The new Chinese Chelsea official website will build a bridge between us.'*

(www.chelsea.fc.com, Accessed 30/05/14)

## **5.2. Michael Porter's generic strategies(Business-Level Strategy)**

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. Each of the generic strategies results from a company's making

consistent choices on product, market, and distinctive competences—choices that reinforce each other.



### A. Cost Leadership Strategy

A company's goal in pursuing a cost-leadership strategy is to outperform competitors by doing everything the company can to produce goods or services at a cost lower than those of competitors.

An integrated set of actions designed to produce or deliver goods or services at the lowest cost, relative to competitors with features that are acceptable to customers.

- Relatively standardized products

- features acceptable to many customers
- lowest competitive price

**Cost saving actions required by this strategy**

- ✓ Building efficient scale facilities ,
- ✓ Tightly controlling production costs and overhead,
- ✓ Minimizing costs of sales, R&D and service,
- ✓ building efficient manufacturing facilities,
- ✓ monitoring costs of activities provided by outsiders
- ✓ simplifying production processes

**Risks of Cost Leadership Strategy**

- ✓ Processes used by the cost leader to produce and distribute its good or service could become obsolete because of competitors' innovations
- ✓ Too much focus by the cost leader on cost reductions may occur at the expense of trying to understand customers' perceptions of "competitive levels of differentiation
- ✓ Competitors may learn how to successfully imitate the cost leader's strategy

**B. Differentiation Strategy**

The objective of the generic **differentiation strategy** is to achieve a competitive advantage by creating a product that is perceived by customers to be *unique* in some important way. The differentiated product's ability to satisfy a customer's need in a way that its competitors cannot means that the company can charge a *premium price*—a price considerably above the industry average.

An integrated set of actions designed by a firm to produce or deliver goods or services (at an acceptable cost) that customers perceive as being different in ways that are important to them

- Price for product can exceed what the firm's target customers are willing to pay
- Non standardized products
- customers value differentiated features more than they value low cost
- Value provided by unique features and value characteristics
- Command premium price

- High customer service
- Superior quality
- Prestige or exclusivity
- Rapid innovation

**Differentiation actions required by this strategy:**

- developing new systems and processes
- shaping perceptions through advertising
- quality focus
- capability in R&D
- maximize human resource contributions through low turnover and high motivation

**Major Risks of Differentiation Strategy**

- Experience may narrow customer's perceptions of the value of differentiated features of the firm's products
- Makers of counterfeit goods may attempt to replicate differentiated features of the firm's products

**C. Focused Strategies**

In this strategy the firm concentrates on a select few target markets. It is also called niche strategy. It is hoped that by focusing your marketing efforts on one or two narrow market segments and tailoring your marketing mix to these specialized markets, you can better meet the needs of that target market. The firm typically looks to gain a competitive advantage through effectiveness rather than efficiency. It is most suitable for relatively small firms but can be used by any company. As a focus strategy it may be used to select targets that are less vulnerable to substitutes or where a competition is weakest to earn above-average return on investments.

A focus strategy must exploit a narrow target's differences from the balance of the industry by:

- isolating a particular buyer group
- isolating a unique segment of a product line
- concentrating on a particular geographic market

- finding their “niche”

### **Major Risks of Focused Strategies**

- Firm may be “out focused” by competitors
- Large competitor may set its sights on your niche market
- Preferences of niche market may change to match those of broad market

### **D. Integrated Strategy**

A firm that successfully uses an integrated cost leadership/differentiation strategy should be in a better position to:

- adapt quickly to environmental changes
- learn new skills and technologies more quickly
- effectively leverage its core competencies while competing against its rivals

### **Benefits of Integrated Strategy**

- Successful firms using this strategy have above-average returns
  - Firm offers two types of values to customers some differentiated features (but less than a true differentiated firm)
  - relatively low cost (but now as low as the cost leader’s price)

### **Major Risks of Integrated Strategy**

- An integrated cost/differentiation business level strategy often involves compromises (neither the lowest cost nor the most differentiated firm)
- The firm may become “stuck in the middle” lacking the strong commitment and expertise that accompanies firms following either a cost leadership or a differentiated strategy

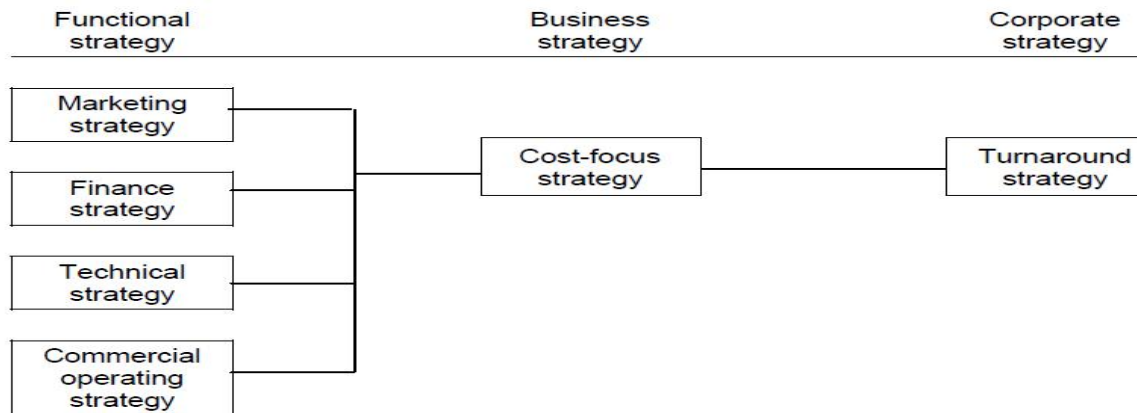
## **5.3. Functional (or operational) strategies**

Functional strategies, sometimes referred to as operational strategies, are at the lowest rung of strategy development. **They are normally developed as part of the implementation process.** Functional strategies specify the means by which the different functional areas of a business must contribute to business and corporate strategies. Say a diversified maritime company has one



business – a shipping agency – that is in deep financial trouble. At the corporate level, the strategy is to turn this business around so that it will not drag the company down.

At the business level, this means competing by means of, say, a cost-focus strategy. Each functional area of the business must then come up with a particular strategy to implement both the business and corporate strategies. This relationship is shown in figure below.



#### 5.4. The Nature of Strategy Analysis and Choice

Strategy analysis and choice seeks to determine alternative courses of action that could best enable the firm to achieve its mission and objectives. The firm's present strategies, objectives, and mission, coupled with the external and internal audit information, provide a basis for generating and evaluating feasible alternative strategies.

#### 5.5. 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 time frame for objectives and strategies should be consistent, usually from two to five years.

##### 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 time line. 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. Clearly established objectives offer many benefits. They provide direction, allow synergy, aid in evaluation, establish priorities, reduce uncertainty, minimize conflicts, stimulate exertion, and aid in both the allocation of resources and the design of jobs.

Long-term objectives are needed at the corporate, divisional, and functional levels in an organization. They are an important measure of managerial performance.

Clearly stated and communicated objectives are vital to success for many reasons. First, objectives help stakeholders understand their role in an organization's future. They also provide a basis for consistent decision making by managers whose values and attitudes differ. By reaching a consensus on objectives during strategy-formulation activities, an organization can minimize potential conflicts later during implementation. Objectives set forth organizational priorities and stimulate exertion and accomplishment. They serve as standards by which individuals, groups, departments, divisions, and entire organizations can be evaluated. Objectives provide the basis for designing jobs and organizing activities to be performed in an organization. They also provide direction and allow for organizational synergy.

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.

## **5.6. A comprehensive strategy formulation**

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

### **Stage-1 (Formulation Framework)**

1. External factor evaluation
2. Competitive matrix profile

### 3. Internal factor evaluation

#### **Stage-2 (Matching stage)**

1. TWOS Matrix (Threats-Opportunities-Weaknesses-Strengths)
2. SPACE Matrix (Strategic Position and Action Evaluation)
3. BCG Matrix (Boston Consulting Group)
4. IE Matrix (Internal and external)
5. GS Matrix (Grand Strategy)

#### **Stage-3 (Decision stage)**

##### **1. QSPM (Quantitative Strategic Planning Matrix)**

#### **Stage-1 (Formulation Framework)**

*Stage 1* of the formulation framework consists of the EFE Matrix, the IFE Matrix, and the Competitive Profile Matrix. Called the *Input Stage*, Stage 1 summarizes the basic input information needed to formulate strategies.

*E. External factor evaluation*

*F. Competitive matrix profile*

*G. Internal factor evaluation*

#### **1. The 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 consists of five steps process.

#### **Five-Step process:**

##### **• List key external factors (10-20)**

➡ Opportunities & threats

You have to prepare a list of all external factors which will affect the EFE matrix. These factors should be two points to be kept in mind these are opportunities and threats.

##### **• Assign weight to each (0 to 1.0)**

➡ Sum of all weights = 1.0

Now you have to arrange them according to their weight age that which factor is most important. It should be weight age in % ages. The sum of the total of all the factors should always be one.

##### **• Assign 1-4 rating to each factor**

- Firm's current strategies response to the factor: how well firms response to these factors.
- **Multiply each factor's weight by its rating**
- Produces a weighted score

How the firm will respond to these factors external factors. Such criteria are known as rating.

- **Sum the weighted scores for each**

➡ Determines the total weighted score for the organization.

- Highest possible weighted score for the organization is 4.0; the lowest, 1.0. Average = 2.5

Illustrated in Table 3-11, 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 from ten to twenty factors, including both opportunities and threats affecting 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 too 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 1-to-4 rating 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.

An Example External Factor Evaluation Matrix for UST, Inc.			
KEY EXTERNAL FACTORS	WEIGHT	RATING	WEIGHTED SCORE
<i>Opportunities</i>			
1. Global markets are practically untapped by smokeless tobacco market	.15	1	.15
2. Increased demand caused by public banning of smoking	.05	3	.15
3. Astronomical Internet advertising growth	.05	1	.05
4. Pinkerton is leader in discount tobacco market	.15	4	.60
5. More social pressure to quit smoking, thus leading users to switch to alternatives	.10	3	.30
<i>Threats</i>			
1. Legislation against the tobacco industry	.10	2	.20
2. Production limits on tobacco increases competition for production	.05	3	.15
3. Smokeless tobacco market is concentrated in southeast region of United States	.05	2	.10
4. Bad media exposure from the FDA	.10	2	.20
5. Clinton administration	<u>.20</u>	1	<u>.20</u>
<b>TOTAL</b>	<b>1.00</b>		<b>2.10</b>

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 effect of external threats. A total score of 1.0 indicates that the firm's strategies are not capitalizing on opportunities or avoiding external threats.

An example of an EFE Matrix is provided in Table for UST, Inc., the manufacturer of Skoal and Copenhagen smokeless tobacco. Note that the Clinton administration was considered to be the

most important factor affecting this industry, as indicated by the weight of 0.20. UST was not pursuing strategies that effectively capitalize on this opportunity, as indicated by the rating of 1.01. The total weighted score of 2.10 indicates that UST is below average in its effort to pursue strategies that capitalize on external opportunities and avoid threats. It is important to note here that a thorough understanding of the factors being used in the EFE Matrix is more important than the actual weights and ratings assigned.

**Total weighted score of 4.0 =**

Organization response is outstanding to threats & weaknesses

**Total weighted score of 1.0 =**

Firm's strategies not capitalizing on opportunities or avoiding threats

UST (in the previous example), has a total weighted score of 2.10 indicating that the firm is below average in its effort to pursue strategies that capitalize on external opportunities and avoid threats.

**Note:** Understanding of the factors used in the EFE Matrix is more important than the actual weights and ratings assigned. This is important to understand the factors for which you are preparing the EFE matrix than the weight age given to the each factors.

#### 4. The Competitive Profile Matrix (CPM)

*The Competitive Profile Matrix (CPM) identifies a firm's major competitors and their particular strengths and weaknesses in relation to a sample firm's strategic position.*

The weights and total weighted scores in both a CPM and EFE have the same meaning. However, the factors in a CPM include both internal and external issues; therefore, the ratings refer to strengths and weaknesses, where 4 major strength, 3 minor strength, 2 minor weakness, and 1 major weakness.

There are some important differences between the EFE and CPM. First of all, the critical success factors in a CPM are broader; they do not include specific or factual data and even may focus on internal issues. The critical success factors in a CPM also are not grouped into opportunities and threats as they are in an EFE.

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.

A sample Competitive Profile Matrix is provided in Table. In this example, advertising and global expansion are the most important critical success factors, as indicated by a weight of 0.20. Avon's and L'Oreal's product quality is superior, as evidenced by a rating of 4; L'Oreal's "financial position" is good, as indicated by a rating of 3; Procter & Gamble is the weakest firm overall, as indicated by a total weighted score of 2.80.

A Competitive Profile Matrix							
CRITICAL SUCCESS FACTORS	AVON			L'OREAL		PROCTER&GAMBLE	
	WEIGHT	RATING	SCORE	RATING	SCORE	RATING	SCORE
Advertising	0.20	1	0.20	4	0.80	3	0.60
Product Quality	0.10	4	0.40	4	0.40	3	0.30
Price Competitiveness	0.10	3	0.30	3	0.30	4	0.40
Management	0.10	4	0.40	3	0.30	3	0.30
Financial Position	0.15	4	0.60	3	0.45	3	0.45
Customer Loyalty	0.10	4	0.40	4	0.40	2	0.20
Global Expansion	0.20	4	0.80	2	0.40	2	0.40
Market Share	<u>0.05</u>	1	<u>0.05</u>	4	<u>0.20</u>	3	<u>0.15</u>
<b>TOTAL</b>	1.00		3.15		3.25		2.80
<i>Note:</i> (1) The ratings values are as follows: 1 = major weakness, 2 = minor weakness, 3 = minor strength, 4 = major strength. (2) As indicated by the total weighted score of 2.8, Competitor 3 is weakest. (3) Only eight critical success factors are included for simplicity; this is too few in actuality.							

Other than the critical success factors listed in the example CPM, other factors often included in this analysis include breadth of product line, effectiveness of sales distribution, proprietary or patent advantages, location of facilities, production capacity and efficiency, experience, union relations, technological advantages, and e-commerce expertise.

A word on interpretation: Just because one firm receives a 3.2 rating and another receives a 2.8 rating in a Competitive Profile Matrix, it does not follow that the first firm is 20 percent better than the second.

Numbers reveal the relative strength of firms, but their implied precision is an illusion. Numbers are not magic. The aim is not to arrive at a single number but rather to assimilate and evaluate information in a meaningful way that aids in decision making.



## 5. The Internal Factor Evaluation (IFE) Matrix

*(Great spirits have always encountered violent opposition from mediocre minds.)* Albert Einstein

A summary step in conducting an internal strategic-management audit is to construct an *Internal Factor Evaluation (IFE) Matrix*. This strategy-formulation tool summarizes and evaluates the major strengths and weaknesses in the functional areas of a business, and it also provides a basis for identifying and evaluating relationships among those areas. Intuitive judgments are required in developing an IFE Matrix, so the appearance of a scientific approach should not be interpreted to mean this is an all-powerful technique. A thorough understanding of the factors included is more important than the actual numbers.

Similar to the EFE Matrix and Competitive Profile Matrix, an IFE Matrix can be developed in five steps:

1. List key internal factors as identified in the internal-audit process. Use total of from ten to twenty internal factors, including both strengths and weaknesses.

List strengths first and then weaknesses, Be as specific as possible, using percentages, ratios, and comparative numbers.

2. Assign a weight that ranges from 0.0 (not important) to 1.0 (all-important) to each factor. The weight assigned to a given factor indicates the relative importance of the factor to being successful in the firm's industry. Regardless of whether a key factor is an internal strength or weakness, factors considered to have the greatest effect on organizational performance should be assigned the highest weights. The sum of all weights must equal 1.0.

3. Assign a 1-to-4 rating to each factor to indicate whether that factor represents a major weakness (rating 1), a minor weakness (rating 2), a minor strength (rating 3), or a major strength (rating 4). Note that strengths must receive a 4 or 3 rating and weaknesses must receive a 1 or 2 rating. Ratings are, thus, company based, whereas the weights in Step 2 are industry based.

4. Multiply each factor's weight by its rating to determine a weighted score for each variable.

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

Regardless of how many factors are included in an IFE Matrix, the total weighted score can range from a low of 1.0 to a high of 4.0, with the average score being 2.5. Total weighted scores



well below 2.5 characterize organizations that are weak internally, whereas scores significantly above 2.5 indicate a strong internal position. Like the EFE Matrix, an IFE Matrix should include from 10 to 20 key factors. The number of factors has no effect upon the range of total weighted scores because the weights always sum to 1.0.

When a key internal factor is both strength and weakness, the factor should be included twice in the IFE Matrix, and a weight and rating should be assigned to each statement. For example, the Playboy logo both helps and hurts Playboy Enterprises; the logo attracts customers to the *Playboy* magazine, but it keeps the Playboy cable channel out of many markets.

An example of an IFE Matrix for Circus Circus Enterprises is provided in Table. Note that the firm's major strengths are its size, occupancy rates, property, and long-range planning as indicated by the rating of 4. The major weaknesses are locations and recent joint venture. The total weighted score of 2.75 indicates that the firm is above average in its overall internal strength.

A Sample Internal Factor Evaluation Matrix for Circus Circus Enterprises			
Key Internal Factors	Weight	Rating	Weighted Score
<i>Internal Strengths</i>			
1. Largest casino company in the United States	.05	4	.20
2. Room occupancy rates over 95% in Las Vegas	.10	4	.40
3. Increasing free cash flows	.05	3	.15
4. Owns one mile on Las Vegas Strip	.15	4	.60
5. Strong management team	.05	3	.15
6. Buffets at most facilities	.05	3	.15
7. Minimal comps provided	.05	3	.15
8. Long-range planning	.05	4	.20
9. Reputation as family-friendly	.05	3	.15
10. Financial ratios	.05	3	.15
<i>Internal Weaknesses</i>			
1. Most properties are located in Las Vegas	.05	1	.05
2. Little diversification	.05	2	.10
3. Family reputation, not high rollers	.05	2	.10
4. Laughlin properties	.10	1	.10
5. Recent loss of joint ventures	<u>.10</u>	1	<u>.10</u>
TOTAL	1.00		2.75

### Stage-2 (Matching stage)

Stage 2, called the *Matching Stage*, focuses upon generating feasible alternative strategies by aligning key external and internal factors. Stage 2 techniques include :

- ➡ *TWOS Matrix (Threats-Opportunities-Weaknesses-Strengths)*
- ➡ *SPACE Matrix (Strategic Position and Action Evaluation)*

- ➡ BCG Matrix (Boston Consulting Group)
- ➡ IE Matrix (Internal and external)
- ➡ GS Matrix (Grand Strategy)

### 1. THREATS-OPPORTUNITIES-WEAKNESSES-STRENGTHS (TOWS) MATRIX

The *Threats-Opportunities-Weaknesses-Strengths (TOWS)* is also named as SWOT analysis. A TOWS Analysis is a **strategic planning** tool used to evaluate the Threats, Opportunities and Strengths, Weaknesses, involved in a **project** or in a **business** venture or in any other situation requiring a decision.

This is an important tool in order to formulate strategy. This Matrix is an important matching tool that helps managers develop four types of strategies: SO Strategies (strength-opportunities), WO Strategies (weakness- opportunities), ST Strategies (strength-threats), and WT Strategies (weakness-threats). The most difficult part of TOWS matrix is to match internal and external factor.

➡ TOWS are defined precisely as follows:

**Strengths** are attributes of the organization that are helpful to the achievement of the objective.

**Weaknesses** are attributes of the organization that are harmful to the achievement of the objective.

**Opportunities** are external conditions that are helpful to the achievement of the objective.

**Threats** are external conditions that are harmful to the achievement of the objective.

**Strengths and weaknesses are internal factors.** For example, strength could be your specialist marketing expertise. A weakness could be the lack of a new product.

**Opportunities and threats are external factors.** For example, an opportunity could be a developing distribution channel such as the Internet, or changing consumer lifestyles that potentially increase demand for a company's products. A threat could be a new competitor in an important existing market or a technological change that makes existing products potentially obsolete. It is worth pointing out that SWOT analysis can be very subjective - two people rarely come-up with the same version of a SWOT analysis even when given the same information

about the same business and its environment. Accordingly, SWOT analysis is best used as a guide and not a prescription. Adding and weighting criteria to each factor increases the validity of the analysis.

- ✓ **SO Strategies:** Every firm desires to obtain benefit from its resources such benefit can only be obtained if utilize its strength to take external opportunity. Resources (Assets) an important firm's strength to get opportunity for external resources. For example the firm enjoying a good financial position which is strength for a firm and externally opportunity to expand business. The strong financial position provides an opportunity to expand the business. The matched strategy is known as SO strategy.
- ✓ **WO Strategies:** WO Strategies developed to match weakness with opportunities of the firm. WO strategy is very useful if the firm take advantage to external resources in order to overcome the weakness. For example the firm is in the critical financial problems that is weakness and firm is availing merger with Multinational Corporation.
- ✓ **ST Strategies:** ST Strategies is an important strategy to overcome external threats. This does not mean that a strong organization should always meet threats in the external environment head-on. This strategy is adopted by various colleges by opening new branches in order to overcome competitive threat.
- ✓ **WT Strategies:** Every firm has a desire to overcome its weakness and reducing threats. This type of strategy helpful when weaknesses are removed to overcome external threats. It is difficult to target WT strategy. For example weak distribution network creating many problems for the firm if it strong many external threats can be removed.

#### **Steps for developing strategies:**

There are eight steps involved in constructing a TOWS Matrix:

1. Rank external opportunities
2. Rank external threats
3. Rank internal strength

4. Rank internal weaknesses.
5. Match internal strengths with external opportunities and mention the result in the SO Strategies cell.
6. Match internal weaknesses with external opportunities and mention the result in the WO Strategies cell.
7. Match internal strengths with external threats and mention the result in the ST Strategies cell.
8. Match internal weaknesses with external threats and mention the result in the WT strategies cell.

Blank	<u>Strengths–S</u> List Strengths	<u>Weaknesses – W</u> List Weaknesses
<u>Opportunities – O</u> List Opportunities	<u>SO-Strategies</u> Use strength to obtain opportunities	<u>WO-Strategies</u> Overcome weaknesses by taking advantage of opportunities
<u>Threats – T</u> List Threats	<u>ST-Strategies</u> Use strengths to avoid threats	<u>WT-Strategies</u> Minimize weaknesses and avoid threats

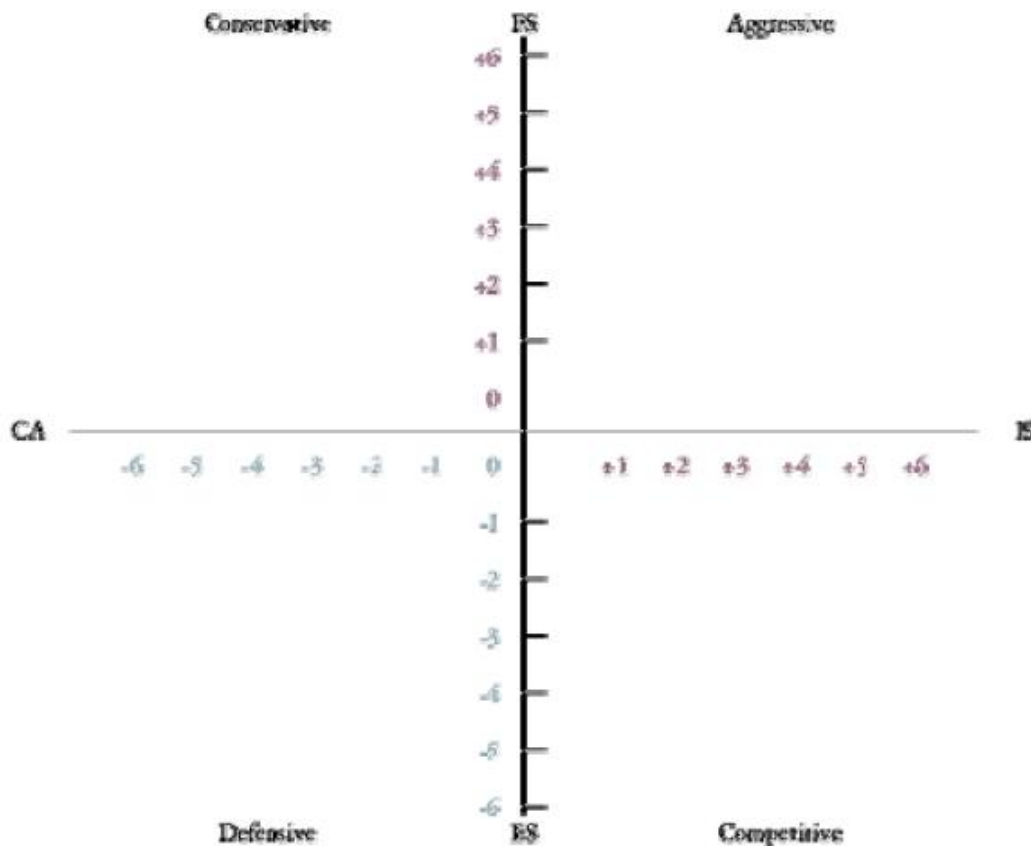
## 2. THE STRATEGIC POSITION AND ACTION EVALUATION (SPACE) MATRIX

The Strategic Position and Action Evaluation (SPACE) Matrix is another important Stage 2 matching tool of formulation framework. It explains that what is our strategic position and what

possible action can be taken. It is not closed matrix. It is prepared on graph. It is closed matrix. This follow counter clock wise direction. It contains four-quadrant named aggressive, conservative, defensive, or competitive strategies.

The axes of the SPACE Matrix represent two internal dimensions financial strength [FS] and competitive advantage [CA]) and two external dimensions (environmental stability [ES] and industry strength [IS]).

These four factors are the most important determinants of an organization's overall strategic position.



It is divided into two internal and external dimensions which are as follow (Internal dimensions) financial strength, competitive advantage, (External dimensions) environment stability and industry strength. This sequence is convention to be followed as graphed above. This frame work determines appropriate set of strategies for each quadrant.

- ➡ First quadrant is aggressive the firm fall in this quadrant that follow the aggressive strategy. Second quadrant is conservative all those firms that fall in this quadrant that must follow conservative strategy and in next the firm follow the defensive strategy. All the firms fall on competitive follow that strategy. After a rating is assigned ranging from +1 (worst) to +6 (best) to each of the variables that make up the financial strength and industry strength dimensions. Assign a numerical value ranging from -1 (best) to -6 (worst) to each of the variables that make up the environment stability and Competitive advantage dimensions.

These dimensions are explained below:

**Internal Strategic Position****Financial Strength (FS)**

Risk involved in business

Debt to equity ratio

Working capital condition

Leverage

Liquidity

Ease of exit from market

Cash flow statement

Return on investment

**Competitive Advantage (CA)**

Access to the market

Market share

Quality of product and services

Product life cycle

Customer loyalty

Capacity, location and layout

Technological know-how

Backward and forward integration

**External Strategic Position****Environmental Stability (ES)**

Impact of technology

Price elasticity of demand

Political situation

Demand variability

Price range of competing products

Rate of inflation

Competitive pressure

**Industry Strength (IS)**

Demand and supply factors

Resource utilization

Growth potential

Profit potential

Financial stability

Technological know-how

Productivity, capacity utilization

Capital intensity

Ease of entry into market



- ➡ After the selection of variables the rating is assigned to each. After the addition of these variables taking the average. For example financial strength is explain below

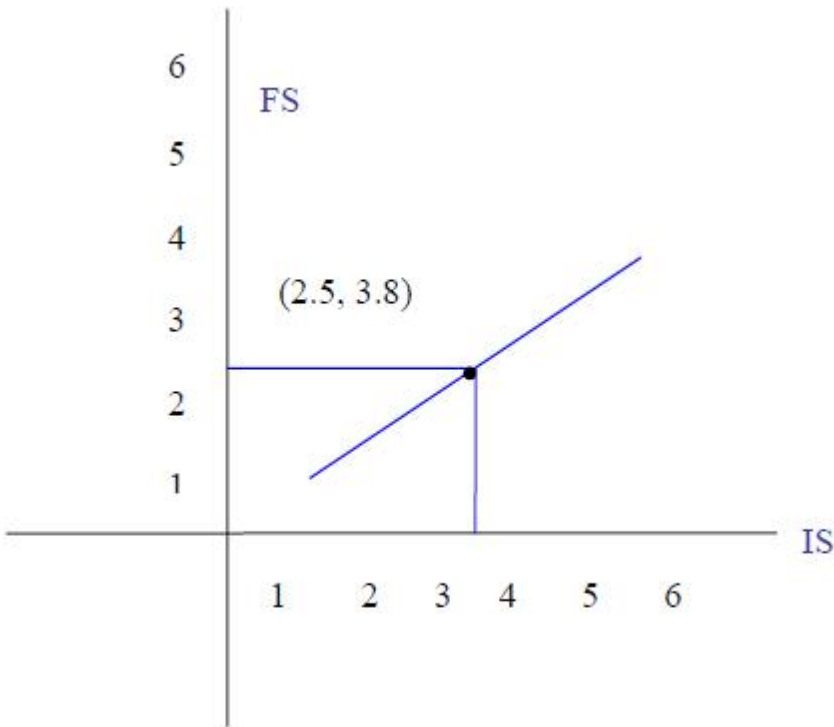
Financial Strength (FS)	Rating
High Return on investment	3
Large amount of capital	2
Consistently increasing revenue	4
Working capital condition	1

Financial strength average is  $(3+2+4+1)/4 = 2.5$

The industry strength is explained as follows

Industry Strength (IS)	Rating
Demand and supply factors	5
Resource utilization	3
Profit potential	3
Technological know-how	6
Ease of entry into market	2

Industry strength average is  $(5+3+3+6+2)/5 = 3.8$ . It is plotted on graph:



➡ The graph indicates that firm adopts aggressive strategy

### Steps for the preparation of SPACE Matrix

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

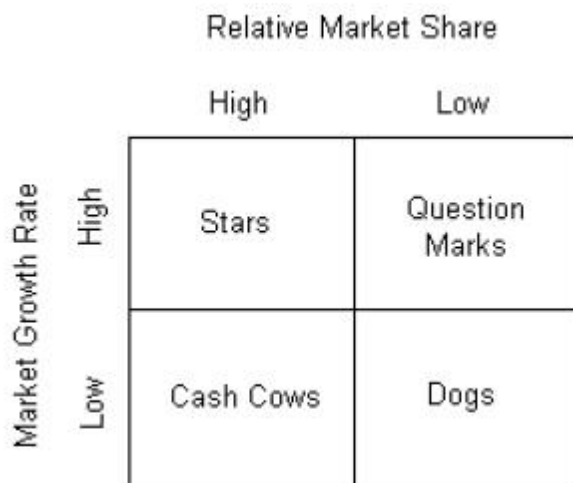
1. Select a set of variables relating to financial strength, competitive advantage, environmental stability, and industry strength.
2. Assign a numerical value ranging from +1 (worst) to +6 (best) to each of the variables that make up the financial strength and industry strength dimensions. Assign a numerical value ranging from -1 (best) to -6 (worst) to each of the variables that make up the environmental stability and competitive advantage dimensions.
3. Compute an average score and dividing by the number of variables
4. Plot the average scores 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.

### 3. BOSTON CONSULTING GROUP (BCG) MATRIX

The **Boston Consulting Group (BCG)** is a management consulting firm founded by Harvard Business School alum Bruce Henderson in 1963. The **growth-share matrix** is a chart created by group in 1970 to help corporation analyze their business units or product lines, and decide where to allocate cash. It was popular for two decades, and is still used as an analytical tool.

To use the chart, corporate analysts would plot a scatter graph of their business units, ranking their relative market shares and the growth rates of their respective industries. This led to a categorization of four different types of businesses:



- **Cash cows** Units with high market share in a slow-growing industry. These units typically generate cash in excess of the amount of cash needed to maintain the business. They are regarded as staid and boring, in a "mature" market, and every corporation would be thrilled to own as many as possible. They are to be "milked" continuously with as little investment as possible, since such investment would be wasted in an industry with low growth.
- **Dogs** More charitably called pets, units with low market share in a mature, slow-growing industry. These units typically "break even", generating barely enough cash to maintain

the business's market share. Though owning a break-even unit provides the social benefit of providing jobs and possible synergies that assist other business units, from an accounting point of view such a unit is worthless, not generating cash for the company. They depress a profitable company's **return on assets** ratio, used by many investors to judge how well a company is being managed. Dogs, it is thought, should be sold off.

❁ **Question marks** Units with low market share in a fast-growing industry. Such business units require large amounts of cash to grow their market share. The corporate goal must be to grow the business to become a star. Otherwise, when the industry matures and growth slows, the unit will fall down into the dog's category.

❁ **Stars** Units with a high market share in a fast-growing industry. The hope is that stars become the next cash cows. Sustaining the business unit's market leadership may require extra cash, but this is worthwhile if that's what it takes for the unit to remain a leader. When growth slows, stars become cash cows if they have been able to maintain their category leadership.

#### 4. The Internal-External (IE) Matrix

This is also an important matrix of matching stage of strategy formulation. This matrix already explains earlier. It relate to internal (IFE) and external factor evaluation (EFE). The findings form internal and external position and weighted score plot on it. It contains nine cells. Its characteristics is a s follow

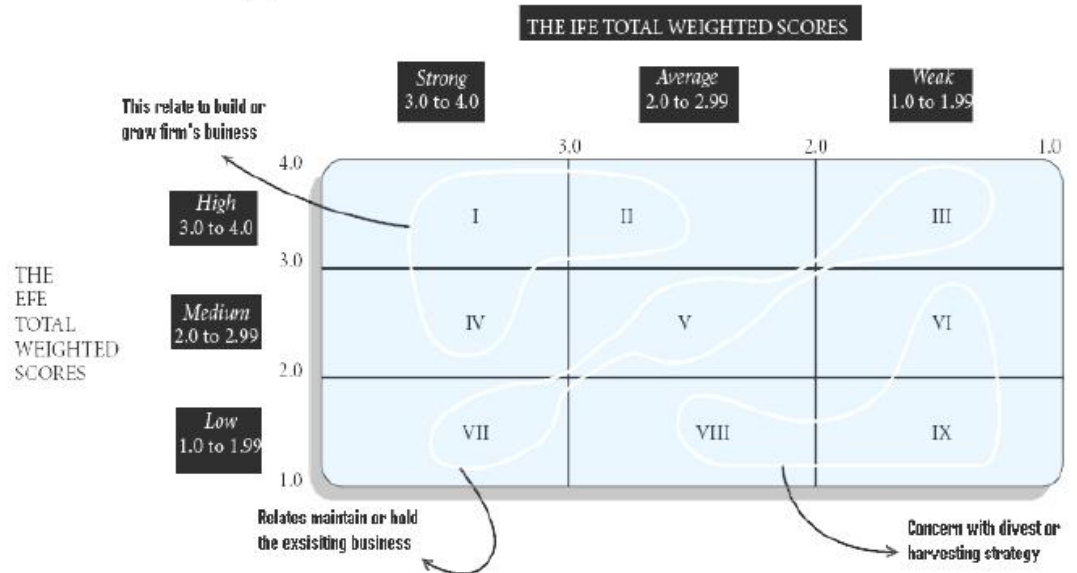
➤ Positions an organization's various divisions in a nine-cell display.

Similar to BCG Matrix except the IE Matrix:

- Requires more information about the divisions
- Strategic implications of each matrix are different
- Based on two key dimensions
  - ✓ The IFE total weighted scores on the x-axis
  - ✓ The EFE total weighted scores on the y-axis
- Divided into three major regions
  - ✓ Grow and build – Cells I, II, or IV
  - ✓ Hold and maintain – Cells III, V, or VII

- ✓ Harvest or divest – Cells VI, VIII, or IX

The Internal-External (IE) Matrix



### Steps for the development of IE matrix

1. Based on two key dimensions IFE and EFE.
2. Plot IFE total weighted scores on the  $x$ -axis and the EFE total weighted scores on the  $y$  axis
3. On the  $x$ -axis of the IE Matrix, an IFE total weighted score of 1.0 to 1.99 represents a weak internal position; a score of 2.0 to 2.99 is considered average; and a score of 3.0 to 4.0 is strong.
4. On the  $y$ -axis, an EFE total weighted score of 1.0 to 1.99 is considered low; a score of 2.0 to 2.99 is medium; and a score of 3.0 to 4.0 is high.
5. IE Matrix divided into three major regions.
  - Grow and build – Cells I, II, or IV
  - Hold and maintain – Cells III, V, or VII
  - Harvest or divest – Cells VI, VIII, or IX

### 5. GRAND STRATEGY MATRIX

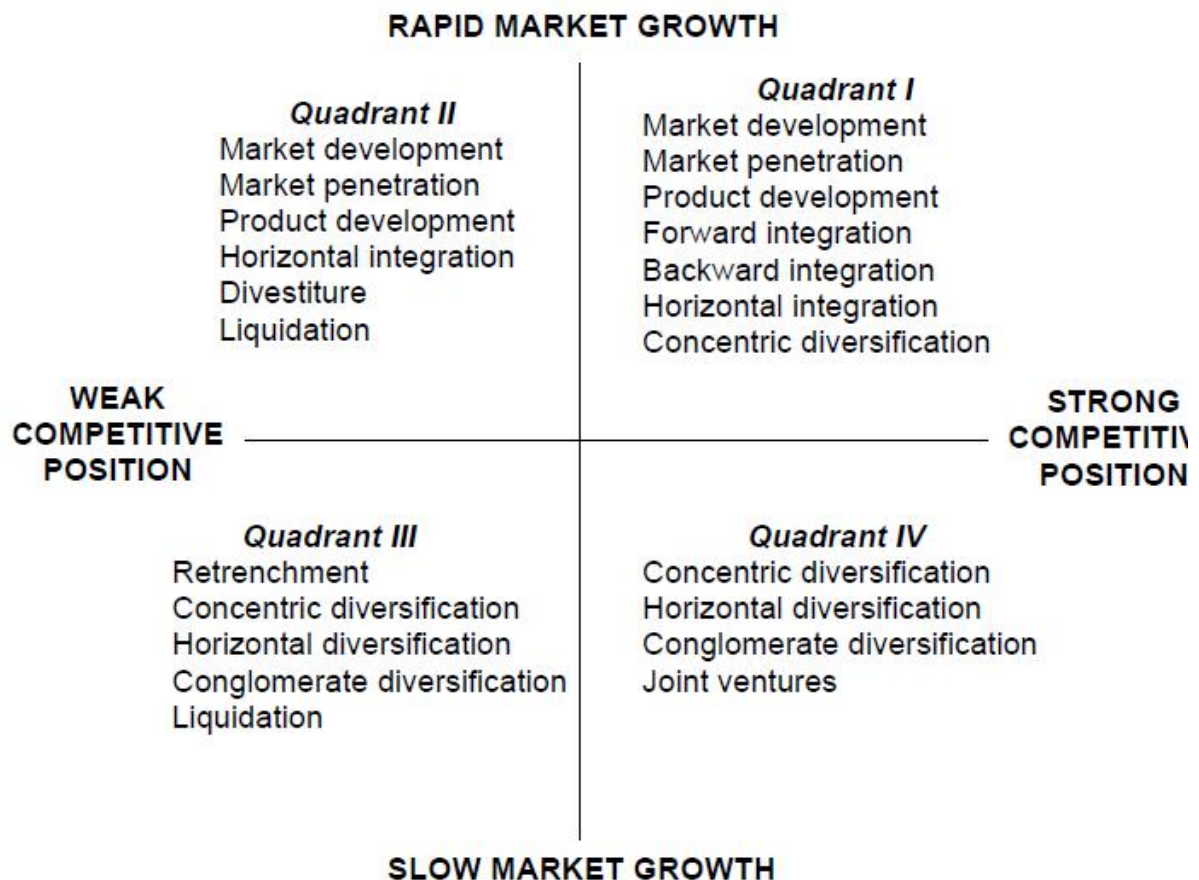
This is also an important matrix of strategy formulation frame work. Grand strategy matrix it is popular tool for formulating alternative strategies. In this matrix all organization divides into four quadrants.

Any organization should be placed in any one of four quadrants. Appropriate strategies for an organization to consider are listed in sequential order of attractiveness in each quadrant of the matrix.

It is based two major dimensions

1. Market growth
2. Competitive position

➡ All quadrant contain all possible strategies



**Quadrant-I** contains that company's strong having competitive situation and rapid market growth. Firms located in Quadrant I of the Grand Strategy Matrix are in an excellent strategic position. These firms must focus on current market and appropriate to follow market penetration, market development and products development are appropriate strategies.

**Quadrant-2** contains that company's having weak competitive situation and rapid market growth. Firms positioned in Quadrant II need to evaluate their present approach to the marketplace seriously.

Although their industry is growing, they are unable to compete effectively, and they need to determine why the firm's current approach is ineffectual and how the company can best change to improve its competitiveness. Because Quadrant II firms are in a rapid-market-growth industry, an intensive strategy (as opposed to integrative or diversification) is usually the first option that should be considered.

**Quadrant-3** contains that company's weak competitive situation and slow market growth. The firms fall in this quadrant compete in slow-growth industries and have weak competitive positions. These firms must make some drastic changes quickly to avoid further demise and possible liquidation. Extensive cost and asset reduction (retrenchment) should be pursued first. An alternative strategy is to shift resources away from the current business into different areas. If all else fails, the final options for

Quadrant III businesses are divestiture or liquidation.

**Quadrant-4** contains that company's strong competitive situation and slow market growth. Finally, Quadrant IV businesses have a strong competitive position but are in a slow-growth industry. These firms have the strength to launch diversified programs into more promising growth areas. Quadrant IV firms have characteristically high cash flow levels and limited internal growth needs and often can pursue concentric, horizontal, or conglomerate diversification successfully. Quadrant IV firms also may pursue joint ventures

### Stage-3 (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 an objective basis for selecting specific strategies.

#### ➡ The Quantitative Strategic Planning Matrix (QSPM)

The last stage of strategy formulation is decision stage. In this stage it is decided that which way is most appropriate or which alternative strategy should be select. This stage contains QSPM that

is only tool for objective evaluation of alternative strategies. A quantitative method used to collect data and prepare a matrix for strategic planning. It is based on identified internal and external crucial success factors. That is only technique designed to determine the relative attractiveness of feasible alternative action. 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 TOWS Matrix, SPACE Analysis, BCG Matrix, IE Matrix, and Grand Strategy Matrix that make up Stage 2, provide the needed information for setting up the QSPM (Stage 3).

### **Preparation of matrix**

Now the question is that how to prepare QSPM matrix. First it contains key internal and external factors. An internal factor contains (strength and weakness) and external factor include (opportunities and threats). It relates to previously IFE and EFE in which weight to all factors. Weight means importance to internal and external factor. The sum of weight must be equal to one. After assigning the weights examine stage-2 matrices and identify alternatives strategies that the organization should consider implementing. The top row of a QSPM consists of alternative strategies derived from the TOWS Matrix, SPACE Matrix, BCG Matrix, IE Matrix, and Grand Strategy Matrix. These matching tools usually generate similar feasible alternatives. However, not every strategy suggested by the matching techniques has to be evaluated in a QSPM. Strategists should use good intuitive judgment in selecting strategies to include in a QSPM. After assigning the weight to strategy, determine the attractiveness score of each and afterwards total attractiveness score. The highest total attractiveness score strategy is most feasible.

### **Steps in preparation of QSPM**

1. List of the firm's key external opportunities/threats and internal strengths/weaknesses in the left column of the QSPM.
2. Assign weights to each key external and internal factor
3. Examine the Stage 2 (matching) matrices and identify alternative strategies that the organization should consider implementing
4. Determine the Attractiveness Scores (AS)



5. Compute the Total Attractiveness Scores
6. Compute the Sum Total Attractiveness Score

<u>Key External Factors</u>	<u>Weight</u>	<u>Strategy 1</u>		<u>Strategy 2</u>		<u>Strategy 3</u>	
		<u>AS</u>	<u>TAS</u>	<u>AS</u>	<u>TAS</u>	<u>AS</u>	<u>TAS</u>
Economy conditions							
Social/Cultural/Demographic							
/Environmental							
Political/Legal/Governmental							
Competitive							
Technological							
Consumer attitude							
 <u>Key Internal Factors</u>							
Research and Development							
Computer Information							
Finance/Accounting							
Production/Operations							
Management							
Marketing							
Systems							

### Limitations

1. Requires intuitive judgments and educated assumptions
2. Only as good as the prerequisite inputs
3. Only strategies within a given set are evaluated relative to each other

### Advantages

1. Sets of strategies considered simultaneously or sequentially
2. Integration of pertinent external and internal factors in the decision making process

## 5.6. The Balanced Scorecard (BSC Model )

Objective setting is not an isolated process. As has already been discussed there is a need for managers to know the key criteria by which their performance against objectives will be measured. There is a clear link between setting objectives and the setting of performance measures. The balanced scorecard (Kaplan and Norton, 1992, 1993) is an approach that more

clearly links these two activities. Kaplan and Norton suggest that a balanced set of objectives should be created and at the same time a coherent set of performance measures should be developed alongside them.

➡ At the core of the balanced scorecard approach is the belief that managers have to be able to look at a business from four key perspectives:

1. *Customer perspective*: How customers see a business is critical, but financial measures alone do not provide this view. Customers are generally concerned with, quality, performance, service and time. For each of these categories the organization should develop objectives and performance measures. Obviously how these categories are defined has to be from the customer's perspective. This will allow the organization to track how customers view the business overtime.
2. *Internal perspective*: Managers have to identify the critical internal processes that will allow them to satisfy customer needs. Identifying the processes that are important to customer satisfaction allows managers to identify the functions and competencies in which they need to excel.
3. *Innovation and learning perspective*: An organization's ability to create value is inextricably linked to its capacity to continually improve through innovation and learning.
4. *Financial perspective*: This allows the organization to see how the business looks from the shareholders point of view. This financial performance measures the success, not only of an organization's strategy, but also of its implementation.

➡ The balanced scorecard widens the view managers have of the business rather than concentrating purely on financial criteria. For each of these perspectives the organization has to create distinct objectives and at the same time develop the accompanying performance measures. This process also forces managers to understand many complex relationships and to surmount some of the traditional functional barriers that hamper strategic development (see Figure).

	Strategic objectives	Strategic measures
Financial	F.1 Return on capital F.2 Cash flow F.3 Profitability F.4 Profitability growth F.5 Reliability of performance	→ ROCE → Cash flow → Net margin → Volume growth rate versus industry → Profit forecast reliability → Sales backlog
Customer	C.1 Value for money C.2 Competitive price C.3 Customer satisfaction	→ Customer ranking survey → Pricing index → Customer satisfaction index → Mystery shopping rating
Internal	I.1 Marketing <ul style="list-style-type: none"> <li>• Product and service development</li> <li>• Shape customer requirement</li> </ul> I.2 Manufacturing <ul style="list-style-type: none"> <li>• Lower manufacturing cost</li> <li>• Improve project management</li> </ul> I.2 Logistics <ul style="list-style-type: none"> <li>• Reduce delivery costs</li> <li>• Inventory management</li> </ul> I.4 Quality	→ Pioneer percentage of product portfolio → Hours with customer on new work → Total expenses per unit versus competition → Safety incident index → Delivered cost per unit → Inventory level compared to plan and output rate → Rework
Innovation and Learning	I.L.1 Innovate products and services I.L.2 Time to market I.L.3 Empowered workforce I.L.4 Access to strategic information I.L.5 Continuous improvement	→ Percentage revenue from pioneer products → Cycle time versus industry norm → Staff attitude survey → Strategic information availability → Number of employee suggestions

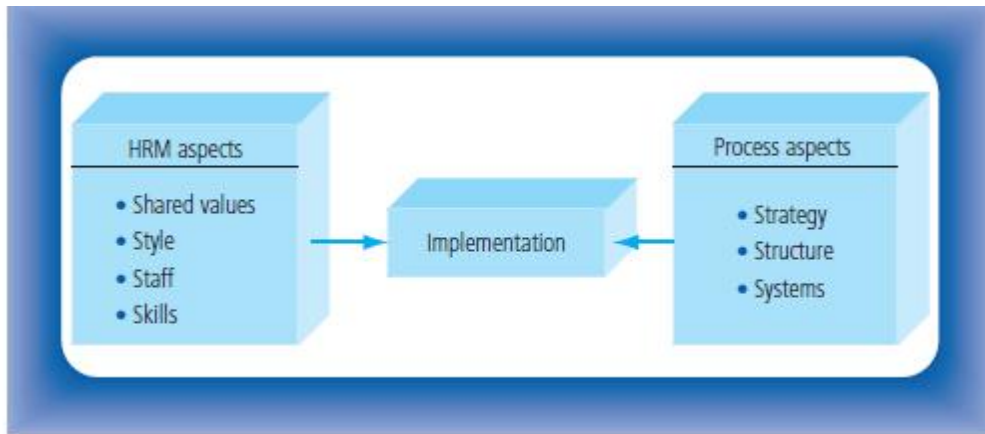
**Figure:** The balanced scorecard (Source: Adapted from Kaplan and Norton, 1992, 1993)

- ➡ The balanced scorecard approach also addresses one other potential problem that of ensuring consistency between objectives. This can be difficult in practice because objectives are formed in a range of areas, at different levels and on different time scales (effectively objectives are formed both horizontally and vertically through the organization).

### 5.7. The 7'S model (The seven S's)

The McKinsey and Company's 'Seven-S' model provides a useful summation of these ideas. The model can be adapted as seen in Figure and split into:

- ➡ HRM – dealing with the people-based aspects of implementation and
- ➡ (ii) Process – the policy, procedures, reporting and systems aspects of implementation.



#### **Skills**

The appropriate skills mix is required in order to achieve any aim or goal. Within the context of implementing marketing strategy 'softer' human resource management (HRM) skills can be lacking. It should be remembered that project management is a skill in its own right.

- ➡ To summaries, successful implementation requires skills such as:
  - Technical/marketing skills for example, design, market research, industry analysis.
  - HRM skills for example, delegation, performance appraisal, training.
  - Project management skills for example, budgeting, resourcing, forecasting.

#### **Strategy**

To state the obvious, there must be a strategy to implement. However the fact that a strategy exists may not be apparent to everyone.

Additionally, the strategy may not be seen as appropriate by all staff. The project leader must ensure people are aware of the strategy, the reason for it and their role in making it work.

Potential strategy should be screened to ensure that it is appropriate to current circumstances. For example, what is the basis of competitive advantage? What organisational changes need to take place?

### ***Systems***

Several systems are important in the implementation process and fall into two general groups: reporting and forecasting. It is necessary to have systems which aid management decision making. *Note:* These are aids to decision making and not replacements for decision making.

Such systems will cover areas such as finance and budgeting, project evaluation/refinement and market research. The key factor is often the interpretation of information rather than the system itself.

### ***Structure***

The structure of any organisation, or project, has two primary functions. Firstly, it defines lines of authority denoting levels of responsibility. Current management thinking promotes a move towards flatter structures with more devolved authority. Secondly, structure is a basis for communication. Structures can filter out information making senior management remote from the customer. In the area of implementation consideration should be given to how communication occurs.

In relation to developing marketing strategy, it can be advisable to have multi-functional teams. A group with a diverse range of backgrounds can promote ownership of projects, identify operational problems in advance and enhance overall quality.

## CHAPTER SIX: STRATEGY IMPLEMENTING

### Chapter Objectives

At the end of this unit, students will be able to:

- ✓ Explain the nature of strategy implementation.
- ✓ Describe the key concepts in strategy implementation.
- ✓ Explain the importance of implementing strategy

## INTRODUCTION

The strategic-management process does not end with deciding what strategy or strategies to pursue. There must be a translation of strategic thought into action. This translation is much easier if managers and employees of the firm understand the business, feel a part of the company, and through involvement in strategy-formulation activities have become committed to helping the organization succeed. Without understanding and commitment, strategy implementation efforts face major problems.

**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. Although implementation is usually considered after strategy has been formulated, implementation is a key part of strategic management. Strategy formulation and strategy implementation should thus be considered as two sides of the same coin.

Poor implementation has been blamed for a number of strategic failures. For example, studies show that half of all acquisitions fail to achieve what was expected of them, and one out of four international ventures does not succeed. The most-mentioned problems reported in post-merger integration were poor communication, unrealistic synergy expectations, structural problems, missing master plan, lost momentum, lack of top management commitment, and unclear strategic fit.

### 6.1. The Nature of Strategy Implementation

It is possible to turn strategies and plans into individual actions, necessary to produce a great business performance. But it's not easy. Many companies repeatedly fail to truly motivate their people to work with enthusiasm, all together, towards the corporate aims. Most companies and organizations know their businesses, and the strategies required for success. However many corporations - especially large ones - struggle to translate the theory into action plans that will enable the strategy to be successfully implemented and sustained. Here are some leading edge methods for effective strategic corporate implementation. These advanced principles of strategy realization are provided by the very impressive.

Most companies have strategies, but according to recent studies, between 70% and 90% of organizations that have formulated strategies fail to execute them.

A Fortune Magazine study has shown that 7 out of 10 CEOs, who fail, do so not because of bad strategy, but because of bad execution.

In another study of Times 1000 companies, 80% of directors said they had the right strategies but only 14% thought they were implementing them well.

Only 1 in 3 companies, in their own assessment, were achieving significant strategic success.

The message clear - effective strategy realization is key for achieving strategic success. Successful strategy formulation does not guarantee successful strategy implementation. It is always more difficult to do something (strategy implementation) than to say you are going to do it (strategy formulation)! Although inextricably linked, strategy implementation is fundamentally different from strategy formulation. Strategy formulation and implementation can be contrasted in the following ways:

- Strategy formulation is positioning forces before the action.
- Strategy implementation is managing forces during the action.
- Strategy formulation focuses on effectiveness.
- Strategy implementation focuses on efficiency.
- Strategy formulation is primarily an intellectual process.
- Strategy implementation is primarily an operational process.
- Strategy formulation requires good intuitive and analytical skills.
- Strategy implementation requires special motivation and leadership skills.
- Strategy formulation requires coordination among a few individuals.
- Strategy implementation requires coordination among many persons.

- ✓ Implementation is the action phase of the strategic management process. It is the process of making things happen & involves (Holt, 1993):
  - Allocating resources through budgets
  - Developing programs & projects that activate the organization
  - Articulating policies, procedures & rules that can be used in guiding activities on daily basis.
- ✓ For **successful execution** of the formulated strategy, the following must be considered:
  - Acquiring human, financial, & physical resources.
  - Organizational structure, culture, & internal systems must be consistent with the formulated strategy.
  - Making necessary internal changes in order to achieve the objectives.
  - Briefly, resources must **match** with the formulated strategy for its implementation.
  - Consistently, **strategy implementation** should focus on:
    - ✓ Research & Development
    - ✓ Marketing effort
    - ✓ Changing the way activities are grouped
    - ✓ Rearranging reporting relationships
    - ✓ Reward system for encouraging extra attention needed by new activities.
    - ✓ Controlling & information systems, etc.

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 computer information system.



## 6.2. Key Concepts in Strategy Implementation

Components of strategy implementation (Rue & Holland, 1989)

- Is the formulated strategy communicated properly?
- Are structuring mechanisms properly aligned?
- Are functional area conflicts reconciled?
- Does leadership inspire commitment to the formulated strategy
- Do reward systems reinforce appropriate behavior?
- Are functional issues addressed & implemented?
- Does the control system provide appropriate feedback?

✓ **Communicating strategy:** Before a strategy can be implemented it must be understood. A clear understanding of strategy gives purpose to the activities of each organization member.

✓ **Matching Structure with Strategy:** Achieving a fit between strategy & structure is a complex process that involves how activities will be grouped & groups will be coordinated. This refers to the need for identifying the appropriate types of organizational structure, linking organizational units, & decision making (centralization vs. decentralization)

- **Definition: Organizational structure** is a firm's role configuration, procedures, governance, control mechanisms, authority & decision-making processes.
- Thus, organizational structure must be congruent with the strategy to achieve strategic competitiveness. However, the structure should be changed when no longer provides the coordination, control & direction required to implement the strategy successfully.
- Organizational structure facilitates the implementation of the strategy .Although there are many types of structures, three basic types identified:
  - ✓ Simple,
  - ✓ functional &

✓ Matrix structure

- **Simple structure:** an organizational form in which the owner-manager makes all decisions directly & monitors all activities – employees serve as an extension of the manager's supervisory authority.
- **Features:**
  - Little specialization of tasks
  - Few rules & limited formalization
  - Communication is frequent & direct
  - Offering products in a single geographic market
  - New products tend to be introduced to the market quickly – competitive advantage
- **Functional structure:** an organizational form where dominant organizational areas such as human resource, production, accounting & finance, marketing, R&D, & engineering are separately organized. A *functional structure* is groups' tasks and activities by business function, such as production/operations, marketing, finance/accounting, research and development, and management information systems. A university may structure its activities by major functions that include academic affairs, student services, alumni relations, athletics, maintenance, and accounting.

Besides being simple and inexpensive, a functional structure also promotes specialization of labor, encourages efficient use of managerial and technical talent, minimizes the need for an elaborate control system, and allows rapid decision making.

- **Features:**
  - Facilitates specialization, knowledge sharing & idea development
  - Facilitates career paths & professional development in specialized areas
  - However, differences in orientation impede communication & coordination
- A **matrix structure** is the most complex of all designs because it depends upon both vertical and horizontal flows of authority and communication (hence the term *matrix*). In contrast, functional and divisional structures depend primarily on vertical flows of authority and communication. A matrix structure can result in higher overhead because it creates more management positions. Other disadvantages of a matrix structure that

contribute to overall complexity include dual lines of budget authority (a violation of the unity-of-command principle), dual sources of reward and punishment, shared authority, dual reporting channels, and a need for an extensive and effective communication system.

- ✓ **Leadership commitment:** The behavior & activities of top management contribute to strategy implementation by:
  - Supporting the strategy & building the culture of the organization by example
  - Making decisions based on skills, personality, & experience
- ✓ **Design & implement reward systems**
  - Recognizing or not outstanding performance sends different signals
  - The timing & criteria used to determine salary increments & bonuses have impacts on performance
  - Differentiate b/n monetary reward vs. status, recognition, & attention – there are employees who highly value the latter

### 6.3. Implementing Strategies Management Issues

#### Functional issues

- The most common functional areas & issues:
  - Marketing:
    - Products/services
    - Pricing & distribution
    - Promotion, etc.
  - Operations:
    - Production methods & processes
    - Adequate capacity to meet demand
    - Adequate inventory level & proper inventory control
    - Availability of appropriate employees & raw materials, etc.
  - Accounting & Finance:

- Availability of long & short-term financing
- Cost of capital
- Dividend policy
- The effect of currency revaluation & devaluation
- The overall tax regimes
- Preparation of budgets, etc.

**Research & Development:** Research and development (R&D) personnel can play an integral part in strategy implementation. These individuals are generally charged with developing new products and improving old products effectively. R&D persons perform tasks that include transferring complex technology, adjusting processes to local raw materials, adapting processes to local markets, and altering products to particular tastes and specifications. Strategies such as product development, market penetration, and related diversification require that new products be successfully developed and that old products be significantly improved.

Information systems:

- Provide support for internal decision-making & for monitoring the progress of strategy implementation
- Provide information about external trends: markets, political, economic, technological environments, etc.
- It is important that the information system provides information that is:
  - ✓ Timely
  - ✓ Relevant
  - ✓ Complete
- Moreover, the system itself must be easily accessible to the user
- In designing an information system to fit the strategy the two variables that must be observed: Focus of the system (cost and/or profit) and the relationship of organizational units (*shared resources* vs. *independent units*).

## CHAPTER SEVEN: STRATEGY EVALUATION AND CONTROL

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*“The prime task is to think through the overall mission of a business”. (Peter Drucker )*

### Chapter Objectives

At the end of this lesson students will be able to:

- ✓ Explain the nature of strategy evaluation.
- ✓ Describe a strategic evaluation
- ✓ Understand about the published sources of strategy evaluation.
- ✓ Elaborate the characteristics of an effective evaluation system.
- ✓ Define the contingency model.
- ✓ Explain the control process

## INTRODUCTION

Evaluation is the systematic determination of merit, worth, and significance of something or someone.

Evaluation often is used to characterize and appraise subjects of interest in a wide range of human enterprises, including the Arts, business, computer science, criminal justice, education, engineering, foundations and non-profit organizations, government, health care, and other human services.

In the field of evaluation, there is some degree of disagreement in the distinctions often made between the terms 'evaluation' and 'assessment.' Some practitioners would consider these terms to be interchangeable, while others contend that evaluation is broader than assessment and involves making judgments about the merit or worth of something (an evaluand) or someone (an evaluatee). When such a distinction is made, 'assessment' is said to primarily involve characterizations – objective descriptions, while 'evaluation' is said to involve characterizations *and* appraisals – determinations of merit and/or worth. Merit involves judgments about generalized [value](#). Worth involves judgments about instrumental value. For example, a history and a mathematics teacher may have equal merit in terms of mastery of their respective disciplines, but the math teacher may have greater worth because of the higher demand and lower supply of qualified mathematics teachers. A further degree of complexity is introduced to this argument when working in different languages, where the terms 'evaluation' and 'assessment'

may be variously translated, with terms being used that convey differing connotations related to conducting characterizations and appraisals.

### **7.1. The Nature of Strategy Evaluation**

The strategic-management process results in decisions that can have significant, long-lasting consequences. Erroneous strategic decisions can inflict 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, and (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 operates. 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. No one likes to be evaluated too closely! The more managers attempt to evaluate the behavior of others, the less control they have. Yet, too little or no evaluation can create even worse problems. 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.

### **7.2. Purpose of Strategy Evaluation**

- Strategy evaluation is vital to the organization's well-being
- Alert management to potential or actual problems in a timely fashion
- Erroneous strategic decisions can have severe negative impact on organizations

**Basic Activities –**

1. Examining the underlying bases of a firms' strategy
2. Comparing expected to actual results
3. Corrective actions to ensure performance conforms to plans

In many organizations, evaluation is an appraisal of performance –

- Have assets increased?
- Increase in profitability?
- Increase in sales?
- Increase in productivity?
- Profit margins, ROI and EPS ratios increased

**Four Criteria (Richard Rumelt):** He explains four criteria for strategy valuation. These four criteria are as follow:

**Consistency:** Strategy should not present inconsistent goals and policies.

- Conflict and interdepartmental bickering symptomatic of managerial disorder and strategic inconsistency

**Consonance:** Need for strategies to examine sets of trends

- Adaptive response to external environment
- Trends are results of interactions among other trends

**Feasibility:** Neither overtaxes resources nor creates unsolvable sub problems

- Organizations must demonstrate the abilities, competencies, skills and talents to carry out a given strategy.

**Advantage:** Creation or maintenance of competitive advantage

- Superiority in resources, skills, or position.

**Difficulty in strategy evaluation –**

1. Increase in environment's complexity
2. Difficulty predicting future with accuracy

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*"The prime task is to think through the overall mission of a business". (Peter Drucker )*



3. Increasing number of variables
4. Rate of obsolescence of plans
5. Domestic and global events
6. Decreasing time span for planning certainty

### **Advantage**

Creation or maintenance of competitive advantage

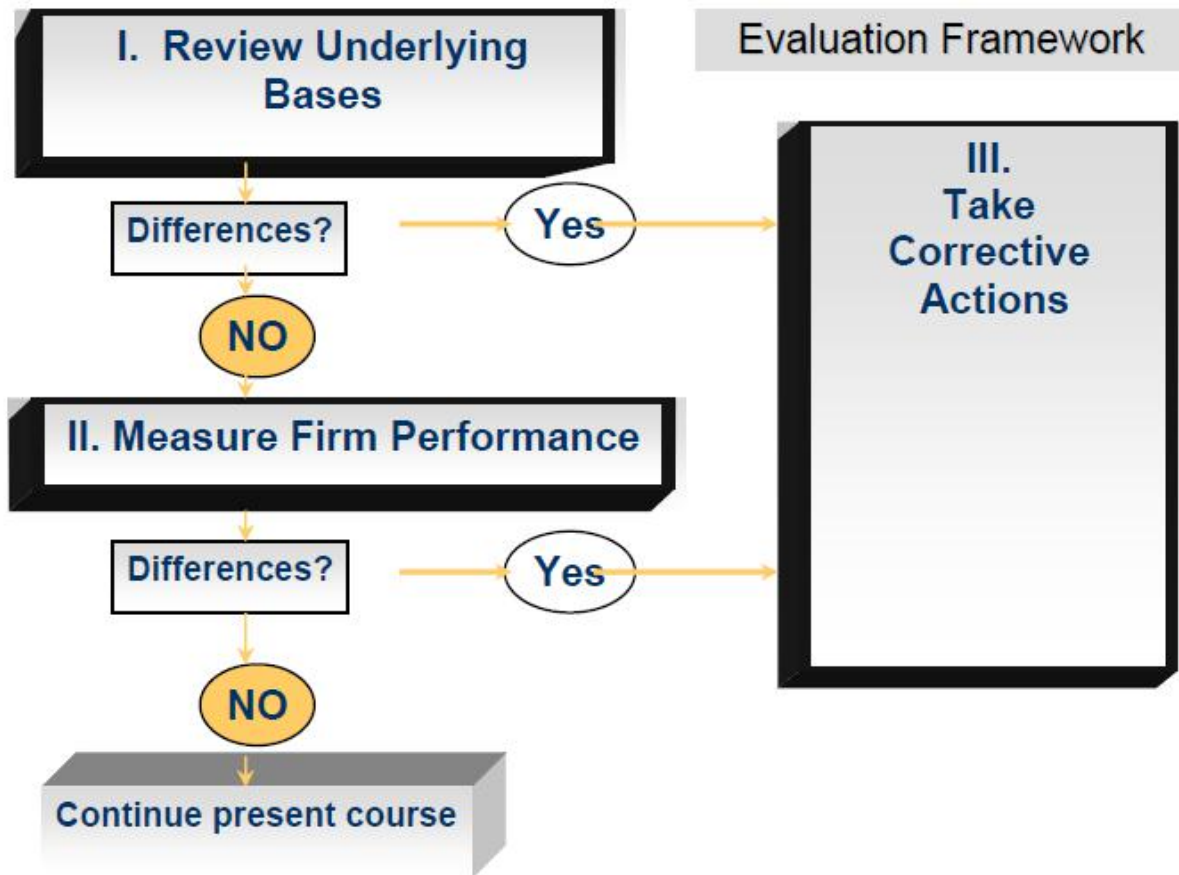
- Superiority in resources, skills, or position

## **7.3. The Process of Evaluating Strategies**

1. Strategy evaluation is necessary for all sizes and kinds of organization. Strategy evaluation should initiate managerial questioning of expectations and assumptions should trigger a review of objectives and values and should stimulate creativity in generating alternative and formulating criteria of evaluation
2. Evaluating strategies on continuous rather than a periodic basis allows benchmark of progress to established and o\more effectively monitored
3. Managers and employees of the firm should be continually aware of progress being made towards achieving the firm's objectives. As a critical success factors change, organization members should be involved in determining appropriate corrective action.

## **7.4. A Strategy Evaluation Framework**

Strategy-evaluation activities 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.



### 1. 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 computer 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:

1. How have competitors reacted to our strategies?
2. How have competitors' strategies changed?
3. Have major competitors' strengths and weaknesses changed?
4. Why are competitors making certain strategic changes?
5. Why are some competitors' strategies more successful than others?
6. How satisfied are our competitors with their present market positions and profitability?

7. How far can our major competitors be pushed before retaliating?
8. How could we more effectively cooperate with our competitors?

Numerous external and internal factors can prohibit 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 prohibit 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. Sometimes managers and employees on the front line discover this well before strategists.

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 what ways. Some key questions to address in evaluating strategies are given here.

1. Are our internal strengths still strengths?
2. Have we added other internal strengths? If so, what are they?
3. Are our internal weaknesses still weaknesses?
4. Do we now have other internal weaknesses? If so, what are they?
5. Are our external opportunities still opportunities?
6. Are there now other external opportunities? If so, what are they?
7. Are our external threats still threats?
8. Are there now other external threats? If so, what are they?
9. Are we vulnerable to a hostile takeover?

## **2. Measuring Organizational Performance**

Another important strategy-evaluation activity is *measuring organizational performance*. This activity includes comparing expected results to actual results, investigating deviations from plans, evaluating individual performance, and examining progress being made toward meeting stated objectives. Both long-term and annual objectives are commonly used in this process. Criteria for

evaluating strategies should be measurable and easily verifiable. Criteria that predict results may be more important than those that reveal what already has happened. For example, rather than simply being informed that sales last quarter were 20 percent under what was expected, strategists need to know that sales next quarter may be 20 percent below standard unless some action is taken to counter the trend. Really effective control requires accurate forecasting.

Failure to make satisfactory progress toward accomplishing long-term or annual objectives signals a need for corrective actions. Many factors, such as unreasonable policies, unexpected turns in the economy, unreliable suppliers or distributors, or ineffective strategies, can result in unsatisfactory progress toward meeting objectives. Problems can result from ineffectiveness (not doing the right things) or inefficiency (doing the right things poorly).

Determining which objectives are most important in the evaluation of strategies can be difficult. Strategy evaluation is based on both quantitative and qualitative criteria. Selecting the exact set of criteria for evaluating strategies depends on a particular organization's size, industry, strategies, and management philosophy. An organization pursuing a retrenchment strategy, for example, could have an entirely different set of evaluative criteria from an organization pursuing a market-development strategy.

Quantitative criteria commonly used to evaluate strategies are financial ratios, which strategists use to make three critical comparisons: (1) comparing the firm's performance over different time periods, (2) comparing the firm's performance to competitors', and (3) comparing the firm's performance to industry averages. Some key financial ratios that are particularly useful as criteria for strategy evaluation are as follows:

1. Return on investment
2. Return on equity
3. Profit margin
4. Market share
5. Debt to equity
6. Earnings per share
7. Sales growth
8. Asset growth

But there are some potential problems associated with using quantitative criteria for evaluating strategies. First, most quantitative criteria are geared to annual objectives rather than long-term objectives. Also, different accounting methods can provide different results on many quantitative criteria. Third, intuitive judgments are almost always involved in deriving quantitative criteria. For these and other reasons, qualitative criteria are also important in evaluating strategies. Human factors such as high absenteeism and turnover rates, poor production quality and quantity rates, or low employee satisfaction can be underlying causes of declining performance. Marketing, finance/accounting, R&D, or computer information systems factors can also cause financial problems. Seymour Tilles identified six qualitative questions that are useful in evaluating strategies:

1. Is the strategy internally consistent?
2. Is the strategy consistent with the environment?
3. Is the strategy appropriate in view of available resources?
4. Does the strategy involve an acceptable degree of risk?
5. Does the strategy have an appropriate time framework?
6. Is the strategy workable?

Some additional key questions that reveal the need for qualitative or intuitive judgments in strategy evaluation are as follows:

1. How good is the firm's balance of investments between high-risk and low-risk projects?
2. How good is the firm's balance of investments between long-term and short-term projects?
3. How good is the firm's balance of investments between slow-growing markets and fast growing markets?
4. How good is the firm's balance of investments among different divisions?
5. To what extent are the firm's alternative strategies socially responsible?
6. What are the relationships among the firm's key internal and external strategic factors?
7. How are major competitors likely to respond to particular strategies?

### 3. Taking Corrective Actions

The final strategy-evaluation activity, *taking corrective actions*, requires making changes to reposition a firm competitively for the future. Examples of changes that may be needed are altering an organization's structure, replacing one or more key individuals, selling a division, or

revising a business mission. Other changes could include establishing or revising objectives, devising new policies, issuing stock to raise capital, adding additional salespersons, allocating resources differently, or developing new performance incentives. Taking corrective actions does not necessarily mean that existing strategies will be abandoned or even that new strategies must be formulated.

The probabilities and possibilities for incorrect or inappropriate actions increase geometrically with an arithmetic increase in personnel. Any person directing an overall undertaking must check on the actions of the participants as well as the results that they have achieved. If either the actions or results do not comply with preconceived or planned achievements, then corrective actions are needed.

No organization can survive as an island; no organization can escape change. Taking corrective actions is necessary to keep an organization on track toward achieving stated objectives.

### **7.5. Characteristics of an Effective Evaluation System**

A Good evaluation system must possess various qualities. It must meet several basic requirements to be effective. First, strategy-evaluation 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. Strategy-evaluation activities also should be meaningful; they should specifically relate to a firm's objectives. They should provide managers with useful information about tasks over which they have control and influence.

Strategy-evaluation activities should provide timely information; on occasion and in some areas, managers may need information daily. 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 as 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.

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 portray this type of situation fairly.

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 for informational purposes only; not all managers need to receive all reports. Controls need to be action-oriented rather than information-oriented.

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. 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.

Large organizations require a more elaborate and detailed strategy-evaluation system because it is more difficult to coordinate efforts among different divisions and functional areas. Managers in small companies often communicate with each other and their employees daily and do not need extensive evaluative reporting systems. Familiarity with local environments usually makes gathering and evaluating information much easier for small organizations than for large businesses. But the key to an effective strategy evaluation system may be the ability to convince participants that failure to accomplish certain objectives within a prescribed time is not necessarily a reflection of their performance.

There is no one ideal strategy-evaluation system. The unique characteristics of an organization, including its size, management style, purpose, problems, and strengths, can determine a strategy-evaluation and control system's final design. Robert Waterman offered the following observation about successful organizations' strategy-evaluation and control systems:

Successful companies treat facts as friends and controls as liberating. Morgan Guaranty and Wells Fargo not only survive but thrive in the troubled waters of bank deregulation, because their strategy evaluation and control systems are sound, their risk is contained, and they know themselves and the competitive situation so well. Successful companies have a voracious hunger

for facts. They see information where others see only data. They love comparisons, rankings, anything that removes decision-making from the realm of mere opinion. Successful companies maintain tight, accurate financial controls. Their people don't regard controls as an imposition of autocracy, but as the benign checks and balances that allow them to be creative and free.

## **7.6. The Contingency Model (Contingency Planning)**

A basic premise of good strategic management is that firms plan ways to deal with unfavorable and favorable events before they occur. Too many organizations prepare contingency plans just for unfavorable events; this is a mistake, because both minimizing threats and capitalizing on opportunities can improve a firm's competitive position.

Regardless of how carefully strategies are formulated, implemented, and evaluated, unforeseen events such as strikes, boycotts, natural disasters, arrival of foreign competitors, and government actions can make a strategy obsolete. To minimize the impact of potential threats, organizations should develop contingency plans as part of the strategy-evaluation process. *Contingency plans* can be defined as alternative plans that can be put into effect if certain key events do not occur as expected. Only high-priority areas require the insurance of contingency plans. Strategists cannot and should not try to cover all bases by planning for all possible contingencies. But in any case, contingency plans should be as simple as possible.

Some contingency plans commonly established by firms include the following:

1. If a major competitor withdraws from particular markets as intelligence reports indicate, what actions should our firm take?
2. If our sales objectives are not reached, what actions should our firm take to avoid profit losses?
3. If demand for our new product exceeds plans, what actions should our firm take to meet the higher demand?
4. If certain disasters occur—such as loss of computer capabilities; a hostile takeover attempt; loss of patent protection; or destruction of manufacturing facilities because of earthquakes, tornados, or hurricanes—what actions should our firm take?



5. If a new technological advancement makes our new product obsolete sooner than expected, what actions should our firm take?

Too many organizations discard alternative strategies not selected for implementation although the work devoted to analyzing these options would render valuable information. Alternative strategies not selected for implementation can serve as contingency plans in case the strategy or strategies selected do not work.

When strategy-evaluation activities reveal the need for a major change quickly, an appropriate contingency plan can be executed in a timely way. Contingency plans can promote a strategist's ability to respond quickly to key changes in the internal and external bases of an organization's current strategy. For example, if underlying assumptions about the economy turn out to be wrong and contingency plans are ready, and then managers can make appropriate changes promptly.

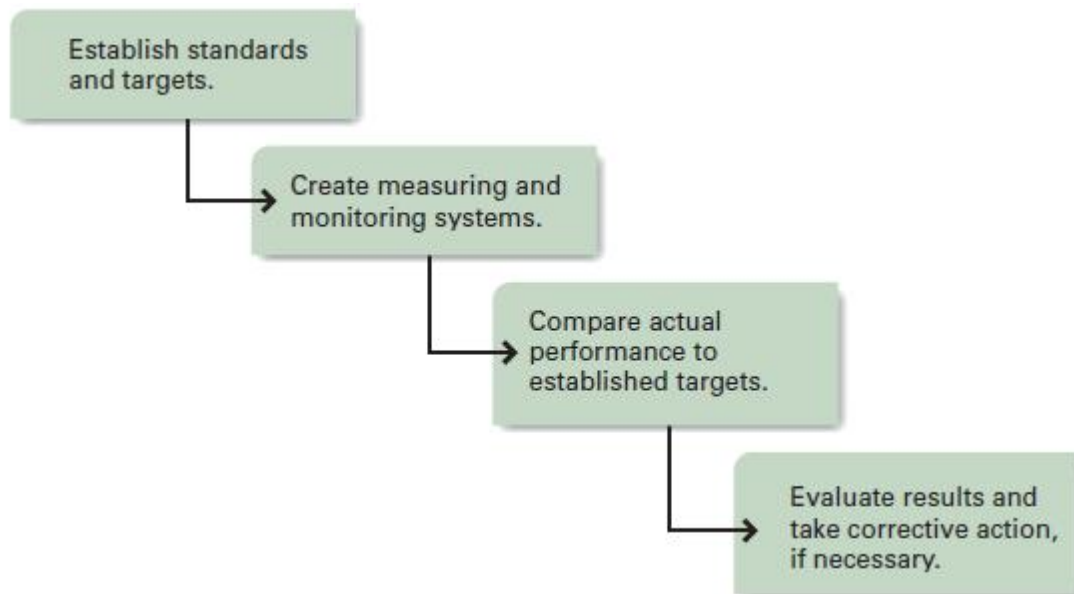
In some cases, external or internal conditions present unexpected opportunities. When such opportunities occur, contingency plans could allow an organization to capitalize on them quickly. Linneman and Chandran reported that contingency planning gave users such as DuPont, Dow Chemical, Consolidated Foods, and Emerson Electric three major benefits: It permitted quick response to change, it prevented panic in crisis situations, and it made managers more adaptable by encouraging them to appreciate just how variable the future can be. They suggested that effective contingency planning involves a seven-step process as follows:

1. Identify both beneficial and unfavorable events that could possibly derail the strategy or strategies.
2. Specify trigger points. Calculate about when contingent events are likely to occur.
3. Assess the impact of each contingent event. Estimate the potential benefit or harm of each contingent event.
4. Develop contingency plans. Be sure that contingency plans are compatible with current strategy and are economically feasible.
5. Assess the counter impact of each contingency plan. That is, estimate how much each contingency plan will capitalize on or cancel out its associated contingent event. Doing this will quantify the potential value of each contingency plan.
6. Determine early warning signals for key contingent events. Monitor the early warning signals.

7. For contingent events with reliable early warning signals, develop advance action plans to take advantage of the available lead time.

### 7.7. Strategic Control: Control Process

**Strategic control systems** are the formal target-setting, measurement, and feedback systems that allow strategic managers to evaluate whether a company is achieving superior efficiency, quality, innovation, and customer responsiveness and is implementing its strategy successfully. An effective control system should have three characteristics: it should be *flexible* enough to allow managers to respond as necessary to unexpected events; it should provide *accurate information*, giving a true picture of organizational performance; and it should supply managers with the information in a *timely manner*, because making decisions on the basis of outdated information is a recipe for failure.



*Figure. Steps in Designing an Effective Control System*

As figure shows, designing an effective strategic control system requires four steps.

1. *Establish the standards and targets against which performance is to be evaluated.* The standards and targets that managers select are the ways in which a company chooses to evaluate its performance. General performance standards often derive from the goal of achieving superior

efficiency, quality, innovation, or responsiveness to customers. Specific performance targets are derived from the strategy pursued by the company. For example, if a company is pursuing a low-cost strategy, then reducing costs by 7% a year might be a target. If the company is a service organization such as McDonald's, then its standards might include time targets for serving customers or guidelines for food quality.

2. *Create the measuring and monitoring systems that indicate whether the standards and targets are being reached.* The company establishes procedures for assessing whether work goals at all levels in the organization are being achieved. In some cases, measuring performance is fairly straightforward. For example, managers can measure quite easily how many customers their employees serve by counting the number of receipts from the cash register. In many cases, however, measuring performance is difficult because the organization is engaged in many complex activities. How can managers judge how well their research and development department is doing when it may take five years for products to be developed? How can they measure the company's performance when the company is entering new markets and serving new customers? How can they evaluate how well divisions are integrating their activities? The answer is that managers need to use various types of control systems, which we discuss later in this chapter.

3. *Compare actual performance to established targets.* Managers evaluate whether and to what extent performance deviates from the standards and targets developed in step 1. If performance is higher, management may decide that it has set the standards too low and may raise them for the next time period. The Japanese are renowned for the way they use targets on the production line to control costs; they are continually trying to raise performance, and they raise the standards to provide a goal for managers to work toward. On the other hand, if performance is too low, managers must decide whether to take remedial action. This decision is easy when the reasons for poor performance can be identified—for instance, high labor costs. More often, however, the reasons for poor performance are hard to uncover. They may stem from external factors, such as a recession.

Alternatively, the cause may be internal. For instance, the research and development laboratory may have underestimated the problems it would encounter or the extra costs of doing unforeseen research.

4. *Initiate corrective action when it is determined that the standards and targets are not being achieved.* The final stage in the control process is to take the corrective action that will allow the organization to meet its goals.

For example, managers may invest more resources in improving R&D, diversify, or even decide to change their organization structure. The goal is to continuously enhance the organization's competitive advantage.

**THE END.....**