Madhya Pradesh Bhoj (Open) University, Bhopal

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मध्यप्रदेश भोज (मुक्त) विश्वविद्यालय, भोपाल

SELF - LEARNING MATERIAL

MBA, Second Year

Paper - VII

STRATEGIC MANAGEMENT

MBA Second Year

Paper VII

STRATEGIC MANAGEMENT

मध्यप्रदेश भोज (मुक्त) विश्वविद्यालय – भोपाल

MADHYA PRADESH BHOJ (OPEN) UNIVERSITY - BHOPAL

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INTRODUCTION

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The ability of a business to grow and prosper in today's highly competitive environment depends on a number of factors. Managers are the ones who shoulder the responsibility of selecting and implementing the latest processes that facilitate the best possible position of a firm in a business environment that poses new challenges every day.

The strategic position of a firm is determined by the influence that the changes in the external environment may have on the firm, the advantages that the resources within the firm may possess and the wants and expectations of all those associated with the firm. This is where strategic management comes into play.

Strategic management is an effective and powerful approach towards the formulation, implementation and evaluation of strategies that help a business achieve its goals. Therefore, it is right to say that successful businesses are built on strategies aimed at achieving benefits in the long run

This book, *Strategic Management*, has been written in the Self-Instructional Mode (SIM) wherein each unit begins with an Introduction to the topic followed by an outline of the Objectives. The detailed content is then presented in a simple and an organized manner, interspersed with Check Your Progress questions to test the understanding of the students. A Summary along with a list of Key Terms and a set of Self-Assessment Questions and Exercises is also provided at the end of each unit for effective recapitulation.

UNIT 1 OVERVIEW OF STRATEGIC MANAGEMENT

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1.0 INTRODUCTION

The term 'strategy' is defined as the determination of the basic long-term goals of an organization, and the adoption of required actions, along with the allocation of resources for achieving desired goals. An organization adopts strategies to give direction, focus efforts and provide guidance to adapt changes brought in the internal and external environment. Strategic management is the process that involves the development of policies and plans to achieve set objectives and allocation of resources for their implantation. It specifically describes the mission, vision and objectives of an organization. This unit will discuss the concept of strategic management and its advantages and disadvantages. In addition, it will explain the effects of the external environment on the functioning of an organization.

1.1 OBJECTIVES

After going through this unit, you will be able to:

- Understand the concept of strategic management and its advantages and disadvantages
- Explain the various dimensions of strategic management
- Discuss the effects of the external environment on an organization

1.2 INTRODUCTION TO STRATEGIC MANAGEMENT

The word 'strategy' stems from the Greek word '*strategia*', which means an army general or a military commander. Battles are fought based on well-conceived strategies. Wars are reinforced by strategies. Similarly, businesses can be referred to as battles based on business strategies. The success of a business or its victory over another, in terms of capturing the market share, is dependent on its strategy.

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In the 1960s, there was a little competition between organizations. There were immense opportunities, and companies had to merely perform the function of setting long-term goals meeting those goals.

In the 1970s, external factors, such as the environment, were given more importance while designing strategies. Opportunities and resources became limited and attention was shifted to organizational growth through progressive changes and diversification.

In the 1980s, with emerging competition from the newly industrialized countries, the focus of strategic management and planning shifted to accomplishing and promoting a competitive edge. Businesses considered mergers and acquisitions to gain the advantage of size over the competition. Organizations formulated competitive strategies and attempted to provide more value to their customers in order to establish profitable and sustainable positions in their respective industries.

In the 1990s, markets and businesses became increasingly complicated. This was mainly attributed to advancement in technology, increase in global competition, changing tastes of consumers and fluctuations in exchange rates. Taking on the ever-changing business environment became the main focus of most organizations. Close and continuous monitoring of autonomous and indigenous conditions became definitive to strategic management.

The dynamic business environment of the twenty-first century, continual transformation and new developments became the formula for success of organizations. With progressing information technology and the advent of globalization, businesses and be more flexible, need to work on adaptable processes, and realize the significance of competitive advantage. Hence, it becomes integral to select superior functional strategies that add value to the business, customers and stakeholders.

Work Done in the Field of Strategy

The concept of strategy was pioneered by Igor Ansoff and developed further by Henry Mintzberg and Michael Porter.

I. Ansoff's strategic success paradigm

Igor Ansoff promoted the systematic study of strategic management. During extensive research, he discovered that American businesses that were acquired on the basis of a realistic and far-sighted strategy were more successful than those acquisitions that were done on the basis of immediate or transient benefits. The strategic success paradigm points out the conditions that lead to optimum profits. Paradigm states the following.

(a) There is no universal formula for success that can be applied to all businesses.

(b) Depending on the turbulence in the environment, a business can decide the degree of aggressiveness of the strategy to achieve optimum success.

(c) The success strategies for different firms depend on the level of changes, instability or agitation in the environment.

(d) The success of a firm depends on the political, psychological, cognitive, anthropological and sociological variables. These variables, together, form the internal capability variables.

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Based on thorough empirical testing for over a decade, Ansoff translated his success paradigm into a diagnostic instrument named 'Strategic Readiness Diagnosis'. Ansoff's contribution to the development of the concept of strategic management was developed/transformed into books entitled *Corporate Strategy* and *An Analytical Approach to Business Policy for Growth and Expectation*. In the former book, published in 1965, he discusses strategic planning, whereas in the latter book, he introduces the concepts of synergy and gap analysis.

II. Henry Mintzberg: Strategy as a craft

Henry Mintzberg contributed to the development of strategic management by adding a new dimension to the field. His perceptive view of the field of strategic management incorporated the manager's personal opinion. His view point challenged the views of other rational thinkers of his time. The task of formulating a strategy was considered by him as immensely calculative, critical and sensitive. Propagating a more humane approach to the formulation and implementation of strategies, he came up with the term 'crafting strategy' for the same. Accordingly, an ideal organizational structure consists of (i) a simple organizational structure, (ii) machine and professional bureaucracy, (iii) adhocracy, and (iv) a divisionalized form.

III. Peter Drucker's contribution

Peter Drucker propagated the practice of using formal strategic thinking in management decisions after World War II. He argued that management translated into relevant action, which aimed to achieve desired results. He was of the opinion that management was much more than mere passive, adaptive behaviour.

The concept of management by objectives, popularly known as MBO, was introduced by Drucker in 1954. Before MBO came into existence, managers were more involved with processes than with goals. MBO caused them to shift their focus from processes to goals. Drucker described MBO as not only a management technique but also a management philosophy. The basic assumptions of management were shifted from exercising control to self control.

IV. Michael Porter: Strategy and competitive advantage

Michael Porter recommended the use of his 'Five Forces Model' to study the different elements that comprise strategic management, such as the conditions of company operations. Generic strategies such as cost leadership, focus, and cost differentiation were introduced by Michael Porter with the aim to decrease uncertainties of the competitive environment.

Porter authored the following books:

(i) *Competitive Strategy* (1980)

(ii) *The Competitive Advantage of Nations* (1990)

In his books, Porter discusses the issues of sustaining competitive advantage, economic development and competitiveness.

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Porter's Five Forces Model states that in any industry, competition is dependent on the following five forces:

(i) Threat posed by new entrant
(ii) Suppliers' bargaining power
(iii) Threat posed by substitute product
(iv) Existing rivalry between current players
(v) Buyers' or customers' bargaining power

To survive and succeed in this volatile business environment, it becomes integral for an organization to understand how these five forces operate and influence the industry.

Dimensions of Strategic Decisions

There are six typical dimensions that are identifiable in strategic issues, which are as follows:

(i) Require decisions to be made by top management
(ii) Involve the allocation of a large amount of resources of the company
(iii) Have a significant impact on the prosperity of a firm in the long run
(iv) Are future-oriented
(v) Have multifunctional or multibusiness consequences
(vi) Make it necessary to consider external environmental factors

Like strategy, strategic management also has been defined differently by different authors and strategy analysts. Three definitions of strategic management have been mentioned below, which together give completeness to the concept of strategic management.

'Strategic management is that set of decisions and actions which leads to the development of an effective strategy or strategies to help achieve corporate objectives.'

'Strategic management is defined as the set of decisions and actions in the formulation and implementation of strategies designed to achieve the objectives of an organization'

'Strategic management is primarily concerned with relating the organization to its environment, formulating strategies to adapt to that environment, and assuming that implementation of strategies takes place.'

All management functions of a company can be broadly classified into two categories: strategic and operational. Strategic functions are performed more at the senior and top management level whereas operational functions are discharged more by middle and lower management levels. In other words, it can be said that as the level of management moves up, managers perform more strategic functions and less operational functions. Moreover, in any company, operational functions constitute a higher percentage of total management functions than strategic functions, as shown in (Figure. 1.1).

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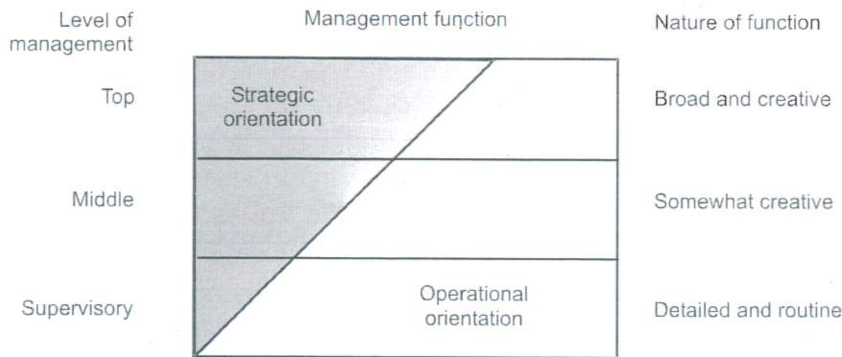

Fig. 1.1 *Nature of Functions at Different Management Levels*

Operational functions or operational management, as the name implies, is concerned with routine matters of day-to-day management, such as efficient production of goods, management of a sales team or sales force and monitoring of financial performance. Strategic management would be concerned with, say, devising or innovating methods for improving financial performance of the company. The major differences between strategic management and operational management are shown in Table 1.1.

Table 1.1 *Characteristics of Strategic Management and Operational Management*

Strategic Management	*Operational Management*
Higher level	Lower level
Innovative	Routinized
Imprecise	More precise
Complex	Less complex/simple
Organization-wide	Operationally specific
Consequential	Task-driven
Result-driven	Productivity-driven
Long-term implication	Short-term/immediate implication

Strategic management consists of three distinct steps or stages. These are: (i) strategy formulation, (ii) strategy implementation, and (iii) evaluation and control. In sequential order, these three stages may be shown as:

Strategy formulation → Strategy implementation → Evaluation and control

Some consider these three stages to be the basic elements of strategic management. These three elements can be considered individually, but they are closely interrelated and must be integrated into the total management process.

Strategic planning and strategic management

Plan or planning should precede action. Similarly strategic planning should precede strategic management. Strategic planning (also called corporate planning) provides the framework (some call it a tool) for all major decisions of an enterprise—decisions on products, markets, investments and organizational structure. In a successful organization, strategic planning or strategic planning division acts as the nerve centre of business opportunities and growth. It also acts as a restraint or defence mechanism that helps an organization foresee and avoid major mistakes in product, market, or investment decisions.

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A *strategic plan;* also called a corporate plan or perspective plan, is a *blueprint* or *document* that incorporates details regarding different elements of strategic management. This includes vision/mission, goals, organizational appraisal, environmental analysis, resource allocation and the manner in which an organization proposes to put strategies into action.

The concept and role of strategic planning would be clear if we mention the major concern areas of strategic planning in an organization. First, strategic planning is concerned with environment or rather the fit between the environment, the internal competencies and business(es) of a company. Second, it is concerned with the portfolio of businesses a company should have. More specifically, it is concerned with changes—additions or deletions—in a company's product-market postures. Third, strategic planning is mostly concerned with the future or the long-term dynamics of an organization rather than its day-to-day tasks or operations. Fourth, strategic planning is concerned with growth—direction, pattern and timing of growth. Fifth, strategy is the concern of strategic planning. Growth priorities and choice of corporate strategy are also its concerns. Finally, strategic planning is intended to suggest to an organization measures or capabilities required to face uncertainties to the extent possible.

All large organizations formulate strategic plans. In 1997, All India Management Association (AIMA) conducted a study to find out about business plans, strategies, techniques and tools adopted by various Indian companies. The study results were published in *Business Today.* The study showed that 56 per cent of the total number of companies (160) surveyed had published strategy. In terms of planning horizon, the period covered in the strategic plan was less than 3 years by 44 per cent of the companies, 3–5 years by 40 per cent of the companies and more than 5 years by 16 per cent of the companies. In terms of company size, bigger companies planned for a longer period. For 45 per cent of the large companies, the planning period was more than 5 years, but for 70 per cent of the small companies, the period was less than 3 years.

A characteristic feature of the starting plans of many large Indian companies is that the long-term planning horizons of these companies generally coincide with the national planning period. This means that many of these companies follow a five-year planning period, which synchronizes with the five-year plans of the country. This is particularly true for public sector enterprises in the core sector.

For example, companies like BHEL, SAIL, NTPC and NHPC have formulated corporate plans, which are linked to the national plans. The five year planning period of these companies, however, is not a generalization. Corporate plans of some of these companies are linked to the national plans, but not necessarily for exactly five-year duration; the duration can be a multiple of 5 years. For example, SAIL had prepared an ambitious corporate plan with a planning horizon of 15 years (1985–2000). Such plans are more appropriately called perspective plans.

Marico Industries, the maker of Parachute coconut oil, had prepared a strategic business plan for the period 1991–96. For the preparation of the plan, a strategic planning team was formed, which consisted of six managers from different

functional areas/disciplines. The planning team made some forecasts about the general macroeconomic environment during 1991–96 and how the Indian economy would perform during the period in terms of aggregate demand, technology development and availability of raw materials. In addition to these, the company had considered other environmental factors. Based on the analysis of the major strengths and weaknesses of the company and the environmental factors (opportunities and threats), a detailed SWOT analysis of the company was undertaken. The objective of SWOT analysis was to identify growth and expansion possibilities in existing and new products/businesses. These were finally translated into projected volumes, turnover and profitability.

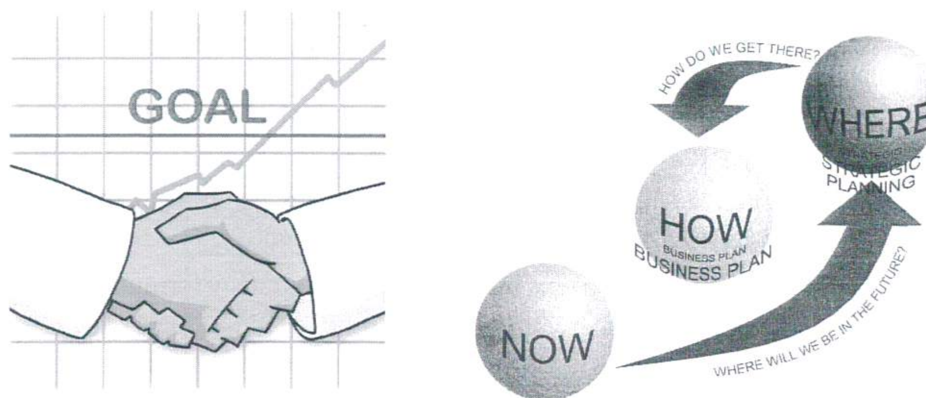

Fig. 1.2 *Corporate Strategy Planning and Management*

Once a strategic plan is prepared, the same is submitted to the senior management/top management personnel for their consideration and approval. In Marico Industries also, the strategic business plan prepared by the planning group was submitted to the senior management and finally to the top management (CEO). Deliberations took place at different levels and the business plan was finalized. This became more like an annual plan which was to be revised and updated every year during the reference period (1991–96) as per the strategic business plan. Marico's target was to increase its turnover to ₹300 crore by 1995–96. The business plan also stipulated that Marico should add a new product to its portfolio every year and seek technology tie-up for the introduction of new products.

Strategic planning and strategic management are intimately related to each other. Where strategic planning ends, strategic management takes over; however, both are complementary to each other. They form vital links in an integrated chain in corporate management. Both are continuous processes. Strategic management may be more continuous because it involves implementation and monitoring also.

Advantages of strategic management

The process of strategic management has become significant because of several other benefits:

- **Financial benefits**: The impact of strategic management is primarily that of improved financial performance in terms of profit. The growth of firms with a developed strategic management system has a major impact on both planning and implementation of future strategies.

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- **Improved ability to prevent problems**: By encouraging subordinate attention to management considerations, an improved ability to prevent problems can be achieved.

  When employees who are aware of the need of strategic management assist managers in their monitoring and forecasting role, they can facilitate the improvement of problem-prevention tactics.

- **Improved quality of strategic decisions through group interaction**: The process of group interaction for decision making helps in generating alternative strategies. It also helps in better screening of options due to specialized perspectives of group members. Thus, the best alternatives are selected and pursued effectively.

- **Better employee incentive**: Participation of employees or their representatives in strategy formulation leads to a better understanding of the priorities. Moreover, they appreciate the link between productivity on their part and its subsequent rewards that is inbuilt in a strategic plan. Thus, goal-directed behaviour is likely to follow the incentives.

- **Reduced gaps and overlaps in activities**: With strategy formulation, there is a better understanding of the responsibilities of individuals and groups. This helps in role identification by the employees, which reduces the gaps and overlaps in the activities of groups and individuals.

- **Lesser reluctance to change**: Another benefit of strategic management is the acceptability of change on part of the employees of the organization. This is because strategic management is an all-inclusive process, which creates greater understanding of the reason for choosing a particular option and the limits of the other available alternatives. This removes the feeling of uncertainty related to change, and reluctance to change is reduced.

Disadvantages of strategic management

Besides the advantages, there are certain negative effects of strategic management worth noting:

- **A costly exercise**: Strategic management is a costly exercise in terms of the time that needs to be devoted to it by managers. Managers cannot ignore their operational responsibilities, as this will lead to an irrepairable loss to the organization. Preventive measures, however, can be taken in this regard. Managerial activities can be scheduled such that adequate time is devoted to strategic work without deducting any time that managers have to devote to normal operations.

- **Sense of frustration**: Sometimes, the participant subordinates may get frustrated due to their unfulfilled expectations. This can happen, for example, when they expect that the particular strategy being adopted will be the one they prefer and they would accordingly get the associated rewards. However, this may not actually happen, as strategy selection is a general process.

- **Evading responsibility**: One more disadvantage of strategic management is the risk of avoiding responsibility for the information that has been provided

in the decision-making process and the conclusions drawn thereby. This may happen if those associated with the formulation of strategy are not involved thoroughly with the implementation of the strategy. Figure 1.3 shows the advantages and disadvantages of strategic management.

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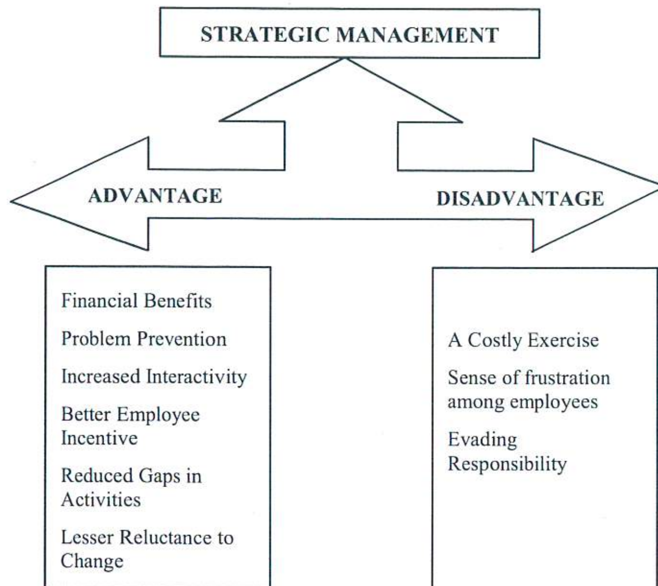

Fig. 1.3 *Advantages and Disadvantages of Strategic Management*

1.2.1 Growing Relevance of Strategic Management in India

Due to the limited competition and limited strategic maneuverability under the controlled regime, strategic management did not have much relevance in India prior to the economic liberalization ushered in India in 1991. Things have changed since then, making strategic management of great relevance.

Many companies have embraced strategic management. A number of companies have reformulated their missions and objectives. Portfolio strategies have undergone changes. Organizational restructuring has become common. Expanding opportunities and growing competition have been making companies adopt corporate and competitive strategies. To some extent, there has even been an overpopularity of the concept that it has also become a fashion to speak of vision, mission, corporate strategy and the like.

The following environmental changes have increased the relevance of strategic management:

1. The abolition of public sector monopoly or dominance in a number of industries has enormously increased business opportunities. Many of them are high-tech and heavy-investment sectors, which make strategic management all the more relevant.
2. Delicensing has removed not only an important entry and growth barrier but also a consumption barrier. In the past, because of non-production/ limited production and import restrictions, many goods were non-available or had limited availability (in quantity and/or variety).

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3. The liberalization of policy towards foreign capital, technology and imports and the accessing of foreign capital markets provide companies with the chance of enhancing their strength to exploit the opportunities.
4. Liberalization in other countries, expanding foreign markets, growing competition in India , the policy environment, etc. increase the importance of foreign markets and strategic management.

Liberalization, at the same time, has generated serious threats to many firms. The industrial policy liberalizations, import liberalizations and MRTPA liberalizations have opened floodgates of competition, posing surging threats to many existing businesses. Companies that have enjoyed the comforts of protection of the restrictive regime are now facing growing competition. Many industries are characterized by increasing competition in all its dimensions: interfirm rivalry, threat of potential competition, substitutes and growing power of buyers and suppliers.

In short, in the new environment, the old equations are not valid. Companies have to adopt strategies for establishing effective organization environment fit in the changing environment. Fundamental questions that a company should ask itself include the following:

- What are the oppurtunities and threats posed by the emerging environment?
- What are our strengths and weaknesses?
- How can we increase our strengths and minimize our weaknesses?

Therefore, it can be said that the operation and performance of a company are affected by external factors despite their innate inability to be changed. They play a vital part in both the PESTEL analysis and the scenario analysis. These factors affect not only small companies but also huge companies with massive turnovers such as Nestle, Apple and Pepsico.

Check Your Progress

1. Who pioneered the concept of strategy?
2. Who wrote the book, *Competitive Strategy*?
3. How many forces are there in Porter's model?

1.3 UNDERSTANDING EXTERNAL ENVIRONMENT

Strategies are operative in and responsible to the external business environment. The efficiency or productivity of a firm has to be read in the context of its external conditions. Forecasting is a medium of examining various environmental trends. Forecasts comprise environmental monitoring and scanning to identify prevalent trends. It becomes significant to understand the rival's knowledge and information to develop forecasts and scenarios in order to focus on present probabilities and curtail future challenges.

The general external environment will be seen in the context of two frameworks—PESTEL Framework and Scenario Analysis.

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PESTEL Framework

The word 'PESTEL' is short for Political, Economic, Social, Technological, Environmental and Legal. Let us now discuss each of the components of the framework in detail.

(i) Political environment

The rules and regulations of a country are deeply influenced by the political forces. All firms operating in a country adhere to these rules and regulations which are formed by government to protect consumers and the local environment. These regulations and political constraints for the firms come in the form of pricing policies, anti-trust laws, tax programmes, legislation of minimum use, pollution policies, fair-trade decisions, administrative activities, etc. These laws, rules and regulations affect a company's profits. However, there are other political actions such as patent laws, government subsidies and product research grants that support business activities. Thus, political forces have a positive as well as negative influence on the organization. Political activity also influences three additional functions—supplier function, customer function and competitor function.

The supplier function is influenced by political activity when any private business is dependent on government-owned resources and national stockpiles of agricultural products. This dependence undoubtedly affects the firm's strategies.

As regards the customer function, government demand for products and services can create, sustain, enhance or eliminate many market opportunities.

Similarly, when the government takes precautions to protect consumers and local industries, its decisions greatly affect businesses. So, the government's actions are of great concern to every firm. Firms analyse the government's strategies and develop complementary plans that can help them in exploiting the opportunities.

(ii) Economic environment

Economic environment, as the name suggests, is concerned with the economic condition of the consumers and the market. Before formulating strategic plans, it is important to study the macroeconomic trends in the market which cover the following:

(i) Trends in the growth of the gross national product or GNP

(ii) Inflation rates

(iii) Disposable income

(iv) Propensity to spend (nationally and internationally)

(v) Prime interest rates

Each and every market is unique because the pattern of consumption in each of them is different. The consumption pattern in the different market segments depends on the wealth of the consumers that keeps fluctuating and affects their buying behaviour.

(iii) Social environment

The social environment is a very important factor as changes in the values, beliefs, attitudes, opinions and lifestyles in society create potential opportunities for an

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organization. In order to grow, a company should take advantage of societal changes. The cultural, demographic, religious, educational and ethnic conditioning of individuals in society affects the social environment.

Since the middle of the twentieth century, a large number of women have started working outside their homes. Women in the workforce have decisively affected the hiring and compensation policies and resource capabilities of firms that employ them. They have also created a demand for a wide range of products and services necessitated by their absence from home. A whole range of products and services such as convenience foods, microwave ovens and day-care centres, have entered the market on account of this social development.

(iv) Technological environment

All factors related to the materials and machines used in manufacturing goods and services are categorized as technology.

A very important consideration in a technology-intensive business is the expenditure on technology. Similarly, the rate of change of technology influences the decisions in various organizations. The receptivity to new technology and its adoption by the public also has an impact on decisions made in an organization. Technological innovations determine how organizations compete and thrive in the marketplace.

(v) Environmental forecasting

As mentioned earlier, the tools used for environmental forecasting are as follows:

(i) Environmental scanning
(ii) Monitoring
(iii) Competitive intelligence

For managers to be able to make accurate forecasts, these tools should be capable of giving results that are reliable. Otherwise, the raw material provided by environmental scanning, monitoring, etc., will be rendered useless in forecasting. As the word 'forecasting' suggests, the purpose of environmental forecasting is to predict the changes that are likely to take place in the environment, the speed with which they will take place, their intensity, their direction as well as their scope. It will also study the time that will be required for any new technology to enter the market, the formation of new legislations in the context of an issue raised, the trends and lifestyles that exist and whether they will continue or die out.

Scenario analysis/planning

Scenario analysis involves more detailed and deep forecasting. This analysis covers subjects like demographics, sociology, economics and psychology. It analyses the trends prevalent in society, the technology available and likely to be developed, the political scene, the condition of the economy, etc., because all these may affect the issue being discussed. Take Lego, for example, the famous Danish toy manufacturing company. It holds one of the topmost positions in the construction segment of the toys market. However, if some drastic change occurs in the toys market, the company may find its market shrinking steadily. This is because Lego is not the only player in this market. Competition gets tougher with more and more children spending time at the computer. Lego obviously has many competitors,

including computer-based game and toy manufacturers. Some of its competitors are even technologically more superior. Besides, there will be many more inventions ready to enter the market and pose fresh threats.

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To keep such losses and adverse effects at bay, efficient managers will always look at the future in a wider context, that is, far beyond the existing, conventional or narrow markets. They will not look at just the immediate future but will plan and set guidelines in anticipation of the changes that might take place ten years down the line. Let us take the example of Shell Oil Company which effectively used various tools of analysis along with other information collected to create scenarios regarding possibilities or possible results or repercussions in the 1960s and 1970s. Its strategic planning, with effective use of scenarios, had prepared the company well in advance for the steep rise in the prices of crude oil, the scarcity of gasoline and a general depression in the global economy that resulted from the oil embargo in 1973. As a result, the company was able to foresee the instability in the environment and the focus of power shifting to the oil producers. With enough time to think over the repercussions and consider various options, the company was able to identify the risk factors involved and explore corrective options or solutions.

The company's process of scenario planning was done in six stages:

(i) People from within the organization were interviewed and asked for their honest opinions. People external to the business were also asked open-ended questions that demanded frank answers.

(ii) The responses received in the interviews were analysed according to the issues. This naturally led to the creation of a processing agenda.

(iii) Each agenda was synthesized in order to bring out the uncertain or disputable issues and their relationship with each other.

(iv) Workshops were organized to facilitate the understanding of key issues in order to further assist research work.

(v) A workshop was also organized to identify plausible repercussions and create scenarios that may come into existence ten to fifteen years down the line.

(vi) The strategy options were tested keeping in mind the scenarios to judge their effectiveness.

(vi) Legal

While scouting for opportunities in the environment, corporates try to seek out investment destinations where legal framework is quite stringent. By legal framework it could mean monopolies legislation, employment law, health and safety, product safety, human rights issues, etc. Generally firms try to locate in such areas where legal matters are simplified and transparent ways of dispute resolutions exist.

Too many regulations can actually help a company if the company is an established one. This is because it helps remove the competition. However, it should be noted that legal issues usually involves difficult employment laws which can eventually lead to lawsuits. When a company is able to assess regulation or

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legal changes, it can make adjustments accordingly. For example, real estate companies should keep themselves updated about the changes in market regulations. Legal issues can also affect the public image of the company. In some cases, a company is compelled to invest significantly in promotion in order to rebuild their image after a negative event.

Check Your Progress

4. What are the two frameworks of the external environment?
5. List the tools used for environmental forecasting.

1.4 ANSWERS TO 'CHECK YOUR PROGRESS'

1. The concept of strategy was pioneered by Igor Ansoff.
2. Michael Porter has written the book, *Competitive Strategy*.
3. There are five forces in Porter's model.
4. The general external environment will be seen in the context of two frameworks—the PESTEL framework and scenario analysis.
5. The tools used for environmental forecasting are environmental scanning, monitoring and competitive intelligence.

1.5 SUMMARY

- The success of a business or its victory over another, in terms of capturing the market share, is dependent on its strategy.
- The concept of strategy was pioneered by Igor Ansoff and developed further by Henry Mintzberg and Michael Porter.
- Igor Ansoff promoted the systematic study of strategic management.
- Henry Mintzberg contributed to the development of strategic management by adding a new dimension to the field. His perceptive view of the field of strategic management incorporated the manager's personal opinion.
- Peter Drucker propagated the practice of using formal strategic thinking in management decisions after World War II.
- The concept of management by objectives, popularly known as MBO, was introduced by Drucker in 1954.
- Michael Porter recommended the use of his 'Five Forces Model' to study the different elements that comprise strategic management, such as the conditions of company operations.
- All management functions of a company can be broadly classified into two categories: strategic and operational.
- A strategic plan, also called a corporate plan or perspective plan, is a blueprint or document that incorporates details regarding different elements of strategic management.

- Expanding opportunities and growing competition have been making companies adopt corporate and competitive strategies
- The general external environment will be seen in the context of two frameworks—PESTEL framework and scenario analysis.

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1.6 KEY TERMS

- **Cognitive Variable:** These are the variables that are used on a regular basis to collect information.
- **Management by Objectives:** This is the process to define specific objectives within an organization that management can convey to the members, then decide the sequence to be followed to achieve set objectives.
- **Bargaining Power:** It is the relative ability of parties involved in an argumentative situation for exerting influence over each other.
- **Cost Differentiation:** It refers to the difference between the cost of two alternative products or services.
- **Macroeconomic Environment:** It refers to how the macroeconomic conditions in which a company or sector operates influence its performance.

1.7 SELF-ASSESSMENT QUESTIONS AND EXERCISES

Short-Answer Questions

1. What are the different dimensions of strategic decisions?
2. List the characteristic features of operational management.
3. What do you understand by scenario analysis?

Long-Answer Questions

1. Explain the concept and role of strategic planning.
2. Discuss various advantages and disadvantages of strategic management.
3. Describe the PESTEL framework.
4. Examine the various environmental changes that increased the relevance of strategic management.

1.8 FURTHER READING

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UNIT 2 INTERNAL ENVIRONMENT

NOTES

Structure

2.0 Introduction
2.1 Objectives
2.2 Understanding Internal Environment
2.3 Establishing Strategic Focus
2.4 Answers to 'Check Your Progress'
2.5 Summary
2.6 Key Terms
2.7 Self-Assessment Questions and Exercises
2.8 Further Reading

2.0 INTRODUCTION

The structure of an organization comprises the internal and external environment. The internal environment refers to the elements or factors present within the organization and therefore it projects its internal situation. There are various internal factors, such as resources, owners/shareholders, the board of directors, employees and trade unions, goodwill and corporate culture. The internal environment of a company is responsible for the decisions taken in an organization. It can be completely controlled or managed by an organization and therefore it can be said that it is more controllable than the external environment. Various resources of an organization affect internal environment factors, such as physical, human, financial, informational and technological. This unit will explain the various factors and effects of the internal environment of an organization. It will also introduce the concept of focus strategy along with the risks associated with it.

2.1 OBJECTIVES

After going through this unit, you will be able to:

- Understand the internal environment of an organization
- Describe the concept of a turnaround strategy
- Discuss how to establish strategic focus and its risks

2.2 UNDERSTANDING INTERNAL ENVIRONMENT

Internal environment is the element of the business environment that exists inside the organization. It includes climate, culture, machines/equipment, work and work processes, members, management and management practices. The internal environment of an organization can be affected by various factors, such as choices, decisions and objectives of an organization.

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Various elements of the internal environment must be evaluated by an organization, which are as follows:

(a) It must evaluate the processes that a firm or SBU (strategic business unit) follows for the production, distribution and marketing of its products. This can be done by using Porter's Value Chain Analysis and benchmarking it with its leading rival in the industry. This analysis studies the equipment used for production, manufacturing processes and products. It also tells whether it will be better to procure the products from vendors or manufacture on its own.

(b) It must evaluate the core competencies of a firm and whether there are processes in the value chain which fall under them.

(c) It must evaluate whether the cost structure of a firm and its overheads are beyond the norms of the industry. Firms usually evaluate the cost of production per employee, cost of marketing per unit sold, cost of distribution per unit sold, number of days of debtors, etc.

(d) It must evaluate the talent of the management in a firm.

(e) It must evaluate the culture prevailing in the management team since it also affects the productivity in a firm.

(f) It must evaluate industrial relations within the firm.

Therefore, it can be said that it is important to analyse the cost incurred for each component of the value addition to understand the weaknesses of a firm, incurring losses to the firm.

This analysis will help in understanding whether there exists some scope for the firm to take advantage of the external opportunities and reduce internal cost in order to revive the business. This can be done only when it is favourable to take the decision to turnaround.

This is equivalent to saying that the patient should be in a position to recover, and only then a treatment would be advisable. It is also pertinent to mention that just because the patient is treated does not mean that he will fully recover. Similarly, a turnaround strategy, if adopted, does not guarantee the recovery of the firm/ SBU. However, chances of improvement is always there.

A turnaround strategy therefore implies that the firm's operational effectiveness must be improved. This is usually done by incorporating some or all of the following:

(a) Removing all unwanted activities that do not add value to the desired extent. This means that if using external agencies will result in the same value addition at a lower cost, then this should be followed.

(b) Re-examine the product range and decide the products to be pursued, divested or closed down.

(c) Re-examining the markets in which the firm is operating and deciding which ones to continue and which ones to drop.

(d) Restructuring the process of value addition using modern technology so that the per unit cost of production comes down substantially.

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(e) Restructuring the methods of financing and having tighter controls on expenditure.

(f) Managing debt effectively and reducing cost by keeping a tighter control on inventory.

(g) Laying off workers or re-organizing workforce wherever it is prudent and possible.

(h) Motivating workers and even senior management personnel and boosting their confidence to pursue the objectives of the organization/ SBU without fear. Accountability should however be fixed clearly.

The leadership should be convinced that such a strategy would be effective and must wholeheartedly support the plan for turnaround. It should be borne in mind that the strategy to be implemented will take time and results can only follow if the environment remains unchanged and becomes better. However, during the intervening period, there will be a constant change in the environment which may even make it necessary to have a relook at the strategy and dispense with it if required.

An interesting example of a successful implementation of a turnaround strategy is that of a public sector bank the Indian Bank. During the period 1995–96, the bank was in dire straits with a record loss of nearly ₹1300 crores. Thereafter, the bank was continuously making losses till the management was taken over by Mrs Ranjana Kumar as the CEO. She had been earlier highly successful at NABARD.

Her main task was to turnaround the bank and bring it back to life. She introduced several steps including motivating people to work fearlessly. She fixed responsibilities at all levels and gave freedom to operate. Several marketing initiatives were also launched along with strategic alliances, with insurance and mutual funds products being marketed by the firm. Thus, restructuring operations helped the firm to turnaround and post profits by 2002.

Similarly, Lucent Technologies experienced serious difficulties during 2001. Their turnaround strategy consisted of reducing the workforce and yet managing to service its customers so that it could defend its customers which were profitable. They also sold of their stock and assets so as to generate cash to run its operation. Finally, restructuring loans from its bankers brought it back to life.

Check Your Progress

1. What is the full form of SBU?
2. What does a turnaround strategy imply?

2.3 ESTABLISHING STRATEGIC FOCUS

Focusing on a particular buyer group, segment of the product line, or geographic market, is a focus strategy. The main difference between cost leadership, differentiation and focus strategies is that while the first two are aimed at the total industry, the third is aimed at serving a particular target market. This strategy assumes that a firm can serve its strategic target market more effectively than its

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competitors who serve much bigger markets. A firm can thus obtain the advantages of differentiation and low cost or both. A focus strategy selects target markets where the firm is least vulnerable to substitutes or where competitors are the weakest. An example of this is Maybach, a car from Daimler Benz targeted at the elite group who want customization of the product and do not mind its exorbitant cost.

Risks of Focus

A focus strategy is vulnerable to the following risks:

- Increasing cost differential between broad range competitors and the focus firm might offset the differentiation achieved through focus and turn the customers towards firms that offer a broad range of products.
- Perceived or actual differences between products and services might disappear.
- Other firms might find submarkets within the target market of the focus firm and out focus the focuser.

Check Your Progress

3. Define focus strategy.
4. What is the aim of a focus strategy?
5. What is the main difference between cost leadership, differentiation and focus strategies?

2.4 ANSWERS TO 'CHECK YOUR PROGRESS'

1. The full form of SBU is strategic business unit.
2. A turnaround strategy implies that the firm's operational effectiveness must be improved.
3. Focusing on a particular buyer group, segment of the product line, or geographic market, is a focus strategy.
4. A focus strategy aims at serving a particular target market.
5. The main difference between cost leadership, differentiation and focus strategies is that while the first two are aimed at the total industry, the third one is aimed at serving a particular target market.

2.5 SUMMARY

- Internal environment is the element of the business environment that exists inside an organization.
- The internal environment of an organization can be affected by various factors, such as choices, decisions and objectives of an organization.

- It is important to analyse the cost incurred for each component of the value addition to understand the weaknesses of a firm, incurring losses to the firm.
- A turnaround strategy implies that the firm's operational effectiveness must be improved.
- Focusing on a particular buyer group, segment of the product line, or geographic market is a focus strategy.
- The main difference between cost leadership, cost differentiation and focus strategies is that while the first two are aimed at the total industry, the third one is aimed at serving a particular target market.

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2.6 KEY TERMS

- **Value Chain:** It includes various activities that are operated in an organization to deliver goods or services in the market.
- **Standard Business Unit:** It refers to a separate branch of the parent company with strategic objectives. However, it aims to improve the overall performance of the organization.
- **Intervening Period:** It refers to the time period that separates two events.
- **Turnaround:** It refers to an unexpected change that brings a more favourable environment in a company.
- **Focus Strategy:** It is the kind of strategy that involves setting up desired goals— short- and long-term, implementation and allotment of resources to fulfil the desired goals.
- **Cost Leadership:** It refers to a situation wherein an organization has the advantage of having lower operational cost than others.

2.7 SELF-ASSESSMENT QUESTIONS AND EXERCISES

Short-Answer Questions

1. List the four elements that must be evaluated by a firm regarding its internal environment.
2. What are the risks of a focus strategy?

Long-Answer Questions

1. What are the main steps that can be introduced in a turnaround strategy? Discuss.
2. Discuss with the help of an example how a turnaround strategy is used to return to a profitable position in the market.

2.8 FURTHER READING

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UNIT 3 CORPORATE AND BUSINESS-LEVEL STRATEGIES

Structure

3.0 Introduction
3.1 Objectives
3.2 Corporate Strategy
3.3 Business-Level Strategy
  3.3.1 Growth Strategies
  3.3.2 Reduction Strategies
  3.3.3 Turnaround Strategies
  3.3.4 Generation of Strategic Alternatives
  3.3.5 Organizational-Level Strategies
  3.3.6 Expansion Strategies
  3.3.7 Mergers, Acquisitions and Takeovers
3.4 Answers to 'Check Your Progress'
3.5 Summary
3.6 Key Terms
3.7 Self-Assessment Questions and Exercises
3.8 Further Reading

3.0 INTRODUCTION

A corporate strategy involves a clearly defined, long-term vision that an organization sets to create corporate value and motivate the workforce for the implementation of the appropriate actions to achieve customer satisfaction. It involves the careful analysis of the selection of businesses in which a company can compete. It is a continuous process that requires a constant effort to engage investors to develop trust in the company and therefore the equity of a company increases. An organization that manages to deliver customer value without a fail revisits its corporate strategy regularly to improve areas that may not deliver the aimed results. This unit will discuss corporate and business-level strategies. In addition, it will explain the various ways to implement strategies on these levels along with their impacts.

3.1 OBJECTIVES

After going through this unit, you will be able to:

- Understand the concept of corporate strategy
- Explain business-level strategies and the ways to implement them
- Describe the concept of mergers and acquisitions

3.2 CORPORATE STRATEGY

A well-formulated strategy is vital for the growth and development of any organization—whether it is a small business, a big private enterprise, a public sector company, a multinational corporation or a non-profit organization. However, in these different types of organizations the nature and focus of a corporate strategy

will be different, primarily because of the nature of their operations and organizational objectives and priorities.

Small businesses, for example, generally operate in a single market or a limited number of markets with a single product or a limited range of products. The nature and scope of operations are less likely to be a strategic issue in smaller firms than in larger organizations. Not much of strategic planning may also be required or involved, and the company may be content with making and selling the existing product(s) and generating some profit. In many cases, the founder or the owner forms the senior/top management and his/her wisdom gives a right direction to the company.

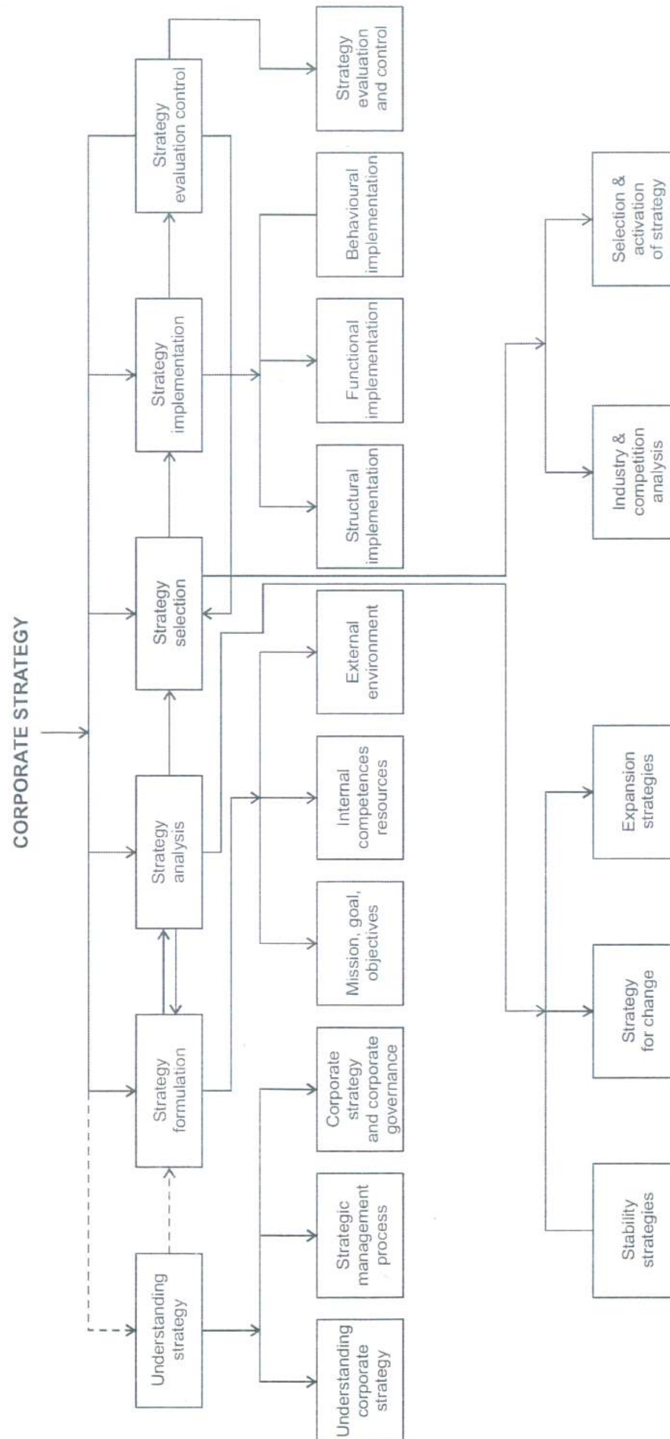

Fig. 3.1 Corporate Strategy

In large businesses or companies—whether in the private sector, public sector or multinationals—the situation is entirely different. Both the internal and the external environment and the organizational objectives and priorities are different. For all large private sector enterprises, there is a clear growth perspective, because the stakeholders want the companies to grow, increase market share and generate more revenue and profit. For all such companies, both strategic planning and strategic management play dominant roles.

Multinationals have a greater focus on their growth and development and also on diversification in terms of both products and markets. This is necessary to remain internationally competitive and sustain their global presence. For example, multinational companies, such as, General Motors, Honda and Toyota may have to decide about the most strategic locations or configurations of plants to manufacturing the cars. They are already operating multi-location (country) strategies, and, in such companies, roles of strategic planning and management become more critical in optimizing manufacturing facilities, resource allocation and control.

In public sector companies, objectives and priorities can be quite different from those in the private sector. Generation of employment and maximizing output may be more important objectives than maximizing profit. Many times, stability rather than growth may be the priority. Accountability system is also very different in public sector from that in private sector. There is also greater focus on corporate social responsibility. The corporate planning system and management have to take into account all these factors and evolve more balancing strategies.

In non-profit organizations, the focus on social responsibilities is even greater than in the public sector. In these organizations, ideology and underlying values are of central strategic significance. Many of these organizations have multiple service objectives, and the beneficiaries of service are not necessarily the contributors to revenue or resource. All these factors make strategic planning and management, in these organizations, quite different from all other organizations. In additions the evaluation criteria also become different.

Check Your Progress

1. What is the reason behind different organization corporate strategies?
2. What is the main focus of non-profit organizations?

3.3 BUSINESS-LEVEL STRATEGY

Let us discuss various business level strategies.

3.3.1 Growth Strategies

Growth is essential to life. If we do not grow we do not stand the chance of being counted in this competitive environment. Here, growth means an organization's increase in turnover and profitability consistently over time. It is essential to grow so that a firm is not left behind as others are also growing. This means that if you

do not run faster than others in a competition, you will be left far behind. If you see companies, such as Bombay Dyeing, their growth has been far less than that of Reliance Industries and therefore, today, they are nowhere near in comparison. Hence, it is necessary for a firm to keep growing.

How should a Firm Grow?

There are basically two ways of growing. One is known as 'organic growth' and the other, 'inorganic growth'. Organic growth means that firms grow through better penetration in the market, improved market share, the second way is introduction of avariety of products, i.e., extend the product line, or make innovations in the existing product range, increase production capacity, and thereby, grow. This kind of growth is, of course, slow and takes a lot of time.

The other method of growth is when you expand quickly by acquiring new businesses in the same area of business, acquiring new business in unrelated areas by means of mergers or acquisitions. There are other methods, such as joint ventures consortiums for the growth of an organization. These methods shall be discussed later in this section.

Before getting into what it takes to grow, we must understand the time when management wishes to pursue this type of strategy.

Based on the mission statement and the objectives that the firm has set for itself, it sees a large gap between what will be achieved by doing what it is presently doing and what needs to be achieved in the given time frame.

For example, let us say a firm has a present turnover of ₹100 crores and it wishes to achieve ₹500 crores in the next five years. However, if it pursues its current strategy it can at best achieve ₹300 crores in the next five years. This means there is a gap of ₹200 crores which will not be fulfilled if the firm continues to pursue its present strategy. Hence, there is a need for growth at a faster pace. The firm therefore needs to either add new products or reach new markets hitherto not explored, and do so at a faster pace. The firm may pursue a combination of getting into new markets, new products and also entering into business relationships with other firms by either an understanding or by an acquisition.

Adopting a Growth Strategy —What does it Imply?

Growth strategies are inherently more risky and capital intensive. Therefore, to pursue this type of strategy it is necessary that the firm must have adequate financial muscle in the form of reserves and surpluses, or have the kind of goodwill that will allow them to borrow money either from the public or from banks.

Further, there must be opportunities in the market for growth. If opportunities do not exist in the kind of business which the firm is planning, the risk level will be high and the objectives will not be achieved. This will result in the draining of their resources and the firm will further sink. Hence the risk level is quite high.

Growth in related areas (also known as concentric diversification) of business is quite common because the firm understands the business and possesses the core competencies that are needed for such business. For example, Tata Steel is in the process of producing steel of different grades and quality and it acquired the British firm Corus, which is also in the business of steel. Similarly, Tata Motors,

which is in the business of producing vehicles, has tried to grow rapidly by acquiring Jaguar and Land Rover.

Growth into completely unrelated areas is also possible (called conglomerate diversification). For example, Grasim, which is in the business of producing textiles ventured into producing cement. However, to pursue this type of strategy, the expertise of the other business is needed and this can be expensive. Hence, such plans need deep thought and deliberation before one would ventures into such projects.

Growth strategy when decided by a firm can be achieved in the following ways. These ways are not necessarily mutually exclusive and can be adopted concurrently.

(a) **Vertical growth:** This happens when a firm starts to take over the function which hitherto was being purchased from other suppliers. For example, Reliance used to buy raw materials, such as PTA, DMT, MEG for producing polyester fibre, from other vendors. They then decided to produce these raw material themselves and use it for producing polyester fibre. To produce these raw materials, Reliance had to purchase petroleum products. Reliance once again decided to have their own refinery. This way the firm was able to go all the way back to the basic raw material needed for production of polyester fibre. This kind of growth is also called backward integration. Now they are also into extraction of crude oil for refining.

Similarly, firms may decide to produce pig iron (produced in steel plants) and use the pig iron to produce different types of finished steel which can be further processed to produce stainless steel. This way the firm can have vertical growth in the forward direction. Hence, it is also called forward integration.

(b) **Horizontal growth:** When a firm introduces the existing products in new markets or new products in the existing markets, the firm is said to have a horizontal growth. For example, Tata Motors was only active in the commercial vehicle business and it decided to enter the light commercial vehicle business with the introduction of the Tata Indica in the domestic market. Similarly, it is now intending to export Nano in the international market.

(c) **Merger and acquisitions:** When two large companies decide to become one single entity it is said to be a merger. When a large firm buys another firm (usually smaller), it is called an acquisition. Examples of mergers include Grindlays Bank merging with Standard Chartered. This way the combined entity operated in the name of Standard Chartered Bank and the name Grindlays Bank slowly faded away when full integration took place. Example of acquisition include Brooke Bond acquiring Lipton, and Hindustan Lever acquiring Brooke Bond itself or Lord Krishna Bank being acquired by Centurion Bank of Punjab and finally HDFC Bank acquiring Centurion Bank of Punjab. These days firms have found that acquisition is a very good and fast way to grow. Tata Motors' acquisition of Jaguar and Land Rover or Tata Steel's acquisition of Corus are examples of acquisitions.

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This method gives quick results though the investment to acquire could be very high. However, all mergers and acquisitions do not succeed.

(d) **Joint ventures:** Two or more firms join hands and take equity by creating an independent business entity (firm). This new entity is created for a specific purpose and can be wound up once the purpose is completed. For example, the Kirloskar group and Cummins had a joint venture to create Kirloskar Cummins Ltd which produced diesel engines of different sizes. Similar joint ventures resulted with the setting up of Maruti Suzuki, Hero Honda, etc.

(e) **Strategic alliances:** These are similar to joint ventures except that there is no new entity created. A company enters into a strategic alliance with another firm and does new business. This alliance could be in terms of transferring technology, aiding the firm with finances, etc. Examples include Mahindra forming a strategic alliance with Renault to produce the Mahindra Logan car.

(f) **Consortium:** This means coming together of different firms having core competency in different areas so that the combined strength can be used for carrying out a project which otherwise one single entity would not be able to execute, and thereby increase their profitability. Examples include banks forming consortium in order to lend to a very high value project and also thereby reduce high risk. This way risk on the project is pooled by each of the consortium partners. Major projects in the country are generally financed by a consortium of banks. Similarly, DIAL (Delhi Airport) is carried out by a consortium of contractors.

3.3.2 Reduction Strategies

A reduction strategy, also known as retrenchment strategy, usually means that the firm decides to discontinue some of the products or removes itself from some of the markets. It may decide to remove itself from some of the businesses if it sees itself doing poorly in comparison with other businesses or if its rivals in the business are far ahead and the firm sees itself unable to reach that level. IBM, for example, was a leading manufacturer of mainframe and personal computers. They later decided to sell off their personal computer business to Lenovo. This was a reduction strategy.

How should a firm decide when to pursue a reduction strategy or retrenchment strategy? Usually a firm has a portfolio of products or businesses. For example a firm like L&T is in the business of engineering and construction, electrical and electronics, machinery and industrial products. Each of these businesses are known as a strategic business units (SBU). When some of the business units do not perform to the level desired by the firm, the firm may decide to divest or to retrench the business. More recently, the firm decided to retrench the cement business. These businesses can be mapped using the BCG matrix where the market share of the firm is plotted against the business growth potential. If the firm sees a business unit where it does not have a good market share and the industry also has a low growth rate, such business is referred to as 'dog'. Whenever a business is classified in this category, it is time to divest this business and thus reduction strategy for this business is decided upon.

A business that has been decided to divest is a business which is not attractive to the firm either because there is insufficient profitability in the business, or the growth in the market is insignificant enough for it to be attracted to, or the firm finds other businesses more attractive and therefore decides to concentrate and deploy its resources into those businesses rather than the business which is not attractive anymore.

Methods for Pursuing a Reduction Strategy

1. Those businesses which still have sufficient potential to make profits but not attractive enough for a firm, can be sold off to other firms. This method is known as divestment or sell-out strategy. A sell-out should always work for the benefit of the buyer as well as the seller. The seller gets an advantage by the fact that he can concentrate his resources on other businesses which are more attractive and thus focus on his areas of strength. The buyer on the other hand finds synergy in the acquisition by either being in a position to have a larger market share and thereby commanding the market or by having economies of scale in operation making the total production costs cheaper and thereby getting an advantage in the market. Take the example of the cement business of Larsen & Toubro, which they finally sold off to Grasim. The cement unit of L&T did serve a purpose as they could use their product was in their construction projects. Even then, they found that this business not in their strategic interest. Given the hostile attempts being made to take over this business, they finally decided to dispense with it.
2. Firms can also liquidate a business. This means winding up the business and closing down. This is only done when it sees no other alternative and also no other buyer can be found to acquire such businesses. However, this is a very painful task as there are considerable legal, ethical and moral hurdles in implementing this process. Examples can be seen in firms like Enron, Arthur Anderson, etc. The firm after getting permission to liquidate sells off its assets and then pays off its creditors and other stakeholders and finally its equity shareholders.

Issues in Implementing Reduction Strategy

The following issues may arise while implementing a reduction strategy:

1. What is to be done with the additional number of employees? This is a critical issue that needs to be addressed. The employees of the business units that are being closed down should be absorbed in other divisions. However, most of the other business units would not welcome such employees as they are perceived to be as those who have not performed well and that could be one reason why the existing unit did not do well. Hence, there is always a resistance to take employees from those units which are being closed down.

   Promotional opportunities for the existing employees of other divisions / business units where these excess staff are deployed also gets effected and therefore there is apprehension that the employees who will be absorbed in other business units will disturb the existing cultural and group dynamics of the remaining business units.

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2. The additional employees who can be absorbed in other business units may need training for the new work that they will be required to perform and this costs money and time. Finance for this has to be arranged. Further, the other business units need not be located in the same place and hence, costs have to be incurred for relocating. Many employees may have other difficulties in getting relocated. Such employees have to be retrenched for which some separation pay need to be offered (this is often called voluntary retirement scheme).
3. For those businesses which are to be completely closed down, the firm has to get a legal permission which can be time-taking and tedious. The process involves considerations, such as revenue loss to the state, the social implications of the retrenched employees, etc.
4. There are various factors responsible for the sale of a business to other firms including why it is being sold, what the management has done to keep the business unit alive and the environmental conditions that have not helped in maintaining the communication with the employees. These communications have to be made to the trade union employees as well as to the management-level employees so that a smooth transition can take place. These are critical and can have long-term implications for the image of the firm. Hence, a considerable amount of planning is needed.

3.3.3 Turnaround Strategies

Companies at times do not perform and hence, their balance sheets show losses. It is a matter of concern if these losses occur periodically over a few years. Sometimes a company as a whole may not incur losses but certain specific SBUs may indicate losses and therefore, they become a serious concern for the management.

At this stage, the management should look into the reasons for the losses very closely. If it is found that it is impossible to bring the SBU back to life, then a decision should be taken to close it down, which is the reduction strategy. However, if the review analysis suggests that certain actions can be taken which will revive the firm, then a strategy which will revive the SBU or the firm itself should be formulated. This strategy is known as the turnaround strategy.

In order to decide a turnaround strategy which will be effective, it is necessary to understand the reason for the decline of the firm. This assessment of the firm must begin by looking at the external environment and the internal environment.

External environment

It is necessary to know the changes in the external environment that led to the present situation of the firm/SBU and whether that situation has eased or would ease in the immediate future or in the long run. These could be due to several factors and some of them are given below.

(a) The economies of scale have undergone a change and the profitability of the firm/SBU has taken a bad hit. For example, new technology has replaced old technology which now enables competing firms to produce larger quantities with lesser costs and thus bringing down the per unit cost. The economies of scale for producing steel were around 1 million tonnes per

annum, but now firms with capacity below 6 million tonnes per annum will not be able to compete in the long run.

(b) The rules of the game in the market have changed. For example, firms till the late 1970s used to sell equipment but the concept of turnkey projects was alien to these equipment suppliers. However, during the 1980s most equipment suppliers started offering equipment on a turnkey basis (equipment supplied after a trial run). If a firm/SBU does not organize itself for such a change in rules, it will soon get into the danger zone and unless action is taken, will soon fade away.

(c) Policies of the government can play a significant role. In the 1990s the liberalization of import restrictions allowed foreign goods to enter into markets that the firm had been operating in till date. Such changes call for steps on the part of the firm to evaluate its own action and any delay in such actions could result in a period of crisis. For example, Chinese products like toys, electronic goods were a cause of considerable anxiety to Indian product manufacturers.

(d) Barriers, if any, for the firm for entering into new markets or making innovations in their product range must be evaluated and understood.

Similarly, other external environment factors also need to be assessed.

Internal Environment

Internal environment also effects an organization. Therefore, it is imperative to assen these factors too before the implementation of a turnaround strategy.

These factors are usually controllable factors that can be managed. These include issues relating to production, finance and marketing. These factors can be poor management, poor financial control, and high cost structure. If these factors are managed, it can give companies competitive advantage. However, these factors can also pose to be a threat if they are mismanaged.

3.3.4 Generation of Strategic Alternatives

A company, by virtue of its vision and mission statements, objectives and goals that it has set for itself, must first work out its corporate strategy by which it will achieve the goals and then decide on the business strategy by which the corporate strategy will be achieved.

Corporate strategy

A big challenge in any corporate house lies in producing effective and consistent results over a long period. Big corporations tend to have an inertia of their own, and by the time the consequences of bad strategies unfold, it may be too late. It is important for management to frame appropriate strategies for a firm in a changing business environment. A company has to identify its strengths, weaknesses, opportunities and threats to both survive and prosper in today's highly competitive market.

An effective corporate strategy comprises five elements that together make the corporate strategy triangle. The three sides of the triangle are resources (such as assets, skills and capabilities in a firm), businesses and organization, which have to be aligned with the vision, and goals and objectives, to seek what is known as the corporate advantage.

Corporate strategy broadly indicates the area of businesses that the firm should operate in and the ones which it should not enter. This may be done based on the external environment analysis and internal value chain analysis. The external analysis indicates the opportunities as well as the threats which either should be avoided or overcome. The internal analysis indicates the firm's strengths and weaknesses. Similarly, the external analysis also indicates the competencies that a particular type of business requires and the internal analysis gives the type of core competencies which a firm possesses. If the required and the available competencies are matched, a definite broad corporate strategy will emerge.

How to identify corporate strategies

The threats, opportunities, weaknesses and strengths (TOWS) matrix is a good method by which a corporate strategy can be identified. This matrix can be represented as follows:

Table 3.1 *Tows Matrix*

	Strengths	**Weaknesses**
Opportunities	Adopt those markets or businesses in which the firm finds opportunities and also has strength to exploit these opportunities. (Quadrant I)	Adopt those strategies where the opportunities can be exploited by trying to overcome their weakness. (Quadrant II)
Threats	Adopt strategies which can use their strength so that the threats can be neutralized or avoided. (Quadrant III)	Use strategies which will overcome weakness and also avoid threats. (Quadrant IV)

Source: Wheelen, Thomas and J. David Hunger. *Strategic Management and Business Policy* 8th edition. Pearson Education, 2002.

• Quadrant I (avail opportunities and utilize strength)

If a firm sees the economy opening up globally and there is a business opportunity in exports, the firm could use its strength of image, quality, etc. to expand rapidly into the global market and take advantage of this opportunity. Thus, a firm can grow quickly. Similarly, if imports are easily permitted the firm can procure cheaper capital equipment or more productive capital equipment so that it can reduce its costs of production and thus become more competitive in the international market.

• Quadrant II (avail opportunities and overcome weaknesses)

Here, the firm has opportunities but it is unable to capitalize on it because of some weakness which could be technical know-how, finance, etc. In such situations, the firm could bring its own strengths and enter into a strategic alliance or joint venture, so that the specific weakness can be overcome by the strength of the

strategic partner. For example, Piramal Healthcare acquired Minrand International Inc. so that additional products, such as generic inhalation anesthetics, could also be in the portfolio of the firm.

- **Quadrant III (use the strength and deflect the threats)**

Here, strategies can be adopted to overcome threats by using their strengths. For example, a firm which is posing a threat by innovating products can be acquired so that this competition can be eliminated. Such practices may sometimes infringe upon laws governing competition, but in specific instances it is usually carried out. AT & T had to buy competing firms several times in the telecom business so that they retain a strong presence in the industry.

- **Quadrant IV (the firm is weak and there is a threat)**

Here, the strategy says that be only in those products and markets where a firm has core competencies and operates in niche markets.

The use of the TOWS matrix usually brings out a broad corporate strategy which enables the firm to decide the business and the market they should be in.

A correct corporate strategy must result in the following:

1. The firm is able to arrive at a strategic fit between the business it intends to pursue and its competitive external environment.
2. The said business will help to achieve its strategic objectives in terms of profitability and growth targets.
3. The business will help it to build on its competitive advantage and develop new core competencies for the future.

The generic strategies that a firm follows could be classified into one of the following:

1. Stability strategy
2. Growth strategy
3. Retrenchment/divestment strategy
4. A combination of any of the above strategies

1. **Stability strategy:** This strategy is usually pursued when the firm does not see any significant growth in the opportunities but does possess a good market share so that it can keep reaping the profits and these profits can then be used in other businesses where it sees considerable opportunities as well as it has strengths. ITC's tobacco business is one business where a stability strategy could be very effective.
2. **Growth strategy:** This strategy is followed when a firm sees that some of its businesses have very attractive opportunities and also the firm has strength in the business. In this type of strategy, the firm may grow by expansion, acquisition, joint ventures, alliances, etc.
3. **Retrenchment/divestment strategy:** This strategy is adopted in a situation where a firm neither has strength nor finds enough opportunities to carry on with the business. Thus, firms tend to either sell such businesses or even decide to close down. HLL, for example, left out several of their products in their personal care division and concentrated only on a few products which gave them enough returns.

4. **Combination strategy:** Some firms follow the strategy of stability, growth and retrenchment for several of their businesses. L&T follows the growth strategy in their infrastructure business, and retrenchment in their cement business.

NOTES

What is a business strategy?

Once the broad parameters of the business and markets have been decided upon, the firm has to develop a strategy by which these businesses will be carried out so that the profitability and growth targets are achieved. This in turn will result in the achievement of the goals that have been set up. A business strategy is also called a competitive strategy. It can be analysed using Porter's Generic Competitve strategy. The various types of business strategies are as follows:

- **Cost leadership:** In this strategy the business is carried out on the basis of large-scale operation so that economies of scale are achieved and the cost of production/distribution are kept at a low level. This enables the firm to serve a large market at a very low price and make reasonable profits.
- **Cost focus:** This is a strategy wherein the costs are kept low but the focus is on serving a small market which can be called a niche market.
- **Differentiation strategy:** This strategy creates uniqueness in its product offerings and at the same time serves a large market. This differentiation can be in the quality of the product, features which can be customized, a strong distribution system in place, or even a responsive customer service.
- **Differentiation focus:** The differentiated product is concentrated only for a few specific customer bases.

3.3.5 Organizational-Level Strategies

Organizational-level strategies have been discussed as follows:

Corporate-Level Strategy

A corporate-level strategy is a plan consisting of several layers that is used by a firm for defining, outlining and achieving specific business goals.

Do all corporate centres add value to the underlying group businesses? If they have been set up just for coordinating and controlling the group's businesses, they are not adding any value though they are perceived to be adding value.

The objective of this discussion is to focus on the specific nature of the corporate centre or headquarter in diversified corporations and to identify ways in which this corporate centre could add sustainable value to its underlying businesses. At present, these corporate centres are frequently perceived as not creating any value and merely adding cost to their groups.

The focus of this section is to identify the key value-adding processes of corporate centres and the roles and key skills they require on a sustainable basis. The value additions may be termed as core competencies, dynamic capabilities, critical resources or it could well be sources of sustainable advantage.

Worldwide, large corporate groups have spent considerable time, effort and money in seeking to justify their continued existence by developing groupwide

vision or mission statements. Unfortunately, many of these do not indicate how remaining as a group will create more value compared to the value generated by the component businesses comprising the group. As such the corporate centres influence the value creation process.

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The '**how**' dimension refers to the nature of the involvement of the centre and the type and degree of intervention that the corporate centre makes in the operations of the group's businesses.

Similarly, the '**what**' dimension seeks to find out the source of competitive advantage by justifying its own central cost levels. The two underlying factors that can justify the role of a corporate centre in its efforts to identify sources of competitive advantage are as follows:

(a) By reducing the total costs of the group, even after allowing for its own costs

HOW (nature of corporate involvement)		
	Direct	Total cost reduction by direct intervention of the corporate centre
	Indirect	Total cost reduction through indirect corporate centre involvement
		WHAT **cost reduction as a source of competitive advantage**

(b) The centre should add more value to its businesses in the group than the centre itself costs to run

HOW (nature of corporate involvement)		
	Direct	Total value added increased by direct intervention of the corporate centre
	Indirect	Total value added increased through indirect corporate centre involvement
		WHAT **Increased value as a source of corporate advantage**

As shown in the above configuration model, combining these alternative types of involvement with these two ways of adding value generates four potentially value-adding roles for any corporate centre.

Primarily, these combinations represent broad ways in which corporate centres can consistently and sustainably create value, as opposed to adding costs.

In order to realize this potential added value, each corporate centre has to ensure that it is operating within the appropriate configuration for its group. The appropriate configuration depends on the specific external environment that the group is facing and the mix of businesses in the group.

Sources of corporate advantage

In many diversified corporations, the different businesses comprising the group have developed their individual, appropriately tailored sources of sustainable competitive advantage or areas of core competence. These should be tailored to suit the specific environment that they face in the markets where they operate. As no other businesses within the group may operate in these markets or face these specific circumstances, there is no certainty that any of these competitive advantages will be common across the group. This by itself does not, however, destroy the economic rationale for the businesses staying together as a group. The role of the corporate centre of the group is important, and it needs to be seen how this corporate centre can develop its own appropriate, sustainable core competence, which will allow it to enhance the overall value of the businesses within the groups.

Rationale for creating or capturing value

It is very important to understand where the increased value comes from when considering strategies that seek to increase shareholder value. Some strategies seek to create completely new value that would not otherwise have existed, while other strategies try to capture more of the already existing value available within an industry.

How can value be captured?

Value can be captured from external suppliers by centralizing the sourcing of support activities or even core business processes. This is really increased value capture by the centre, because the impact of this corporate strategy is unseen by the customers of the underlying businesses.

This cost-reducing corporate centres change the way businesses do things, not what they do. As an example of increased value capture many of the automotive companies like Tata Motors, Dana Corporation go in for an e-bidding while purchasing in bulk from their vendors. This process, which can be compared to a reverse auction, gives a huge cost reduction to these companies as the suppliers are pitted against themselves in getting the share of business. Accordingly, the corporate headquarters' diktat of reducing costs can be very well justified through the above process.

How can value be created?

Where the corporate centre applies its skills or knowledge to increase value, it is much more likely to create new value by the underlying businesses. The whole motive of this type of centre is to change what the businesses do and these changes are normally clearly visible to their external customers. Thus, new products may be created and launched by the businesses, existing products may be sold in innovative ways or to new market segments. The emphasis is on transforming the underlying businesses, rather than improving their efficiency.

The first indigenously developed motorcycle 'Pulsar' by Bajaj Auto is an example of value creation, which was clearly visible to the external world as constituting of superior value.

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Nature of corporate involvement

The value added by the corporate centre is depicted as follows:

Table 3.2 Value Added by Corporate Centre

Corporate involvement / intervention			
	Direct	CENTRALIZATION OF ACTIVITIES AT LOWER COST	LEVERAGE KNOWLEDGE
	Indirect	IMPOSING CONTROLS AND FINANCIAL TARGETS	FACILITATING CREATION OF NEW KNOW-HOW
		Economies of scale	**Knowledge**
		Source of corporate advantage	

The two sources of corporate advantage are as follows:

(a) Economies of scale

(b) Knowledge

These two sources of corporate advantage can be implemented within a group in different ways.

(a) Economies of Scale

- In some diversified corporations , the corporate centre actually carries out certain key activities on behalf of the individual business units. This centralization may involve only support activities that are common across the group, such as sourcing, procurement, logistics, production, sales and even marketing.

  Thus, this direct style of intervention may be done to reduce the total costs of the group by achieving economies of scale in centralized activities. The role of the corporate centre is that of a 'manager'. The corporate centre needs a high degree of supply chain management skills, so that it can centralize those processes that generate a high level of true net savings for the group.

  Typical examples of the cost reduction principle for achieving corporate advantage through a direct intervention could be Wal-Mart, IKEA and in the Indian context, Bajaj Auto, Hero Honda and Reliance.

- The other way the corporate centre can seek to reduce the total costs of the group is through a more indirect method of involvement. This normally involves setting of controls and financial targets as measures of performance.

  However, this type of corporate centre does not normally get involved either in doing things on behalf of the businesses or directly running the businesses within the group.

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Acquisitions and divestments often form a significant part of the role carried out by the corporate centres focused on indirect cost reduction. The role of the corporate centre may be that of a 'shareholder'. The key skills needed at the corporate centre for this type is that of financial management.

The use of the cost reduction principle by an indirect method of intervention can be found in Xerox, Philips and in the Indian context, ICICI Bank, Hindalco, etc.

(b) Knowledge

- A very different indirect nature of involvement can also be value adding. The main focus of this type of corporate centre is in creating new know-how within the group, rather than reducing costs across the groups. As a key part of this role, the corporate centre establishes a clear vision for the group as a whole and states a set of values that all group businesses must subscribe to. Thus, it facilitates the creation of new corporate know-how. This type of corporate centre may therefore increase the total costs incurred by the group, but it tries to create far more value from the creative stimulus and values leadership that it gives to its businesses. Thus, the role here may be that of a 'leader'. Therefore, its management team requires highly developed communication and counselling skills, if the group's vision and values are to be widely and accurately adopted.

  Value addition by indirect intervention of the corporate centre can be found in companies that promote creativity in a big way and can be found in 3M, Sony and in India in Infosys, etc.

- Knowledge in comparison to generating economies of scale (to reduce group costs) is the main source of corporate advantage in many groups. However, it has been observed that on some occasions it requires a more direct intervention by the corporate centre. Businesses that form a part of this kind of group are known to have created strong, knowledge based competitive advantages in the form of the following:

  - Brands
  - Customer service processes
  - Differentiated products
  - Process advantages

  One striking feature that emerges is that this kind of group structure is that these business units may only focus on a specific geographical region in the world, whereas the technological advantage may have broader applicability.

  Therefore, the role of the corporate centre as a value-adding source is not to support the development of a new-technology as it is evident from around this type of group. The corporate centre needs to ensure that the present knowledge is completely exploited in the entire group. Hence, the role of the corporate centre is more of a consultant. This type of corporate centre requires skills like systems and process and management skills. Companies like Unilever, Toyota and Tata Group avail the facility of direct intervention to enhance value.

NOTES

Roles of Corporate Centres

The required skill set and roles which are essential at the corporate centre are as follows:

Table 3.3 Roles of Corporate Centre

Corporate involvement/ intervention			
	Direct	**Centralizing** (Supply chain management) MANAGER	**Leveraging** (Systems/Process management) CONSULTANT
	Indirect	**Controlling** (Financial management) SHAREHOLDER	**Creating** (Vision/values management) LEADER
		Economies of scale	**Knowledge**
	Source of corporate advantage		

Different roles for the corporate centre in each of these configurations can be understood from the four possible value-adding combinations. The presence of different roles suggests that extremely different key skills are required at the corporate centre.

Instead of adding costs and destroying value, the corporate configuration models give four different ways to corporate centres to add value. The left-hand side of the model has the most limited value-adding configuration since no group has ever 'cost cut its way into sustained greatness.' It has been observed that the manager and the shareholder configuration can add value to the existing portfolio for a certain period of time, however after a certain amount of time, the portfolio requires radical changes in order to enhance value by the corporate centre.

In the same manner, the consultant configuration will be exhausted when the corporate centre has ensured that the existing knowledge has been completely exploited. In this case, the business mix needs to be changed or else the corporate centre needs to initiate some new sources of advantage that can easily be applied throughout the existing business.

Creative configuration can be emphasized through new corporate know-how and thereby become the most sustainable value-adding role for a corporate centre.

Caselet

Enhancing competitive advantage—Acquisition of L&T Cement by Grasim Industries

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India is the second largest cement producer in the world with cement production of approximately 144 million tons and consumption at 117 million tons per year, surpassing developed countries like the US and Japan. the early 2000s, the industry was highly fragmented in nature with more than fifty-five companies controlling a total capacity of around 140 million tons. The Indian cement industry had tremendous scope for improvement in the long run, in spite of the fact that it had produced more than 100 million tons of cement for two consecutive years.

Before the acquisition of L&T cement division, Grasim Industries Limited, a flagship company of the Aditya Birla Group, ranked among India's largest private sector companies, with a turnover of ₹5,233.3 crore in 2003–04.

This deal, which took years to complete, was to enable Grasim reap economies of scale and at the same time provide the company with enough market power. However, the company was not willing to stop there and it planned to do more aggressive investment in the cement sector.

As regards Ultra Tech (the new name of the demerged L&T division), the Aditya Birla Group had obtained a majority shareholding of 51 per cent. The financial institutions held 12 per cent, 11.5 per cent was held by L&T and the remaining was with other institutions and individuals. At the time of acquisition, it was agreed that Grasim would use the L&T brand till 31 March 2004. The company also sold cement under regional brands, such as Birla Super, Grasim Super, etc. However, in 2003, it came up with a new national brand called Birla Plus. The company opined that it would operate both the national brand and the regional brand at the same time.

Industry Structure

The industry structure was such that the entire industry had been divided into four main zones—east, west, south and north. The reasons for doing so was that cement, being a bulk commodity, could not be economically moved for long distances. Moreover, as the availability of a sizeable amount of limestone reserves was one of the key factors in determining the location of a cement plant, the plants gathered around such reserves. This had resulted in clusters of cement plants. The southern region had a higher supply of limestone than demand, whereas the markets were more lucrative in the northern region. As it was cheaper to transport limestone than cement, players like Grasim and Gujarat Ambuja enjoyed higher price realization because of the concentration of their plants in the northern region. This concentration of limestone reserves in certain regions, high transportation costs of cement and low entry had resulted in fragmentation of the industry, with several players operating in the market.

Key Inputs and Cost Structure

Transportation, coal, power and limestone costs accounted for around 75–80 per cent of the total cost of sales. Limestone was the main raw material required for the cement manufacturing process, but it was a low value mineral and accounted for only 7–9 per cent of cost of sales.

The Road Ahead

At that time, the industry had been growing at 8 per cent and it was expected that the growth rates would continue in the near future. Development of rural roads, additional highways, commencement of NHDP projects and government incentives were likely to be important drivers of growth in the industry.Although supply was higher than demand and there was no major expansion planned, it was expected that by the year 2007, the demand–supply mismatch would vanish. This would result in the improvement of prices. Analysts, however, argued that as supply of cement was much higher in the southern region as compared to the northern region, this region would take more time to stabilize its demand and supply position.

Industry in Focus

The areas which were close to the plants were fed through roads, and the areas which were far flung were fed by rail. Clearing and forwarding agents (C&Fs) were appointed. In some regions, such as the Eastern zone, the collection responsibility also rested with the C&F agents. A Technical and Service Cell (TASC) was formed under a vice-president who looked after the brand building exercises. Before 2000, Grasim Industries marketed different brands of cement in different regions. They had Grasim Super in the East, Vikram and Aditya Cement in the North, Grasim Super, Rajashree and Vikram Cement in the West and Rajashree Cement and Birla Super in the South. This led to fractured brand building exercises, which resulted in additional expenditures. Therefore, in 2000, under the recommendation of the Boston Consulting Group, 'umbrella branding' was sought to be introduced. An umbrella brand 'Birla Plus' was launched first in the North zone and then subsequently in the East, West and South. The pricing of the brand was kept deliberately higher than the other brands in order to give it an image of exclusivity. Besides these, other promotional activities like dealers' meets, masons' meets, architects' meets, and engineers' meets. were conducted regularly for relationship management. As per calculations, for every bag of cement sold, ₹5.00 had been allocated for inculcating relationship management.

Questions for Discussion

1. What competitive advantage did Grasim gain by acquiring L&T Cement?
2. Suggest ways in which Grasim could further improve their market presence?
3. Was pricing the product higher than other brands a smart move? Given reasons for your answer.

(ii) Stability Strategy

A stability strategy is defined as the strategy wherein no critical changes are made in the existing status or functioning of an organization. In this strategy, the main focus is the existing market and products. It has been observed that companies that do well in unstable environments choose not to make any changes in their existing strategy as the need does not arise. A company is said to follow a stability strategy under the following circumstances:

(i) Satisfaction with the same consumer groups

(ii) Maintains the same market share

(iii) Satisfaction with the incremental improvements in the area of functional performance

(iv) Management wants to avoid risks which are associated with expansion or growth

Stability strategy is a unique feature of small businesses or companies in their mature stage of development. The 'steady as it goes' approach is followed when it comes to implementing stability strategies. The key is not to make any drastic changes in the product line, markets or functions. However, one must not confuse stability strategy to be bereft of any change. It is also not a 'do-nothing' approach to decision-making. Changes do take place but are very subtle. Hence, goals of profit enhancement and growth are not abandoned. Stability strategy can be designed to increase the company's profits by increasing efficiency in current operations.

A company may pursue a stability strategy due to the following reasons:

- Unsatisfactory performance of a company
- Involvement of less risk
- Presence of comfort factor
- Unstable environment
- High expansion may lead to inefficiencies

Situations where a stability strategy is more advisable than the growth strategy:

- Presence of a highly dynamic and unpredictable external environment
- If cost of growth is higher than potential benefits
- Due to excessive expansion there is a possibility of violating anti-trust laws

Different types of stability strategies are as follows:

(i) **Pause/Process with caution strategy:** Many organizations follow a stability strategy for a temporary phase until environmental situations changes. This kind of stability strategy helps a company to consolidate resources after a period of prolonged rapid growth. It has been observed that companies prefer to do a test trial prior to moving ahead with a full-fledged grand strategy and therefore apply a stability strategy.

(ii) **No change strategy:** When an organization chooses not to introduce anything new in its present operations or policies in the near future. An organization follows a no change strategy in the following circumstances:

- Absence of significant opportunities
- Absence of any threats in the operating environment
- No major strength or weakness emerges within the organization

Under these circumstances a no change strategy is following, which means the company will continue with its present operations and policies until a certain period of time after which the organization shall re-evaluate its situation.

(iii) Profit strategy: Under this type of stability strategy, the organization tries to artificially maintain its profits by reducing its investments and short-term expenditures. Instead of announcing the organization's declining position to shareholders and other investors, the top management engages in profit strategy. One important point to remember is that profit strategy is a small-term solution to avoid an issue temporarily. However, if the negative situation lasts longer then it may lead to serious deterioration in the organization's position in the related industry.

In general, stability strategies are useful in the short run. However, they may prove to be harmful if relied upon for a long duration of time.

Business-Level Strategy: Cost Leadership and Differentiation

Michael Porter presented three generic strategies that a firm can use to overcome the five forces and achieve competitive advantage. Each of Porter's generic strategies has sthe potential to allow a firm to outperform rivals within the same industry. The first , overall cost leadership, is based on creating a low-cost position relative to a firm's peers. With this strategy, a firm must manage the relationships throughout the entire value chain and be devoted to lowering costs throughout the entire chain. On the other hand, differentiation requires a firm (or business unit) to create products and/or services that are unique and valued. Here, the primary emphasis is on 'non-price' attributes for which customers will gladly pay a premium. Finally, a firm following a focus strategy must direct its attention (or focus) toward narrow product lines, buyer segments or targeted geographic markets. A firm emphasizing on a focus strategy must gain advantages either through a differentiation or a cost leadership approach. While the overall cost leadership and differentiation strategies strive to attain advantages industrywide, the focusers build their strategy with a narrow target market in mind.

The three strategies of Porter on two dimensions: competitive advantage and strategic target are as follows:

		Competitive Advantage	
		Uniqueness perceived by the customer	Low cost position
Strategic Target	Industrywide	**Differentiation**	**Overall cost leadership**
	Particular segment only	**Focus**	

Before moving on to each generic strategy, it is important to note that both casual observation and research support the notion that firms that identify with one or more of the forms of competitive advantage that Porter identified, outperform those that do not. There has been a rich history of strategic management research addressing this topic. One study analysed strategic business units and found that businesses combining multiple forms of competitive advantage (differentiation and overall cost leadership) outperformed businesses that used only a single form. The lowest performers were those that did not identify with even a single type of advantage. They were classified as 'stuck in the middle'.

NOTES

Overall cost leadership

The first generic strategy is overall cost leadership. Cost leadership requires a tight set of interrelated tactics that include:

- Aggressive construction of efficient-scale facilities
- Vigorous pursuit of cost reductions from experience
- Tight cost and overhead control
- Avoidance of marginal customer accounts
- Cost minimization in all activities in the firm's value chain, such as R&D, service, sales force and advertising.

An important concept related to an overall cost leadership strategy is the experience curve, which refers to how a business 'learns' to lower costs as it gains experience with production processes. That is, with experience , unit costs of production decline as output increases in most industries.

To generate above average performance, a firm following an overall cost leadership position must attain parity on the basis of differentiation relative to competitors. In other words, a firm achieving parity is similar to its competitors, or 'on par' with respect to differentiated products. Parity on the basis of differentiation permits a cost leader to translate cost advantages directly into higher profits than competitors. Thus, the cost leader earns above-average returns.

A business that strives for a low-cost advantage must attain an absolute-cost advantage relative to its rivals. This is typically accomplished by offering a no-frills product or service to a broad target market using standardization to derive the greatest benefits from economies of scale and experience. However, such a strategy may fail if a firm is unable to attain parity on important dimensions of differentiation, such as quick responses to customer requests for services or design changes. ING Direct, a financial services company provides a 'no frills' service but very generous rates on savings accounts and other services. In part, it succeeds by providing parity on differentiation through very good account security, ease and speed for customers in opening accounts, and very thorough online and paper account statements.

Improving competitive position vis-à-vis the five forces

An overall low-cost position enables a firm to achieve above average returns despite strong competition. It protects a firm against rivalry from competitors, because lower costs allow a firm to earn returns even if its competitors have a eroded their profits through intense rivalry. Also a low-cost position provides more flexibility to cope with demands from powerful suppliers for input cost increases. The factors that lead to a low-cost position also provide substantial entry barriers from economies of scale and cost advantages. Finally, a low-cost position puts the firm in a favourable position with respect to substitute products introduced by new and existing competitors.

Potential pitfalls of overall cost leadership strategies

There are many benefits of following a strategy of overall cost leadership. However, there are some pitfalls to avoid:

- **Too much focus on one or few value chain activities:** Firms need to pay attention to all activities in the value chain to manage their overall costs. Managers often make big cuts in operating expenses, but do not question the year-to-year spending on capital projects. The managers may also decide to cut selling and marketing expenses but leave manufacturing expenses untouched. Managers should explore all value chain activities, including relationships among them, as areas for cost reductions.
- **All rivals share a common input or raw material:** Firms that compete on overall low-cost strategies are vulnerable to price increases in the factors of production. Since they are competing on costs, they are not able to pass on price increases much because customers can easily take their business to competitors who have lower prices.
- **The strategy is imitated too easily:** One of the common pitfalls of a cost leadership strategy is that a firm's strategy may consist of value-creating activities that are easy to imitate.
- **Lack of parity on differentiation:** As noted earlier, firms endeavouring to attain cost leadership advantages need to obtain a level of parity on differentiation.
- **Decrease in cost advantages:** Cost advantages decrease when the pricing information available to customers increases.

Differentiation

As the name implies, the strategy of differentiation consists of creating differences in the firm's product or service offering by creating something that the industry views as unique and valued by customers. Differentiation can take many forms:

- Prestige or brand image
- Technology
- Innovation
- Features
- Customer service
- Dealer network

Firms may differentiate themselves along different dimensions at once. For example, BMW is known for its high prestige, superior engineering, and high quality automobiles. Another example is Harley-Davidson, which differentiates on image and dealer services.

Firms achieve and sustain differentiation advantages and attain above-average performance when their price premiums exceed the extra costs incurred in being unique. For example, both BMW and Harley-Davidson must increase consumer costs to offset added marketing expenses. Thus, a differentiator will always seek out ways of distinguishing itself from similar competitors to justify price premiums greater than the costs incurred by differentiating. Clearly, a differentiator cannot ignore costs. After all, its premium prices would be eroded by a markedly inferior cost position. Therefore, it must attain a level of cost parity relative to competitors. Differentiators can do this by reducing costs in all areas that do not affect differentiation.

Many firms successfully follow a differentiation strategy. For example, some firms have been able to appeal to a very upscale and discriminating segment of the market by offering products with an excellent image and strong brand identification.

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Siebel Systems, a leader in software that manages customer relations is well known for its customer service. No software is written until the customer has significant input. Consultants routinely poll clients on satisfaction, and the compensation of managers and technical professionals is heavily based on such reports. In the seven years since its founding, its sales have acceded $ 1 billion, faster than any other software maker, including Microsoft. The CEO of the firm is confident that the firm will sustain its growth rate as long as the company shows respect for the customer.

Improving position vis-à-vis the five forces

Achieving differentiation is a viable strategy for earning above-average returns by creating a defensible position for overcoming Porter's five competitive forces. Differentiation provides protection against rivalry since brand loyalty lowers customer sensitivity to price and raises customer-switching costs. By increasing a firm's margins, differentiation also avoids the need for a low-cost position. Hence, entry barriers result because of customer loyalty and the firm's ability to provide uniqueness in its products or services. Differentiation also provides higher margins that enable a firm to deal with supplier power, and it reduces buyer power, because buyers lack comparable alternatives and are therefore less sensitive to price. Supplier power is also decreased because there is a certain amount of prestige associated with being the supplier to a producer of highly differentiated products and services. Lastly, a firm that uses differentiation will enjoy high customer loyalty, thus experiencing less threat from substitutes than its competitors.

Focus

Focusing on a particular buyer group, segment of the product line, or geographic market is a focus strategy. The main difference between cost leadership, differentiation and focus strategies is that while the first two are aimed at the total industry, the third is aimed at serving a particular target market. This strategy assumes that a firm can serve its strategic target market more effectively than its competitors who are serving much bigger markets. A firm can thus obtain the advantages of differentiation and low cost or both. A focus strategy selects target markets where the firm is least vulnerable to substitutes or where competitors are the weakest. Take the example of Maybach, a car from Daimler Benz targeted at the elite group who want customization of the product and do not mind its exorbitant cost.

Risks of focus

A focus strategy is vulnerable to the following risks:

- Increasing cost differential between broad range competitors and the focus firm might offset the differentiation achieved through focus and turn the customers towards firms that offer a broad range of products.
- Perceived or actual differences between products and services might disappear.

- Other firms might find submarkets within the target market of the focus firm and the focuser may go out of focus.

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International Expansion

By adopting an international strategy, firms attempt to create value by transferring precious skills, knowledge and products to markets abroad where there is a dearth of these. Most international companies create value by transferring various products developed indigenously to new markets abroad. Such firms not only centralize product development activities on their home turf, but also establish manufacturing and marketing functions in the main countries they deal with. They do customize the products and marketing strategy as per the local requirements but only in a very limited way. The control over the marketing and product strategies is generally held by the head office. Examples of international firms are McDonald's, IBM, Kellogs, Procter and Gamble, etc.

An international strategy will only make sense if a company possesses such skills and competencies that their indigeneous counterparts in the foreign market lack. In such cases, it can be extremely profitable to have an international strategy. However, when the pressure is high for local responsiveness, firms going in for international strategy tend to be overtaken by firms that focus on customizing products, services and market strategy to local conditions. Firms pursuing international strategies may also face high operating costs when facilities of manufacturing get duplicated.

Diversification Strategies

Diversification may be defined as a business development strategy which permits a company to get involved in other businesses that are different from present-day products, services and markets. In today's fast-moving world, the markets have a very dynamic character and these markets include possibilities of strong competition. A successful business neither focuses on a single product or service nor limits their distribution to a single market. If a diversification strategy is implemented wisely after thorough analysis, it keeps the company stable in times of hardship. It has been observed that once an economic downturn occurs, it affects all sectors and all markets simultaneously. Diversification of business activities gives an organization competitive advantage and thereby reduces business risks. Due to this reason diversification is considered a great tool for business development. But to apply diversification successfully to an organization, requires experience and knowledge along with a thorough assessment of the organizational environment. Though diversification is difficult to achieve in small organizations, it becomes inevitable in some occasions. Some of the common reasons for diversification are minimising risk, capitalising on strengths and providing a new perspective in business.

There are two types of diversification strategies which are as follows:

- Concentric or related diversification
- Conglomerate or unrelated diversification

Concentric or related diversification: In this type of diversification, an organization takes up related activities within a broader industry situation. For example, when a sewing machine company starts manufacturing kitchen appliances,

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it is targeting a broader industry situation, i.e., women as a concentrated target whereas, kitchen appliances as concentrated product range.

Types of concentric diversifications

- Marketing-related concentric diversification
- Technology-related concentric diversification
- Market and technology-related concentric diversification

Conglomerate or unrelated diversification: A conglomerate is a combination of two or more corporations which are engaged in entirely different types of businesses but fall under one corporate group. A conglomerate involves a parent company and many subsidiary companies. In simple terms, a conglomerate takes up activities which are unrelated to the core business.

Risks for Diversification

Some of the following risks related to diversification are as follows:

- It is complex and confusing, especially unrelated diversification.
- It demands a wide variety of skills.
- It is witnessing less commitment to the core business.
- It often results in losses.
- It leads to an increase in administrative costs.

3.3.6 Expansion Strategies

Growth is a common long-term goal for every organization as they want to avoid their downfall in a relentless and ruthless competitive environment. Growth is key to an organization as it provides an opportunity to each and every employee. Not only does growth provide an opportunity to every employee of an organization, it is crucial for the survival of the organization. Growth is only possible if the main factors of expansion have been met by the organization. Expansion strategies are designed in such a manner that an organization is able to maintain its competitive position in an ever changing world market. Therefore, to compete, survive and flourish, an organization needs to employ an expansion strategy. An expansion strategy is an important strategic option that an organization formulates and adheres to so it can accomplish its objective of long-term growth. Organizations basically apply an expansion strategy to gain substantial growth as opposed to incremental growth envisaged in stability strategy. It is implemented to increase the rate of growth of sales, profits and market share faster by entering new markets, acquiring new resources, developing new technologies and creating new managerial capabilities. It is a plan to achieve long term growth objectives. Expansion strategy allows the organization to maintain their competitive advantage even in the advance stages of product and market evolution. Expansion strategy offers growth to an organization which in turn offers economies of scale and scope to an organization. This further reduces operating costs and thereby improves earnings. With the help of an expansion strategy, an organization gains a much larger control of the immediate environment due to the aspect of size. This type of influence is important in mature markets where competitors are known to aggressively defend their market shares.

Rypes of Expansion Strategies

The types of expansion strategies are as follows:

- Expansion through concentration
- Expansion through integration
- Expansion through diversification
- Expanision through cooperation
- Expansion through internationalization
- Expansion through digitalization

(i) Intensification strategies

When expansion takes place within the existing line of business, it is referred to as expansion through intensification. An intensive expansion strategy safeguards the current position of an organization. It expands the current product-market space to accomplish the organization's growth targets. This approach is apt for organizations that are yet to completely exploit the existing opportunities in their current products-market domain. When an organization chooses an intensification strategy, it mainly concentrates on its primary line of business and searches for new avenues to meet its growth objectives. This is done by increasing the size of operations in its primary business. Intensive expansion in an organization can be adequately explained through Ansoff's market matrix. At this point, it is important to mention that an intensification strategy is undertaken by an organization when adequate growth opportunities exist in the firm's current products-market space.

Fig. 3.2 *Ansoff's Matrix*

Source: *https://blog.oxfordcollegeofmarketing.com/2016/08/01/using-ansoff-matrix-develop-marketing-strategy/*

(a) Market penetration: Here the organization aims to seek growth with its existing products in the current market segments. This is done to increase its market share.

(b) Market development: Under market development, the organization wants to grow and in order to achieve growth the organization targets its existing products to new market segments.

(c) Product development: As the name suggests, the organization develops new products keeping the existing market segments as its target.

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(d) Diversification: When an organization grows by diversifying into new businesses by developing new products for new markets.

(ii) Integration strategies

Integration is defined as the process of combining activities that are related to the present activity of the organization. Integration is a part of the diversification strategy. With reference to market penetration, integration strategies are able to widen the scope for an organization. Integration is of two types, which are as follows:

(a) Horizontal integration: This occurs when one organization takes up the same types of products at the same level of production or marketing process. Horizontal integration is also known as mergers and acquisitions. For example, the Satyam takeover by Mahindras.

(b) Vertical integration: When an organization expands for its own needs. Vertical integration is of two types, i.e., backward integration and forward integration. Backward integration refers to a state where the organization goes back to the source of raw materials. For instance, a thermal power company who also ventures in coal mining. Forward integration is when an organization is closer to the finished product. For example, a car spare parts manufacture starts manufacturing cars.

3.3.7 Mergers, Acquisitions and Takeovers

Mergers can be defined as the integration of two or more firms on a co-equal basis. In mergers, the concerned firms pool all their resources together to create a sustainable competitive advantage. An acquisition, on the other hand, refers to the process of gaining complete or partial control of a company by another company for some strategic reasons. Unlike mergers, acquisitions can sometimes be unfriendly or hostile. This implies that a firm attempts to take over another firm by adopting hostile measures which may not be in the interest of the acquired firm. This trend is spreading rather quickly.

Historical perspective of mergers

1. The pattern that emerged with the first merger wave dating back to 1897 lasted till 1904. It was basically an outcome of the industrial revolution. It led to the establishment of large industrial houses, which are still present in the US and many other corners of the world. Mergers during this period were mainly horizontal.
2. The second merger wave started around the 1920s and lasted till 1929. This period was marked by vertical and conglomerate mergers. The period saw the emergence of sectoral clusters in railroads and utilities.
3. The period between 1965 and 1975 can be termed as the period of the third wave of mergers. During this period the emphasis was more on achieving economies of scale by the mass industrial production of consumer goods.
4. The fourth merger wave happened during the period 1984 to 1988 when more mergers took place in Europe than in the US. In this period, the emphasis was on creating synergies. Technology played an important role during this period.

5. The fifth merger wave which started in 1995 was characterized by words like globalization and deregulation. As a result of globalization, markets expanded and the size of the firms also grew. As a result of deregulation, industries which earlier enjoyed a monopoly were exposed to competition from private and international players.

Going by historical evidence, the increase in merger activity can be seen as a reaction to the changing business environment. These changes may vary from time to time and are mostly related to changes in technology.

Rationale for Mergers and Acquisitions (M&As)

The reasons for opting for mergers and acquisitions vary from one firm to the other. We will now look at some of the common reasons.

1. **Increased market power:** The primary reason for firms going in for mergers and acquisitions is their desire to increase their market power. A firm gains market power when it is able to sell its goods or services at a price which is lower than its competitors or is lower than the cost of producing the product or service. A firm may have core competencies but may lack the required resources and size to compete in the market. Thus, most mergers and acquisitions which take place with the intention of increasing market power target competitors, suppliers, distributors or businesses in related industries. In order to expand the size of the firm, firms go for horizontal, vertical and conglomerate mergers.

   (a) ***Horizontal mergers***

   A merger between two firms operating and competing in the same business activity is known as a horizontal merger. Combining two business entities results in a larger firm and thus greater economies of scale. However, it is not the only reason for the popularity of horizontal mergers. Though horizontal mergers benefit from large-scale operations, not all firms merge horizontally to achieve economies of scale. Firms may merge horizontally to share resources and skills and also to derive synergy. Governments make efforts to regulate horizontal mergers as they can minimize competition. By decreasing the number of firms in an industry, a horizontal merger may create a monopoly market causing the consumers to suffer. The proposed merger between GE and Honeywell, for instance, was stopped by European authorities, fearing monopolization in the industry. The merger between Deccan Aviation and Kingfisher Airlines is also a good example of a horizontal merger.

   (b) ***Vertical mergers***

   When two firms in the same industry but in different stages in the value chain merge, it is called a vertical merger. There are different reasons for companies entering into vertical mergers. Vertical mergers can be entered into due to any of the following reasons:

   (i) Reduction in the costs of communication

   (ii) Production coordination

   (iii) Better planning for inventory and production

Coke and Pepsi, for example, acquired many bottling companies to improve marketing and supplying facilities. Similarly, to maintain greater control on the prices of tea leaves, Hindustan Lever Limited and Tata Tea purchased many tea gardens in Assam and West Bengal.

(c) ***Conglomerate mergers***

When two firms from unrelated business activities merge, it is known as a conglomerate merger. Conglomerate mergers can be categorized into three different types:

(i) Product extension merger
(ii) Geographic extension merger
(iii) Pure conglomerate merger

When two firms in a related business activity merge, it is called a product extension merger. This helps broaden the product line of firms. When two firms operating in non-overlapping geographic areas merge, it is known as geographic extension merger. When two firms from unrelated business activities merge, it is known as a pure conglomerate merger.

2. **Overcoming entry barriers:** When firms try to enter new markets, they often face many problems, some of which may act as barriers to their entry. Well-established firms may sell their products and services in large volumes thereby gaining economies of scale. These economies of scale act as barriers to entry. Another barrier that a new entrant in the market faces is product loyalty. An entrant in a new market prefers differentiating its products from its competitors. Thus, economies of scale, product loyalty and high advertising expenses act as barriers for a firm trying to enter a new market. The greater the barriers to entry, the more the likelihood that firms will take to mergers and acquisitions to overcome these barriers.

3. **Cost of new product development:** Developing new products and launching them successfully in the market not only requires commitment of the firm's resources, the return on investment may take a long time. Moreover, the market acceptance of the new product is also unpredictable. According to a research, 88 per cent of new products fail to achieve expected results while 60 per cent of innovative products are copied within four years of being patented.

   Firms prefer mergers and acquisitons in order to avoid the internal costs of developing new products. Moreover, M&As also reduce the risks associated with the launch of a new product, as the product is already tested in the market. If a company acquires another company that already has an established product in the market, the acquiring company can enter the market more quickly.

4. **Increased speed to market:** As discussed earlier, mergers and acquisitions lead to faster market entry when compared to the time taken for new product development. Research has shown that M&As are the quickest route to new markets and new capabilities. The new capabilities can be used to introduce new products and enter markets and this can create an

advantageous market position. However, how long the advantage may last depends upon the rivals' competitive responses.

5. **Lower risk compared to developing new products:** Developing a new product involves a lot of risk. Managers view mergers and acquisitions as a risk-free method of gaining entry into new markets. However, one major drawback associated with increasing M&As is that they prevent investments in new product development. Research shows that M&As have become a means to avoid risky internal ventures. Many firms prefer not to incur heavy expenses in developing new products, as acquisitions often seem to provide an economically more viable option.
6. **Increased diversification:** A firm finds it easy to develop and introduce new products in a market where it has some experience. On the contrary, if a firm launches a product that has no relation to its existing portfolio of products, there are lower chances of its success. Thus, in order to diversify, firms would prefer the M&A route as it can be used for both related as well as unrelated diversification. Therefore, M&As are more common when firms want to diversify on a global level.
7. **Reshaping the firm's competitive scope:** The intensity of competition affects the profitability of a firm. To reduce the negative effect of competition, and also to reduce their dependence on a single or a few products, firms acquire other firms. If a firm is dependent on a single product for all its revenues and profits, the competitive scope of the company is likely to be reduced. To avoid dependence on a single product, many firms venture into new industries through acquisitions.

Reasons for Cross-Border Mergers and Acquisitions

There are various reasons for the increasing number of cross-border mergers and acquisitions. Some of these reasons are as follows:

1. **Growth:** Growth is one of the primary motivating factors behind cross-border M&As. A firm making profits in an ailing economy would not like to make additional investments in the same country. It makes perfect business sense for the firm to invest in an economy which promises faster growth. Firms which have operations in one particular country may not have a cost advantage because of limited sales. If the operations are expanded to other countries due to the economies of scale, the firm can gain a cost advantage.
2. **Technology:** A technologically superior firm may go in for M&As to exploit its technological advantage. On the other hand, a firm which lacks technological advantage may go for M&As to gain access to superior technology. By using the advanced technology of the acquired firm, the acquirer can improve its competitive position and profitability both at home and abroad.
3. **Government policy:** Government policies and regulations relating to tariffs and quotas can have a major impact on M&As. If a country imposes tariffs and quotas to protect its domestic industry, exports will suffer. Environmental and other regulations can increase the time and cost required to build facilities

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for entry abroad. Thus, acquiring a company with facilities in place makes good business sense.

4. **Differential labour costs and productivity:** Labour costs comprise a significant portion of the cost of production. Many multinational companies go in for M&As to take advantage of the availability of cheap labour. It is because of this reason that many multinational companies are heading towards developing countries like India and China to set up their manufacturing bases. Higher productivity of labour also influences cross-border M&As.
5. **Source of raw materials:** This factor plays an important role in the growth of vertical mergers, more so for acquiring firms from resource-poor domestic economies. This approach may not be feasible in the case of strategic raw materials as many countries have restrictions on foreign ownership of such assets.

Blueprint for Integrating Acquisitions

Integration is a crucial part of any successful acquisition. According to a study conducted by Booz-Allen Hamilton, the success of M&As does not depend much on the nature of industry, type of integration, the purchase premium or the capitalization ratio. Rather, it depends on the firm's pre and post-integration strategy and the ability to act quickly. An efficient integration strategy brings together the strategies, policies and procedures of the merging companies, whereas an inefficient integration strategy results in inefficient operations, communication gaps, misunderstandings of objectives, and clashes in culture and leadership that prevent the merging companies from realizing their full potential.

At the beginning of negotiations, the concerned management/managers must pay attention to the business portfolio, but as the deal advances, they must switch their focus to people and processes. Once the deal closes, the new entity that has been formed must settle the uncertainty of who is going to report to whom and who is responsible for what. Losing external focus is one of the biggest risks that the management faces when integrating two businesses and it is precisely at this time that the firm loses people and customers. Once questions concerning key people are answered, the firm must start integrating the basic work processes, computer systems, financial systems, and so on. Management should never underestimate the difficulty of achieving such integration. In the early days of integration, managers find it hard to get the information they need to make timely decisions. This makes having the right people in the right places within the organization all the more important.

Once an acquisition has been announced, the firm must try to have the management structure completely laid out. The work of integration should really start when the firm is planning the acquisition, because integration determines, to a large extent, whether the merger is going to be a failure or a success.

Management has to explain (to the people involved in the merger process) the process that will determine the new management structure. If the management can show how that's going to work, some of the concerns of these people are taken care of. The management then has to bring in the best people available to implement the changes. Its particularly important to do this for international acquisitions.

Corporate Restructuring

Restructuring can be defined as a strategy by which a company changes its business or financial structure. Restructuring also involves making radical changes in the composition of the business. GE witnessed tremendous growth during the tenure of Jack Welch (1981–2001). Many analysts attribute GE's success to its effective use of restructuring strategies. As a CEO, Jack Welch sold 350 businesses for a total of $23.8 billion and acquired some 900 businesses for a total of $105.5 billion. Under Jack Welch, restructuring became a continuous process, resulting in the creation of greater efficiencies and globalization of operations. The success of GE highlights the importance of restructuring in a competitive business environment.

Firms use restructuring strategies in response to the changes in the external and internal environment. In the light of rapid environmental changes, restructuring is one of the best strategies for companies to create maximum value for their stakeholders.

Between the 1960s and the 1990s, diversification became a common phenomenon. Many firms diversified to an unmanageable extent. Overdiversification led to an increase in bureaucratic inefficiencies and the performance of these companies was adversely affected. As a result, stock prices of these companies fell drastically, making them soft targets for hostile takeovers. To minimize such risks, firms had to undertake restructuring activities.

The various forms of restructuring are as follows:

1. **Expansion:** Firms can expand their operations through mergers and acquisitions, tender offers and joint ventures. A merger can be defined as any transaction through which two or more firms integrate their operations on a relatively coequal basis. It is a transaction that forms one economic unit from two or more previous ones. Different firms have different resources and capabilities and bringing them together can lead to the creation of competitive advantage. As already discussed, mergers can be classified as horizontal, vertical or conglomerate mergers.

   In a tender offer, a company which intends to acquire a controlling interest in another company asks the shareholders of the target company to submit or tender their shares of stocks in the firm. If the company wants to take over control of another company, it has to first take approval from the target company's management and the board of directors of the target company. An alternate approach known as the bear hug can also be adopted. In this approach, a company communicates with the directors of the target company regarding its acquisition proposal. The directors are required to make a decision on the proposal. If the acquiring company does not get the approval, it can directly appeal to the stockholders through tender offers. If the company obtains a favourable response to the tender offer, the acquiring company can gain control over the company and replace the directors who did not cooperate in the takeover effort. This type of taking control is referred to as a hostile takeover.

   A target company, in order to avoid being taken over, may join hands with another company with which it would like to form an association. The organization with which the target company wants to form an association is

referred to as a White Knight. To avoid another company from taking over, the target company can also go for some form of restructuring, such as offering shareholders a large cash dividend financed by debt. Shareholders prefer this form of restructuring to an outside offer, making the target less financially attractive to the bidder. In a joint venture, the participants continue to exist as separate firms with the joint venture representing a newly created entity. Partners share a proportional capital, distinctive skills, personnel, reporting systems and technologies to gain competitive advantage. Joint ventures result in a collaborative approach among the partners to create new value.

2. **Sell-offs:** There are two major types of sell-offs—spin-offs and divestures. A spin-off results in the creation of a separate legal entity, the shares are distributed among the existing shareholders of the parent company on a pro-rata basis. It is a form of dividend to the existing shareholders. The new entity has the power to make independent decisions. It can also develop policies and strategies which are different from those of the parent company.

   There are two types of spin-offs—split-offs and split-ups. In a split-off, some of the existing shareholders receive stocks in a subsidiary in exchange of stocks of the parent company. In a split-up, the entire firm is fragmented into a series of spin-offs. This is to ensure that the parent firm no longer exists and the new company created as a result of split-up survives in the long run. Unlike spin-offs, where only shares are transferred or exchanged, divestures involve the sale of a portion of the firm to a third party. Since the buyer is an existing firm, no legal entity is created.

   Equity carve-out is a variation of divesture. In this, a portion of the firm is sold to outsiders through an equity offering, giving them ownership of the previously existing firm. Equity carve-out also results in the creation of a new legal entity.

3. **Corporate control:** Corporate control can be established through premium buy-backs, standstill agreements, anti-takeover amendments and proxy contests. In premium buy-backs, a substantial stakeholder's ownership interest is re-purchased at a premium that is above the market price. In connection with such buy-backs, a standstill agreement is often signed. A standstill agreement is a voluntary contract in which a shareholder whose shares have been purchased agrees that he or she will not make further attempts to take over the company in the future. If a buy-back is not involved in the standstill agreement, the stock-holder with substantial influence agrees not to increase his or her ownership control.

   Anti-takeover amendments refer to the changes made in the corporate by-laws to prevent mergers and acquisitions. Some of them are as follows :

   (i) Super majority voting provisions, which require a very high percentage of stockholders to approve the merger.

   (ii) Unspecified service terms for directors which can delay change of control for a very long period.

   (iii) Golden parachutes wherein large termination payments have to be made to the existing management.

In proxy contests, a group which is external to the firm (often referred to as 'dissidents' or 'insurgents') tries to obtain representation on the company's board of directors. It tries to reduce the controlling power of the existing board of directors. As the management often controls the board of directors, proxy contests are seen as targeted towards the existing management.

4. **Changes in ownership structure:** This includes exchange offers, share repurchases, going private and leveraged buy-outs. Exchange offers involve exchanging debt or preferred stock for common stock or exchanging common stock for debt or preferred stock. The first type of exchange increases leverage while the second type decreases leverage. The ownership structure can also be changed by repurchasing shares, i.e., a company can buy back some portion of its outstanding shares of common stock. The percentage of shares purchased may vary. If it is successful in purchasing a substantial percentage of shares, it can change the control structure of the company.

   A going-private transaction involves a small group of investors purchasing the entire equity interest in a public company. When the members of the incumbent management group initiates the transaction(purchasing substantial proportion of the equity ownership of the new private company), it is known as a management buy-out. A small group of outside investors may provide funds and secure representation on the private company's board of directors. They may also arrange finance from third- party investors. When the private company borrows substantially from third parties, such transactions are called leveraged buy-outs(LBOs).

Cooperative Strategies and Competitive Advantage

Companies in all types of industries and in all parts of the world have formed strategic alliances and partnerships to complement their own strategic initiatives and strengthen their competitiveness in domestic and international markets. However, in the past, a vast majority of companies were content to go it alone, confident that they already had or could independently develop whatever resources and know-how was needed to be successful in their markets. But globalization of the world economy, revolutionary advances in technology across a broad front, and untapped opportunities in national markets in Asia, Latin America and Europe that are opening up, deregulation, and/or privatization have made strategic partnerships of one kind or another integral to a firm's competitiveness.

Many companies now find themselves thrust in the midst of two very demanding competitive races:

1. The global race to build a market presence in many different national markets and to establish an attractive position among the global market leaders.
2. The technology race to capitalize on today's technological and information age revolution and build the resource strengths and business capabilities to compete successfully in the industries and product markets of the future.

Increasing pervasive use of alliances

Strategic alliances and collaborative partnerships have emerged as an attractive and timely means of breaching the technology and resource gaps that firms now commonly encounter. Alliances have, in fact, become so essential to the

competitiveness of companies in many industries that they are a core element of today's business strategies. They are especially prevalent in industries where change is rapid. General Electric has formed over 100 cooperative partnerships in a wide range of areas. IBM has joined in over 400 strategic alliances. Toyota has forged a network of long-term strategic partnerships with its suppliers of automotive parts and components. Microsoft collaborates very closely with independent software developers that create new programs to run on the next-generation versions of Windows. A recent study indicates that an average large corporation is involved in around thirty alliances today in comparison to fewer than three a decade ago.

Human Resource Strategy

HR policies guide the functioning of HRM. These policies provide guidelines for, among other things, recruitment, differentiation among workers in terms of compensation and social responsibility in terms of policies against child labour, etc. HR policies also lay down guidelines for identifying training needs, selecting employees for foreign postings, developing reporting systems and achieving a level of cooperation between the workers' union and management. They also deal with the amount of autonomy that should be given to subsidiaries for devising HR strategies.

It has been argued that MNCs should replicate HR practices in subsidiaries to make the internal environments similar, and to synchronize the performance appraisal and reporting systems of the parent and subsidiaries. Japanese companies, for example, replicate the home country's best practices in the subsidiaries. Some MNCs identify best practices from all their subsidiaries and implement them throughout the organization.

Equality in recruitment and pay

Some companies discriminate against candidates seeking employment on the basis of religion, race, caste, sex or place of birth. Discrimination can take the form of unequal pay, poor working conditions, or restricted access to facilities.

Japan has a male dominated workforce because of discrimination against female candidates. The consequences of differential treatment may range from employee dissatisfaction and industrial unrest to government interference in regulating the organization. Equality in recruitment and pay assumes more importance in the case of MNCs where people from different nationalities are employed.

Types of Staffing Policy

Staffing means finding the right person for the right job, for the right pay. Staffing begins with the 'job description'. The nature of the work and the skills required to complete the job have to be identified and described in detail. Staffing also involves selecting people who will fit into the culture of the organization. Companies like GE are more concerned with the applicant's cultural fit than his skills. The staffing policy will also depend on the company's approach to globalization.

Ethnocentric approach

MNCs adopting the ethnocentric approach to globalization view the world as one integrated market place. As a result, they prefer standardization among other things,

products, organizational structure and staffing policy. In the ethnocentric approach to staffing, all top management positions are filled by the parent company. Companies exploring emerging markets are often reluctant to recruit locals for senior management positions. They prefer to appoint home country nationals in order to replicate the parent company's corporate culture in the subsidiary.

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Polycentric approach

MNCs adopting the polycentric approach to globalization view the world as a differentiated market place requiring customization in every aspect of business. This approach encourages companies to recognize difference in cultures and customize their products, marketing strategy and HR practices accordingly. The major drawback of this approach is the possible lack of coordination between the parent and the subsidiaries due to language barriers and cultural differences. A communication gap between the parent and the subsidiary can also hinder the transfer of technology.

Geocentric approach

In a geocentric approach to globalization, MNCs identify best practices from within and outside the organization and implement them throughout the organization. Applying this principle to staffing, MNCs identify and appoint the most suitable managers regardless of their nationality. The top management also consists of people from a variety of cultures, thus enabling a greater degree of product customization. Training and relocation costs of managers are high in this approach to staffing.

Employing Expatriates

The purpose of expatriation should be clear. Expatriate managers are not mediocre employees in the organization who are sent for a training or for a refresher course abroad. They are highly motivated managers who can create and share knowledge. Expatriate managers are residents of one country working in another country for the organization's subsidiary. It is not uncommon for MNCs to depute their employees on contract to other organizations. Companies are empowering their employees with functional responsibilities as against the traditional responsibilities. A global product manager is expected to coordinate all the activities concerning a product in all the countries in which the company operates. This has led to two changes in expatriation. First, the duration of stay abroad for an executive has been reduced. Second, younger employees are also required to work abroad for a few years. Shorter assignments for executives have two benefits: it brings down the costs of expatriation substantially, and it enables working spouses to retain their jobs. Thus, shorter assignments are a win-win situation for both the MNC and the employee.

Developing local talent

MNCs cannot depend entirely on expatriates for running international markets and practices. So, a talented pool of local employees is necessary. Formal training can be given to new recruits through Management Development Programmes (MDPs) conducted by business schools. Alternatively, in-house managers can train new recruits since they are familiar with the processes and culture of the company. The challenge is as much in recruiting and training talented employees as in retaining them.

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Training and Development

Training means equipping an individual with the technical or non-technical knowledge for some specific assignment. Development is a wider term, involving the all-round development of an individual and not necessarily related to a specific job assignment. In MNCs, employee development is necessary to prepare employees to take up future international assignments.

Arranging workshops and MDPs is common in MNCs. MDPs aim at improving coordination among employees with diverse cultural, religious and educational backgrounds. During the course of an MDP, employees develop informal networks and share knowledge.

Job rotation also enables sharing of knowledge. MNCs, therefore, transfer employees to their subsidiaries and give them different functional assignments.

Training of expatriates

Several MNCs offer training to employees to be sent abroad, aimed specifically at overcoming cultural and language barriers that could hinder performance. Some even interview and train the spouses of employees since often it is the spouse who finds it difficult to adjust to cultural changes. An employee has to be trained to adapt to differences in culture, language and lifestyle. Training of expatriates can be broadly classified into three types:

(i) Cultural
(ii) Language
(iii) Practical training

Repatriation of expatriates

The repatriation of expatriates involves placing the expatriate in the right job on his return. More often than not, expatriates do not find suitable jobs. This can lead to conflicts, resentment and dissatisfaction. The employees in the home country do not appreciate the fact that the expatriate manager needs time to readjust. With their international experience, former expatriates can share knowledge and help future expatriates.

Compensation

Compensation includes cash payments and non-cash benefits and perquisites. National differences in pay and the salary of expatriates are key issues in managing compensation. A company's ability to attract talent is linked to its compensation policies. In case of companies with ethnocentric approach, compensation poses no problems as employees belonging to the home country are deputed on foreign assignments, i.e., the compensation remains the same as at home.

Companies with a polycentric approach develop country-specific plans. Significant problems regarding compensation arise in companies that follow a geocentric approach. In a geo centric approach, the company attempts to create a cadre of 'international managers' who hail from different countries.

Performance Appraisal in Subsidiaries

Performance Management (PM) attempts to link performance appraisal to employee training and development, and possibly to compensation. PM has an impact on the job satisfaction of employees in an MNC's subsidiaries. Employees regard performance management as fair if the process of evaluation is clearly understood by employees.. Research has shown that fair performance evaluation has a positive impact on the job satisfaction of employees. Employees, who were told whether their performance was good or bad soon after completing ask, were found to be more satisfied with their jobs than those who received feedback much later. An important aspect of PM is to identify the training and development needs of employees. Research has shown that employees prefer PM that helps them advance their careers to PM which concentrates on past performance.

Domestic HR Strategies pursued in Subsidiaries

The three approaches to International HRM (IHRM) are exportive, adaptive and integrative. In the adaptive approach, subsidiaries formulate their own HR policies to reflect the local environment. In the exportive approach, MNCs transfer home country HR practices to subsidiaries to achieve parity of standards. In the integrative approach, MNCs identify the best practices of all their subsidiaries and replicate them throughout the organization. More often than not, managers mix all three strategies. MNCs might follow different approaches for different aspects of HRM. For example, Training may be standardized to ensure quality of teaching in the training programme. Performance appraisal may be undertaken at the local level. The best recruitment process may be identified and implemented across all subsidiaries.

Subsidiaries' Autonomy in Decision-Making

There are three schools of thought about the factors influencing the distribution of power between the parent and the subsidiary. They are limited autonomy, variable autonomy and negotiated autonomy.

Limited autonomy

According to this school of thought, an MNC attitude to globalization affects the relationship between the parent and the subsidiary. Ethnocentric, polycentric or geocentric approaches guide decisions regarding the autonomy of subsidiaries.

Variable autonomy

This school of thought argues that the autonomy of a subsidiary is determined by controllable variables like production systems, and country of origin, and uncontrollable variables like political factors.. variable autonomy is best explained as a continuum along the process of internationalization.

Negotiated autonomy

Negotiated autonomy is an extension of the transnational strategy to globalization, wherein international best practices are identified and replicated in all subsidiaries. Thus the autonomy of the local manager is decided not by the parent company, but essentially by the best practice, wherever it is being followed. For example , a

US MNC having subsidiaries in India and Germany may replicate the recruitment practices of its Japanese subsidiary . Since the Japanese subsidiary has developed the recruitment process that is being implemented at headquarters and in the German subsidiary, it has more negotiating power at headquarters.

Labour Relations

Labour relations refer to the relationship between organized labour and the management. Organized labour refers to trade unions. Labour relations management seeks to maintain a cordial relationship between labour and management, establish a speedy redressal system to minimize losses due to strikes, lock-outs or industrial violence, and promote the participation of workers in management.

Concerns of organized labour

The Indian Industrial Disputes Act, 1947, defines an industrial dispute as 'a dispute' between the employer and employer, employer and worker and other workers, regarding employment, non-employment, terms of employment or conditions of work. Collective bargaining is a tool which employees use to demand more pay, and better working conditions and benefits. Lock-out is a tool which the employer uses to counter the threat of strikes. Since MNCs have the option of relocating their facilities, workers feel insecure about their jobs. They feel that MNCs provide only low- skilled jobs that can be performed as efficiently elsewhere. Workers feel that MN Cs could make use of their better bargaining power to impose unfavourable terms on workers.

The strategy of organized labour

Organized labour has tried in vain to counter the bargaining power of MNCs. Labour organizations have attempted to cooperate with each other in countering the bargaining power of MNCs. There are certain fundamental differences in the approaches of trade unions in different countries. Japanese unions do not encourage strikes.. In contrast unions in France & Italy weld the weapon of industrial strikes as a legitimate way for workers to settle disputes with management and move wage negotiations in their favor. Though the International Labour Organization (ILO) and the Organization for Economic Cooperation and Development (OECD) have formed guidelines for managements in regards to labour relations, the enforcement mechanisms are not strong enough.

Financial Management Strategy

Currency risk is one of the unique problems faced by the internationally operating firms. Currency risk can be managed taking a short-term view and using financial instruments to hedge against specific risks. A long term strategy of diversifying across products, markets and suppliers might involve more initial investment , but subsequently lower short-term hedging costs.

Foreign Exchange

In a foreign exchange market, individuals, banks and other institutions trade in currencies. The principle purpose of a foreign exchange market is to allow traders to have access to foreign currencies required for the export and import of goods

and services. At present foreign exchange markets around the world are equipped with efficient information systems and access to the global Clearing House Inter-bank Payment System (CHIPs), which makes international financial transactions effective and smooth.

The price of one currency in terms of another is called exchange rate. It is determined by factors affecting the demand and supply of the currency in the foreign exchange market. Changes and fluctuations in the exchange rate can be destabilizing. Therefore analysts try to predict exchange rates on the basis of anticipated demand and supply. Ways have also been devised to minimize the problems that arise due to fluctuations in exchange rates, as given below-

Cash, Tom, Spot and Forward Rates

Cash is the exchange rate for currencies to be delivered immediately or in the same day. Tom is the rate for currencies to be delivered a day after the day of contract. Spot rate is the exchange rate for currencies to be delivered 2 days after the day of the contract. Forward rates are exchange rates for currencies to be delivered later. There are many forward delivery dates, one- month forward, three-month forward, six-month forward , etc. These rates depict the market's view about the movement likely to occur in the currency. Forward rates are expressed in terms of percentages..

Bid-ask spreads

These e are quotations of price(exchange rate) between dealers in foreign exchange. Bid is the price at which one dealer will buy the currency in exchange for another currency. Ask is the price at which the dealer will sell the currency. The bid price is slightly lower than the ask price. The Bid- Ask difference is called the spread and it is the profit in the transaction for the dealer. A higher spread indicates less trading in the currency. A very low spread is an indication of high liquidity in the markets for the currency.

Arbitrage

Riskless profit, made by buying and selling the same securities in two different markets simultaneously, is termed as arbitrage. Arbitrage opportunities exist when there is mis-pricing of the instruments in the two markets.

Meaning of Currency Risk

The exchange rate has a direct bearing on the business of the company. Let us suppose GM Chevrolet cars are priced at USD 30,000. The exchange rate is 73/ \$. So an Indian importer will have to pay 2190000 (30000×73), excluding other costs. If the rupee falls to 74/\$, importer will have to pay 2220000 (30000×74). But if the rupee appreciates to 72/\$ then the importer will have to pay 2160000 (30000×72).

Exposure—Meaning and Types

The sensitivity of a firm's cash flows to changes in exchange rates is called exposure. Such exposure can be long term short term or only of an accounting nature.

Economic exposure

This refers to the long-term outlook of the company's investments that are already made or are likely to be made in a country. This exposure is difficult to asses as it involves a subjective projection of future cash flows. Measurement and management of economic exposure requires a long-term strategic plan. It has an impact on the overall value of the firm.

Transaction exposure

This is similar to economic exposure except that it ids for a shorter term. Transaction exposure is caused by any likely change in future cash flows due to changes in exchange rates after completion of transactions but before the actual receipt of cash. There are various strategies for hedging (protecting) against such exposure.

Translation exposure

Translation exposure arises on the basis of Accounting for transactions between trading companies. The holding company in a country needs to include the accounts of its subsidiary in its balance sheet. Investors across the world will require the balance sheet to be in the currency of the country to which the holding company belongs. US GAAP defines translation exposure as arising out of changes in the value of net monetary assets. 'Net monetary assets' is the difference between monetary assets and liabilities. Monetary assets include cash, receivables and stock and monetary liabilities include payables and long-term debt.

Currency Risk Management Alternatives

The liberalization of government regulations regarding international movement of capital and financial and technological innovation has made currency risk management simpler and more accurate. Derivative instruments were developed initially to protect merchandise traders from fluctuations in the prices of commodities. But their application is being rapidly extended to fund management, HR policies and enterprise-wide risk management.

Derivative instruments and their uses

Derivative instruments are also called derivative assets since they derive their value from other underlying assets. They are used extensively in risk management. The major advantage of derivatives is the leverage they offer, i.e., positions can be held which are worth many times the cash outlay. Careful use of derivatives can not only reduce risk substantially but can also help make profits. Some of the common derivative instruments are:

(i) ***Forward Contracts***

These are agreements to buy or sell a product at a future date at an agreed price. Thus the uncertainty arising out of change in prices is done away with. But there is the risk of default on the part of the contracting parties

(ii) ***Futures Contracts***

These are a more standardized form of forward contracts . Here too, there is an agreement to buy or sell at a future date at a specified price. But all these contracts are routed through an exchange established for this purpose. The

exchange specifies the size of contracts, the delivery dates and it requires the contracting parties to deposit margins. Thus the default risk is passed on to the exchange, which takes on the responsibility of performance of contracts.

(iii) ***Options***

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These are relatively more sophisticated in terms of pricing and perhaps the most flexible of all instruments in terms of usage. Terminology and symbols used in option contract are-

- The parties to the contract are option buyer and option seller or writer.
- Call option gives the owner the right but not an obligation to buy the underlying asset for a specified price on a specified future date. Put option gives the owner of the option a right but not an obligation to sell the underlying asset.
- Strike price is the price specified in the option contract at which the buyer can purchase (call) or sell (put) the asset.
- Maturity date is the date on which the option is exercised. In an American option, the option can be exercised at any time during the life of the contract whereas a European option can be exercised only on maturity.
- Premium is the price of the option. This is the fee the buyer or writer of the option must pay upfront for the right to exercise the option.

(iv) ***Swaps***

Swaps are contracts between two parties, with or without an intermediary, to exchange interest payment obligations on domestic or international borrowings for a specified period of time so that the overall costs of funds for both the parties is reduced. Interest rate Swaps(IRS) and Currency Swaps are the most prominent types of swaps.

Corporate Response to Exchange Rate Fluctuations

The different types of responses are as follows:

Forecasting exchange rates

Forecasting exchange rates is an important function of a corporate finance manager. Many corporations like Goldman Sachs, Citibank and Wharton Forecasting Services provide forecasts on various economic indicators including exchange rates. There is no single best model for forecasting exchange rates. And no model can hold good for all time. The models used for forecasting exchange rates can be classified into two types:

(a) **Fundamental Analysis Models**

These models make use of economic fundamentals such as inflation rates and interest rates, and based on the established relationship between these fundamentals, exchange rates are predicted. Some more complex models use, not one, but many of these relationships to predict exchange rates.

(b) **Technical Analysis Models**

These models make use of the historical movements in exchange rates of the countries and predict exchange rates with the use of time-series analysis and charts. It should be remembered that technical analysis provides only the direction of change and not the magnitude of change in exchange rates.

Strategic Alliance

The Business Dictionary defines strategic alliances as 'an agreement for cooperation among two or more independent firms to work together toward common objectives. Unlike in a joint venture, firms in a strategic alliance do not form a new entity to further their aims but collaborate while remaining apart and distinct.' Thus, a relation between two or more parties who come together to fulfill a critical business need while at the same time maintain their individual organizations. In a strategic alliance, the partners provide the following resources:

- Products
- Distribution channels
- Manufacturing capability
- Project funding
- Capital equipment
- Knowledge
- Expertise
- Intellectual property

This strategic alliance is a cooperation and collaboration that aims to achieve a synergy where the partners in an alliance benefit from the alliance. These partners will benefit more from being in an alliance rather than by putting individual effort. An alliance often involves the following aspects:

- Technology transfer, i.e., access to each other's knowledge and expertise
- Economic specialization
- Shared expenses therefore lowering costs
- Shared risks

An alliance is defined as a close collaborative relation between two or more entities which may share complementary assets and strengths to create increased value for their customers and their own organizations that otherwise could not be possible if pursued independently. In his book, *Strategic Alliances for Nonprofit Associations,* Charles E. Bartling defines strategic alliance as 'a co-operative arrangement between two or more parties who combine their strengths to achieve compatible objectives whilst retaining their individual identities and share the risks and rewards.'

Why alliances are formed?

There are numerous reasons as to why companies form alliances. Each company has their own reasons to form an alliance with another company. However, prior to forming an alliance, it is very essential that the partners in an alliance are clear regarding the objectives and expectations from this alliance.

Alliances may be formed due to the following reasons:

(i) In a new and ever-changing economy, strategic alliance provides a business to gain competitive advantage with the help of its partner's resources, market, technologies, capital and people.

(ii) Teaming up with other companies increases complementary resources and capabilities therefore enabling participants to grow and expand efficiently in less time. Strategic alliances are normally witnessed in fast-growing companies as they heavily rely on alliances to extend their technical and operational resource fund.

(iii) Each partner in a strategic alliance has the liberty and convenience of concentrating on activities which they are capable of.

(iv) In a strategic alliance, the learning from partners and developing competences that may be more widely exploited elsewhere.

(v) Many fast-growth technology companies use strategic alliances to benefit from more-established channels of distribution, marketing, or brand reputation of bigger, better-known players. However, more-traditional businesses tend to enter alliances for reasons such as geographic expansion, cost reduction, manufacturing, and other supply-chain synergies.

(vi) As global markets open up and competition grows, midsize companies need to be increasingly creative about how and with whom they align themselves to go to the market.

Motives for forming strategic alliances

- Reducing risks
- Less expensive access to needed competencies and complementary resources
- Credibility
- Test new strategies
- Reduce/share costs
- Provide access to more potential customers
- To broaden service offerings and increase customer satisfaction
- Gain foothold in international marketplace
- Innovate in the industry
- Establish a unique position in the market
- Boost market presence
- Provide added value to customers
- Expand customer base
- Access knowledge and expertise beyond company borders
- Increase sales and profitability
- Reduce overhead through sharing costs or outsourcing completely
- Enhance R&D capability and to conduct R&D
- Strengthen reputation in the industry as a result of associating with world class organizations Extend product offerings
- Speed entry into particular market
- Secure position as front runner in marketplace

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- Provide marketing Establish advantageous Purchaser/Supplier relationships
- Set up Distribution Networks
- Augment selling effort
- Manufacture cost effectively

Success of a strategic alliance

The success of a strategic alliance will be only possible when the capabilities of the participating organizations are effectively matched. Each partner needs to commit to the alliance in order for it to be a success. The benefits originating from the trade-offs in the alliance need to be equally favourable to all parties. Both partners should contribute to the alliance equally. Also, the contribution of one partner should be able to fill a gap in the other partner's capabilities. An alliance will not be beneficial if there is a weak alignment of objectives, performance metrics and clashes between corporate cultures. This may reduce the effectiveness of the alliance. The success of an alliance is based on the following factors:

(a) Trust
(b) Senior management support
(c) Ability to meet performance expectations
(d) Clear goals
(e) Partner Compatibility
(f) Commitment to long-term win-win relationship and results

Mistakes that might occur during a strategic alliance

(i) Low commitment (no champion, minimal executive support)
(ii) Poor operational planning/integration
(iii) Strategic weakness (diverging strategies/under-developed value added proposition, unclear
(iv) strategic return on investment)
(v) Rigidity/poor adaptability
(vi) Focus on internal alliance issues, and not the customer mission
(vii) Not enough preparation time
(viii) Hidden agenda leading to distrust
(ix) Lack of understanding of what is involved
(x) Unrealistic expectations
(xi) Fails the 'public perception test' and damages reputations
(xii) Complex to manage
(xiii) Reactive, not prepared and proactive
(xiv) Overdependence Legal problems

Types of Strategic alliances

(i) Joint venture: When two or more companies come together to create a new legally independent company. This is done to share their individual resources and capabilities for competitive advantage.

(ii) **Equity strategic alliance:** An alliance in which two or more companies own different percentages of the new company formed by combining their resources and capabilities.

(iii) **Non-equity strategic alliance:** In this type of alliance two or more firms develop a contract according to which they will share their resources and capabilities to create competitive advantage.

(iv) **Global strategic alliance:** This involves an alliance between companies across national boundaries and different industries. Global strategic alliances are formed between companies and a foreign government or sometimes between companies and governments.

(v) **Vertical alliances:** This type of alliance exists between organizations which belong to different industries. Vertical alliances are very common in the service sector where collaborated expertise is often coordinated to provide solutions to clients.

(vi) **Horizontal alliances:** This alliance involves two companies belonging to the same industry. This type of alliance usually takes place to achieve scale, adjust for seasonal changes or handle niche areas of expertise.

Check Your Progress

3. Define a joint venture.
4. What is the other name of a reduction strategy?
5. What are the two sources of a corporate advantage?

3.4 ANSWERS TO 'CHECK YOUR PROGRESS'

1. Due to the different nature of their operations and organizational objectives and priorities, companies have different corporate strategies.
2. In non-profit organizations, the focus on social responsibilities is even greater than in the public sector.
3. In a joint venture, two or more firms join hands and take equity by creating an independent business entity (firm).
4. A reduction strategy, also known as retrenchment strategy, usually means that the firm decides to discontinue some of the products or removes itself from some of the markets.
5. The two sources of a corporate advantage are economies of scale and knowledge.

3.5 SUMMARY

- A well-formulated strategy is vital for the growth and development of any organization—whether it is a small business, a big private enterprise, a public sector company, a multinational corporation or a non-profit organization.

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- There are two ways of growing—organic growth and inorganic growth.
- Growth strategies are inherently more risky and capital intensive.
- If opportunities do not exist in the kind of business which the firm is planning, the risk level will be high and the objectives will not be achieved.
- In related areas, growth of business is quite common because a firm understands the business and possesses the core competencies that are needed for such business.
- A growth strategy can be achieved through various ways, such as vertical growth, horizontal growth, merger and acquisitions, joint ventures, strategic alliances and consortium.
- A reduction strategy, also known as retrenchment strategy, usually means that a firm decides to discontinue some of the products or removes itself from some of the markets.
- It is necessary to understand the reason for the decline of the firm to decide an effective turnaround strategy. A turnaround strategy, therefore, implies that the firm's operational effectiveness must be improved.
- A company has to identify its strengths, weaknesses, opportunities and threats to both survive and prosper in today's highly competitive market.
- The threats, opportunities, weaknesses and strengths (TOWS) matrix is a good method by which a corporate strategy can be identified.
- A firm can follow various generic strategies, namely stability strategy, growth strategy, retrenchment/divestment strategy and a combination of any of the aforementioned strategies.
- A business strategy, also called a competitive strategy can be analysed using Porter's Generic Competitive strategy.
- A cost-reducing corporate centre changes the way businesses do things, not what they do.
- A stability strategy can be defined with the organization's strategy of functioning as they have in the past without making any critical changes in direction.
- A stability strategy is defined as the strategy wherein no critical changes are made in the existing status or functioning of an organization. In this strategy, the main focus is the existing market and products.
- A stability strategy can be designed to increase the company's profits by increasing efficiency in current operations.
- Michael Porter presented three generic strategies that a firm can use to overcome the five forces and achieve a competitive advantage.
- An overall low-cost position enables a firm to achieve above average returns despite strong competition.
- Differentiation protects a firm against rivalry since brand loyalty lowers customer sensitivity to price and raises customer-switching costs.

- The main difference between cost leadership, differentiation and focus strategies is that while the first two are aimed at the total industry, the third is aimed at serving a particular target market.
- Most international companies create value by transferring various products developed indigenously to new markets abroad.
- An international strategy will only make sense if a company possesses such skills and competencies that their indigenous counterparts in the foreign market lack.
- Diversification may be defined as a business development strategy that permits a company to get involved in other businesses that are different from present-day products, services and markets.
- The two types of diversification strategies are concentric or related diversification and conglomerate or unrelated diversification,
- When expansion takes place within the existing line of business, it is referred to as expansion through intensification.
- Integration is defined as the process of combining activities that are related to the present activity of the organization.
- Mergers can be defined as the integration of two or more firms on a co-equal basis. An acquisition, on the other hand, refers to the process of gaining complete or partial control of a company by another company for some strategic reasons.
- In order to expand the size of the firm, firms go for horizontal, vertical and conglomerate mergers.
- Some of these reasons for the increasing number of cross-border mergers and acquisitions are growth, technology, government policy, differential labour costs, productivity and source of raw materials.
- Restructuring can be defined as a strategy by which a company changes its business or financial structure.
- Restructuring can be done in the form of expansions, sell-offs, corporate control and changes in ownership structure.
- MNCs cannot depend entirely on expatriates for running international markets and practices and therefore a talented pool of local employees is necessary.
- Training means equipping an individual with technical or non-technical knowledge for a specific assignment.
- Labour relations refer to the relationship between organized labour and the management.
- The principle purpose of a foreign exchange market is to allow traders to have access to foreign currencies required for the export and import of goods and services.
- The sensitivity of a firm's cash flows to changes in exchange rates is called exposure.

- Derivative instruments are also called derivative assets since they derive their value from other underlying assets. They are used extensively in risk management.
- The business dictionary defines strategic alliances as an agreement for cooperation among two or more independent firms to work together toward common objectives.
- An alliance is defined as a close collaborative relationship between two or more entities that may share complementary assets and strengths to create increased value for their customers and their own organizations that otherwise could not be possible, if pursued independently.

3.6 KEY TERMS

- **Concentric diversification:** It is a growth of a firm in related areas of business.
- **Conglomerate diversification**: It is a growth of a firm into completely unrelated areas.
- **Reduction strategy:** It is a strategy in which a firm decides to discontinue some of the products or removes itself from some of the markets.
- **BCG Matrix: It is a method used to** evaluate the strategic position of a firm's brand portfolio.
- **Value capture:** It refers to the act of capturing more of already existing values within an industry.
- **Value creation:** It refers to the act of creating new values that are otherwise absent.
- **Differentiation:** It is a strategy that requires a company to create products/ services that are unique and valued.
- **Turnaround Strategy**: It is a strategy that involves the analysis and planning to save a loss making company and convert it into a profit making company.
- **Strategic Alliance:** It is an arrangement between two companies to undertake a mutually beneficial project while each retains its independence.

3.7 SELF-ASSESSMENT QUESTIONS AND EXERCISES

Short-Answer Questions

1. Why should a firm grow?
2. Differentiate between the vertical and horizontal growth of a company.
3. What are the two methods to pursue a reduction strategy?
4. When does a firm adopt a turnaround strategy?
5. What are the risks involved in the differentiation approach?

Long-Answer Questions

1. Discuss the various issues in implementing a reduction strategy.
2. Explain the TOWS matrix in detail.
3. Examine the various pitfalls of overall cost leadership strategies.
4. Describe the different types of mergers with examples.
5. Analyze the reasons responsible for cross-borders mergers and acquisitions.
6. Analyze the various forms of restricting

3.8 FURTHER READING

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UNIT 4 IMPLEMENTING STRATEGIES-I

NOTES

Structure

4.0 Introduction
4.1 Objectives
4.2 Competitive Strategies
4.3 Implementing Strategies: Management
- 4.3.1 Structure of an Organization
- 4.3.2 Matching Structure with Strategy
- 4.3.3 Organizational Systems
- 4.3.4 Complementarity of Strategy, Structure and Systems
- 4.3.5 Organizational Structures for the Future

4.4 Answers to 'Check Your Progress'
4.5 Summary
4.6 Key Terms
4.7 Self-Assessment Questions and Exercises
4.8 Further Reading

4.0 INTRODUCTION

Competitive strategies refer to a long-term action plan of a company which is directed to gain competitive advantage over its rivals after evaluating their strengths, weaknesses, opportunities and threats in the industry and compare it with your own. It is imperative for businesses to understand the core principles of such strategies that will help them to make a well-informed business decisions in the course of action. Michael Porter has explained how an organization must use its competitive advantage to compete in the similar industry. The two basic way to do so is using the cost leadership approach or differentiation strategy. This unit will explain competitive strategies, and competitive forces along with their advantages and disadvantages. In addition, it will discuss the ways to analyse and implement in an organization.

4.1 OBJECTIVES

After going through this unit, you will be able to:

- Examine the competitive strategies in an organization
- Discuss the advantages and disadvantages of different competitive strategies
- Discuss the ways to implement strategies and their impact on the management

4.2 COMPETITIVE STRATEGIES

The main aim of a strategist is to analyse competition and then provide measures to deal with it. Many managers, unknowingly, narrow down the meaning of competition and therefore only limit it with present competitors. However, the competition for profits exceeds the industry rivals factor and now includes four other competitive forces, which are as follows:

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- Suppliers
- Customers
- Potential entrants
- Substitute products

This extended rivalry resulting from all porters' five forces defines an organization's structure and shapes the nature of competitive interaction within an industry. Though every organization has a different identity, the driving forces of profitability are same in every organization. For example, the global auto industry may not have anything in common with the international market for art masterpieces or the healthcare delivery industry in Europe. However, in order to understand and analyse industry competition and profitability in the three scenarios mentioned, one must assess the industry's underlying structure in terms of the five forces.

What is Porter's Five Forces analysis?

In 1979 Michael E Porter of Harvard Business School developed the 'Five Forces Model'. We have already the five forces model earlier. To recapitulate, Porter created the Five Forces Model to understand the five key areas that affect an organization. These five key areas are as follows:

- Industry rivalry
- Threat of entry
- Threat of substitutes
- Bargaining power of suppliers
- Bargaining power of buyers

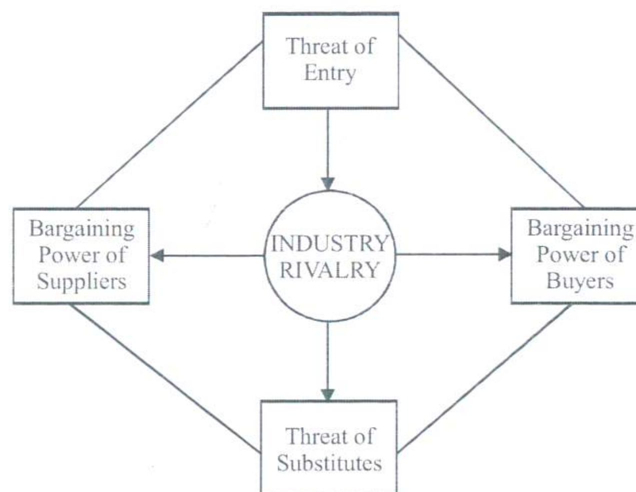

Fig. 4.1 *Porter's Five Forces Analysis*

The afore mentioned forces help to understand the structure of an organization and the level of competition in a particular industry. It should be noted that the stronger the competitive forces in an industry, there are less chances of earning profits. If an industry has no barriers towards new entrants and has less buyers and suppliers along with more substitute products and competitors then the industry will be viewed as being extremely competitive and therefore not so attractive due to its low profitability.

Table 4.1 Competitive Position

Attractive Industry: High Profits	Unattractive Industry: Low Profits
High barriers to enter	Low barriers to enter
Weak suppliers bargaining power	Strong suppliers bargaining power
Weak buyers bargaining power	Strong buyers bargaining power
Few substitute products and services	Many substitute products or services
Low competition	Intense competition

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It is the responsibility of a strategist to evaluate the organization's competitive position in the industry and interpret its strengths and weaknesses so they can be exploited to the fullest to strengthen the organization's position in the industry. Let us understand the five forces and their effects in a particular industry in detail:

(i) **Threat of new entrants:** The threat of new entrants basically explains whether it is easy or difficult to enter a particular industry. It has been seen that if an industry is deemed profitable and there are a few or no barriers to enter, then the aspect of rivalry intensifies. This means that if more organizations are competing for the same market share then profits will start to decline. Therefore, in order to avoid the entry of new competition, the existing organizations need to create high barriers to discourage new entrants. According to Porter, the threat of new entrants is high when the following situation occur:

- Not much capital is required to enter a market
- No protective policies for the existing companies
- Absence of patents and trademarks with existing firms
- Absence of an established brand reputation
- Free from government regulation
- On customer switching costs
- Lack of customer loyalty
- Identical products are quite similar
- Economies of scale are achievable

(ii) **Bargaining power of suppliers:** The presence of strong bargaining power allows suppliers to sell low quality raw materials or high-priced products to their buyers. This will immediately affect the buying firm's profits as it now requires paying more for materials. This situation will exist in an industry, when the following situations occur:

- Number of buyers exceeds the number of suppliers
- Large suppliers threaten to forward integrate
- Limited raw materials
- Scarce the suppliers resources
- High expense to change raw materials is very high

(iii) **Bargaining power of buyers:** In case buyers have a strong bargaining power they have the power to demand lower prices or a better quality.

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When prices are low, then the producer's revenues are also low. Similarly, high prices will result in high revenues for the producer. However, in the case of higher quality products, the production costs increase. This scenario also results in low profits for the producer. A buyer will have strong bargaining powers in the following circumstances:

- Purchase quantities
- More control by buyers to many access points leading to the final customers
- Existence of limited number of buyers
- Low switching costs to other supplier
- Threat to backward integrate
- Availability of many substitutes
- Price sensitive buyers.

(iv) **Threat of substitutes:** If a buyer can find substitutes for the products required, then this becomes a threat. If a substitute is easily available then a buyer can switch products with minimum cost. For instance, a customer may prefer a different brand of coffee which is easily available or cases may prefer tea to coffee.

(v) **Rivalry among existing competitors:** Rivalry among the existing companies is the major factor that determines the competitiveness and profitability of an industry. It has been seen that in a competitive and profitable industry, organizations need to aggressively compete for a market share, which results in low profits. Rivalry among the existing competitors is high in the following circumstances:

- More number of competitors
- High exit barriers
- Negative or slow growth in the concerned industry
- Easy substitution of products
- Equality of competitor size
- Lack of or low customer loyalty

Porter's model, originally, speaks about five forces that may affect an industry. Recently, many scholars have introduced complements as the sixth force. According to many scholars, complements increase the demand for the primary product with which they are used. It increases the organization's as well as the industry's profits. For instance, the ami of the introduction iTunes was to complement iPod and therefore added value for both the products. When the sales for iTunes and iPod increased, the profits of Apple automatically increased.

How to perform the analysis?

Now you have understood the Porter's five forces framework and how it is used to analyse the industry's competitive forces. Once an analysis is completed, an organization formulates its strategy according to the results of this analysis. Now

we shall understand how to put the Porter's five forces framework into use. This tool can be used by the completion of the following steps, which have been explained in detail:

Step 1: Collection of information based on the five forces

This is the first and the most important step. In this step, managers are required to collect information regarding their industry and cross-check it with the influencing force, such as the number of competitors in the same industry. Some of the factors that act as influencing forces are mentioned in Table 4.2.

***Table 4.2** Factors Acting as Influencing Forces*

Threat of new entry	Supplier power	Buyer power
• Amount of capital required • Retaliation by existing companies • Legal barriers (patents, copyrights, etc.) • Brand reputation • Product differentiation • Access to suppliers and distributors • Economies of scale • Sunk costs • Government regulation	• Number of suppliers • Suppliers' size • Ability to find substitute materials • Materials scarcity • Cost of switching to alternative materials • Threat of integrating forward	• Number of buyers • Size of buyers • Size of each order • Buyers' cost of switching suppliers • There are many substitutes • Price sensitivity • Threat of integrating backward
Threat of substitutes	**Rivalry among existing competitors**	
• Number of substitutes • Performance of substitutes • Cost of changing	• Number of competitors • Cost of leaving an industry • Industry growth rate and size • Product differentiation • Competitors' size • Customer loyalty • Threat of horizontal integration • Level of advertising expense	

Step 2: Analysis and diagrammatic representation of the results of the analysed data

Once data is collected, it needs to be analysed in order to understand how each force influences or affects an industry. For instance, if there are a large number of equal-sized companies operating in the slow growth industry, then it means that strong rivalry exists between these companies. It must be nated that though two companies may be a part of the same industry each company is to be considered a different entity. One force may affect one company in a different manner than it does another. Therefore, data and results collected and collated for one company cannot be used for another company.

Step 3: Creation of strategies

In this stage, managers should create strategies to deal with the effects of the influencing forces. For instance, if a company has difficulty in achieving its economies of scale in the market, it should follow a cost leadership strategy. However, in case the present market growth is slow and the market is saturated, then a product development strategy should be pursued.

Check Your Progress

1. What is the main aim of a strategist?
2. Which is the sixth force according to many scholars?
3. According to Porter's model, which force determines the competitiveness and profitability of an industry?

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4.3 IMPLEMENTING STRATEGIES: MANAGEMENT

Based on what has been discussed so far, a fundamental question arises: Is the formulation of a strategy more important or its implementation? This is a continuing debate in strategic management literature. There are exponents on the either side. It is clear that the real test of a strategy is in its implementation. Only implementation can determine the success or failure of a strategy. Even the most perfect strategy or plan may fail if it is not implemented properly. It is said that a technically imperfect plan implemented well may deliver better results than a perfect plan that does not get off the paper. Many companies spend a large amount of time, energy and resources in developing a strategic plan without giving enough thought to its implementation.

This, however, is not to deny the close link or interdependence between strategy formulation and its implementation. Some say, they are 'inextricably linked'. But the distinction between strategy formulation and its implementation should also be clear. Some of the major differences are as follows:

(i) Strategy formulation to strategy implementation is forward linkage and strategy implementation to strategy formulation is backward linkage.

(ii) Strategy formulation is primarily an intellectual process, whereas strategy implementation is dominantly an operational process.

(iii) Strategy formulation needs intuitive and analytical skills, whereas strategy implementation requires more practical and field skills.

(iv) Strategy formulation involves organizing before an action, whereas strategy implementation involves managing during the action.

(v) Strategy formulation needs coordination within a team of few internal stakeholders, whereas strategy implementation involves coordination among many internal and external stakeholders.

(vi) Strategy formulation emphasises effectiveness (plan-output relationship), whereas strategy implementation focusses on efficiency (input-output relationship).

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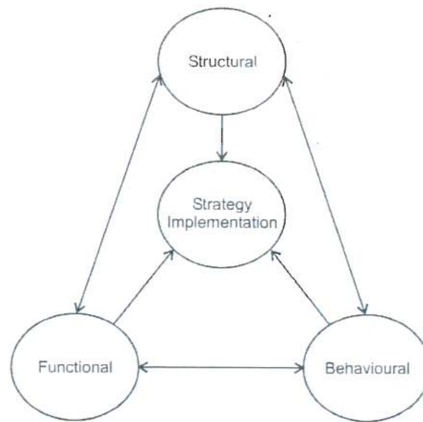

***Fig. 4.2** Strategy Implementation: Structural, Functional, Behavioural*

Implementation, as a concept, seems simple to understand. However, it has a number of dimensions, and serval strategy analysts have given different definitions of strategy implementation highlighting what they consider as more important aspects. The definition given by Harvard Business School offers a good perspective on implementation. The HBS definition is reproduced below:

> Once a strategy has been determined, it is the job of the general manager to ensure that the strategy is embodied in all that his or her organization does... Simply put the major task of implementing strategy is to create a fit between the company's goals and its other activities. Generally, two types of fit need to be created : (i) fit between the strategy and functional policies; (ii) fit between the strategy and the organization structure, processes and systems.

The implementation of a strategy or plan depends on three sets of organizational factors, namely, structure of the organization, various functional areas and operations and behavioural (people) aspects. Strategic analysts, therefore, distinguish between three types or forms of implementation: structural and systems implementation, functional and operational implementation, and behavioural implementation. These three forms of implementation are interrelated or interdependent (Fig. 4.2).

The analysis in this chapter is carried out in six sections. We have already discussed earlier the nature of the relation between strategy formulation and strategy implementation. In the next section, we shall discuss the structure of an organization, its evolution and issues related to it. The three most important aspects of structural implementation are various structural forms or types, matching structure to strategy and organizational systems. In McKinsey's 7-S framework, structure, strategy, and systems are the three 'hard' Ss. An organizational structure and systems are integral parts of each other, and they together make the implementation of a strategy possible and effective. These three aspects would be analysed in detail in three different sections.

4.3.1 Structure of an Organization

The structure of an organization defines the levels and roles of management in a hierarchical way. One can also say that an organizational structure spells out the way tasks, functions and responsibilities are allocated for implementing a policy or strategy. These also imply that an organizational structure facilitates or constrains how processes and relationships work. An organizational structure is presented

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through the organizational chart. The organizational chart, however, is only a visual expression of tasks, functions responsibilities, and the links and hierarchies among them. The structure goes beyond the visible chart and signifies the mechanism through which an organization works.

Generally, the organizational structure of a company changes or evolves as it grows in size and the management process gradually becomes more complex. We can call this the organizational life cycle, and, in some respects, this is analogous to the product life cycle. The organizational cycle depicts the evolution of the organization from simple to complex forms. Thain (1969), Salter (1970) and Scott (1973), among others, has contributed to the analysis of this evolutionary process and the strategies adopted during different stages. The cycle or the evolutionary process can be divided into four major stages which are as follows:

Stage I: This is the launching or introduction stage of organizations. In this stage, organizations are small, and are owned and managed by a single individual—the entrepreneur. A small number of managers/staff may be employed. These organizations are simple in terms of objectives, operations, and management. The form of an organization is also simple and can be called entrepreneurial. Strategy formulation and implementation are done by the entrepreneur, and there is hardly any need for a formal structure. The strategy adopted is generally expansionary.

Stage II: This is the developing stage. In this stage, organizations are bigger than in stage I in terms of size and operations. The organizational form is functional (divided into operations, marketing, finance and personnel) or process oriented (divided into process-based departments). There may be some functional or process specializations. The organization structure is still simple. Strategies followed may vary from stability to growth or expansion.

Stage III: This is the growth stage. In this stage, organizations are large and characterized by geographic diversification in terms of plants, units or offices/branches in different locations. Each unit or division is functionally independent, but, semi-autonomous in terms of authority and delegation of power. The units or divisions may have simple functional forms but are integrated with the corporate organization in terms of line of control. Strategies followed may be either stability, growth or expansion.

Stage IV: This is the maturity stage. In this stage, organizations are large, diversified and complex. They are multi-business or multi-SBU organizations which have grown to their present size through related and unrelated diversification strategies. The organizational form is divisional. The corporate organization assumes the role of corporate parenting providing strategic direction and policy guidance. The units or divisions (subsidiaries, profit centres or SBUs) formulate their business-level strategies and may adopt Stage I, Stage II or Stage III type of structures. Strategies adopted by these organizations are mostly the combination strategies.

The analysis of an organizational structure in terms of various stages of development helps in understanding the way structures evolve as organizations pass through the different phases of their life cycles. Many multinationals of today have passed through these stages beginning initially as an entrepreneurial organization and gradually moving to sophisticated structures. Unilever, Ford and McDonald's are good examples of such organizations. Not all organizations, however, pass through the same path or course. Therefore, the of organizationed four stages should not be taken as generalisations.

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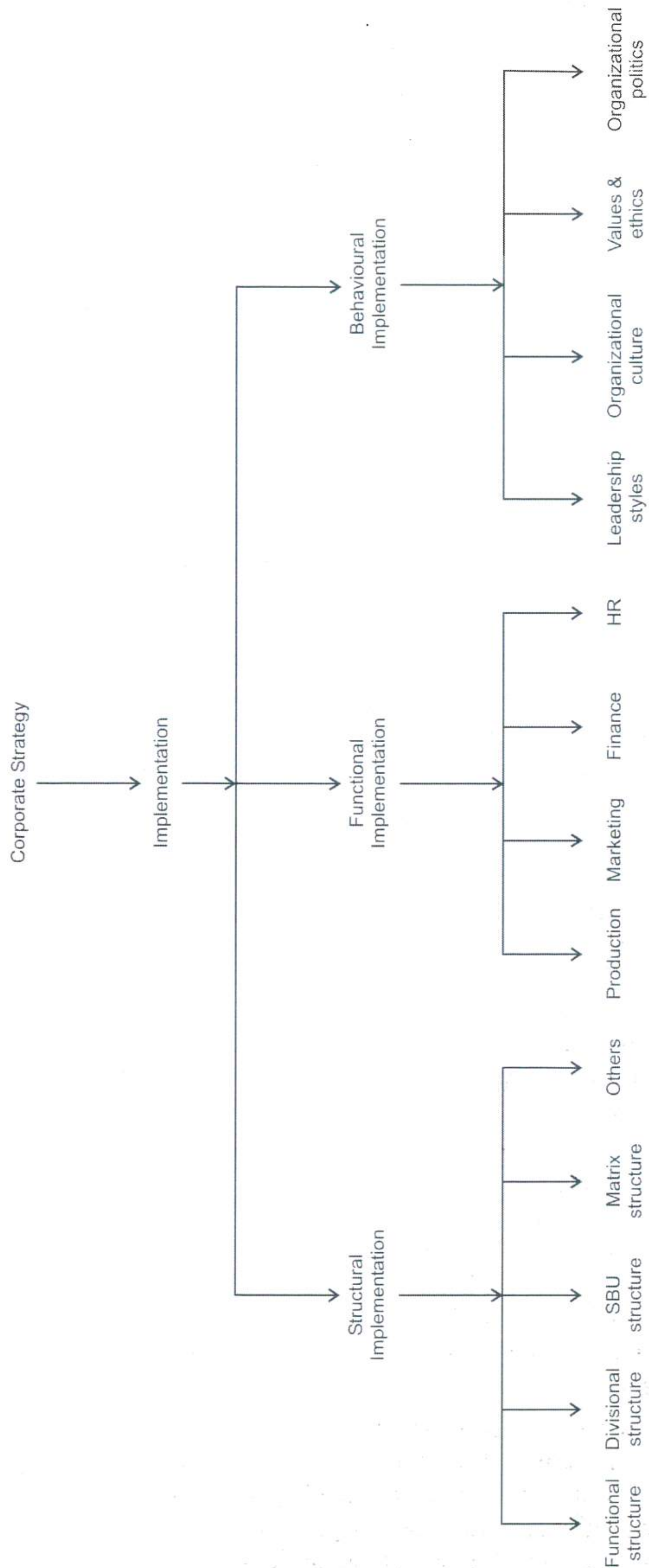

Fig. 4.3 *Implementation of Strategy: Structural, Functional and Behavioural*

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Types of Structure

In practice, structural types are many more than depicted by the four stages of organizational development. In addition to the stage of development, structural forms or types are determined by corporate philosophy or goals, organizational concepts of control and centralization/decentralization and the nature of business or business strategy. More common structural forms are functional structure, divisional structure, SBU structure and matrix structure as shown in Fig. 4.3. There are a number of other structural forms also. Various probable structural types are mentioned below:

(i) Entrepreneurial structure
(ii) Functional structure
(iii) Divisional structure
(iv) SBU structure
(v) Matrix structure
(vi) Project-based structure
(vii) Team-based structure
(viii) Network structure
(ix) Holding company structure
(x) Intermediate structure

Let us discuss the various organizational structure's in detail.

(i) Entrepreneurial structure

This is the most elementary form of the structure of an organization. The entrepreneurial structure represents an organization which is owned and managed by a single individual—the entrepreneur. Some call it a simple structure and contend that this is no formal structure at all. Organizations with such structures are typically a single business product or service companies that cater to local or regional markets.

This is the way most small businesses operate. The owner-entrepreneur assumes/discharges most of the responsibilities of management with some manager(s)/staff assisting him/her. The manager(s)/staff hardly exercise any authority and there is no or very little division of management responsibilities (Fig. 4.4).

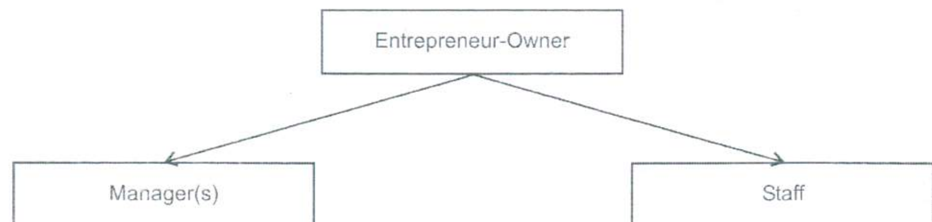

Fig. 4.4 Entrepreneurial or Simple Structure

Advantages and disadvantages

The entrepreneurial structure, although very simple in form, has certain advantages. The most important advantage is that decision making, including strategic decisions, is fast. This also implies a prompt and timely response to environmental changes.

Its implementation also would be fast because authority is vested in one person and is fully centralized. Also , informality is an advantage because the structure is free of procedures.

The entrepreneurial approach also has its disadvantages. Such a structure indicates excessive reliance on the owner-entrepreneur. There may be too much demand on the time of the entrepreneur; this may result in his/her devoting disproportionately more time to day-to-day operational matters and paying less attention to important strategic decisions. Such a structure also carries the bias of a single individual into corporate decisions because there are no checks and balances in the system.

(ii) Functional structure

As an organization increases in size with the expansion of business, the simple entrepreneurial system outlives its utility as a structural form i.e., a functional structure. A *functional structure* is based on the differentiation and allocation of primary functions such as production, marketing, finance, and HR along witha certain delegation of powers. Each of these functions is headed by a general manager or director usually at the board level. Other important functions or activities such as public relations and 'legal' may be directly under the charge of the CEO or MD (Fig. 4.5). The functional structure is most commonly used by medium and large organizations with a narrow or limited product range.

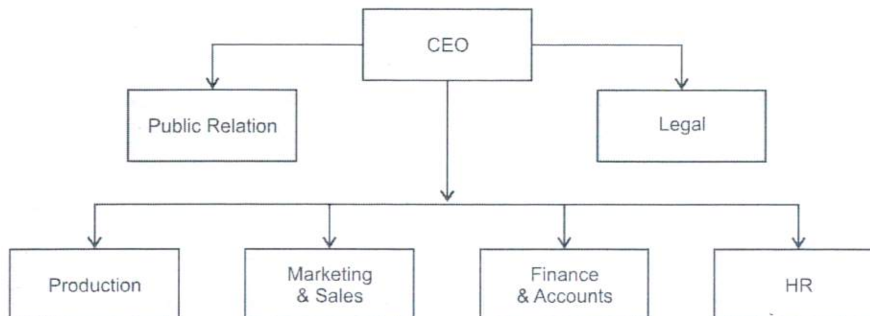

Fig. 4.5 *Functional Structure*

Functional structure: Electrolux Europe

The functional structure at Electrolux Home Products (EHP) Europe demonstrates how such a structure can help in bringing uniformity and simplicity into a business for profitable growth. Electrolux, the Swedish multinational, is a leading manufacturer of consumer durables—washing machines, refrigerators and cookers. From a humble beginning, the company has grown through various acquisitions to become a dominant player in Europe. But, the market in Europe was becoming 'fiercely competitive'. To increase competitiveness and its stronghold on the market, the company needed to reduce costs and improve product and service standards. Hence, the solution or strategy of Electrolux was to introduce a functional structure for the European operations to replace the geographical structure which was primarily the result of acquisitions. In 2001, EHP Europe completely realigned the organization to introduce a functional structure as a part of its competitive strategy in Europe. The new structure is shown in Fig. 4.6.

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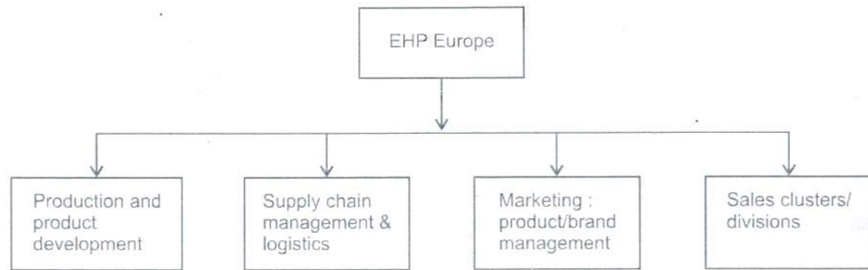

Fig. 4.6 Functional Structure at Electrolux Europe

The functional areas/departments shown in Fig. 4.6 are as follows :

(i) **Production and product development:** This function covers manufacturing and related activities including R&D. It also includes the procurement of raw material inputs to ensure a 'seamless flow' from input supplies to finished products. This was considered essential to sustain a stream of innovative and cost-effective products.

(ii) **Supply chain management and logistics:** This function is necessary for taking products to the market and providing the link between demand/sales forecasting and production.

(iii) **Marketing, product/brand management:** This function covers all aspects of marketing activity. It includes managing products and brands, key customer accounts, service and spare parts.

(iv) **Sales clusters/divisions:** These are sales divisions grouped geographically into seven clusters to maximise revenue generation.

The management of Electrolux explains the rationale for the restructuring of EHP Europe like this: 'The realignment of EHP Europe is a part of a programme to ensure profitable growth as the organization drives more simplicity into its business while reducing the organizational hand-offs and creating more focus on areas where increased effort is required to meet the tougher challenges of the market place.'

Advantages and disadvantages

The functional structure, as the EHP Europe example shows, can lead to efficiency by focussing on functional specialization. Allocation of work or job responsibilities also is clear and straightforward. The all operational matters can be delegated to the functional groups so that the top management/CEO can concentrate more on corporate-level strategies. The functional structure also signifies that specialists are managing tasks and responsibilities at senior-and middle-management levels. The CEO is in touch with all functions/operations through functional heads. This also reduces or simplifies the control mechanism.

If reduction or simplification of the control mechanism is an advantage of the functional structure, coordination among different functions becomes difficult in such a structure and therefore becomes a disadvantage. This structure can also lead to functional conflicts, particularly between line and staff functions. Functional specialization may also lead to narrow specification and compartmentalization, which may affect organizational efficiency and growth prospects. Due to functional

groupings and allocations, senior managers may often be burdened with operational or routine matters and may neglect strategic issues.

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Divisional structure

A *divisional structure,* also known as multidivisional structure, consists of separate divisions constituted on the basis of products, services or geographical areas. A need for a divisional structure arises primarily because of the inadequacy of a simple functional structure to deal with the complexities of business as an organization grows very large. The more common form of divisionalization is on the basis of product or business. The divisionalization gives focus on different divisions with separate product/market strategies. The divisional structure, however, does not do away with the functional structure. Within divisions, the functional allocations will still continue, as shown in Fig. 4.7.

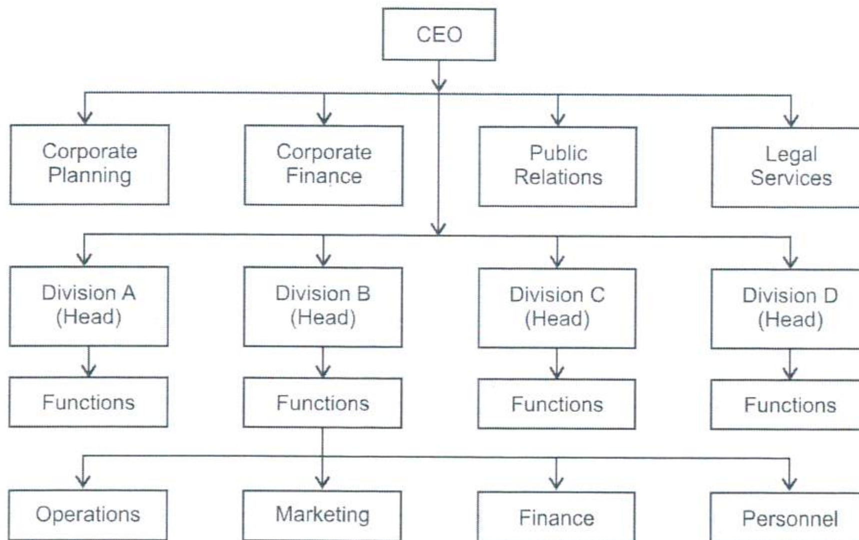

Fig. 4.7 *Divisional Structure*

Advantages and disadvantages

One distinct advantage of the divisional structure is that it enables concentration on major business areas of an organization, i.e., products (product-based divisions) and/or markets (geographic divisions). Since, divisional functions are directly under the control of the divisional head, coordination and management of intra-divisional operations become easy, and this contributes to functional and operational efficiency. Such a structure enables a quick response to environmental changes affecting the division's business. The structure also gives enough time to the top management for concentrating on strategic issues.

However, in a divisional structure, there is a possibility of confusion over authority and responsibility in terms of centralization (top management/CEO and decentralization (divisions)}. There is the possibility of conflicts among the divisions because of differences in interest, objectives and priorities. There is also the issue of intra-divisional trading (and pricing policy) because some divisions may be at as the input supplier to some other divisions. If a division grows very large, problems of divisional management may arise. So, if there are too many divisions, the complexity of coordination and of cooperation is likely to arise.

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SBU structure

Divisions consist of strategic business units (SBUs) in all large multi-business organizations. The fundamental factor in the SBU structure is to identify independent product/market segment which requires distinct strategies. Each of these product/ market segments also face a different environment and therefore more is the need for separate strategies are required. In many companies, particularly in the public sector, the earlier divisional structure has been replaced by an SBU structure to give more focus on individual business and define the role of corporate parents. A typical SBU structure is shown in Fig. 4.8. Some strategic analysts feel that the creation of divisions, which closely match SBUs, may be difficult in practice due to size and efficiency factors because there may have to be too many divisions. So, according to these analysts, the divisional structure should be much broader with more than one SBU in each division.

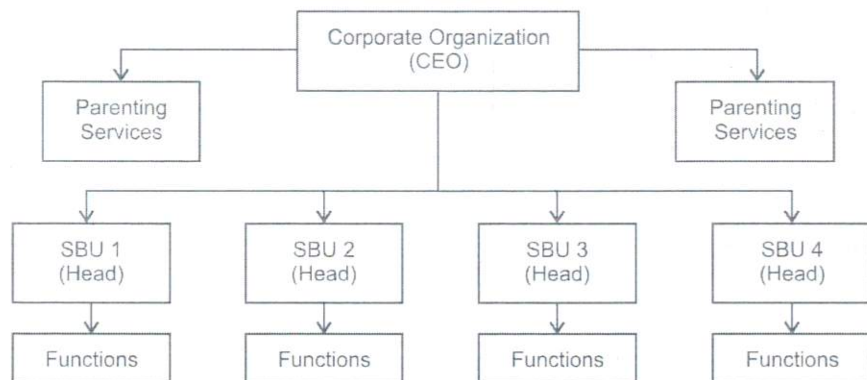

Fig. 4.8 *A Typical SBU Structure*

GE is an interesting example of how divisions and SBUs are matched. It had nine product groups and 48 divisions, which were reorganized into 43 SBUs. Many of these SBUs cut across product groups, divisions and profit centres. For example, three separate divisions in food appliances were merged into a single SBU to serve the houseware market and give strategic focus.

Advantages and disadvantages

In terms of strategic focus, the SBU structure is an improvement over the divisional structure. The structure facilitates strategic management of large and diverse organizations through SBUs. Due to clear strategic focus, the structure enables the assessment/measurement of performance of individual SBUs. This also makes it possible fixing of responsibility and clear accountability at the level of business units on the basis of performance and strategic positions of different businesses. It is also possible or easy to add a new business with high potential and divest unprofitable ones. All large multi-SBU organizations commonly implement this.

A major disadvantage of the SBU structure is that in very big multi-SBU organizations such as GE with too many business units, effective management of all the units simultaneously may become a problem for the corporate organization. Also, there may be problems of defining the autonomy of the SBUs and striking a proper balance between the SBU autonomy and corporate parenting. As in the case of divisions, issues/problems of inter-SBU trading exists including pricing

and profit policies. Also, with diverse SBUs, conflicts of interests among units are quite likely and the larger the number of SBUs, higher are the chances of such conflicts.

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Matrix structure

A matrix structure is a need-based or project-based structure that does not follow the conventional lines of hierarchy or control. We can call it a combination structure—a combination of different divisions or functions. It is designed to form a project team for launching a new product, development of a new market or geographical operations. In the matrix structure, a project manager is appointed to coordinate and manage project activities. Functional/specialist resources are drawn from different divisions/functional areas to constitute the project team. The members of the team have dual responsibility and authority—one is project responsibility and authority, and the other is their 'line' responsibility and authority in terms of hierarchy and command. Every matrix structure, usually, has a defined duration, i.e., is, the project period. After the completion of the project, managers go back to their respective divisions/functional areas. Matrix structures need not be adopted only by very large complex organizations; these can be used by many professional organizations, such as construction companies, and consultancy organizations. A detailed matrix structure is shown in Fig. 4.9. Multinational companies may use a matrix structure for international trading of various products. Here the products are projects. A typical matrix structure for a multinational company is shown in Fig. 4.10.

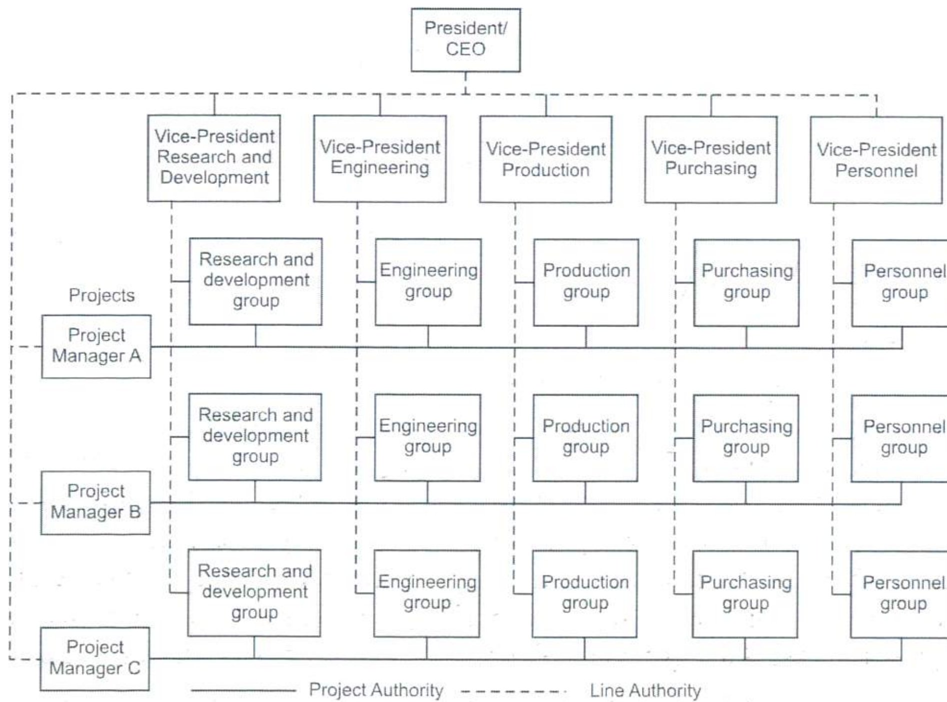

Fig. 4.9 A Matrix Structure

Source: L R Jauch, R Gupta, W F Glueck, *Business Policy and Strategic Management*, 6th ed. (New Delhi: Frank Bros and Co. 2004), 369.

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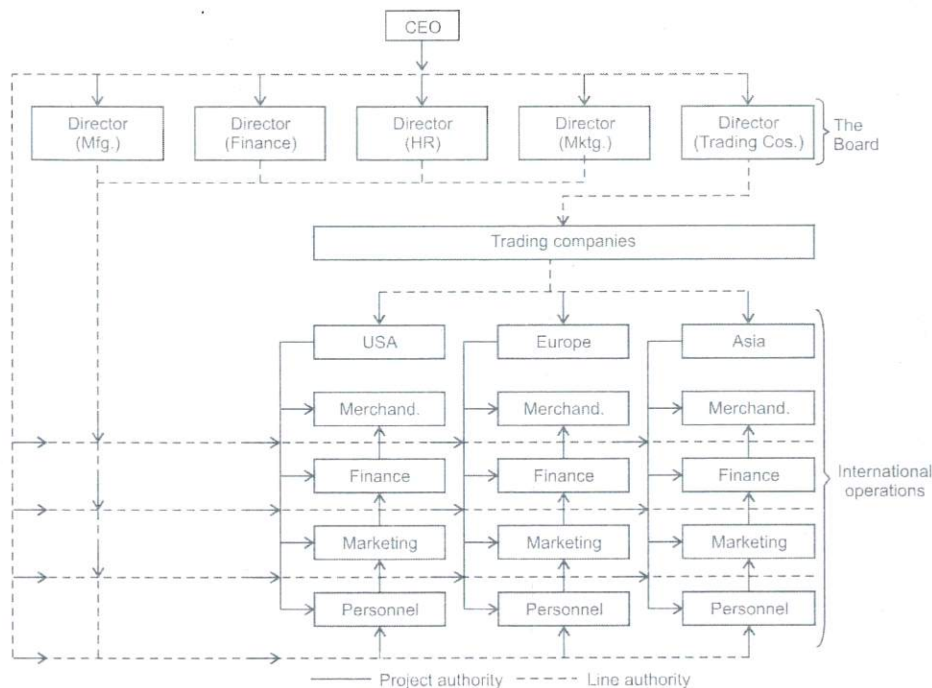

Fig. 4.10 *Matrix Structure of a Multinational Company (For Global Operations)*

Advantages and disadvantages

The greatest advantage of the matrix structure is that it fosters an interdisciplinary approach to organizational business and encourages/promotes teamwork. This also implies harnessing talents in the organization to optimize the outcome. This means, in other words, maximum utilization of the limited resources of functional specialists in an organization must be done. The matrix structure also makes possible timely and efficient responses to different environmental situations because of built-in flexibility (loosely-knit group) and diverse talents in the project group. The structure also facilitates the development of management through increased participation and involvement in organizational business and decisions. This should also generally improve the quality of decision-making skills in all group projects/ businesses.

Some disadvantages of the struture are inherent in the nature of matrix (cross-functional) structure itself because it replaces formal lines of authorities, resulting in ambiguity of relationship, responsibility and authority. This implies a lack of clarity in the given task and job responsibilities. Due to the team approach, decision-making time is longer because consensus has to be reached in all important matters. The team approach also increases the chances or degrees of conflict among team members. This happens partly dua to the accountability system. The dual accountability system also creates confusion and difficulty for individual team members.

Project-based structure

Some strategic analysts, such as Johnson and Scholes (2005), make a distinction between a matrix structure and a purely project-based structure. Most matrix structures are also project based, but many of these structures have indefinite life such as international trading operations of multinational companies. A project

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structure is one in which teams are created for specific purposes or projects, the project team undertakes the assigned work, and the team is dissolved immediately on completion. Project-based structures are more temporary than matrix structures. Such structures typically represent civil engineering/construction, IT/MIS, consultancy, event management and management development programmes. The organizational structure is a constantly changing the collection of project teams created, made functional and knit together loosely by a small corporate team. In such a structure, there may be a discussed cross membership of teams.

Project-based structures, as described above, are growing in importance because of their inherent flexibility and ability to adapt new situations quickly. Such a structure particularly suits some activities or operations . There are, however, some practical issues and difficulties with such structures.

Team-based structure

The team-based structure, like the project-based structure, is another variant of the matrix structure. Matrix structures are becoming less fashionable than earlier, and in many cases, giving a way to project-based structures and team-based structures. A team-based structure combines both horizontal and vertical functions by forming cross-functional groups or teams to manage business processes or activities. An information systems company, for example, may have development teams, product teams and applications teams who are responsible for (*a*) new product development, (*b*) service and support of standard products, and (*c*) customising products for particular customers or customer groups, respectively. Each of these teams consist of a number of specialists so that they are able to analyse the issues holistically.

The exponents of total quality management (TQM) often recommend team-based structures against activity-based structures at the operational level, for example, Volvo, in the automobile industry. Team-based structures are, sometimes, adopted to deal with the diversity of customers. In a university department, for example, different teams of faculty members from different subject groups and administrators are formed to conduct undergraduate and post-graduate programmes separately. In many public services, it is felt that traditional structures—separate professional departments or organizations, such as social services, health and education—do not provide enough capability to effectively address major strategic issues of social concern. For instance, problems related to mental health require professional expertise from each of these areas. Therefore, cross-diagnostic and cross-functional teams are created to tackle such issues. Another area is drug abuse which requires the integration of police, social services and health care services.

Network structure

Many organizations are facing the volatile or fast-changing environment in terms of customer focus or requirements. This requires a quick response, high adaptability and strong innovative skills in products, processes and services. The nature of many such organizations (multinationals in particular) is such that many of their functions or activities do not take place only at a particular location (a factory or an office). Considerations of capability and cost competitiveness also prompt many

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such organizations to outsource various functions or activities, such as manufacturing, logistics, marketing and distribution. A management strategy of such organizations reflects a network structure. A network structure combines together a series of products, locations, outsourced functions or activities and internal functions through a non-hierarchical network. Some call it a 'spider', or 'web' or 'cobweb' structure. The structure is highly decentralized, and there is a great deal of autonomy of the individual product groups, regions or locations and outsourced functions or activities. The corporate or core organization becomes a 'shell' corporation at the centre of the network. An example of a network structure is shown in Fig. 4.11.

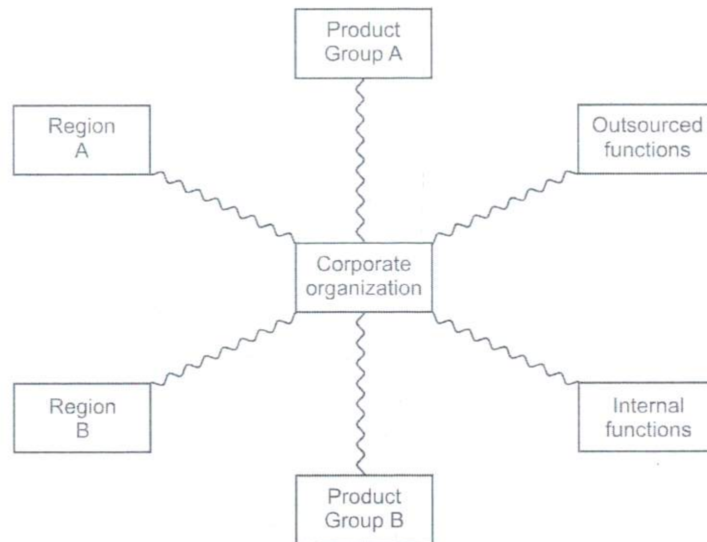

Fig. 4.11 *A Network Structure*

Johnson and Scholes (2005) have explained different forms of network or network structure. In addition to the complex network structure, as shown in Fig. 4.11, a network can be a one-stop shop, a one-start shop or service network (Fig. 4.12).

A one-stop shop is a structure in which a window or a locational point is created by an organization. All client or customer enquiries are channelled and handled through this window or shop. The function of the one-stop shop is to offer a complete package of products or services by coordinating various products or services of the organization. A 'turnkey' contractor (civil engineering) is a good example of this kind of structure. Such contractors use their expertise in project management and implementation and managing a network of suppliers, however, do not actually undertake any of the detailed project works themselves. Today, the 'website' provides a non-physical or online one-stop shop. With the growth of e-commerce and the website, the one-stop shop structure has provided a new dimension. This is becoming more easily accessible and increasingly attractive.

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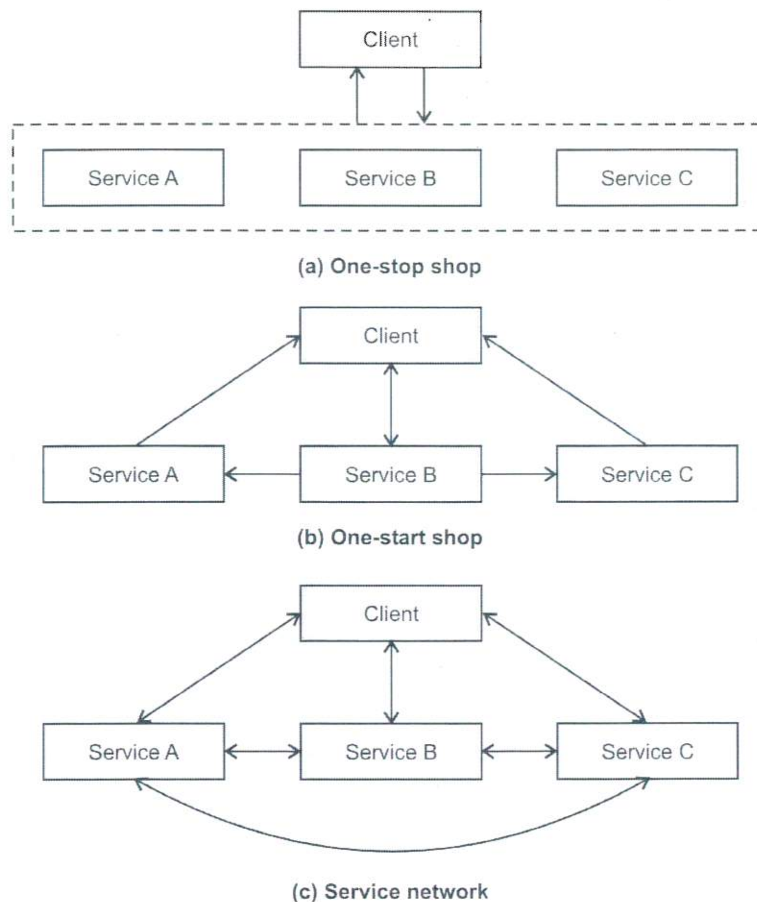

Fig. 4.12 *One-stop Shop, One Start Shop and Service Network*

A one-start shop handles customer enquiries by diagnosing customer needs and referring them to the most appropriate provider. Many advisory services for small-scale business are provided through one-start shop— by bank and government agencies, (e.g., NSIC/SISI in India and business link, a small business service in the UK). There are two critical factors for success of the one-start shop strategy; first, full knowledge of all the existing capabilities throughout the network, and second, an authority to refer clients to particular providers. This also implies good interactive relationship with the providers in the network.

A service network is more inter-connective than a one-stop shop and a one-start shop. In this network, the members can have access to all the services of the network through any constituent member of the network. This networking system requires all the members of the network to be fully 'informed, capable and willing to cross-sell' others' products and services. This assumes, in addition to good networking skills, a high degree of cooperation and collaboration among the members. Most of all, it demands mutual trust and respect among the members of the network. This is the reason why it is often difficult to set up effective service networks and make them operationally successful.

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Advantages and disadvantages

The greatest advantage of this network structure is its high level of flexibility and adaptability to business requirements and environmental changes. The structure shows more agility, and it is also fast moving. Since the members of the network have a high degree of independence, the structure promotes initiative and entrepreneurial culture. Another major advantage of networking is the outsourcing of functions/activities and capabilities to increase efficiency and productivity. The structure is also cost effective because it requires a low overhead expense and less investment in organizational infrastructure.

A high level of flexibility of the network structure can also become a disadvantage. Enough flexibility and autonomy or independence of the members of the network can result in a lack of coordination and loss of control because there are many members/partners in the network. Another reason why this is likely to happen is that the network is loosely knit with no proper built-in command or control system. This also implies the vulnerability of the organizational value chain. The structure also runs the risk of overdependence on others, particularly if outsourcing is very significant.

Holding company structure

A holding company structure may be defined as one in which the role of the parent company is mostly limited to financial matters such as investment and the constituent businesses/divisions/ companies work almost independently. A holding company structure may be conceived to be a more aggregative form of a divisional structure. As the divisions grow large, they almost become separate companies with the least administrative/management role of the parent company including the product/ market strategy. The relationship between the corporate centre or the holding company and the constituent businesses/companies, as just mentioned, is confined to financial and performance matters. The holding company may, however, provide long-term strategic directions to individual divisions/companies for growth and diversification.

The assumption on which the holding company structure is based is that the constituent businesses/companies will formulate and implement their product/ market strategies to their best potential, if left to themselves. The businesses/ companies can, however, benefit from the holding company in terms of finance for investment and long-term strategic directions without having to commit or spend high central overheads. The holding company operates as an umbrella for them. The holding company may reap the benefits by spreading or balancing risk across different businesses and organizational structuring, from time to time, in terms of divestment of unprofitable businesses and acquisition of attractive businesses/ companies.

Many conglomerates adopt the holding company structure. Some examples of this structure can be seen in India. SAIL has the holding company structure. The individual steel plants—Bokaro, Durgapur, Bhilai and Rourkela—operate as almost independent companies with SAIL as the holding company. Tata Sons is

the holding company for Tata group of companies. There is an interesting example of a holding company structure comprising STC and MMTC. A holding company—Bharat Trading Corporation—was created with STC and MMTC, themselves very large corporations, as the constituent units. Both, STC and MMTC, had separate MDs with Bharat Trading Corporation headed by a chairman. This was more of an experiment, but it did not work. In fact, a number of conglomerates with a holding company structure have been demerged into separate companies primarily because benefits of the structure were not strong enough to hold the federation together.

Intermediate structure

An intermediate structure is a temporary structure or arrangement for switching over from one regular structure to another. The intermediate structure is based on the fundamental premise that no structural form is permanent. Environmental conditions change; market requirements change; and therefore, to adapt to or cope with new developments, organizational structure, systems and strategy have also, to change. But, such structural change cannot or should not take place abruptly or in a sweeping way. It should be incremental rather than transformational. This indicates the need for a intermediate structure.

For example, a company may have a functional structure. The company decides to develop both new products and new markets. And, the company soon realises that the existing functional structure is no longer adequate to give the right focus and facilitate the diversity of new and innovative strategic operations. A divisional structure may be more appropriate.

But, the structural change (from functional to divisional) generally occurs through a series of intermediate steps or changes in the processes, systems and operations. This is done to ensure that the organizational change does not disrupt resources, relationships and managerial motivation. This also implies that the intermediate structure is a transitory phase.

Virtual Organization

Virtual organization is one of the latest developments in the evolution of organizational structures and designs. It is not an organization that exists in reality, but, performs like one. This is an organization without a formal structure. A virtual organization is like an extended network. The *Business Week* has given a formal definition of a virtual organization/corporation which aptly summarizes its major characteristics:

> Virtual corporation is a temporary network of independent companies—suppliers, customers, even erstwhile rivals—linked by information technology to share skills, costs and access to one another's markets. It will have neither a central office nor an organization chart. It will have no hierarchy, no vertical integration.

As the given definition shows, in a virtual organization, that the in-house or owned resources and activities are minimized, and, most of those exist outside the organization and are outsourced. Virtual organizations are not held through formal structure or physical proximity of managers/staff, but through partnership,

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collaboration and networking. The important point here is that such an organization appears 'real' to clients and meets their needs almost as well as the real organization. In the telecommunication sector in India, several virtual organizations have been recently created to provide different services.

Business Week has identified and focussed on five basic characteristics of a virtual organization. These characteristics are as follows:

a. **Technology:** Information networks will link up far-flung companies for working together through electronic contacts.
b. **Opportunism:** Partnerships will be less permanent, less formal and more opportunistic.
c. **Excellence:** Each partnering company brings its core competence and special capabilities, and it may be possible to create a best-of-class, virtual organization.
d. **Trust:** Virtual organizations are based on relationship and trust. The partners share a sense of co-destiny.
e. **No Borders:** The virtual organization model redefines the traditional boundaries of a company. Constant cooperation among the partners makes it difficult to determine where one company ends and another begins.

Virtual organizations, like any other organizational form or system, have their limitations and are facing some criticisms. Most virtual organizations represent extreme forms of outsourcing. This may result in serious strategic weaknesses in the long-run because an organization becomes devoid of its core competence and internal capabilities. This is a major concern in industries such as civil engineering, publishing and IT/software solutions, which have become highly dependent on outsourcing. The real concern is that short-term expediencies or improvements are achieved at the expense of long-term competence development and innovation.

4.3.2 Matching Structure with Strategy

We have already analysed various organizational structures. All structures do not suit all strategies. The organizational structure of a company is the result of several factors or forces, such as corporate philosophy, organizational goal and objectives, functional rigidities/flexibilities, and management's attitude towards command and control. Strategies are more concerned with specific targets and action plans for increasing turnover, market share and profitability, given the key environmental factors and market dynamics. To match or support strategies, organizational structures should be more closely aligned with strategic plans and actions. There are some important factors that companies should consider to make structures more compatible with or match organizational strategies. The major factors are summarized in Fig. 4.13.

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***Fig. 4.13** Matching Organizational Structure with Strategy*

Source: Adapted from A A Thompson Jr, A J Strickland III and J E Gamble, *Crafting and Executing Strategy,* (New Delhi: Tata McGraw Hill, 2005), 329 (Fig. 11.3).

(i) **Identifying strategy-critical activities:** In the value chain primary activities should be closely analysed by organizations to identify those activities which are critical for strategic success, and, should be performed very efficiently. For example, in the speciality electronics industry, R&D, product innovation, quality control and customer service are considered as strategy-critical activities. In the hospitality business, on the other hand, strategy-critical activities are housekeeping, room service, kind of food served, etc. The organizational structures in these and other businesses should permit and facilitate the identification of strategy-critical activities.

(iii) **Selecting value chain activities to be performed internally and to be outsourced:** Generally speaking, in the value chain strategy-critical activities should be performed internally and non-critical activities (including support-activities) should be outsourced. Among the strategy-critical activities, however, prioritization can be done, and some activities can be outsourced on grounds of cost-competitiveness and quality considerations. In fact, some companies have found it justified to outsource strategically important value chain activities. For example, Polaroid, for many years, bought its film from Eastman Kodak, its electronics from Texus Instruments and its cameras

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from Timex and others; and, the company concentrated on producing unique self-developing film packets and designing next-generation cameras and films. Nike outsources almost the entire production of its shoes and sporting apparel and concentrates on design, marketing and distribution. But, such decisions should be based on carefully chosen criteria.

(iii) **Internally performed strategy-critical activities to be in the building blocks of the organizational structure :** Every strategy relies on certain critical activities on which its success depends. The implementation of every strategy involves a set of key activities, competences or capabilities. These elements necessitate certain key resources, decisions and organizational arrangements which support the activities and competences. If the required organizational arrangements or adjustments are not made, there is a strong likelihood of a mismatch between the strategy and the structure, and this can lead to serious implementation problems. This actually means implementing a new strategy with an old organizational structure and in other words, it is like trying to match two dissimilar things. The building blocks of the organizational structure, (i.e., any strategy) are to be based on the strategy-critical activities or competences of that strategy. Such activities should be internally performed so that the management has a better control over these and activities any change or adaptation becomes easy.

The strategy-structure relationship is not always a one-way process, i.e., a structure matching the strategy; it can also work the other way, i.e., choice of a strategy is guided or governed by the existing organizational structure. In any case, the existing structure influences the strategy. Initially, when a strategy is to be selected, organizations look for its compatibility with the present structure. If it is too much out of line with the existing structure and systems, the strategy may not be chosen. But once a strategy is chosen, it may necessitate some changes or modifications in the existing structure to establish the best-fit between the two. This means, in other words, that the structure should influence the strategy before its selection, and the strategy should influence the structure after its selection in terms of the strategy-critical activities.

(iv) **Outsourcing non-critical activities and support services :** If strategy-critical activities should be performed internally, non-critical activities and support services may be good candidates for outsourcing. This enables the managers to concentrate on strategy-critical activities without diverting time and energy to other activities which can be performed by outside agencies and vendors. Apart from this, there are two good arguments for outsourcing. First, specialized agencies or vendors may perform these activities in a better manner because of their expertise, and, second, often at a lower cost because of scale economies and the experience effect. Companies, such as Ford, Eastman Kodak and Merrill Lynch, regularly outsource their data processing and MIS work. Boeing, AT&T, BMW and Dell Computer believe that, for the development of next generation of components and parts, and supplying them at relatively low cost, outsourced R&D should be preferred to central R&D.

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Companies should, however, guard against excessive outsourcing. Excessive outsourcing means overdependence on outside sources, and this may lead to a loss of control over some key activities in the value chain. This may also expose a company's knowledge base and its capability level to the outside world. If outsourcing becomes fully justified on grounds of cost and quality, organizations should take some steps to guard against the dangers of excessive outsourcing. First, outsourcing should be done, as far as possible, not from a single provider or vendor but from two or three of them. Second, outsourcing activities should be closely monitored and regularly evaluated including options for switching of source. Third, to maintain relationships, companies may work closely with the suppliers/vendors, i.e., collaborating or partnering.

(v) **Balancing authority to be centralized and authority to be delegated:** An organizational structure can be highly centralized in which the top management (CEO and few top executives) exercise authority over all strategic decisions and many operating decisions, and not much discretionary authority is delegated to business unit heads, departmental heads and individual managers. In the other extreme, it is the highly decentralized structure. In such a structure, decision-making power is delegated to business units and individual managers with a minimum top management intervention.

In the corporate world, there is a growing consensus that centralized and on authoritarian structure may not be conducive to effective decision making and strategy implementation. Environmental compulsions today necessitate fast decision making, and to ensure that the decisions are also appropriate or correct, these decisions should best be taken by managers who are at the centre of actions. This means the empowerment of managers at different levels. This also suggests a more horizontal organizational structure with fewer management levels, i.e., approximating a matrix or a network kind of structure. In today's electronic communication systems (Internet, MIS the company Intranet), managers at all organizational levels have direct access to data/information on markets and customers. They can readily seek guidance/approvals from seniors and can take timely and responsible decisions. However, to ensure that decision making is correct and conducive to organizational success, a decentralized system should ensure a careful selection of a business unit head and individual managers and establish a transparent system of accountability through results. This may be the optimal way of balancing centralized authority with decentralization of decisions and functions.

(vi) **Effective cross-unit coordination and communication:** In any organization, more so in a decentralized system, cross-unit coordination becomes an important factor for successful operations and strategy implementation. This is a typical problem in all multi-SBU organizations with an SBU structure. This problem also exists in functional structures. Organizations have to devise effective ways to handle this issue. Some of the coordinating mechanisms which can be used are cross-functional or cross-SBU task forces, dual reporting system, informal organizational

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networking, compensation or incentive linked to group performances and clear senior management directive for teamwork and cross-functional or cross-SBU cooperation. The CEO/COO should closely monitor the coordination and communication process and intervene, whenever necessary, to ensure effective coordination. However, more than intervention, the CEO/COO should create an appropriate organizational culture to induce units or departments or managers to interact more freely and objectively.

A very good example of this structure is 3M. 3M has 100 laboratories in different parts of the world managed by technology experts. The 3M management has been successful in creating a 'collegial' working environment globally for cross-unit technology coordination. The management has constituted a Technical Council comprising the heads of the major labs. The Council meets regularly every month and goes for a three-day annual retreat to discuss the cross-unit transfer of technology. Overall, the culture or environment is so congenial that scientists call on each other for assistance and advice on all technological and related maters.

(vii) **Collaborative relationship with suppliers and strategic allies:** You have already studied about the need for collaboration or partnering with outsourcing agencies or suppliers or vendors, or, in one word, strategic allies. This significantly improves value additions during the different stages of the value chain. If close working relationships with the outsourcing partners are to be developed, supply chain management should be given a formal position in the organizational structure and proper linkages established with strategic activities in the organization. To provide proper focus, some groups, cells or individual manager should be designated to coordinate/collaborate with the outsourcing partners. Some strategic analysts have suggested a 'relationship manager' for the same job. The job of the relationship manager is to form alliances and a relationship with the outsourcing partners. He should also ensure that the relationship grows, develops and blossoms and results in significant benefits. This is happening in many companies. Japanese companies, particularly in the automobile sector, are leading the way. Toyota and Honda are equity partners in many supplier companies. The relationship is given different names by different companies in different countries. At AT&T, it is called 'vendorship partnership'; at Philips in Europe, it is called 'co-makership' and in many companies in the US, it is called 'reverse marketing'.

Which is the best organizational structure?

In all organizations, a logical question is arises that which is the best or ideal organizational structure or if there is any ideal structure. The stages of development theories suggest that certain organizational forms are uniquely or ideally suited to organizations during certain stages of their growth. Should, then, the organizational structure be linked to the stage of growth of a company? Studies, in more recent times, however, indicate that the stage of growth, although very important, is only one of the many critical factors or parameters on which an ideal organizational structure depends. These factors have complex interrelationships with each other,

and also with the conditions in the environment. To design or evolve the best/ideal organizational structure, a company has to find the best fit between these factors and strategy implementation.

All organizational structures work in some companies or the other and would be quite appropriate under certain business conditions. For example, a functional structure works best under stable market/environmental conditions with less need for cross-departmental coordination and communication, also any major innovation. The narrower the product line and markets, the more effective is the functional structure. The divisional structure or SBU structures are most effective under changing markets/environmental conditions which require more innovations and faster adaptation. The more diversified the product line and markets, the better the divisional, particularly the SBU structure works.

For all products/projects (including international operations) where a strong cross-functional approach is required, the matrix structure (or the project structure) may be the best.

However , it must be kept in mind that an organizational structure should never be static or permanent. For instance, as business diversifies and markets become more complex, a functional structure should be replaced by a divisional or SBU structure. If an organizational strategy is for major expansion/diversification through takeover or merger, the increased size and new organizational composition may require a change in the structure. If the strategy is unrelated diversification, (i.e., new processes, products and markets), added complexity and diversity may necessitate a change in the structure. If the strategy is market penetration through cost reduction and improvement in service standards, a change in the structure would give better results. You have already studied that how Electrolux Europe replaced the geographical structure by a functional structure. Organizational restructuring may also be required if environmental or business development creates compulsions for divesting businesses. Tatas divested TOMCO and Lakmé business, Voltas divested its refrigerator and air conditioner businesses; the companies accordingly restructured themselves.

So, to conclude, we can say that the best or ideal organizational structure is one that adapts itself perfectly to changing business and market conditions and consequent strategy requirements.

4.3.3 Organizational Systems

An organizational structure provides a mechanism for the distribution of authority and responsibility among various managerial positions in the organization. This is done through organizational constituents, such as business units, departments, divisions, projects or networks. Through these constituents, the organization performs a set of tasks, activities or functions to achieve its goals or objectives. To do this effectively, certain organizational inputs are necessary, some linkages need to be established among the constituents and some controls have to be enforced. These are done through a series of systems. The structure and the systems complement each other in the implementation of organizational strategies. The strategy, structure and systems form the interrelated hard Ss of an organization (Fig. 4.14). Six major systems from the strategy point of view as follows:

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a. Planning system (PS)
b. Management information system (MIS)
c. Management development system (MDS)
d. Motivation system (MS)
e. Evaluation system (ES)
f. Management control system (MCS)

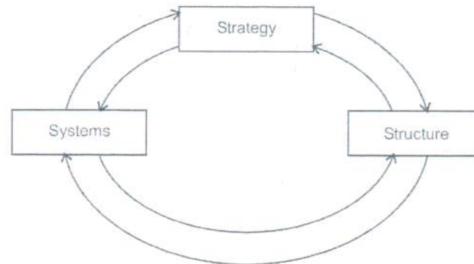

Fig. 4.14 *Interrelated Strategy, Structure, Systems*

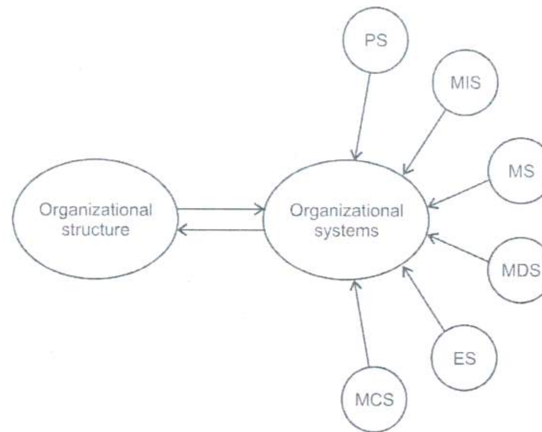

Fig. 4.15 *Organizational Structure and Organizational Systems*

Planning system

Planning, strategy and implementation have the most direct and intimate relationship among them. A planning system represents the planning process in its entirety, i.e., all matters related to planning. The most important factor in the planning system is the constitution of the corporate planning team. In many organizations, the planning team/system is directly under the control of the CEO. In such cases, the planning system or activity also includes strategy formulation except pure functional strategies which may be delegated to the functional or departmental heads. Implementation directives are also given by the centralized planning system. Several organizations also follow a decentralized planning system. In such an organization, planning, strategy formulation and implementation are decentralized at the division or the SBU level; the parent organization confines itself to corporate directives or only corporate-level strategies. The strongest argument in favour of a decentralized planning system is that if managers are actively associated with the planning process/ system, there are more chances of successful implementation.

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Different planning systems (centralized and decentralized) suit different organizational structures. For example, in an entrepreneurial structure, and a functional structure, a centralized planning system would be generally more appropriate with the functional areas/heads given necessary flexibility/authority for implementation. In a divisional or SBU structure, a decentralized planning system would be more effective with the active involvement of SBU-level managers in strategy formulation and implementation. The same applies to matrix structures and network structures. In all such decentralized structures and systems, however, the corporate/parental organization will have its own planning cell. But, all this also indicates the need for adaptation of the planning system to organizational structure and strategy requirements.

Management Information System (MIS)

The planning system in any organization depends heavily on the management information system (MIS). The MIS provides critical inputs to the planning system regarding all important aspects of organizational functioning and performance. It also provides a connectivity between different constituents of the organizational structure in terms of information flow and feedback. The MIS helps managers in two important ways; first, it enables them to equip themselves with all relevant data/information which they may require to perform their tasks better, and second, to coordinate their activities with other managers/departments through a central organizational mechanism. Although the MIS is more frequently used by middle and operating management, it also greatly helps the top management in decision making.

In fact, the MIS provides the foundation for the design and implementation of a number of other organizational systems. Therefore, the development of the MIS in an organization is a critical management activity because many vital decisions are based on it. For effectiveness, the development of the MIS should be guided by the organizational structure and the style of management. In some organizations, the MIS is part of HR; in some companies, it is a part of finance; in some organizations, the MIS is an independent activity reporting directly to the top management; in some companies, the MIS is outsourced. But, for cohesion, the MIS should be a part of the planning system as it is the case in many companies. A close connectivity between the planning system and the information system should increase value addition by the MIS in the organizational process. It should also facilitate strategy development and implementation.

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Management Development System (MDS)

The management development system (MDS) is essentially concerned with the development of individual managers and preparing them better for organizational activities including planning, strategy making and implementation. The *Encyclopedia of Professional Management* has described the MDS as a 'process of gradual, systematic improvement in the knowledge, skills, attitudes and performance of those individuals in an organization who carry management responsibilities.'

GE is regarded as one of the best talent generators and many of its executives have become chairmen, CEOs of other companies.

The objectives of the MDS are to nurture individual managers and build human capital. The focus of MDS should be the orientation and development programmes with particular reference to strategic tasks, planning skills and implementation capabilities. The nature of strategic tasks change with the change of organizational strategy or adoption of new strategy. MDS should regularly modify or update existing programmes or design new development programmes to prepare managers for changing tasks and responsibilities. Therefore, MDS has a special role to play in the strategy development and implementation process.

To effectively play its role, the MDS should focus or concentrate on the following three functions:

a. Training and development of managers through in-house or external programmes to impart required skills to enable them to perform strategic tasks
b. Career planning of managers to motivate and prepare them to undertake future strategic tasks and responsibilities and organizational development through this
c. Planned positive intervention to ensure a smooth transition from one strategic phase to another to minimize resistance to change; this is done through motivational programmes.

Motivation System

The motivation system can greatly contribute to the management development system. Many companies work on the basis of a 'carrot and stick' policy, i.e., reward and punishment system. But, recent trends are more towards 'carrot' than 'stick'; 'carrot' here means inducement, encouragement and incentives. And, these are done through the motivation system. Incentives are the most important motivational factor. Incentives can be of two types: monetary and non-monetary. Common monetary incentives are salary increase (increments), productivity or performance bonus, profit sharing, welfare allowances, etc. Non-

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monetary incentives are special rewards, certificates of excellence, nomination to a prestigious training programme, foreign tours, foreign postings, etc. Both monetary and non-monetary incentives are used by progressive organizations to motivate their employees.

For example, infosys motivates its employees through monetary and particularly, non-monetary incentives. Infosys employees receive high salaries and salary-linked compensations compared to Indian compensation norms/practices. Infosys is also one of the few Indian companies which offer employees stock option plans (ESOP). ESOP increases financial stake of the employees and also gives them a proud feeling of ownership of a company through shareholding. It is common knowledge that most employees of Infosys become financially 'rich' because of significant market capitalization of company stocks. But, monetary incentives/compensations are not the only motivating factors in Infosys. In fact, monetary compensations are not always enough to completely motivate the employees. As Narayana Murthy, CEO, Infosys, put it: 'My employees seek challenging opportunities, respect, dignity and the opportunities to learn new things ... Salary alone is a very dangerous way of rewarding capability.' Infosys has a motivation system which goes much beyond pure monetary incentives. The company has created an environment and work culture in which employees are encouraged to communicate with each other freely and with the higher management. The CEO keeps in regular contact with the employees by sending them mails every fortnight. There are live chats also. There is a concept of 'chairman's list', and, based on this list, an annual excellence award is given to recognize talent.

Evaluation System

Motivations are required to induce employees/managers to perform. Evaluation or appraisals are necessary to ascertain whether employees/managers are actually performing or performing satisfactorily. So, the evaluation system has a role almost parallel to the motivation system. The evaluation system assesses managerial performance in terms of organizational objectives, priorities, and strategies. The purpose of a positive appraisal system is to remind managers how they are discharging their tasks and responsibilities, particularly in relation to the strategy implementation. In a progressive organization, this is a continuous process.

For the development of an effective evaluation system, choice of factors to be used for appraisal becomes a critical issue. It is generally advisable to use a number of factors or multiple criteria to make the assessment system more objective and broad based. This indicates the need for inclusion of a good number of quantitative factors in addition to the subjective or qualitative factors. Several appraisal methods are available; some are purely quantitative or objective, some are totally subjective or qualitative, and, some are mix of the two. Most of the actual appraisal systems are based on an appropriate mix of the two types of factors to make the system more acceptable and reliable.

Also, relevance or suitability of the evaluation method to the corporate strategy adopted by an organization should be considered. For example, if a stability strategy is followed, the objective of the appraisal system should be to focus on improving efficiency in current operations. Improvement of efficiency in current operations, combined with initiative, can also help to achieve short-term growth.

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For long-term growth, i.e., growth through expansion or diversification, focus should be on long-term managerial characteristics of initiative, aggressiveness, risk taking attitude, etc. The evaluation system should lay emphasis on these factors and be structured accordingly.

Management Control System (MCS)

The management control system (MCS) runs parallel to the evaluation system, and, also, to some extent, is complementary to the evaluation system. The objective of the control system is to ensure that implementation of strategy takes place according to plan. A properly structured MCS should consist of four steps:

a. Establishing standards
b. Measuring performance
c. Evaluating performance against standards
d. Taking corrective measures to improve performance

These four steps constitute a cyclical process. known as the MCs cycle as shown in Figure. 4.16.

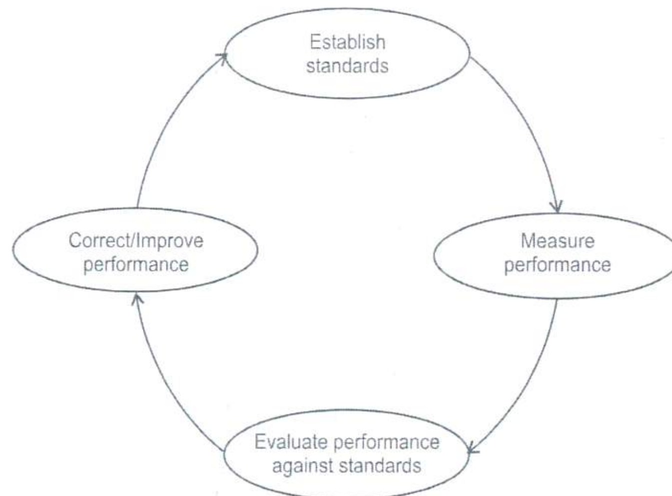

Fig. 4.16 *Management Control Cycle*

Organzational standards are prescribed in terms of targeted or planned performance. Measurement of performance is done through the evaluation system discussed above. Performance of employees/managers is evaluated with respect to the prescribed standards and deviations are noted. On the basis of deviations or observed drifts in performance, corrective action is initiated so that performance improves and meets the prescribed organizational standards. This is the MCS cycle.

The MCS cycle depicts a purely quantitative control system in terms of formal or measurable indicators of standards and performance. But, in many organizations, all controls are not enforced only through the formal machinery or methods; they also use informal methods. In almost every organization, there is a formal structure, which specifies the official hierarchy and reporting system in the organization. But, there is also an informal structure which shows the way systems and relationships actually work bypassing, or parallel to, the formal structure.

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Informal controls are apprising the managers about possible problems or lapses in strategy implementation in advance: guiding them through the implementation process; cautioning them about mistakes or repeat of mistakes; adherence to ethical norms, etc. These are done in a more unstructured way. The informal control system many times complement or reinforces the formal control system. To make the MCS more positive and successful, a good mix of formal and informal control systems is generally recommended.

4.3.4 Complementarity of Strategy, Structure and Systems

We had mentioned earlier about interrelations between strategy, structure and systems. Now, this can be seen in more specific forms in terms of strategy options, structural alternatives and appropriate systems. We can also introduce environmental factors to make the exercise more contextual. Environmental factors, strategies, structures and systems can be combined in the form of a linkage matrix. This is shown in Table 4..2.

Table 4.2: *Strategy Implementation, Structure and Systems: A Linkage Matrix*

	Environmental Characteristics	
Strategy/Structure/ Systems	*Certain, stable, predictable*	*Unstable, volatile, unpredictable*
Strategy	Growth/expansion/acquisition/ divestment	Stability/controlled growth
Structure	Entrepreneurial/divisional SBU/matrix	Divisional/functional/holding company
Systems		
Planning	Participative	Directive
MIS	Decision-orientation	Efficiency-orientation
Management development	External-focussed; need-based; contingency	Internal-focussed; programmed
Motivation	Monetary/non-monetary	Monetary/non-monetary
Evaluation	Broad-based; qualitative/subjective	Efficiency-based; quantitative/objective
Control	Formal/informal; direct/indirect	Predominantly formal/direct

Source: Adapted from A Kazmi, *Business Policy and Strategic Management* (2005), 344 (Exhibit 10.13).

Since the matrix is two-dimensional, it has limitations in terms of options or alternatives or combinations of environmental characteristics, strategies, structures and systems which can be shown. So, the combinations of strategies, structures and systems presented in the matrix are to be taken as more indicative rather than definitive. For example, for growth and expansion strategy, appropriate structural form may be divisional/SBU/matrix and the planning system should be participative. But, for the same strategy, the organizational structures can also be entrepreneurial; in that case, the planning system should be directive and not participative. In such cases, more exactness can be obtained through further analysis. But the matrix is important as a framework of analysis. This can be made more detailed or sophisticated by adding more dimensions or variables.

4.3.5 Organizational Structures for the Future

Most professional/progressive companies are today actively considering major restructuring of their organizations. This is the emerging trend. The process was

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initiated in the late 1980s. Corporate restructuring initiatives during the late 1980s and early 1990s were primarily aimed at changing 'authoritarian, pyramidal organizational structures into flatter, decentralized structures.' The changes were necessitated by new drivers in market dynamics. Customer choices and preferences were fast moving from standardized mass products to customized products, faster and better services, and product life cycles were becoming shorter. Organizational structures had to be reoriented or reinvented to respond to such growing demands.

Changes in structural designs during 2001–02 to make organizations leaner and fitter to increase efficiency showed further refinements. The objectives have been to make the organization leaner, flatter and more responsive to change. To achieve these objectives, companies have been focussing on newer measures or methods to drive changes. Five important measures for organizational redesign have been highlighted:

a. empowering managers and workers
b. re-engineering work process
c. self-directed work teams
d. incorporation and increasing use of Internet technology
e. networking with suppliers/outsourcing partners for improving existing organizational capabilities and creating new ones

Macy and Izumi (1993) have conducted extensive research on structural changes, innovations and organizational redesign. They have focussed on changing characteristics from traditional organizational design to the emerging or new design. They have considered features or characteristics like decision making, communication system, relationship patterns, functional work teams, outsourcing, quality, training, etc. (Table 4.3).

Table 4.3 *Paradigm Shift in Organizational Design*

Traditional characteristics	*Emerging/New characteristics*
• Single large organization	
• Centralized top-down decision making	
• Instructional (boss-subordinate) relationship	
• Vertical communication channel	
• Functional work teams	
• Job/assignment-based teams	
• Individual-focussed specialized job design	
• Quality focus	
• Vertical integration	
• Training: lack of focus	

Source: Adapted from B Macy, and H Izumi, 'Organizational Change, Design and Work Innovation: A Meta-Analysis of 131 North American Field Studies—1961–1991', in *Research on Organizational Development*, Vol. 7 (1993), 298.

Thompson, Strickland and Gamble (2005) have suggested several new characteristics for organizations of the future. Some of these compare well with those mentioned by Macy and Izumi. Others reflect more on recent thinking. These suggestions are as follows

a. Fewer barriers between different vertical positions (ranks), functions and disciplines and units in different geographical locations (delayering)

b. Inclination, initiative and capacity for changes and quick learning

c. Direct and regular communication between the company and its suppliers, customers, collaborators and strategic partners including networking

d. Collaborative efforts among managers/staff in different functional specialities and geographical units to create or enhance organizational competences or capabilities

e. Extensive use of Internet technology and e-commerce business practice—greater reliance on online systems for transacting business with customers and suppliers and better communication with strategic allies

Check Your Progress

4. On what factors does the implementation of a strategy depend?
5. How many stages are there in the evolution of the organizational cycle?
6. What is a matrix structure?

4.4 ANSWERS TO 'CHECK YOUR PROGRESS'

1. The main aim of a strategist is to analysis competition and then provide measures to deal with it.
2. Recently many scholars have introduced complements as the sixth force.
3. The rivalry among existing companies is the major factor that determines the competitiveness and profitability of an industry.
4. The implementation of a strategy or plan depends on three sets of organizational factors, namely the structure of the organization, various functional areas and operations and behavioural (people) aspects.
5. The organizational cycle is divided into four major stages.
6. A matrix structure is a need-based or project-based structure which does not follow the conventional lines of hierarchy or control.

4.5 SUMMARY

- In 1979, Michael E. Porter of Harvard Business School developed the Five Forces Model.
- The five forces help to understand the structure of an organization and the level of competition in a particular industry.
- These five key areas are industry rivalry, threat of entry, threat of substitutes, bargaining power of suppliers and bargaining power of buyers.
- The implementation of a strategy or plan depends on three sets of organizational factors, namely, the structure of the organization, various functional areas and operations and behavioural (people) aspects.
- The structure of an organization defines the levels and roles of management in a hierarchical way.

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- The analysis of organizational structure in terms of various stages of development helps in understanding the way structures evolve as organizations pass through different phases of their life cycles.
- More common structural forms are functional structure, divisional structure, SBU structure and matrix structure.
- The fundamental factor in the SBU structure is to identify independent product/market segment which requires distinct strategies.
- A matrix structure is a need-based or project-based structure which does not follow the conventional lines of hierarchy or control.
- A project structure is one in which teams are created for specific purposes or projects, the project team undertakes the assigned work, and immediately on completion, the team is dissolved.
- A one-stop shop is a structure in which a 'window' or a locational point is created by the organization.
- A one-start shop handles customer enquiries by diagnosing customer needs and referring them to the most appropriate provider.
- A service network is more inter-connective than a one-stop shop and a one-start shop; in this network, the members can have access to all the services of the network through any constituent member of the network.
- A holding company structure may be defined as one in which the role of the parent company is mostly limited to financial matters such as investment and the constituent businesses/divisions/ companies work almost independently.
- An intermediate structure is a temporary structure or arrangement for switching over from one regular structure to another.
- An organizational structure provides the mechanism for distribution of authority and responsibility among various managerial positions in the organization.
- Six major systems are planning system (PS), management information system (MIS), management development system (MDS), motivation system (MS), evaluation system (ES) and management control system (MCS).

4.6 KEY TERMS

- **Bargaining Power:** It is the relative power of parties in a situation to exert influence over each other.
- **Patent:** It is a temporary Government grant of a monopoly to the inventor in return for complete disclosure about the invention to the government.
- **Product Differentiation:** It is the process of distinguishing a product or service from others, to make it more attractive to a particular target market.
- **Forward Linkage:** It includes a relationship in the supply chain that moves products toward end consumers.

- **Backward Linkage:** It is an effect in which increased production by a downstream manufacturer provides positive pecuniary externalities to an upstream manufacturer.
- **Holding Company:** It is a company whose primary business is holding a controlling interest in the securities of other companies.

4.7 SELF-ASSESSMENT QUESTIONS AND EXERCISES

Short-Answer Questions

1. State the differences between strategy formulation and strategy implementation.
2. How does an organization implement a strategy? Explain it with the help of a flowchart.
3. What is an entrepreneurial structure, functional structure and divisional structure?
4. What are the advantages and disadvantages of the matrix structure?
5. *Business Week* has identified and focussed on five basic characteristics of a virtual organization. Discuss them in brief.
6. Give an example of an organization to show effective cross-unit coordination and communication.
7. List the three functions of MDS.

Long-Answer Questions

1. Discuss the five forces and their effects in a particular industry.
2. Explain the process of the organizational cycle.
3. Describe an SBU structure. Also, give an example of a typical SBU structure.
4. Analyze the structure of a holding company in India.
5. The motivation system can greatly contribute to the management development system. Justify the given statement.

4.8 FURTHER READING

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UNIT 5 IMPLEMENTATION STRATEGIES-II

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Structure

5.0 Introduction
5.1 Objectives
5.2 Implementing Strategies: Organizational Issues
5.3 Strategic Evaluation and Control
    5.3.1 The Balanced Scoreard Approach
    5.3.2 Organizational Controls
5.4 Answers to 'Check Your Progress'
5.5 Summary
5.6 Key Terms
5.7 Self-Assessment Questions and Exercises
5.8 Further Reading

5.0 INTRODUCTION

Strategy implementation is defined as the translation of a chosen strategy into organizational action so as to achieve strategic goals and objectives. In other words, strategy implementation is the process of turning plans into action to reach a desired outcome. It involves various ways to develop, utilise, and amalgamate organizational structure, control systems, and culture to follow strategies that lead to a competitive advantage and a better performance. The success of every organization rests on its capacity to implement decisions and execute key processes efficiently, effectively, and consistently. Simultaneously, an organization must have a control system is also required. This control system prepares managers with motivational incentives for employees as well as feedback on employees and organizational performance. This unit will discuss various organizational issues a firm faces while implanting strategies. It will also explain the concept of strategic evaluation and control.

5.1 OBJECTIVES

After going through this unit, you will be able to:

- Discuss various organizational issues in the implementation of strategy
- Explain the concept of strategic evaluation and control

5.2 IMPLEMENTING STRATEGIES: ORGANIZATIONAL ISSUES

It is necessary for an organization to have the appropriate structures and systems, but the real implementation of a strategy takes place through major functional areas of manufacturing, marketing, finance, etc. In each of these

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functional areas, operational implementation is equally important. Functional implementation and operational implementation are complementary to each other. One can even say that operational implementation is an extension of functional implementation (Fig. 5.1).

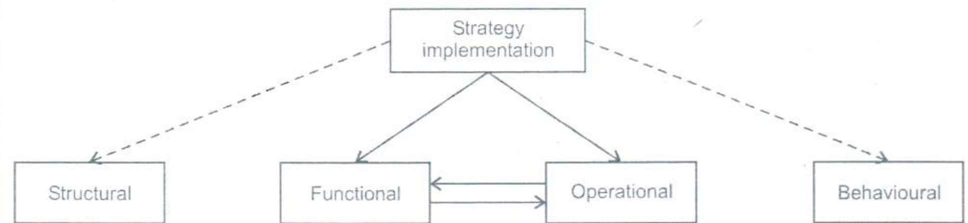

Fig. 5.1 Strategy Implementation: Functional and Operational

There are various issues related to functional implementation and operational implementation. These issues include defining functional strategy, understanding the role of the functional policies and plans in implementing the strategy, identifying major factors involved in formulating policies and plans in different functional areas, integrating various functional policies and plans, and analysing all important aspects of operational implementation.

Let us study these issues in detail.

A. Functional Implementation

Functional implementation takes place through functional policies, plans and strategies.

A functional strategy is related to a particular functional area and follows the business strategy of an organization, either a corporate-level strategy or a business unit-level strategy. Let us understand this with the help of an example. Assume that a company adopts a low-cost strategy for one of its businesses because of either market compulsions or profit considerations. The company will now focus its activities and resources in developing a low-cost structure and achieving cost effectiveness. But, this has to be implemented or achieved through a low-cost strategy in individual functional areas such as manufacturing, marketing, finance. Each of these functional areas will now work out its own cost reduction strategies to contribute to the SBU or organizational low- cost strategy. A similar approach would be adopted for any other strategy to be undertaken by the organization. There is also the issue of alignment or matching of strategies at different levels. In any organization, different strategies operate at different levels in terms of scope, coverage and organizational significance. For example, a business strategy is a higher-level strategy, and a functional strategy is a lower-level strategy because it follows from the business strategy.

Another example is: a company might be undertaking a major diversification strategy, and this strategy would be expressed in terms of specific product-market strategies. When diversification strategy is a higher-level strategy and a product-market strate is a lower-level strategy. But, there has to be a proper alignment or coordination among strategies at different levels for overall organizational strategic effectiveness and success.

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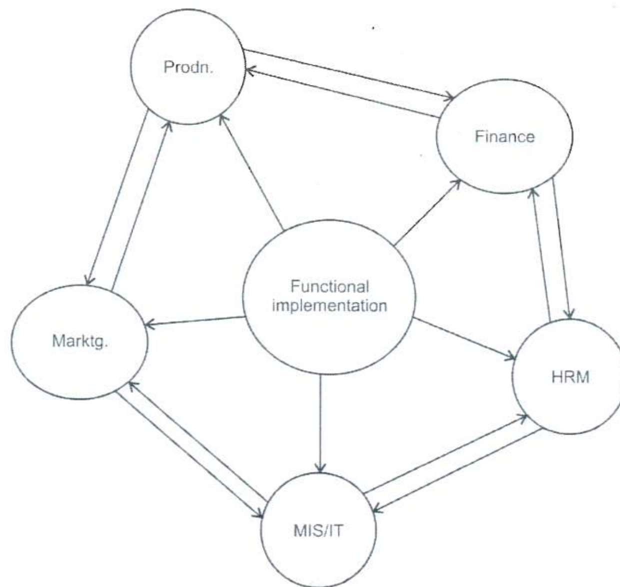

Fig. 5.2 *Interdependent Functional Areas*

This alignment can also be called strategy-level fit. One can distinguish between a vertical fit and a horizontal fit. A vertical fit is an alignment between higher-level and lower-level strategies. A horizontal fit is an alignment or fit between activities or strategies at the same level; for example, functional strategies in manufacturing and marketing, or manufacturing and finance, or marketing and finance. Both vertical fit and horizontal fit are applied to operational implementation. In an operational implementation, vertical fit is related to the alignment between a functional strategy and corresponding operations, and horizontal fit is related to two or more operational activities, which pertain to the same functional strategy or business strategy. For the effective implementation of a strategy, both vertical fit and horizontal fit are essential at the functional level as well as at the operational level. Lack of alignment or fit may result in strategic or implementation failure.

Functional policies, plans and strategies

The analysis of functional implementation will be carried out in terms of policies, plans and strategies in different functional areas. In any organization, five major functional areas are production, marketing, finance, HRM and MIS/IT. Some consider R&D also as an important functional area, but we shall confine ourselves to the four traditional functional areas, i.e., production, marketing, finance, HRM and the emergent area of MIS/IT. For strategy implementation, these functional areas have to have proper horizontal fit among themselves, i.e., play interdependent roles (Fig. 5.2).

Strategists give directions to different functional areas to formulate their plans for strategy implementation. These plans are guided by functional area policies already formulated or corporate policies already prescribed. Plans are prepared to select or follow a particular course of action; policies work as guidelines for these actions. For example, a marketing policy (supported by corporate policy) may not indulge in price war even if competition is intense. Therefore, all marketing plans relating to pricing implementation will be subject to this policy. Pricing is a

sub-function or sub-functional area in the marketing area, other sub-functions being market research, advertising and sales promotion, distribution management, etc. Similarly, other major functional areas will also have sub-functions or sub-functional areas. Through their policies and plans, major functional and sub-functional areas make possible the implementation of a strategy. Therefore, it is an interactive relationship between strategies and functional policies, and plans.

At the functional level, the implementation of a strategy is usually carried out by middle-level managers. Functional managers also make plans for using resources allocated to them for strategy implementation. For effective functional implementation, line managers, particularly in manufacturing and marketing, should be actively involved because they are in the best position to implement the strategy. They should also be given certain authority to take tactical decisions to ensure fast and efficient implementation. Senior-and top-level managers should play active supervisory roles, often known as the parenting role.

The development of functional policies and plans serves a number of useful purposes. Jauch, Gupta and Glueck (2004) have given five reasons why functional policies and plans are necessary, which are as follows:

a. To ensure that all constituents (functional areas) in an organization are actively involved in the implementation of strategic decisions

b. To provide a basis for controlling activities in different functional areas of prganization

c. To reduce the time taken by managers (in different functional areas in decision making) because policies and plans prescribe a clear course

d. To ensure consistency in handling of similar situations in different functional areas

e. To facilitate coordination among different functions. wherever necessary

Production policies and plans

Production processes typically constitute more than 70 per cent of a company's total assets and therefore they have high stakes in terms of roles and activities in strategy formulation and implementation. Production policies, capabilities and limitations can significantly affect strategic planning and implementation and the attainment of organizational objectives. Production, in the core, is related to manufacturing, i.e., decisions regarding plant size, plant location or layout, product design, choice of equipment, spares and accessories, technology level/technological innovation, inventory control, quality control, cost control, packaging, use of standards, capacity utilization, etc.

However, production as a function, in a broader sense, also includes the procurement of raw materials and inputs, R&D and any other operations (logistics) related to the production process. Some, therefore, prefer to call this function 'production/operations'. Again, production, as a function, is not confined to manufacturing-related activities/operations only. It also extends to production of services, retailing, etc. Both manufacturing and service organizations have to formulate policies regarding capacity, technology, purchasing, etc. Similarly, retailers have to formulate policies and prepare plans for buying and selling—may be, buy

in bulk, repackage and sell in smaller packs. There have to be policies and plans for bulking also as folllows.

By and large, however, production relates to manufacturing; and, a number of issues are involved in formulation of production policies and plans. Some of these issues also apply to non-manufacturing production activities. The major issues are:

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a. Involvement of the company in the production process
b. Choice of the production process
c. Determination of production capacity
d. Quality policy/management
e. Procurement policy
f. Inventory policy/management
g. Maintenance/replacement of existing production facilities
h. Integration of production and operations and system adjustments

(a) Involvement in the production process

The major policy issue in this is whether, and, to what extent, a company should get involved in the manufacture of the products it sells. At one extreme, a company may decide to manufacture all the intermediate inputs including parts, components and accessories and also undertake assembly, i.e., manufacture the finished product. At the other extreme, finished products may be outsourced, may be on contract manufacturing basis and marketed in the name of the company. Between these two extremes, there are a number of other possibilities or choices for a company. A common policy adopted by many companies is to outsource parts and components and assemble or manufacture the finished product. Each of these alternatives has its own investment implications and risks and returns associated with it. Companies need to evaluate different alternatives and then decide their manufacturing policy and make plans accordingly.

(b) Choice of the production process

If a company decides to manufacture the product, it has to consider some major policy issues in relation to the production process. Four major issues to be considered are as follows:

(i) Size and location of plants
(ii) Choice of technology
(iii) Process/job specialization
(iv) Mechanization of operations

For all large companies and multinationals, a basic policy decision with respect to size and location of plants pertains to two alternatives: large size plant with single centralized location or small size plants in multiple locations. Both the alternatives have advantages and disadvantages. An obvious advantage of a large size plant is economies of scale as enjoyed by many companies in steel, cement, fertilizers, etc. Centralized location also enables better top management control. But,

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advantages of economies of scale may be offset by higher costs of transportation of raw materials and finished products. Small size plants in multiple locations may have the opposite advantages and disadvantages. Many times, however, the decision between single and multiple locations is governed by the nature of industry and market compulsions. The soft drinks industry is a good example. In the soft drinks industry, the cost of transportation of the finished product is much higher than the cost of transporting the basic raw materials (i.e., the concentrate). All large soft drink manufactures, therefore, have bottling plants located near the markets. Coca-Cola has bottling plants all over the world.

Choice of technology is a very important factor in the production process. This assumes special significance today because of increased global competition, faster communication network and high rate of technological obsolescence. Like product life cycle, there is also technology life cycle. There are four phases in the technology life cycle: embryonic, growth, maturity and decline. Each of these phases has a cost and return factor associated with it. In the embryonic or development phase, the development cost is high and the time span long. At the growth phase, the technology is operational, updated and modified if necessary, and, there is feedback from the market about the product, i.e., technological performance. During this phase, there is increase in financial returns at a rate higher than the cost of modification. The growth phase is followed by the maturity phase during which the benefits of technology are fully derived without any additional cost. This phase may last long, but it depends on the type of technology, i.e., the product and intensity of competition. Finally, the declining phase sets in where the upgradation cost starts rising. (See Fig 5.3).

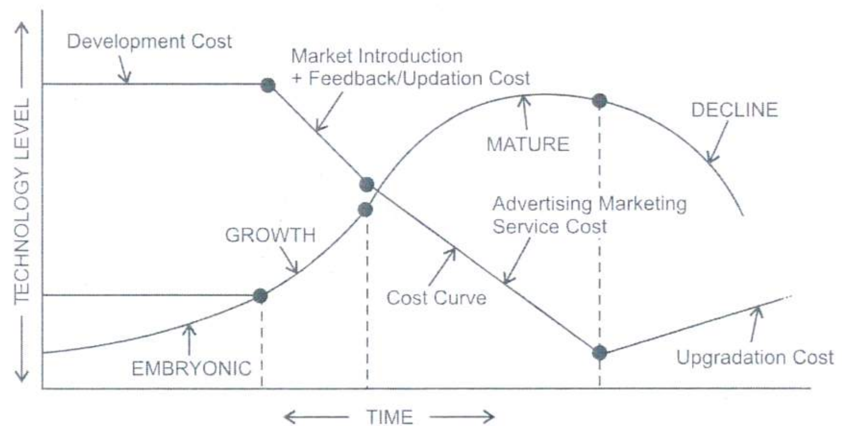

Fig. 5.3 Technology Life Cycle: Embryonic, Growth, Maturity, Decline

In some industries (products), there is a single or highly standardized technology, and technological change is very slow. Paper is a very good example. Others are edible oil, cotton textiles, woollen textiles, etc. But for majority of the industries or products, regular technological upgradation is necessary, consumer electronics being one of the best examples. For choice of technology, companies have three options: first, in-house development of technology through R&D; second, development through a mix of in-house R&D and collaboration or strategic alliance; and, third, purchase of technology from technology owners. These options have different implications in terms of investment, control over technology/

technology development and cost benefits. The technology policy of a company has to be guided by these considerations.

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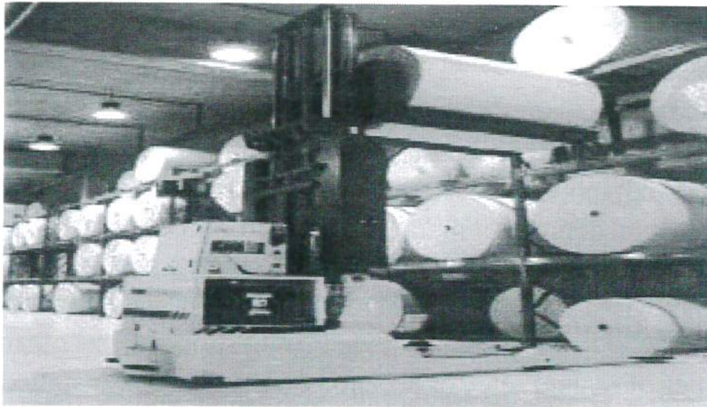
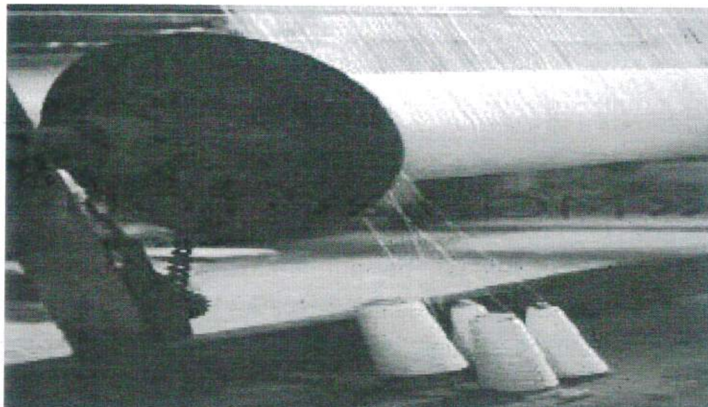


In the paper industry, there is single or highly standardized technology and technological change is very slow

Technology governs, to a large extent, the production process and also process or job specialization. In technologically sophisticated processes, i.e., with high focus on standardization, job specialization or division of labour becomes imperative. This, in fact, is a distinct characteristic of all large-scale manufacturing activities. Job specialization also produces the experience effect (discussed in Ch.5) which helps to increase productivity and efficiency. Specialized experience enables a worker to perform the same operation faster and better. But, it is not easy to determine what is the optimal or ideal level of specialization.

Related to process or job specialization is mechanization and automation of operations. Mechanization and automation are labour saving methods. Automatic spinning and weaving in textile mills, packaging of products, loading and unloading of cargo, computerization of banking and insurance operations are good examples of increased mechanization and automation but, at the same time, these cause displacement of labour. Technological advances drive mechanization and automation. Displacement of labour, on the other hand, faces resistance from worker's unions and also creates employment problem. Every big company, therefore, needs to formulate a policy on mechanization which can balance technology advances and labour relations.



Automatic spinning and weaving in textile mills has led to the displacement of labour

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(c) Determination of plant size/production capacity

Plant size (based on certain level of technology) determines production capacity. Determination of plant size, therefore, is a major policy decision of a company. Production capacity, however, depends, in addition to plant size, on the number of shifts in operation.

Decision on plant size and installed production capacity is governed by the level of output to be produced. Decision on output, in turn, depends on two important factor: first, market demand or marketability, and, second, minimum capacity utilization for enabling certain cost advantages. In most companies, output level is first determined based on assessment of market demand, and, then, the plant size is so determined that there is optimal capacity utilization in terms of productivity and economies of scale. Policy or decision on plant size or installed capacity should, however, take into account provision for growth in sales or demand.

(d) Quality policy/management

Quality of a product is closely linked to the production process, operational efficiency and the quality control system. But, above all, quality depends on the quality policy of a company. In a highly competitive market, quality of products and services determine, to a large extent, success and failure of the companies. This is particularly applicable to industrial products and consumer durables. In fact, the major developments in quality policy and quality movement pertain to industrial products (both intermediates and finished products) and consumer durable categories like automobiles.

The quality movement was initiated in the US. During the post-World War II period, the concept of total quality control (TQC) was developed in the US by Armand Feigenbaum. The term, TQC, was defined as 'a system of integrating the quality development, maintenance, improvement efforts of various groups in an organization to enable production, marketing and service at the most economical level with full customer satisfaction.

In the early 1960s, Japan introduced Quality Circle (QC) for quality management. A quality circle, as a tool, aims at 'defining, analysing and solving quality related problems' in a company through a team approach. Seven to ten managers from interrelated functional or work area form a quality circle. Members of the team are given necessary training in all quality-related matters so that they can develop an effective approach to quality management. In India, many companies, including BEL, BHEL, SKF, Godrej and Mahindra & Mahindra (Jeep Division) have attempted quality control through QCs. Many other countries have introduced their own quality controls and standards.

International Organization for Standardization (ISO) has taken the lead in internationalization of quality. ISO has published a series (ISO 9000 series) of quality system and standards. ISO standards have now become international quality benchmarks for all countries. All these have led to the development of Total Quality Management (TQM) as a tool for integrated quality control. Many progressive companies are now striving for Six Sigma quality standards — a benchmark set by GE.

(d) Procurement policy

The quality of a finished product depend not only on the production process and quality policy as just mentioned; but also on the quality of raw materials and inputs. If in an air conditioner or refrigerator a sub-standard compressor is used, then nothing can improve the quality or performance of the product. Therefore, procurement policies or decisions are also very important in the manufacturing function. For evolving a proper procurement policy, companies need to seek answers to the following three strategic issues or questions:

a. Should the company outsource all components and parts or go for backward integration for more vital ones?

b. What should be the basis or policy for vendor selection?

c. What should be the correct policy or approach for coordinating or balancing procurement, production and sales?

'Make' (backward integration) or 'buy' decisions generally depend on the relative costs (subject to quality standards) of in-house manufacturing and outsourcing. The common principle is : if the unit cost of manufacturing is lower than the cost of outsourcing, produce internally; in the opposite case, go for outsourcing. But, it would also depend on the organization's corporate-level policy or strategy on integration and diversification because there are objectives of different priorities.

In vendor selection, three factors or criteria are used: quality, price and delivery. Hardly any single supplier is the best in terms of all the three criteria. In practice, one criterion compensates for the other, say, better quality and higher price, less price and lower quality, etc. On delivery schedule, however, there is hardly any compromise. But, given these three major criteria, companies are generally faced with one more important decision. This is regarding the number of vendors to be chosen. This is a matter of policy. Should a company have a large number of vendors so that they compete among themselves to make the most competitive offerings? Or, should there be selected suppliers who would be loyal, and, there would be more intimate buyer-seller relationship? The present trend is towards having selected loyal or even captive suppliers. Maruti has drastically reduced the number of its suppliers of components and accessories. Many organizations, particularly the Japanese automobile companies, are forging partnerships with suppliers. They call it 'vendorship partnership'.

Coordination or balancing of procurement of raw materials and inputs, production and sales is one of the most difficult tasks of a company, and, most companies struggle to strike an optimal balance between them. The problem of management is caused by the divergence between the planned and the actual. For most of the companies, whether in consumer goods or industrial products, the planning process is:

Planned sales → Planned production → Planned procurement

Any divergence between the planned sales and the factual sales, and, therefore, between the planned production and the actual production is matched by inventory build-up as shown in the equation :

Sales = opening stock + production – closing stock

Ideal position is: Opening stock = Closing stock = 0 except for some operating stock.

(f) Inventory policy/management

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So coordination or balancing of procurement, production and sales is leveraged by inventory control and management. But, it is not only inventory management of finished goods as shown above, but also of raw materials and inputs. So, a company's inventory policy should relate to both raw materials and finished goods. Both have direct implications in terms of carrying cost. Every company, therefore, has to have an inventory policy for determination of optimum inventory levels.

All companies agree that there have to be minimum inventory levels of both raw materials/inputs and finished products. This is what we call operating or floating stock to ensure that the pipeline does not become dry. Some also call it replenishment stock. For finished products, the re-ordering point, i.e., the inventory level at which replenishment should be ordered has to take into account sales during the lead lime, that is, the period required for replenishment. For raw materials/inputs, the replenishment period or the lead time is the time taken for supplying a minimum reorder quantity. The reorder quantity and the replenishment period are interrelated (the shorter the replenishment period, less will be the order quantity) and both can be manoeuvred or worked upon to minimize the stock levels of raw materials and components/accessories. A number of theories, techniques, or models have been developed for the determination of optimum inventory level/reorder quantity and the replenishment period or cycle.

One of the latest or more successful approaches or methods is the just-in-time (JIT) inventory system. First introduced by Toyota Motors in Japan, JIT model has been adopted by many companies in electronics and automobiles. In the JIT system, storage of material,. i.e., inventory level is almost zero. Raw materials/inputs are supplied/procured just-in-time so that the pipeline does not become dry, production continues and sales do not suffer. To make the JIT system effective or successful, many vendors have set up production facilities either in the product manufacturing site or in close proximity. The objective, and the crux of the JIT system, is to minimize the lead time for supply of raw materials and inputs.

(g) Maintenance/replacement of production facilities

Proper maintenance and repair and replacement of components and parts are the keys to smooth and successful working of plants and equipment. It improves quality, increases productivity and operational efficiency and helps cost reduction. The policy should be of preventive maintenance rather than repairs after breakdown. Some breakdown may not be foreseen, and, may, therefore, be unavoidable, but, efforts should be made to keep such breakdowns to the minimum. Cost of preventive maintenance may be higher than repair cost (not always, however), but, the pay-off justifies the cost. Another choice is between repair and replacement of parts/components. Repair has immediate or short-term effects, replacement gives long-term productivity benefits. In making a choice between repair and replacement, relative cost-benefits should be considered. The general guideline is: replace critical components and repair non-critical parts. Companies need to evolve their policies and plans on this.

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(h) Integration of production and operational and system adjustments

We have covered above all the major individual policies and plans of various operations connected with manufacturing which affect strategy implementation. For effective implementation of strategy, policies and plans of individual areas/ operations should be properly aligned and integrated. This may involve both backward and forward integrations, reorganizing processes, restructuring systems, etc. Gupta and Datta (1995) have mentioned about three rules of this integration/ reorganization process:

Rule 1: Integrating production with procurement, sales and distribution

Example: Boots pharmaceuticals had 300 suppliers and raw material/input costs constituted more than 50 per cent of total production cost. There was a major problem of resource integration. To solve the problem, the company adopted a software solution—a variant of the Materials Requirement Planning (MRP II) system—to integrate production, sourcing, quality control, sales and distribution into one seamless process.

Rule 2: Working backwards from customer requirements/specifications to ensure competitiveness through efficiency

Example: Lloyds, a comparatively small company, produces about 6 lakh tonnes of HR coils annually compared to 160 million tonnes produced by SAIL. So, it could not compete with SAIL on size economies. Instead, it adopted a differentiation strategy, taking small orders and executing them faster than the larger players in the industry. It installed the electric arc furnace technology which enabled it to cater to small customized orders.

Rule 3: Re-engineering systems to remove operational inefficiency

Example: Siemens adopted a strategy of reducing operational inefficiency through re-engineering processes. The company introduced structural changes (from a functional to a product-based structure), installed an MRP-II package, revamped its value chain, and identified and corrected the inefficiencies in the operations control and reduced delivery time.

Three rules explained above illustrate different processes of integration and restructuring in the production system required for effective strategy implementation. These clearly indicate the need for flexibility and adjustability in the system. Stobaugh and Telesio (1983) have elaborated on this further: the tasks of a production system can be stated in terms of requirements for cost product flexibility, volume flexibility, product performance and product consistency. These factors determine, which manufacturing policies are appropriate. As strategies change over time, so should production policies covering location and scale of manufacturing facilities, choice of manufacturing process, degree of vertical integration of each manufacturing facility, use of R&D and control of the production system.

David (2003) gives clearer examples of the nature of production system adjustments, which may be required for strategy implementation. Such adjustments are not confined to particular industries and products. These apply to almost all categories of products—industrial products, consumer goods and services (Table 5.1).

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***Table 5.1** Production System Adjustments for Strategy Implementation*

Product/ company	*Strategy implementation*	*Production system adjustment*
Bank	Adding new branches (Market development)	Conduct site location analysis
Automobile manufacturer	Expanding into LCV (concentric diversification)	Procure new equipment and hire specialised staff
Steel manufacturer	Acquiring a fast food chain (conglomerate diversification)	Introduce fast food systems and practices
Beer brewery	Purchasing a barley farm (backward integration)	Revise inventory control/management system
Computer company	Acquiring a retail chain (forward integration)	Change packaging and transportation system

Source: Adapted from F R David, *Strategic Management: Concepts and Cases* (2003), 261 (Table 7.3).

Marketing policies and plans

Marketing is the most vital function in an organization because it establishes the link between the company and the market or the customers. It is the function which generates turnover (through sales) or revenue and earns profit for the company. So, the marketing function fulfils the most important objective of a company. In the implementation of most corporate strategies, marketing has a definite role to play. Marketing policies and plans are, therefore, of great significance in implementing business plans and strategies of a company. Marketing policies and plans are expressed though the four Ps: product, price, promotion and place (distribution). Each of these Ps has a number of elements associated with it. These are shown in Table 5.2.

***Table 5.2** Four Ps of Marketing and their Elements*

Product	*Price*	*Promotion*	*Place*
• Quality	• List price	• Advertising	• Customer location
• Brand	• MRP	• Sales promotion	• Outlet location
• Features	• Discounts	• Personal selling	• Channels
• Packaging	• Trade margin	• Test selling	• Warehousing
• Warranties	• Commission	• Publicity	• Stocks
• Services	• Instalment	• Communications	• Delivery
	• Credit terms		

Marketing policies and plans have to be understood and analysed in terms of the four Ps and their elements as shown in the table. Many marketing strategists call this marketing mix analysis. But there is a difference; marketing mix is not just the four Ps. *Marketing mix* is the *way* the four Ps or some of the Ps (depending on the product category) are *combined* or *blended* to optimize market offerings to increase sales and market share.

In this section, the main issues in marketing policies and plans will be analysed in terms of the following:

a. Product and product mix

b. Pricing decision

c. Product promotion

d. Place (distribution)
e. Marketing mix

(a) Product and Product Mix

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Product design, product manufacturing (except services) and product development are primarily the task or concerns of the production function/department (along with R&D). But, market or customer analysis is done by the marketing people; they may know better than production the nature of market demand, performance or acceptability of different products made by the company. Market reaction or feedback on a product is conveyed to the production department by the marketing group. Therefore, in every organization, marketing and production functions work in tandem in all matters relating to product planning, product making and product modification or adaptation.

Formulation of product policies and plans by a company should be based on answers to certain key questions:

- Which products should the company market?
- Which products contribute faster to sales and market share?
- Which products contribute most to profitability?
- Which products make an optimal product mix?
- How do a company's products compare with those of competitors?
- How frequently should the company change the product?

Let us start with product mix. To have a product mix is a common policy or strategy of most companies. The basic objective of the product mix is to balance the product portfolio. This implies or includes two more objectives; first, to optimize market offerings, (i.e., to cater to as large a cross section of market segments as possible) and, second, to effectively match competitors' products and brands. To achieve optimality of product mix, companies have to continuously review their existing product lines and market developments. Such review pursues resource allocation to different products (existing and proposed); examines whether the rate of new product development is satisfactory; and, ascertains whether, or, to what extent, each product contributes to sales growth, market share and profitability. Different products generally contribute differently to sales, market share and profit. Drucker has mentioned that a typical portfolio may consist of six different product types:

- Tomorrow's breadwinners, i.e., new products or today's breadwinners modified.
- Today's breadwinners, i.e., the innovations of yesterday.
- Yesterday's breadwinners, i.e., products with high volume, but, fragmented into 'specials', small orders and the likes.
- Products capable of becoming breadwinners or net contributors if major changes/improvements are made.
- The 'also rans'—the high hopes of yesterday, which, although did not perform well, have not become outright failures.
- The failures of today.

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The failures have to be removed from the product portfolio. Hindustan Unilever sold off its 'Dalda' product when, during successive reviews, the company found that the product was not viable any more. In fact, the timing of deletion of unviable or obsolete products and addition of new products is a matter of strategic policy decision of a company. For this, some have suggested planning based on simulation approach to future deletions and additions. For developing an optimal product mix, companies can also use the Boston Consulting Group.

Related to timing of product deletions and additions, is product life cycle (PLC) and changes in product design. Every product goes through a life cycle of four distinct stages—introduction, growth, maturity and decline. Where a product/ brand enters into the decline phase of PLC, companies can either try to sustain the product for some more time by changing the product design and repositioning or relaunching it (because many competitors may be exiting from the market), or, alternatively, withdraw it from the market.

Product design or changes in product design is a matter of a broader policy decision of a company. Companies have certain alternative policy or strategy options available with them. Newman and Logan distinguish between four possible alternatives depending on the nature of the product, company position, market structure, etc. The four alternatives are : annual change, product leadership, leapfrogging and straddling. Some companies change the product design annually as a regular practice. A number of automobile companies in the US and Europe have been following this approach for some time. Major advantages of the policy are twofold : first, raising market/customer expectations for changed/new products every year and capitalizing on this in terms of increase in sales; and, second, production adjustments can be planned properly with certain cost effectiveness, because changes are consolidated into an annual package or programme. In product leadership approach, a company changes product design whenever warranted (generally more than a year) by technological changes to be the first in the market with a modified product. This gives the company 'first mover' advantage. IBM has been doing this for many years; Microsoft is doing the same in the field of computer software packages (some might call these new products); Maruti has been successfully doing this in the Indian automobile market. Leapfrogging implies change of design only when significant improvement can be made keeping the cost or investment factor in mind. This may happen with considerable time lag. Such policy may be suitable for products in which technological change is slow. Policy of straddling means minimum 'content' change in a product; changes are more cosmetic or in appearance. Swiss watch manufacturing companies largely follow this policy.

Product design and changes in product design also imply product differentiation. An integral part of product policy or strategy is product differentiation. And, product differentiation is at the core of creating and sustaining competitive advantage. A good product differentiation should be guided by an appropriate competitor product analysis. Differentiation can be on the basis of product design, quality, packaging, special features, etc. Five differentiating factors are important, which are as follows:

1. Characteristics of the product which are important from the customer's point of view

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2. Customer's ability and inclination to appreciate the distinctiveness of the product compared with competitor's product
3. Cost of providing the distinctive design, quality or feature
4. Value creation through differentiation and
5. Customer's willingness and ability to pay for the differentiated product

(b) Pricing decisions

Traditionally, two limits to pricing or price policy are set by an economic or cost of production factor and the other by the market factor. A company would not normally sell its product(s) at a price less than the unit (average) cost of production, and, a customer would not pay a price more than the perceived value of the product. These two would set the limits to pricing of the product — unit cost would set the lower limit and customer's perceived value the upper limit. The pricing policy of a company is mostly guided by these two limits ; and, in most market situations, the actual price would be settled between the two.

Given these two limits, the pricing policy of a company would depend on the pricing objectives. The objective of pricing is not always to maximize profit, although this should be the ideal objective. Many companies have other overriding objectives dictated by organizational objectives and their positions in the market vis-a-vis competitors. There can be short-term objectives and long-term objectives, and there can be a dichotomy between the two. Various pricing objectives followed by companies, including the more common ones, are as follows:

- Maximizing growth of sales
- Maximizing short-term profitability
- Achieving product-quality leadership
- Maximizing long-term profitability
- Skimming the market
- Creating entry barriers for competitors
- Dumping the product
- Organizational survival

Pricing objectives govern selection of pricing approaches or methods. The pricing methods are based on the fundamentals of cost, demand and competition. Based on these factors, companies usually adopt one of the four pricing methods:

a. Cost-based pricing
b. Demand-based pricing
c. Competition-based pricing
d. Value-based pricing

1. Cost-based pricing

The fundamental law of pricing states that it is based on cost of production. Most companies try to fix selling prices which are based on their cost of production. In India, about 70 per cent of consumer goods companies and about 90 per cent of

industrial product manufacturers take their pricing decisions based on cost of production. More commonly used cost-based methods are as follows:

- Cost-plus or mark-up pricing (average unit cost plus some margin)
- Full cost or standard cost pricing (includes all fixed and variable costs, but no margin)
- Marginal cost or incremental cost pricing (includes only variable cost, no fixed cost)

All cost-based pricing methods are based on certain fundamental principles of economics and are straightforward in application. However, these methods are, on many occasions, not tenable in the marketplace. Such cost data ideally provide some benchmark or floor levels. Pricing decisions under actual market conditions are dictated more by demand and/or competition levels.

Demand-based pricing

The underlying principle in all demand-based pricing methods is the customer's willingness to pay a particular price for a product under prevailing market conditions. This would partly reflect the price elasticity or sensitivity of demand for the product, however, more the effectiveness of marketing strategies of companies to exploit particular market conditions and induce or entice the customers. Seven demand-based pricing methods are as follows:

- Premium pricing
- Penetration pricing
- Bundle or package pricing
- Skimming pricing
- Neutral pricing
- Portfolio pricing
- Promotional pricing
- *Premium pricing* is based on the principle that the product or brand should be positioned at the top end of the market (a niche) and must offer far greater value in qualitative terms (sometimes also in quantitative terms) than similar brands in other price segments. Cost or price is not the consideration. Some good examples of premium pricing are : Swiss watches, Mercedes cars, Toshiba laptop, Ray-Ban sunglasses, Sony TV and Dove conditioner.
- *Penetration pricing* is the opposite of premium pricing. In penetration pricing, a company uses a low price to penetrate the market and gain a foothold. Nirma detergent powder, Videocon television, Hero cycle, and Babool toothpaste are all examples of penetration pricing. Penetration pricing is commonly used to increase market share. Most of the Chinese products use penetration pricing. Walmart also is a good example.
- In *bundle or package pricing,* a company clubs a set of products or services to offer them at a price lower than the individual prices of the package components combined together. Service organizations such as hotels, airlines and travel agencies commonly offer package prices. The

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Times of India uses such pricing for its classified ads. A volume or quantity discount given in industrial products closely approximates bundle or package pricing.

- *Skimming pricing,* also called opportunistic pricing, is used by companies whenever they introduce a new or novel value added product which has no immediate comparison or substitute. Customers are willing to pay a higher price because of novelty or uniqueness of the product. But, once the demand at a particular level gets saturated, competitors emerge and the product becomes common, price is reduced to expand the customer base. Photocopiers, word processors, personal computers and mobile phones are all good examples of skimming pricing.
- *Neutral pricing* means offering extra value or benefits with the product, cost or price remaining competitive. Cadbury offers 30 per cent more chocolate in its 5-Star bar for the same price. Hindustan Unilever adds more into their product—like a bigger Rin washing bar or more Sunsilk shampoo —without increasing price. Offering of more for the same price on a regular basis rather than through temporary promotions makes the price a good value differentiator.
- In *portfolio pricing,* prices are adjusted across various extensions of a particular product category in such a way that a slow moving item is supported by charging a higher price for items which are more in demand. Gillette shaving razors, for example, are priced very conservatively. This is supported by blade cartridges on which the company makes its profits. We have many such examples in cosmetics and toiletries also.
- *Promotional pricing* is used to break consumer hesitation or resistance to a new untested product to facilitate market acceptance of the same. This is usually an introductory price. After introducing the product in the market (usually after some months) companies revert to their standard pricing depending on the marketing plan and strategy. Promotional pricing need not, however, be always introductory. There can be special promotional price to increase sales, e.g., the invitation price of Re 1 on weekday editions of the *Times of India* (this practice has now been changed).

Competition-based Pricing

In competition-based pricing approach, companies take their pricing positions more as a reaction to the competitive structure in the market. A company first assesses or ascertains its role (leader, challenger, follower) in the competitive market structure and then decides the pricing approach or strategy. Three major approaches are more commonly prevalent:

- Top-of-the market pricing
- Follow-the-leader pricing
- Parity pricing

The top-of-the-market pricing is same as premium pricing. For adopting the top-of-the-market pricing, companies should also offer the top-of-the market product in terms of quality and value.

The follow-the-leader pricing, a company assumes the role of a follower, avoids all confrontation with the leader and chooses a price line which is either at par or marginally below the leader's price. This is the ideal pricing policy for those companies which are generally content with playing the second fiddle or the third, to the leader. They generally sell a residual tonnage or volume having a low market share and making small profits. LML Vespa was following this policy for a number of years with a market leader, Bajaj. Many unbranded products in both industrial and consumer goods follow this approach.

Parity pricing means pricing the product more or less on par with competing products and brands. This minimizes the risk of any hostile competition from the established players, and, therefore, avoids the possibilities of any head-on clash or marketing war. This is a compromise pricing strategy—live and let live. This is quite common in the seller's market.

4. Value-based pricing

The final pricing decision by a company for its product would depend on its value to the customer. Pricing methods based on customer value are as follows:

- Perceived value pricing
- Value-for-money pricing

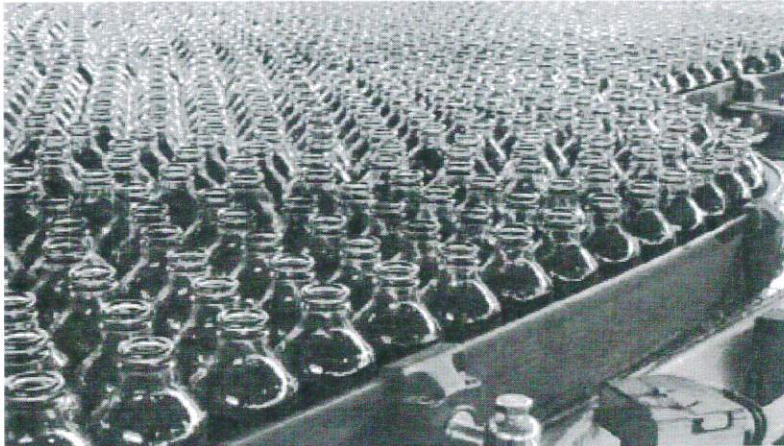
Both perceived value pricing and value-for-money pricing are very focussed policies or methods in today's marketing. It is not enough to offer value to the customer, but the customer must perceive value in his/her own value judgment. It is also the customer who has to decide how much value he/she is getting for his/her money.

In *perceived value pricing,* the price-value matching is important and companies realize this. Whirlpool India realized this and they probed buyers' mind to find out what they really perceived as value. Whirlpool discovered that it was not the advantage of a frost-free fridge. It was a very different need—large refrigeration space made necessary by the habit of storing cooked food and smaller crispers necessary because of frequent vegetable shopping. As the company puts it: 'Instead of launching the fancy three-door or four-door models, we went for the single-door product taking care to meet the customer need for space.' This is where the real perceptions of value came from.

Value-for-money pricing is another form or extension of perceived value pricing. In modern marketing, many companies use it as a complete marketing strategy. Videocon did it when they launched 63 cm flat-screen, Bazooka when BPL's FHR and Onida's KY series models were dominating the flat screen TV segment. Market research showed that the value of Bazooka, as perceived by the prospects, was around ₹ 25,000. But driven by value-for-money strategy, Videocon priced Bazooka at ₹ 21,000 only. After one year of the launch, Bazooka's turnover was more than the combined sale of BPL's FHR and Onida's KY models. Similarly, consolidated Coffee's Tata Cafe used this method. Tata Cafe's pricing was such that customers found that the price was much lower than what they had thought. Tata Cafe's pricing became a great provider of value. Said Bijoor, General Manager (Marketing), Consolidated Coffee: 'The task for Tata Café is to outmatch

competition to build brand equity. We want to offer real value rather than deceptive value.'

Cost-based pricing, demand-based pricing, competition-based pricing and value-based pricing are the different ways of looking at the same pricing approach. Rarely, a company bases pricing of its products entirely on either a cost factor or a demand factor, a competition factor or a customer value factor. It is mostly a combination of some or all these four factors with different weights given to each of these factors depending on the market conditions. The marketer's test of acumen is in deciding the relative weights or the focus factors to decide on a pricing policy or system which would succeed.



All large soft drink manufactures have located their bottling plats near markets to achieve cost effectiveness and pricing efficiency

(c) Product Promotion

Many marketers feel that right promotion is half the marketing. There are many ways to promote a product and most companies use a mix of different promotional tools.

The major elements of a promotional mix are as follows:

a. Advertising
b. Sales promotion
c. Personal selling
d. Public relations

Marketing policy-makers and strategists should also take into account the major factors which determine the choice of a particular promotion mix. These factors are as follows:

- *Nature of the market,* i.e., market size, number of products/brands in the market, intensity of competition, etc.
- *Product awareness and buyer readiness,* i.e., buyers' awareness of various products and their readiness to buy particular products/brands.
- *Product life cycle*, i.e., introduction stage, maturity stage, etc.—in the introduction stage, advertising and publicity are more important while in the maturity stage, sales promotion and personal selling are more effective.

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D. *Overall marketing strategy,* i.e., whether a company likes to 'push a product (through marketing and distribution network) or create a 'pull' (strong consumer demand). In the 'push' strategy, the focus is on personal selling and trade promotion in the 'pull' strategy, the emphasis is on advertising and consumer promotion. For many companies, overall promotional policy or strategy can be a combination of 'push' and 'pull'.

Given these factors and the promotional tools, companies have to decide the right mix for different product, market, and buyer situations. As a general rule, advertising is known to be more effective in consumer non-durables (FMCGs). Personal selling has been found more successful in consumer durables, computer, software, etc. Public relations are generally more important in business-to-business products and services. Sales promotion will be common to all. But, in each case, the roles of the promotional tools have to be carefully worked out and the right mix must be obtained. This is the job of a marketing strategist.

For sales promotion, companies use a variety of tools. These tools include promotion letters, catalogues, point of purchase (retail stores) displays, customer service programmes, sales demonstrations, contests, free samples, discounts, coupons, free offers, extras, price-offs, etc.

Nowaday, point-of-purchase (POP) promotion through displays in retail outlets is one of the most widely used promotional tools today. Innovative displays have become a prerequisite for product/brand success. With limited space available in retail stores, products/brands compete with one another for consumer attention and shelf space. In today's high intensity marketing, the retailers are virtually flooded with POP promotions from various manufactures. More and more companies are going for innovative displays to give their products/brands more visibility in shelves. When Nestlé had introduced Maggi noodles in 1983, they had used a unique dispenser—the wire mesh bag. It had not only helped in product/brand identification and focus, but, also helped the retailer. The dispenser, hung from the ceiling helped the retailers save shelf space. Cadbury too came up with a dispenser. Customized racks are also being used by companies for display. Companies like Procter and Gamble, Nestlé, Hindustan Unilever, Lakme and Tips and Toes make yearly bookings for display space in various stores. In many companies, salesmen are evaluated not only on the basis of sales performance, but also on the basis of number of displays organized by them for their companies.

All product promotions must be continuously tracked for the best results against defined objectives or set benchmarks. If promotions are not executed well or if the markets outplay promotions, these can be counter-productive. Classic failures include Pepsi's numbered bottle cap lottery fiasco in the Philippines. We must remember that promotions of declining brands are almost like demotions unless those are backed by a comprehensive turnaround strategy for the products/ brands.

(d) Place (Distribution)

Place or distribution is the process by which goods and services are delivered to the customers. In industrial products and consumer goods (not for services), an important matter of policy for a company is to decide whether it should sell its

products directly to consumers or through intermediaries or middlemen, i.e., channels. There can be a zero channel or there can be multiple channels. The possible channel alternatives are shown in Fig. 5.4.

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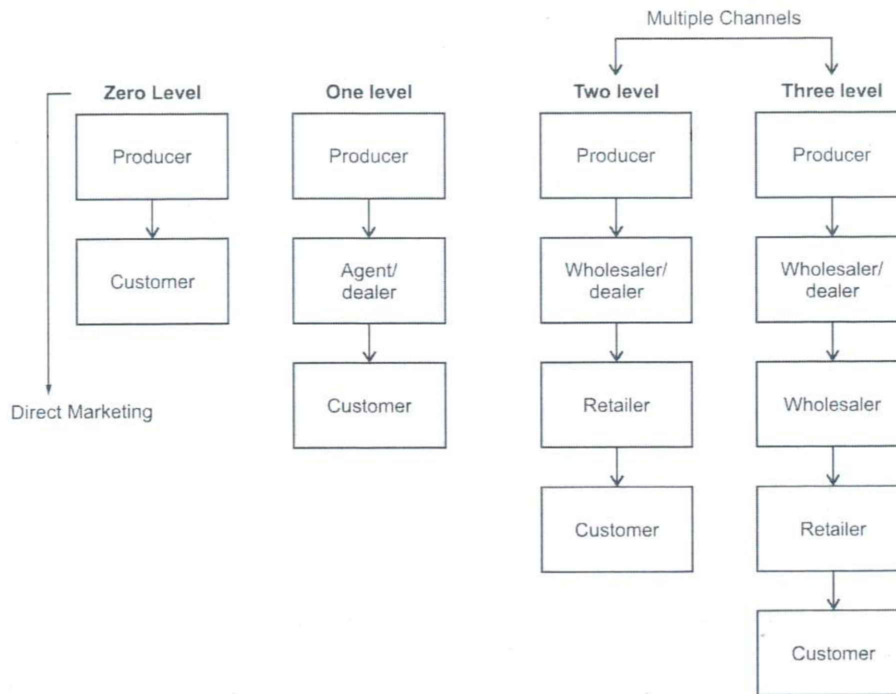

Fig. 5.4 *Alternative Channels of Distribution*

Because of the factor of inseparability, all service companies like banking, insurance, hotels, restaurants, telecommunication, etc., use zero level marketing channel, i.e. direct marketing. Few consumer goods companies—Amway is one of the best examples—also adopt direct marketing strategy. In industrial products, most of the finished goods and industrial inputs (intermediates), parts, components and accessories are sold to original equipment manufacturers (OEMs) through a direct distribution system. Only sale in the replacement market is made through one level channel and, sometimes, through two-level channels. But, most of the consumer goods, FMCGs in particular, are sold through multiple channels. Distribution channels are, therefore, vitally important for consumer goods.

Development of a policy or strategy on distribution channel involves consideration of three major factors: evaluation of channels, selection of channels and channel management.

Given the alternative channels, a company has to evaluate these and determine which channel suits its strategy implementation. Determination of suitability or unsuitability of a channel is based on three criteria: economic, control and adaptability. The economic criteria relate to distribution cost. Relative costs of distribution through different channel alternatives have to be considered for viability. Since the intermediaries or channel members are independent, a manufacturer has to take into account the controllability factor of these channels. A preferred channel is one which offers more controllability. Finally, adaptability of a channel is important. A channel should provide for flexibility so that changes can be introduced when

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situations demand. Inflexibility or rigidity may affect operational efficiency of a channel.

In addition to the evaluation criteria mentioned above, companies need to consider some additional factors for selection of a channel. These include product characteristics, company position and location of customers. For high volume products with low unit value, zero level channel or very few channels are preferred to avoid or reduce cost of handling at different points. For perishable products also, zero or fewer channels are recommended because of the perishability factor. Bulks of FMCGs do not have these problems. Company position in terms of product mix and cost of channel operation influence choice of a marketing channel. Hindustan Unilever, with a very extensive product mix, adopts two-level channels for better channel control. Reliance has planned a chain of departmental stores for marketing petroleum and other products with each store costing about ₹ 5 crore–the cost of channel operation. Many companies cannot afford such cost. Finally, location of customers becomes an important determining factor for selection of a channel. If the customers are few in number or located in clusters, it is advisable to have zero level channels because it saves distribution cost. But, if customers (individuals, households) are very widely distributed with low individual purchase, multiple channels may be the recommended course.

In all multiple channels, channel management is a major task of a company. Channel management involves two issues: managing channel conflict and motivating channel members. Channel conflicts can be vertical (channel members at one level in conflict with members at higher or lower level), horizontal (conflicts between members at same channel level) or multichannel (channels get in conflict with the company). Three different types of conflicts require different types of channel management approaches. Also, it is not enough for a company to resolve or reduce channel conflict; it is necessary to keep the channel members motivated. Motivation can be achieved through both financial (higher margins, bonuses, extended credit limits, etc., and non-financial (contests, recognition of better performance, paid holidays, etc.,) methods. Companies like Philips, Bajaj Electrical and Parle Exports are known to publicly acknowledge and reward high performance of selected dealers. Reliance, Videocon, etc., sponsor holidays for their high-performing dealers to foreign destinations.

(e) Marketing mix

If one manages to achieve the right product at a right price with the right promotion and in the right place, the marketing programme would be effective or successful. Therefore, assembling and managing the marketing mix (including all the elements shown in Table 5.2) is a basic marketing task and blending the marketing mix into a winning combination is a matter of strategy. The interconnected marketing mix system is shown in Fig. 5.5. Marketing success and failure depend, to a large extent, on the choice and balance of the marketing mix.

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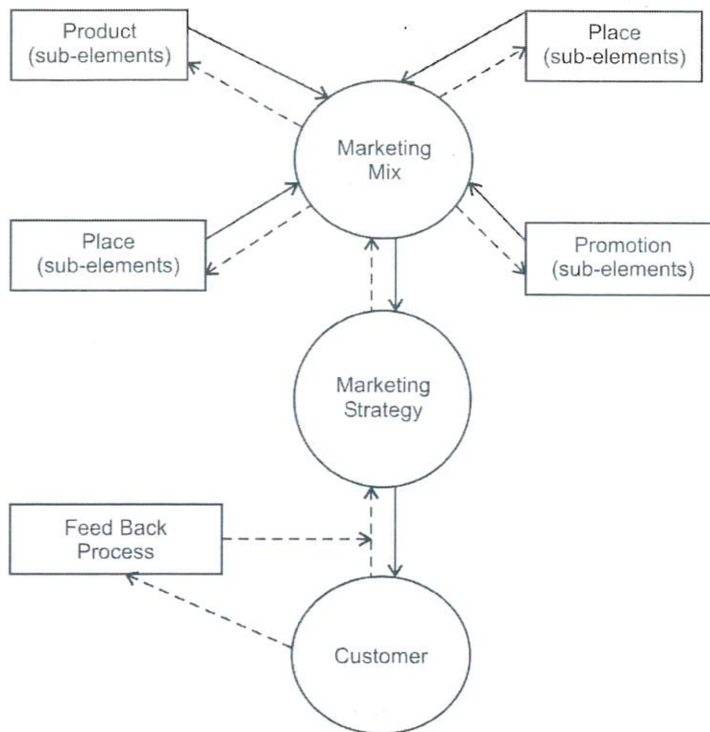

***Fig. 5.5** Interconnected Marketing Mix System*

We give here an example of how wrong balancing in the marketing mix can lead to marketing failure. In 1987–88, Parle Exports (then makers of Thumps Up, Limca, Gold Spot) made a high profile launch of Big Bite. Big Bite was like a burger—a bun with vegetables, or chicken or mutton filling topped with different sauces. The launch was preceded by several campaigns in Mumbai which had tantalizing punch lines. Mumbaiites responded overwhelmingly, and, in the first month of the launch, 90 per cent of the target customers had tried Big Bite. But, thereafter, the sales declined, and, in less than six months, it was reduced to 10 per cent. Big Bite was a big failure and Parle had to withdraw the product. Follow-up research showed that Big Bite did not live up to customer expectations. Customers found it dry compared to its nearest rival 'Rolls' and perceived it to be like any other burger. Their expectations were raised by the Big Bite ads, but, the product failed to rise to those levels. This was a case of product-promotion mismatch.

Another way to look at marketing mix policy or applications is in terms of product categories. As a general rule or proposition, the marketing mix pattern, i.e., assembling or blending the four elements and the sub-elements is different for industrial products, consumer goods and services. For example, in industrial products, the product is most important. Most of the industrial products are either equipment or machinery or are inputs to another industrial product or a consumer durable, and, therefore, the quality of the industrial products is very vital. Promotion is not very important (except company presentations). In contrast, in consumer goods, promotion (including positioning) is vital, but, the quality of the product may not be so critical (except premium or niche category) because price-product combinations can sell well, particularly in FMCGs. Distribution is very important for consumer goods. For mass markets (lower end of the market or bottom of the

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pyramid), distribution may be more important than promotion. For such markets 'formulating the right product with a combination of performances, features and price and finding the right combination of the distribution structure is probably more important than high decibel advertising'. In services, in contrast, distribution has hardly any role to play (except for courier services) because of the characteristic of 'inseparability' (between production and consumption). A general framework of weightage of marketing mix elements in industrial products, consumer goods and services is shown in Table 5.3.

Table 5.3 *Relative Weightage of Marketing Mix Elements in Industrial Products, Consumer Goods and Services*

Marketing Mix element	*Relative Weightage*		
	Industrial Products	*Consumer*	*Goods/Services*
Product	3	2	2
Price	2/3	2	3
Promotion	1	3	2
Place (Distribution)	1	3	1

Notes: 1. '3' indicates highest weightage; 1 indicates lowest weightage.
2. The weightage system indicated above shows some *orders* rather than *magnitudes*.

Financial Policies and Plans

Next to production and marketing policies and plans, financial policies and plans are most vital for strategy implementation of a company. Some may even argue, and rightly so, that all the three are equally important or vital. Implementation of every strategy has financial implications in terms of cost or investment. Financial policies and plans relate to the following three important factors:

a. Sourcing of funds
b. Allocation of funds or investment decisions
c. Management and control of funds

a. Sourcing of funds

Policies and plans related to sourcing of funds deal with financing mix or capital mix decisions. Policies have to be formulated and decisions taken on major financing factors or issues: capital structure, capital issues, capital procurement pattern, working capital borrowings, reserves and surplus or retained earnings as sources for funding, relationship with lenders, banks, financial institutions, etc. These policies and decisions are vital because of two reasons : first, these determine how and how much financial resources will be made available for implementation of different strategies; and, second, each of the sources or choices has certain cost associated with it.

Various sources of funds can be broadly divided into two categories: short term and long term. The other way to classify sources is as internal or external (Table 5.4).

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Table 5.4 *Sources of Funds: Internal, External, Short term, Long term*

Source	Short term	Long term
Internal	• Nil	• Retained earings
External	• Short-term loans – Banks – Financial institutions • Public deposits • Leased assets • Trade credits • Customers' advances	• Share capital – Equity shares – Preference shares • Debentures • Fixed deposit • Long–term loans

Given the various sources of funds, a major policy decision for a company is to secure the optimal financing mix, i.e., the right combination of internal and external, and short-term and long-term sources of funds. Such combination or mix is governed by a number of factors. The major factors are as follows.

a. *Nature of business :* If a particular business is likely to earn a fixed rate of return regularly, it is advisable to finance it through debentures, long-term loans, etc. If, however, a business is more related to the fluctuating environment, it is recommended to have higher proportion of equity.

b. *Purpose of financing :* This is related to the nature of business. If funds are required for expansion or diversification which always has a gestation period, the recommended course is to use long-term sources. For working capital, short-term sources are to be always preferred.

c. *Cost of financing :* The cost of financing or cost of capital is the rate of interest on borrowings. In the case of equity, cost is not explicit but, it is related to expected returns. Optimal financing mix is the one which has least 'composite' cost of capital, i.e., the weighted average cost of all the components of the financing mix.

d. *Financial leverage:* Financial leverage helps in balancing the financing mix—the proportions of fixed cost capital (like loans and debentures) and other sources of funding.

e. *Control or interference in management:* Providers of finance like shareholders and financial institutions usually like to have control over the management of a company. Excessive holding by any individual or financial institution may lead to excessive control and interference. From this point of view, it is preferable to have sourcing through instruments such as preference shares and debentures.

f. *Organizational ability*: The ability of an organization to procure funds from different sources at competitive rates. Reliance example is given below.

Because of these various factors, different companies adopt different policies for financing mix commensurate with their business conditions. Ingersoll Rand, for example, adopted a policy of blending internal and external sources for financing its strategies for expansion and growth. Almost 70 per cent of the company's post-tax profit was reinvested to reduce its dependence on external sources (borrowed funds). This enabled the company to keep its interest costs low. Reliance

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Industries gives a different kind of example. It has successfully used its capabilities to source funds at lower cost. To achieve this, it has used a mix of external long-term sources — fully convertible debentures, partly convertible debentures, and global depositing receipts (GDRs). The company has used these sources to finance its expansion plans without putting much pressure on equity. The company's debt-equity ratio is maintained around 1:1 which is very favourable for a rapidly growing company as against a general private sector norm of 2:1.

Allocation of Funds or Investment Decisions

All strategy implementations, except retrenchment strategy, involve allocation and deployment of funds or investment decisions. As sound corporate practice, uses or allocation of funds should be kept in view while formulating policies on sourcing of funds. Policies and plans related to allocation or utilization of funds essentially relate to asset mix decisions, i.e., regulating investments in fixed assets and holding of current assets. *Fixed assets* are long term in nature, have certain life and depreciate; *current assets* are short term in nature and are either held as cash or expected to be converted into cash during the accounting period. But, in these two categories also, there are assets in different forms (Table 5.5).

Table 5.5 *Corporate Asset Mix: Fixed Assets and Current Assets*

Asset mix	
Fixed Assets	***Current Assets***
• Land and buildings • Factory structures/machineries • Electrical installation • Plant and equipment • Furniture and fixtures • Transport vehicles	• Cash in hand • Cash in banks • Inventories – Raw materials – Work-in-progress – Finished products • Short-term loans/advances • Current investments

Fixed investment or investment in fixed assets and investments in current assets or working capital are meant for different business or corporate purpose; but, both forms of investment are used simultaneously and, in certain combinations, with a common objective of strategy or project implementation. For example, in manufacturing, a company requires both fixed capital and working capital to fulfil the same objective—to produce or make a product as per strategy requirements.

Investment in fixed assets has long-term implications both in terms of costs and benefits. The general principle governing determination of cost-benefits of a fixed investment is that the returns, i.e., net present value (NPV) should be higher than the cost of the fixed asset or investment. The strategy or project implementation process plays an important role in balancing the costs and benefits. If project implementation is planned and undertaken properly, much of cost and time (which ultimately results into cost) can be saved. Many companies use PERT/CPM—a commonly adopted technique — for designing, scheduling and managing project implementations. Failure to adopt some such approach may lead to time overrun, and, consequently, cost over run. Reliance is a good example of timely project implementation. The company's project implementation policy is like this : go slow

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in the initial stages, deploy resources in profitable alternatives for sometime, and, as project implementation approaches critical phases, concentrate all energies and resources on project completion on time. Such an approach has helped the company save significant cost.

In Table 5.5, we have given the composition of current assets or working capital. Working capital requirements depend on various factors, like production or sales, raw material/input procurement pattern, inventory norms, seasonal fluctuations in demand/sales, etc. For formulating its working capital policy, a company should take into account these and related factors. The fundamental guiding principle for working capital policy formulation and implementation is the endeavour to maintain working capital at a level which enables efficient business operation and, at the same time, minimize the cost of working capital. This requires three major steps or actions:

(i) **Inventory management:** Efficient inventory control is an integral part of working capital policy or management. We had discussed, in details, inventory policy and management earlier in this chapter.

(ii) **Credit/ debit policy:** Many companies have to sell on credit. In fact, credit sale is a standard practice in industrial products and consumer durables. Simultaneously with credit sale, companies should also buy on credit. Investment in debtors should be minimized by rationalizing credit policy, i.e., matching debtors and creditors. In fact, companies like ITC, L&T, and Hindustan Unilever, with efficient financial management system, have more creditors (also credit amount) than debtors.

(iii) **Cash balance:** As a policy or practice, minimum cash balance should be kept at hand or in bank—just above or around the critical level. Surplus funds can be channeled to short term or current investment. Bajaj had been investing its surplus funds in units of UTI—mostly Unit 64—and earning good profit. This position has, however, changed now. Unit 64 has gone out of market.

c. Management and control of funds

For a sound financial policy or strategy, management of funds is as important as sourcing of funds and deployment of funds. Management and control of funds also include management of earnings and redeployment of funds or reinvestment. Various factors which should be considered for efficient management and control of funds are management accounting and budgeting, systems of finance, cash, credit and risk management, cost control measures through financial instruments and dividend policy and tax planning.

Policy on, and the management of, earnings involve disposal or utilization of profit. There can be two alternatives: first, to distribute all the profits to equity shareholders as dividend; second, to retain the entire profit to meet the company's future fund requirements. Companies hardly adopt any of the two extreme alternatives. In fact, most companies face a pertinent question in financial management: how much of earnings should be distributed as dividend and how much should be retained? The answer to this depends on certain factors which

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mostly represent company circumstances. Factors which generally govern the decision are past dividend payouts, shareholder expectations, fund requirements for growth, debt-equity ratio of the company and government regulations on dividend payment/ retained earning.

Good management of funds, including management of earnings, can make the difference between a strategically successful company and an unsuccessful one. For example, Gujarat Ambuja Cement achieved significant financial success primarily on the basis of policies of cost control. The company had been very successful in maintaining low cost of electric power which is a major input in cement manufacturing. Asahi India, manufactures of glass, followed a policy of managing cash flows strategically through conservation in the form of depreciation control and management. Finolex Cables implemented its competitive growth strategies by pursuing a policy of better management of project costs which were less than half of what its competitors spent. The company recovered the project costs much before its competitors could even break even. These examples demonstrate that companies can implement their strategies more effectively through judicious management of funds. Williamson Major group adopted a growth strategy of diversifying through takeovers into the FMCG sector from its traditional tea and engineering businesses. Restructuring debts had been a major policy initiative in the company's management of funds. This was achieved by restructuring debts from short term to long term, reducing liabilities by selling assets, raising equity through rights issue and generating cash through disinvestment.

HR policies and functions

Human resource function in an organization may not appear as significant as production, marketing and finance, but, its role is becoming increasingly important. Strategic importance of HR function/activity received widespread attention in the 1990s, and, its role is encompassing newer dimensions. The job of the HR manager is changing rapidly as companies are downsizing and reorganizing or restructuring and his/her strategic responsibilities are assuming greater significance. Also, HR policies and functions essentially deal with people who are at the core of all the functions and are considered the most precious resource of an organization. HR policies are, therefore, very sensitive in terms of application because these affect employees more directly than other functional area policies. HR policies and functions should concentrate on the following four major factors or areas:

a. Development of human resource

b. Retaining personnel

c. Incentive system

d. Job mobility/Succession planning

a. Development of human resource

Management of human resource (HRM) and development of human resource (HRD) are both important. HRM helps in retaining personnel by keeping them happy and motivated. HRD prepares personnel/ managers for performing the present jobs better and for newer tasks and responsibilities which help in job

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mobility and succession planning. HRD, therefore, plays a more vital role. In practice, however, HRM and HRD play complementary roles. These two together govern HR policies and plans.

Human resource development is a continuous process. HR development takes place through counselling, postings, promotions and training. Training is the most important. In most companies concerned with HR development, elaborate and systematic training programmes are planned depending on development requirement of managers at different levels. In planning and designing training programmes, two factors are important: first, assessment of training needs, and, second, partly following from the first one, training methods and intensity of training.

Training needs are usually different for different managers. Therefore, many tailor-made programmes or modules are necessary. There are two major methods of training: on-the-job and off-the-job. *On-the-job* training is provided through counselling, apprenticeship, understudy, position rotation, special projects, etc. *Off-the-job* training methods are brainstorming, role playing, management games, special courses and lectures, conferences, seminars, workshops, etc. Often, a combination of on-the-job and off-the-job training methods is used to cater to the development needs of managers/employees. Resource persons for training can be from within the organization or outside professionals or experts, and, many times, it is a combination of both. To determine the methods or modes of training and frequency, and, because HRD is a continuous process, many companies have their own training cells and, also centres. Hindustan Unilever, Larsen & Toubro, RCF, Tata Steel, SAIL and BHEL, are among them.

b. Retaining personnel

Employee turnover is a common characteristic of the corporate world. Incidence of such turnover is comparatively high in knowledge-based organizations—consulting, IT services, investment banking, etc. The IT industry has one of the highest turnovers. But, almost every organization is affected by this. Employee turnover results in discontinuity and loss of productivity and, may affect plan and strategy implementation. Therefore, retaining personnel should be one of the major objectives of HR policies and plans. Companies are also concerned about it, and, they use different courses or methods for retaining personnel. Three major methods or courses of action are as follows:

- Coercive methods
- Employee stock ownership plan (ESOP)
- Package for long-term association

Some companies adopt coercive methods for retaining employees. The most common coercive method is insistence on bond execution. Managers are asked to execute a bond with the company for serving for a minimum period. On promotion, a manager may be asked to execute a fresh bond. If a manager leaves during the bond period, he/she is required to pay a heavy financial penalty. Another form of coercion is delaying or threatening to delay settlement of financial claims on resignation. Coercive methods are short-term or short-sighted tactics and are not a long-term solution for retaining good managers.

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Employee stock ownership plan (ESOP), some call it employee stock option plan, is a very effective instrument for motivating and retaining employees. An *ESOP* is a tax-qualified, defined-contribution, employee benefit plan in which employees buy stock of the company through borrowed funds or cash contribution. ESOPs empower employees to be owners, and, this establishes the bonding between the employees and the organization. Under ESOP, employees are offered stocks of the company at prices lower than the market price with certain lock-in period. If an employee leaves the company before completion of the lock-in period, his /her benefits accruing from allotted stock under ESOP may be forfeited. The amount involved being substantial, this discourages employees from leaving the company.

ESOP reduces employee alienation and stimulates productivity. It allows companies other benefits also such as substantial tax savings. Principal, interest and dividend payments on ESOP are tax deductible. The exact rules/regulations governing this may vary from country to country. Research shows that ESOPs can have significant effect on employee motivation and corporate performance, particularly if ownership is combined with increased employee participation and involvement in decision making. Market surveys indicate that customers prefer to do business with companies which are employee owned.

Infosys is leading the Indian companies in offering ESOP (discussed in the last chapter). Polaroid used ESOP with a different strategic objective in addition to employee retention. The company adopted ESOP to consolidate employee strength as a strategy for preventing hostile takeover. Some other American companies are also implementing ESOP to prevent hostile takeover. The total number of ESOPs is increasing fast in the US—ESOPs grew dramatically during the 1980s and the 1990s. Today, ESOPs cover about $100 billion in corporate stock in the country.

ESOP is a step towards long-term association between the employees and the organization. Companies can also devise other measures/methods for fostering long-term relationship with their employees. One is career planning, i.e., working out a career growth plan for individual managers subject to certain levels of performance. This would cover promotional avenues for managers commensurate with their qualifications, experience and job suitability. Some special measures or incentives can also be devised. These may include housing assistance, superannuation allowance, loyalty bonus, etc.

c. Incentive system

All the measures undertaken by a company for long-term association or relationship with employees are incentives. All incentives, however, do not have or need not have a long-term perspective. For all companies, current performance is the most vital factor. Business policies and strategies are designed to improve or optimize current performance of the company, and, many incentives are linked to present performance of the managers and/or improvement in performance. Incentive can be directly linked to organizational strategies. This is illustrated in Table 5.6.

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Table 5.6 Linkage of Incentives to Organizational Strategy

Market Situation	Dominant Strategy	Compensation/Reward Strategy	Incentive Package
· Growing	· Growth through diversification	· Rewarding entrepreneurial abilities	· Above average incentives linked to individual performance
· Maturing	· Stable growth strategy	· Rewarding skills	· Moderate incentives linked to individual unit or corporate performance
· Declining	· Harvesting and retrenchment strategy	· Rewarding cost control	· Average incentives linked to cost control

If companies view compensation or incentive from strategic point of view, they should incorporate some important steps or action points in the strategy-incentive linking process. Cascio (1995) suggests four such steps or action points:

(i) Companies should recognize compensation as a pivotal control and incentive mechanism which can be used by the management to achieve organizational objective.

(ii) Companies should make the compensation system an integral part of strategy formulation.

(iii) Companies should integrate compensation packages with the strategic decision-making processes such as those involving planning and control.

(iv) Companies should view organizational performance as the final criterion of success of strategic compensation decisions and operational remuneration programmes.

d. Job mobility and succession planning

Job mobility or personnel mobility means movement of personnel within the company or outside it (but, within the same parent group) in the form of promotion, transfer or deputation. Job/personnel mobility has three major objectives: (a) posting appropriate persons at the right jobs; (b) motivating managers for better performance; and (c) helping the management in succession planning. Promotion and transfer are the two most common forms of personnel mobility. Deputation is more common in public sector and government.

Many companies fill up higher positions only through promotions. This constantly inspires managers to look forward to higher positions with better compensations. This also helps companies in succession planning. This is a very sound HR policy. Hindustan Unilever is one of the best examples of this. In Hindustan Unilever, most of their Indian chairmen have risen to such positions through job mobility and succession planning. Tandon, Thomas, Ganguly, Datta, Dadiseth, are all examples of this.

Transfer involves movement of a manager/employee from the present job or assignment to a related job in the same functional area (there may be few exceptions to this) or from the present place of posting to another office or geographical location. Vocational transfers (national or international) can be within the same company (branch or subsidiary) or from one company to another within

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the same parent group. Most of the large industrial houses in India like Tata, Birla, Ambani, Goenka and Singhania often depute their key personnel for implementation of a new project either within the same company or in a group company. Transfers augment skill diversity and strengthen the development process of managers.

As the above analysis shows, HR policies and functions are undergoing radical changes. There is a paradigm shift. HRM's paradigm shift involves looking at expenditure on development of managers/employees as an investment in human capital. The paradigm shift also extends to value chain in the organization—business value chain and the value of human resource components along various links in the chain. The underlying basis of the paradigm shift refers to an effort to analyse the use of human capital to create value to maximize human contribution. This continues to challenge and urge HR policies and plans to take into account major recent trends to outsource some HR and other activities not regarded as part of a company's core competence.Differentiating features or characteristics of traditional HRM and emerging/new HRM are summarized in Table 5.7.

Table 5.7 *Traditional HRM and Emerging/New HRM*

Traditional HRM	*Emerging/New HRM*
• HRM identified with personnel functions.	• HRM and HRD are complementary processes.
• Comfort with stability and conformity.	• Tolerance of ambiguity and change.
• Expectation of predictable, repeatitive behaviour.	• Expectation of innovative and creative behaviour.
• Avoiding responsibility and decision making.	• Accepting responsibility for decision making.
• Focus only on physical skills.	• Focus on total contribution to the organization.
• Emphasis on processes and means.	• Emphasis on outcomes value.
• Concern for quantity and throughput.	• Concern for total customer value.
• Training covers only specific areas.	• Training covers broad continuous development.
• Concern for individual efficiency.	• Concern for overall effectiveness.
• Functional and sub-functional specialization.	• Cross-functional integration.
• Workforce is management's adversary.	• Management and workforce are partners.
• Labour force seen as unnecessary expense.	• Labour force seen as investment in human capital.

Source: Adapted from A Miller, *Strategic Management* (New York: McGraw-Hill, 2002), 400.

MIS/IT policies and plans

MIS/IT is a 'new economy' function which is increasingly playing a significant role in planning, strategy formulation and implementation. We had briefly discussed MIS in the previous chapter under systems. It provides vital connectivity between the organization and the environment, and, also among various functional and operational areas within the organization. Earlier, MIS was considered a peripheral function—setting up of information system was purely a matter of option or choice. But, today, it has become an essential requirement. It has been observed that the strategic management process is more efficient in companies which have an effective MIS. Many companies are adopting a new approach to MIS—a system which blends the technical knowledge of IT experts with thoughts and vision of senior/top management.

An effective management information system should consist of five interrelated steps or stages to increase its utility and comprehensiveness:

a. Collection and retention of information

b. Processing and storage of information

c. Database management

d. Synthesis of information, retrieval and usage

e. Transmission and dissemination of information

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Companies are developing MIS policies and plans for its extensive application to increase productivity in different functional areas, efficiency in operation and to improve networking for better connectivity. Hindustan Unilever launched a pilot project to widen its area network by connecting its distributors and important retailers. The purpose was market research and intelligence to source information from the market about customers, competitors and various channel members. The company has also set up a sales force automation system with wireless connectivity through which salespersons in the field can collect useful retail data and send the same to the MIS centre for further analysis and policy formulation. Reliance Fire and General Insurance Company, a subsidiary of Reliance Industries, is using MIS/IT to improve efficiency in operation—complete networking of area offices, service centres and insurance agents for instant service to the customers.

Glaxo India, Corporation Bank and RPG Enterprises have used MIS/IT in different ways. Glaxo India has gathered and processed information for upgrading the knowledge and skill levels of its managers under the 'Individual Training Action Plan'. The Action Plan involves generation and storage of ten years training history of all senior managers of the company and then synthesizing, reviewing and identifying the potential of a manager and his/her growth needs and possibilities. Corporation Bank has introduced fee-based banking, a profitable service for the bank, through MIS titled 'collection and payment services' (CAPS). Through the computerized system, various branches of the bank collect payments from dealers and retailers of different products/companies of the country and disburse payments to client companies at their designated bank branches. In RPG Enterprises, it is a knowledge management system. The system is used to collect information on present cost levels, knowledge base and knowledge sharing in different group companies or businesses. This is done through the company Internet. The synthesized and analysed information is then disseminated to all group companies for better and informed decision making by managers. The ultimate objective is to save costs, stimulate growth and encourage organization-wide sharing of ideas, thoughts, and learning.

The MIS/IT revolution has advanced much further than just tackling information system–related matters. In many companies in the US and Europe (more in the US), information technology is doing away with the workplace and allowing employees to work from home. The concept of mobile workplace allows employees to work anywhere in any of the 24 time zones around the globe. AT&T, Lotus and others have developed desktop video conferencing software system. The software allows employees to 'beam in' whenever needed. Any manager or employee who travels a lot away from the office may be a good candidate for working from home rather than in the office. Consultants and salespersons are good examples. Any person whose job does not involve much of personal interactions can easily operate at home with proper computer system and software. Ernst & Young has reduced its office space requirements by 2 million square feet

during the last three years by allowing employees to work at home. In many cases, this increases productivity also.

Alternative Business Strategies and Functional Policies and Plans

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We have analysed above various dimensions and developments in major functional areas of production, marketing, finance, HR and MIS/IT in relation to corporate strategy. For effective implementation, different business strategies require different functional policies and plans. So, functional policies and plans should be flexible, adaptable and strategy-driven. Expansion or diversification strategies require one set of functional plans; stability strategies need different kind of functional plans; restructuring or downsizing or retrenchment require still different plans; combination strategies would generally require a blending of some of these functional plans. This is illustrated in Table 5.8.

Table 5.8 *Alternative Strategies and Functional Plans*

Strategy	*Production*	*Marketing*	*Financial Plan*	*HR Plan*	*Back-up Action*
· Expansion/ Diversification	· Expand/ install plant capacity to support new products	· Extend and improve product; this is more critical than margin	· Increase debt-equity ratio; Review dividend policy for cash flow needs/ generation	· Hire additional production, R&D and sales workers/ managers	· Evaluate market share and review financial position after two years
· Stability/ Incremental growth	· Defer new investments in plant and equipment	· Push high margin products/ brands	· Strengthen the balance sheet and maintain steady dividends	· Invest in training programmes to improve management skills	· Continue for few years unless market trend shows high opportunity for growth.
· Restructuring/ Retrenchment	· Identify plants to be closed on the basis of capacity utilization and obsolescence	· Identify products for divestment –those with low sales and/ or margin	· Eliminate or reduce dividends and manage cash flows	· Reduce and/or redeploy personnel on the basis of skills and experience	· Sell plants and reduce personnel in one year; cut dividends

Source: Adapted from L R Jauch, R Gupta and W F Glueck, *Business Policy and Strategic Management* (New Delhi: Frank Bros. & Co., 2004), 387 (Exhibit 10.2).

For each of the major strategies and the functional plans mentioned in the Table 5.8, a set of policies has to be laid down relating to a particular area of business. The policies will ensure that the plans are implemented as intended and that different functional plans work towards achievement of the same objectives. The example in Table 5.8 is an illustration of only one group of strategies, functional plans and required policy support.

Plans and policies have to be developed by companies for all the key functional decisions pertaining to each particular business strategy.

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When Hindustan Ciba-Geigy introduced disposable contact lenses, it marked the arrival of new generation products in the vision care market

Integration of functional policies and plans

We have just mentioned that different functional policies and plans in production, marketing, finance, HR and MIS/IT relating to a particular business strategy should work together for achievement of the same organizational objectives. We had mentioned earlier in this chapter about vertical fit and horizontal fit among strategies and functions. This implies the need for alignment, compatibility and coordination among various policies and functions for effective strategy implementation. This also involves assessment of relative strengths and weaknesses of different functions and certain trade-off decisions. Line and staff functions also have to be properly coordinated. All this implies the need for integration of various functional policies and plans for implementation of particular strategies. Glueck and Jauch (1984) have mentioned five important issues which are pertinent to such integration:

a. Need for internal consistency
b. Relevance to development of organizational capability
c. Making trade-off decisions
d. Balancing of intensity of functional linkages
e. Timing of implementation of policies and plans

Need for internal consistency: As four or five major areas are involved in most strategy implementations, internal consistency among them becomes most vital. This is necessary to ensure that different functional areas do not work independently or at cross purposes. For example, a company may adopt a strategy of rapid expansion through diversification. It may develop commensurate production and R&D policies/plans, aggressive marketing policies/plans, but, a conservative financial policy with respect to investment. Conservative financial policy lays emphasis on internal generation of funds rather than going for external financing. But, for rapid expansion/ diversification, internal funding may not be sufficient. Therefore, conservative financial policy/plan will be inconsistent with other functional policies/ plans and requirements of the corporate strategy.

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Relevance to development of organizational capability: Integration produces synergistic effects which lead to increase in capability or efficiency. So, integration of policies and plans in different functional areas can produce the necessary synergy for enhancing organizational capability and strategic advantage. Let us explain this with the example of a company which aspires to be a market leader. For such a company, the highest priority is development of appropriate marketing policies and plans for implementation of strategy. Marketing policies and plans would be expressed in terms of different elements of the marketing mix. Other functional area policies and plans will supplement or support the marketing initiatives. Production will provide product-volume, quality and cost efficiency; financial policies and plans will relate to sources, usage, and management of funds; HR policies are to ensure motivation and better managerial productivity; MIS/ IT is expected to provide necessary systems support. If all these policies and plans are effectively coordinated and integrated, organizational capability will increase and this should ensure securing competitive advantage in the market and help in achieving market leadership.

Making trade-off decisions: Some trade-offs are inherent in functional areas, policies and functions. For example, marketing policies and plans may not be in consonance, or sometimes, may be in contradiction, with financial policies and plans. Marketing policies/plans may be aggressive involving certain amount of risk while financial policies are generally protective or conservative in nature. Again, marketing may require more varieties of products/ brands for effective market coverage penetration but, production may prefer large volume cost-efficient production with lesser product variety. For successful implementation of strategy, some trade-offs may be required to make the functional policies and plans more coherent and suitable for strategy. Some examples of trade-offs are given in Table 5.9:

Table 5.9 *Functional Area Trade-off*

Functional Area	*Policy/ Plan*	*Alternatives*	*Trade-off*
Production planning and control	· Inventory size	· High iniventory or low inventory	· No shortage, higher cost or low cost, chances of shortage
	· Quality control	· High quality and reliability or compromise in quality	· High rejection, higher cost; or low rejection, lower cost
	· Use standards	· Formal or informal or none at all	· Rigidity or flexibility

Integration of functional policies and plans helps to minimize inter-functional conflicts because of trade-off decisions and optimizes strategy implementation.

Balancing of intensity of functional linkages: In every organization certain linkages exist, may be of varying degrees or intensities among different functional areas and their policies and plans. For example, strategy which depends on high-quality products with superior technology requires close linkages between R&D,

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product development and manufacturing. Similarly, a strategy based on low-cost, mass market products/brands necessitates high linkage between marketing and operations/logistics. This, however, does not mean that other functional linkages are to be ignored or are not important. Proper integration of different functional policies and plans helps to determine the intensity of linkages and ensures that required balance is maintained between high-linkage and low-linkage functions.

Timing of implementation of policies and plans: Integration facilitates timing of implementation of functional policies and plans. Right policies and plans implemented at the wrong time may be as bad as implementing wrong policies/ plans at the right time. For example, implementing a strong policy on financial controls, when focus on R&D, operational efficiency and aggressive marketing are major strategic needs, would be quite untimely. Similarly, if availability of trained professionals is a key success factor in strategy implementation, timely introduction of a progressive or development-focussed HR policy is essential. Integration of functional policies and plans connected with a particular strategy resolves many timing mismatch problems.

B. Operational Implementation

We have distinguished between functions and operations earlier in the chapter. Operations are more implementational; they give support to functional policies and plans. Distribution is a function; transportation involved in distribution is operation. Operational implementation, therefore, becomes as vital, if not more, as functional implementation. And, the scope of operational implementation is very wide because it is part of every function or functional implementation. Operational implementation, or its effectiveness, depends on four major interrelated factors. Some call them 4-Ps: processes, productivity, pace and people (Fig. 5.6).

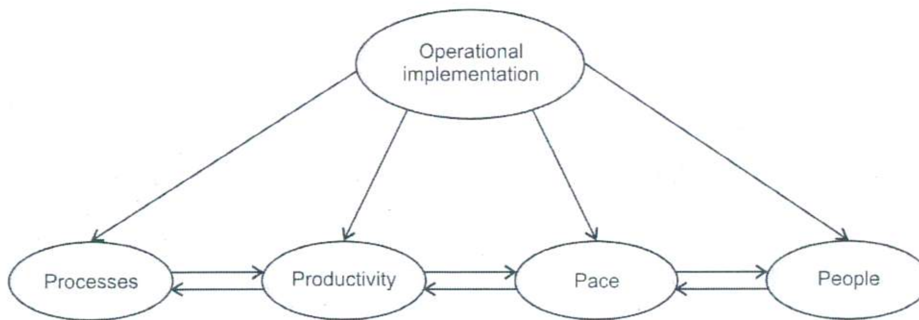

***Fig. 5.6** 4-Ps of Operational Implementation*

(i) Processes or Methods

Processes are methods or courses of action in sequential steps for carrying out tasks for achieving certain organizational objectives. All the functional areas of production, marketing, finance, HR, and MIS/IT operate on the basis of established processes. Processes, however, evolve and change over time, and these affect operational implementation of corporate strategies. Many processes have been developed by strategy analysts, consultants and companies which have affected

strategy implementation in different ways. Major processes which have influenced strategic management in a significant manner are: value chain analysis, supply chain management, enterprise resource planning (ERP), benchmarking, business process re-engineering (BPR) and outsourcing or BPO.

Value chain analysis, as a process, links a set of value-creating activities in a company. These include both primary activities (inbound logistics, production, outbound logistics, marketing/sales and services) in an organization and, also, support activities (R&D, HR, MIS, general administration, etc.). Relative effectiveness of individual value-creating activities, particularly the primary activities, has direct impact on operational implementation, and, therefore, on overall strategy implementation.

Supply chain management (SCM) is one of the developments, which emerged from value chain analysis. SCM is a process in business logistics. It lends logistical support to the activity-based value chain. Supply chain, as a process, manages the entire movement of raw material/ inputs and finished goods from procurement to the market. Each of the steps or stages in SCM is critical for the company on the one hand, and stakeholders like vendors, transporters, channel members and customers on the other. Process improvements in SCM benefit all the parties concerned and operational implementation of strategies also improves.

Enterprise resource planning (ERP) provides vital connectivity within an organization. ERP systems, through appropriate software, seek to integrate the entire business operations of a company including manufacturing, marketing finance, HR, logistics, warehousing, etc., to harmonize operations and reduce cost. Many large organizations use the ERP process to increase operational efficiency. HPCL, among others, has installed an adapted ERP system to optimize communication or linkages among various functional departments/activities of the company.

Benchmarking is a process for identifying, understanding and adopting outstanding or best practices from within the same organization or other organizations in the same industry or organizations outside the industry. We had discussed benchmarking in the previous chapter. Benchmarking helps an organization to analyse where it stands in certain processes or methods in comparison to other organizations so that necessary improvements can be made. Benchmarking is a continuous process because industry standards and practices constantly change. In addition to process, practice or method, effective benchmarking can be in product or performance also which may affect operational implementation.

Business process re-engineering (BPR), as the name indicates, is directly concerned with process modifications and improvements to increase operational efficiency of an organization. Restructuring or reorganization of processes or activities become necessary when organizations are not performing well either because of low productivity, high cost or non-optimal allocation of jobs, tasks and responsibilities. In such situations, fundamental rethinking and redesigning or re-engineering of business process becomes essential for significant improvement in cost, quality, productivity, service, etc.

Outsourcing helps a company to concentrate on the processes related to its core competence and some activities or capabilities from outside. Capability

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sourcing is becoming the new trend and outsourcing is extending to newer processes and activities. Even core functions like R&D, engineering, manufacturing and marketing can be—and often are being—moved outside. And, that is changing the way companies think about their organizations, their value chains and their competitive position. Experience of companies like Chrysler, American Express and others show that strategic outsourcing can significantly improve a company's competitive advantage.

Maruti has been changing product design whenever warranted

(ii) Productivity and efficiency

Productivity and efficiency contribute to the operational effectiveness of various functions. Productivity measures or innovations to increase productivity have, however, primarily taken place in the field of manufacturing. Development of linear and nonlinear programming techniques aimed at optimizing production is subject to certain resource allocations or constraints. Japanese companies had popularized quality and productivity technique during the 1980s. There was virtual explosion of such techniques during the 1990s. Many of these were either initiated by Japanese companies or prompted by their competitive superiority in manufacturing methods over the US and European companies. Six such major techniques/methods are: just-in-time manufacturing, cycle time reduction, mass customization, flexible manufacturing system, optimized production technology and total productive maintenance.

Just-in-time (JIT) manufacturing is a productivity-cum-efficiency technique with two primary objectives: cost reduction and inventory minimization. In trying to achieve these two objectives, JIT, in effect, becomes a more comprehensive approach including simplification of product designs, streamlining process flows, meticulous time planning, etc. Cycle time reduction helps or complements JIT. Cycle time reduction, as the name indicates, seeks to minimize the time taken for each step or work in the assembly line or the manufacturing process. Mass customization of products is a development which has struck a middle course between the two traditional classifications of mass market and niche market. Mass customization is a landmark evolution in production and productivity combining the characteristics and benefits of a mass product and niche product. Flexible manufacturing process or system almost follows from the mass customization

approach; or, rather, it is a necessity to ensure mass customization of products and, at the same time, keep costs under control. Optimized production technology is a computer-aided system for planning and integrating production, materials management and resource utilization to maximize output and control inventory. Total productive maintenance is an improvement over the traditional reactive maintenance system and focusses on a total system of managing productivity through organization-wide autonomous maintenance by everybody concerned rather than a single department.

(iii) Pace or speed of action

Given the processes or methods and productivity, pace or speed of action or implementation becomes a vital factor in operational effectiveness. Pace or speed is essentially concerned with timing or time management of implementation. For example, in value chain analysis, speed can be a differentiating factor in performing different activities in the chain faster than the competitors to lead to competitive advantage. The same is true of timing or speed of action in other processes or methods like supply chain management, benchmarking, outsourcing, etc. Strategy analysts have suggested a number of techniques for better planning and management of time to increase efficacy of operations. Three such techniques are: time study, network analysis and activity charting and time-based management.

Time study is one of the oldest methods of time management. In time study, the emphasis is on analysing and sequencing critical stages in production to identify bottlenecks and wastages, and eliminate or minimize them to build a more efficient and fast process. Network analysis and activity charts are an improvement over time study methods. Charting and networking of activities are done to construct a critical path to optimize time and resource allocation, and consequently, saving costs. Time-based management approach developed during the 1980s and 1990s highlights the role of time as a strategic weapon. For example, first movers in products/markets enjoy a definite competitive advantage over late-movers or parallel innovators or initiators in launching and implementation.

(iv) People factor

Finally, people in an organization become a major factor, or rather, the ultimate factor, for the success in operational implementation of strategy. Be it process or method, productivity or time management, people are a common factor. People signify three categories of human resource who matter most for strategy implementation: workers on the shop floor, operating staff and managers. Each of these categories of people makes a difference in operational effectiveness. Some of the important factors to be considered for optimizing people's role in implementation are: strategic selection and recruitment, training and development and performance management.

Strategic selection and recruitment is the first step in manpower planning and, should be properly aligned with strategies. As selection of right people for right positions leads to enhancement of productivity, recruitment of wrong people can significantly affect performance. After selection and posting, skill levels of people need to be continually developed and updated through appropriate training and development methods. Training and development have to be job based and

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operation based. The third important factor, which supplements selection and development, is performance management of the employees. Productivity comes through performance, and, therefore, many companies use performance appraisal and monitoring to improve employee efficiency in operation. The three factors—selection, development and performance management should be read in conjunction with the four important factors—development of human resource, retaining personnel, incentive system and job mobility/succession planning—mentioned before under 'HR policies and plans'. In fact, the people factor in operations should be viewed as a role extension of human resource from HR policies and plans.

We have analysed above many processes, methods, techniques and practices in different organizational areas for increasing operational effectiveness of strategy implementation. Managers/management often are not clear about which are the right methods and techniques, and, in their search for quick results, sometimes make indiscriminate choices or fall for the latest techniques without assessing their applicability or appropriateness to particular operational situations. Companies should guard against such pitfalls. Even carefully chosen processes and techniques may not always be sufficient to ensure successful strategy implementation. Porter feels that operational effectiveness is necessary, but is not a sufficient condition for success of strategy. By operational effectiveness, he means, performing similar activities better than rivals perform them. It refers to any number of practices that allows a company to better utilize its inputs.

Check Your Progress

1. What is quality of a product closely linked to?
2. List the four major issues relating to the production process.
3. What is distribution?

5.3 STRATEGIC EVALUATION AND CONTROL

For an organization, evaluation and control of strategy is the final and the most important stage of the strategy management process. Through evaluation system, the management tries to demonstrate *how* well the chosen strategy is implemented and how successful the strategy is. If implementation is not taking place as planned or if there are deficiencies in the strategy in terms of achievement of the objectives or targets that are getting exposed during implementation, appropriate control mechanisms have to be put in position for taking necessary corrective actions based on the feedback process.

So, the evaluation system, in addition to reviewing the implementation process, also serves as a useful mechanism to 'recycle' feedback as an input for strategic changes and also for planning and developing new strategies. In details, the evaluation system includes the ways the sub-systems—the SBUs, functional areas and operational areas—perform their roles in strategy implementation. Roles of the sub-systems are assessed against set standards or benchmarks. Evaluation and feedback are also used to review and reward managerial performance.

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In this chapter, you will be discussing here all the factors and issues related to strategy evaluation and control. You will develop an understanding of the evaluation and control process. You will discuss pre-implementation and post-implementation evaluation and control criteria. In terms of specific details, you will analyse participants in the evaluation process, critical success factors, strategic control factors, various quantitative performance criteria and qualitative criteria. You shall also discuss the Six Sigma approach to evaluation and improvement. Finally, you will learn about 7S Model, DuPont Control Model and Michael Porter's approach to strategic management.

Evaluation and control: tools and techniques

The evaluation and control system is a step-by-step or sequential process. The process consists of five interrelated steps or stages. These are as follows:

(i) Set performance targets, standards and tolerance limits for the strategy, its implementation and achievements.

(ii) Measure the actual performance position in relation to the targets at a particular point of time.

(iii) Identify/diagnose deviations from the prescribed targets.

(iv) Analyse/measure deviations from targets and given tolerance limits.

(v) Incorporate modifications, if and as necessary, to revise targets/objectives, strategy and the implementation process.

For clear understanding of the evaluation and control process, see Figure 5.7.

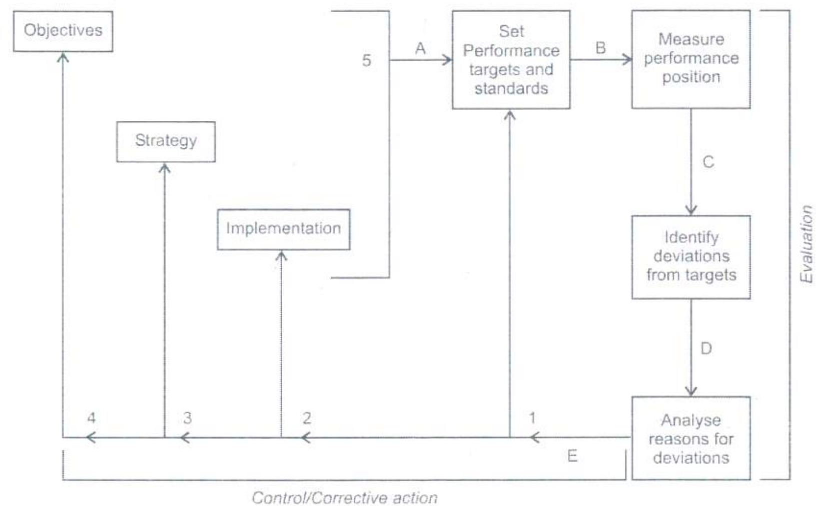

***Fig. 5.7** Strategy Evaluation and Control Process*

***Note:** 1,2.3,4 and 5 indicate possible corrective steps/actions.*

Source: *Adapted from L R Jauch, R Gupta, and W F Glueck,* Business Policy and Strategic Management, *6th ed., (New Delhi: Frank Bros & Co, 2004), 438 (Exhitbit 11.3).*

As seen in the figure, the evaluation and control system actually operates

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through stages C, D and E. The evaluation process may reveal many things. Targets or standards may not be met because those are too high or low (too soft). All objectives and targets are based on certain assumptions. Sometimes, assumptions may be erroneous—too rigid or too general. In some cases, the assumptions may have been based on pessimistic environmental scenario and the goals and objectives might be conservative or narrow in scope. The assumptions might have ignored the new or emerging environmental opportunities. Under the opposite set of assumptions or scenario, the objectives may be too ambitious or unrealistic. It is also possible that the objectives have been achieved because the strategy has not been properly implemented or the selection of strategy has not been very appropriate. The strategists/management have to ascertain which of these factors or cause-and-effect relationships are at work.

Before we discuss these in details, let us see who are the important participants in the evaluation and control process and what roles do they play.

Participants in Strategic Evaluation and Control

In one sense, all the stakeholders of a company are participants in the strategy evaluation process because all of them are directly or indirectly involved in the performance of the company and all significant performances are strategic. The internal stakeholders, however, have greater involvement because they are more directly associated with the strategic process. Various participants with strategic roles are shareholders, financial institutions, government (mostly for public sector enterprises), the board of directors, the CEO, top management, financial controller/CFO, SBU or profit centre heads, strategic planning group, other managers and/or any special committee or task force set up by the management for evaluation, review, and control. Shareholders, financial institutions, government and board of directors are indirect participants; others are direct participants.

Indirect participants

Every company depends on or is accountable to the shareholders for its performance and results. Therefore, the shareholders, particularly the majority holders, keep a watch on the implementation of major strategies or projects because their stakes are high in the outcome or results. They may convey their reactions or voice their concerns through AGMs or special/extraordinary general body meetings or the board of directors or the CEO. The financial institutions may also do the same. The government, in the case of public sector enterprises, is the shareholder and a key stake holder. It monitors progress and exercises control over an enterprise through the administrative ministry concerned, which is always represented on the board of directors.

The board of directors does not directly involve itself in evaluation and control of the strategy implementation process, but it conducts periodic reviews

of the company's performance and results. If any major strategy is under implementation, whether for growth or diversification or internal restructuring, it will come under the review of the board. Different boards, however, play roles of different significance in terms of their control functions. In professionally managed companies, the board generally performs an 'overviewing' type of control unless there are contingency situations. In family-managed companies, as is quite common in India, boards may use more authority to oversee strategic evaluation. In case of public sector companies, the controlling ministry performs the reviewing functions along with the board on which the ministry is strongly represented.

Direct participants

The CEO is finally responsible for implementation, evaluation, control of and any mid-term changes in strategy or revision of objectives or targets. He (she) may get directly involved in the process or participate primarily through the top management, which may represent different functional areas. The top management's job is to assist the CEO in his plans and endeavours to guide the strategy implementation process. The CEO will keep the board apprised of the developments and is also answerable to the board. In entrepreneurial organizations (or family-managed companies), however, the CEO/MD plays a more dominant role and his (her) accountability to the board may get diluted or reduced.

The financial controller/CFO and his team primarily focus on financial implementation, evaluation and control, based on budgeting and financial analysis. Evaluation is done with respect to the financial targets in terms of investment or expenditure vis-a-vis financial achievements or shortfalls. Financial evaluation with respect to investment or expenditure relates to review of financing patterns, debt–equity ratio, financial restructuring, etc.

In large multi-business organizations, SBU or profit centre heads play a critical role in the strategy evaluation and control process. Many implementations actually take place at the SBU level in terms of functions and operations. The SBUs monitor implementation at the business unit level and give necessary feedbacks to the corporate parent for their intervention wherever necessary. In this way, SBUs facilitate evaluation by the CEO/top management. Generally, SBUs also possess some delegated authority to make mid-term corrections in implementation.

In many organizations, the strategic planning groups have a major role to play in the evaluation and control process because they are the initiators of strategy. As a centralized group or department, they see through the implementation process to ensure that their concepts, thoughts and plans are properly put into action. They are also responsible for reformulation or realignment of strategy if implementation reveals the need for any major strategic revisions in terms of target setting, methods or techniques or resource allocations.

Managers in different functional and operational areas may participate in the strategy evaluation and control process in different ways. They will carry out the tasks assigned to them by the SBU heads and/or the strategic planning group.

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They will also be the providers of information and feedback to the SBU heads/ strategy group. In the case of mid-term revisions in the implementation process or the strategy, they will participate in the corrective actions.

In many large organizations, when a major strategic project—a new product development, joint venture, acquisition, etc.,—is under implementation, a special committee or task force is usually formed to see through the entire implementation process. Such committees or task forces are normally interdisciplinary—members are drawn from major functional areas like production (includes R&D), finance, marketing and HR. The committee/task force monitors implementation in terms of investment or cost parameters and time planning and reports to the top management/ CEO the progress, cost or time overruns or any other aspects of implementation for intervention, if necessary, and takes remedial measures.

The direct participants often face dilemma or barriers in implementation, evaluation and control. These relate to resistance to implementation and evaluation, short termism and limits of control. If the strategy involves a major transformation or shift in the organizational paradigm, managers tend to show resistance to the entire process because of uncertainties involved. Short termism is a common tendency among managers in matters of strategy formulation and implementation. Managers generally prefer short-term strategies and results (profitability) so that benefits to the employees accrue quickly. Long-term strategies and their outcomes take time to implement. Limits of control refer to the dilemma of 'too much vs too little'. Imposition of too rigid a control mechanism may hinder the initiative or efficiency of managers, whereas too little or too loose control may make the evaluation process inefficient and consequently ineffective.

The evaluation and control system generally operates during the process of the implementation of a strategy, as shown in Figure 5.7. Nevertheless these can be applied before and after implementation also. So, the evaluation and control process can be analysed during the following three stages:

(i) Pre-implementation

(ii) During implementation

(iii) Post-implementation

(i) Pre-implementation

The major participants in the evaluation and control process have to play both pre-implementation and post-implementation roles. Pre-emptive measures are always better than reactive or corrective actions. To minimize the problems of strategy implementation and possible strategy formulation–implementation mismatch, it is advisable to use certain evaluation criteria before implementation. For pre-implementation assessment of strategies, the following three interrelated evaluation criteria are generally used (Figure 5.8).

1. Suitability
2. Acceptability
3. Feasibility

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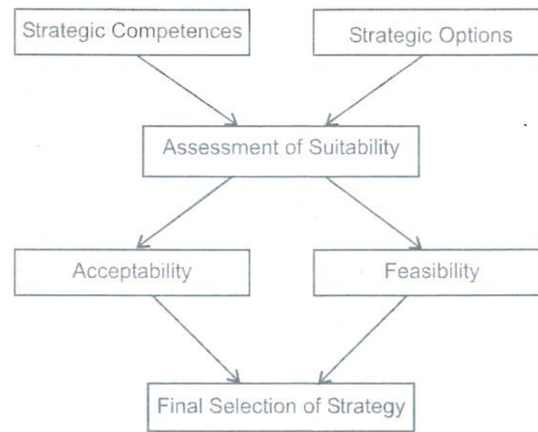

Fig. 5.8 *Evaluation Criteria: Pre-implementation*

1. **Suitability:** It is the most important criterion for evaluating a strategy. As shown in the figure, acceptability and feasibility generally follow assessment of suitability. Based on these three criteria, a final decision is taken about the choice or adoption of a particular strategy, keeping in mind the implementation factor.

   Suitability of a strategy involves assessment in terms of three stages: first, establishing the rationale or logic of each strategic option available; second, analysing relative merits of various options when alternative choices are available; and, third, evaluating the alternatives for final selection of strategy.

   Various factors are considered during this process of evaluation. Johnson and Scholes have specified five such factors: life cycle analysis of the product/brand, positioning, value chain analysis, business profile of the company and portfolio analysis. These factors, along with their implications, are shown in Figure 5.9.

   Examining the suitability of a strategy in terms of all the above factors may appear to be an elaborate process. However, in practice, the process may not be as elaborate as it appears. Most of the strategists/managers should be constantly monitoring product/brand life cycles, positioning and the value chain. While evaluating a particular strategy, the strategy team has to assess the financial results or profitability and the balancing factor in terms of product/brand portfolios to arrive at a final decision.

2. **Acceptability:** It is concerned with the expected performance or outcome. Factors considered for deciding about the acceptability of a strategy are return on investment (on strategy formulation/implementation), risk involved and stakeholders' expectations from or reaction to possible outcomes.

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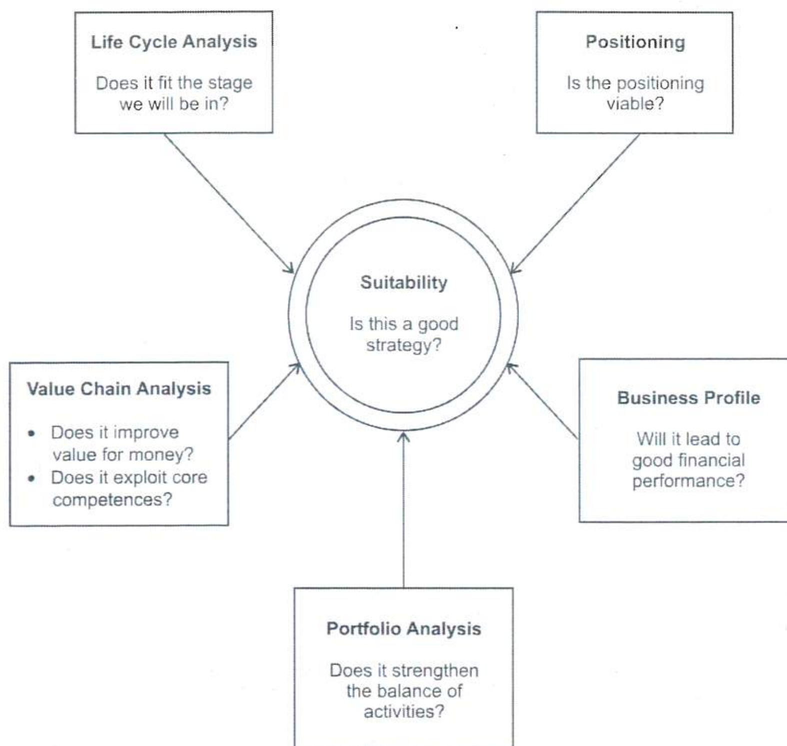

Fig. 5.9 *Assessment of Suitability of Strategy*

Source: *G Johnson, and K Scholes,* Exploring Corporate Strategy, *(1999), 321.*

3. **Feasibility:** It involves three aspects. The first is the compatibility of the strategy with internal competences of the company—resources, capabilities and skills; second is the practicability of the strategy in terms of the environment—market structure, competitors, government controls, etc.; and third is the amenability or easiness of implementation—steps or stages are not ambiguous or mutually conflicting.

Critical Success Factors (CSFs)

Identification of critical success factors (CSFs) helps in analysing the suitability of a strategy. In fact, any strategy, to be successful, must start with identification of CSFs or key success factors (KSFs). Critical success factors are those factors or aspects of strategy in which a company must excel to outperform competitors, and there are underlying core competencies in specific activities of the company which are concomitant with CSFs. For example, if 'speed to market' with new product launch is a CSF, the underlying core competences should be logistics of physical distribution and retail network. CSF analysis highlights the important relationship between resources (includes business assets and skills), competencies and the choice of strategy, which are vital for assessing performance.

One study (Vasconcellos and Hambrick, 1989) of six mature product industries shows that CSFs differ from industry to industry—a capital goods manufacturer will have CSFs different from an input supplying firm or a consumer goods company. Those companies which have strengths matching the CSFs perform significantly better than other companies. Failure of the companies like

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Procter & Gamble and Philip Morris to penetrate the soft drinks market because they lack the CSF of 'access to bottlers' gives a good example of the significance of this concept or tool.

An analysis of the wine market in the early 1990s identified seven CSFs:

1. Access to quality grape supply (50 per cent of the variable cost), particularly for those in the premium segment.
2. Access to technology both in the vineyard and in the winery so that costs can be controlled or minimized.
3. Achievement of adequate scale in production, perhaps with a set of brands.
4. Expertise in wine making.
5. Financial resources to compete in a capital-intensive business.
6. Name or image recognition—a sense of tradition.
7. Strong relationship with distributors.

It is not enough to identify present CSFs. It is also necessary to project them into the future, i.e., identify emerging CSFs. This gives sustainability to success. Experience shows that many companies have faltered when CSFs have changed, and resources and competences on which they were based became less relevant. For example, for industrial products, technology and innovation are most important during the introduction and growth phase, and systems capability, marketing and service back-up play more dominant roles as the market matures. In consumer goods, marketing and distribution skills are critical during the introduction and growth phases, and manufacturing and operations become more vital as the product moves into maturity. For services, the CSFs would be different.

(ii) Implementation process control

In most companies, evaluation and control are exercised during the strategy implementation process itself. Many call these processes as strategic controls. All strategies are based on certain assumptions. These assumptions may change or lose their validity during the period between strategy formulation and its implementation and also during the period or process of implementation. Strategic controls take into account required changes in assumptions, continuously monitor and review the strategic implementation process, and suggest or undertake changes in the strategy to match the new developments. Schreyogg and Steinman (1987) have mentioned four types of strategic control:

(a) Premise control
(b) Strategic surveillance
(c) Implementation control
(d) Special alert control

These controls have a time perspective as shown in see Figure 5.10.

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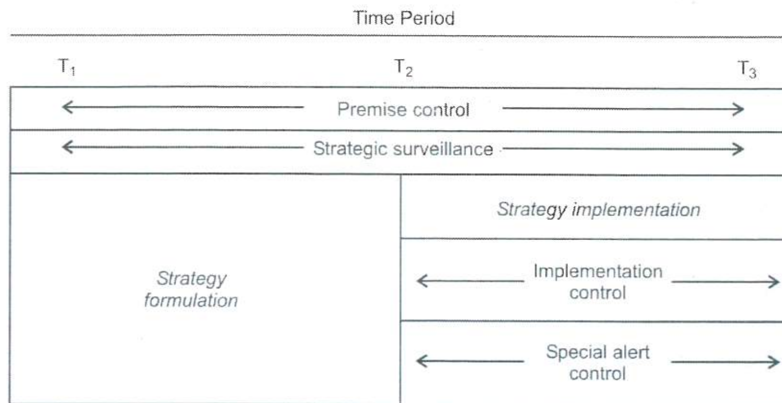

***Fig. 5.10** Strategy, Implementation and Strategic Control*

Source: *Adapted from G Schreyogg, and H Steinman, (1987). 86.*

(a) Premise control

This is the first stage of control. As mentioned above, all plans and strategies are based on certain assumptions. The objective of premise control is to identify key or critical assumptions, and during the course of implementation, the objective is either to maintain constancy of the assumptions or modify or drop some of them or reformulate the strategy if changes of assumptions warrant this. Premise control is the responsibility of the strategic planning group. The premises or assumptions may relate to organizational factors and/or industry factors and/or environmental factors because these are the ones which govern or influence strategy building.

Organizational factors can relate to resource availability—financial as well as managerial. Assumptions about organizational factors can also pertain to different functional areas. For example, it may be about an expected breakthrough in R&D (may be through strategic alliance), which can directly affect any strategy on new product development or diversification. The assumption can also relate to timely installation of a new plant or equipment, i.e., introduction of a new technology. It may also involve marketing or distribution collaboration for market penetration strategy of an existing product.

Assumptions are also made about several industry factors—essentially about industry structure, competitive position and growth. For example, if an industry is exhibiting a high growth rate, like the IT industry, a company's plan and strategy may be based on continuance of such growth rate; or, if there is excess capacity in an industry, creation of any new capacity by a company would be governed by certain assumptions about the nature and magnitude of excess capacity. Lafarge of France had planned to set up a greenfield cement-manufacturing project/plant in India. After assessing the overcapacity in the Indian cement industry, Lafarge changed their strategy to the acquisition route. Proposal of Michelin of France, the international tyre major, was approved by FIPB for setting up a radial tyre project in Pune in 2000. The company has deferred project implementation because of slump in the Indian automobile market.

Important assumptions are required to be made about environmental factors because these are very critical for determination of strategy. Some of the vital environmental developments can be sudden change in government policy, changes

in regulation and/or control, shift in business or market conditions, an unanticipated competitor action and capital market boom or depression. VSNL had planned to raise capital overseas through global depository receipts (GDRs). The company postponed its GDR issue thrice because of the depressed stock market conditions that prevailed during the period between grant of permission and actual issue of GDR. Sometimes, it can be a political or social development. Tata Steel had formulated a strategic plan for the establishment of a steel plant in Orissa. The company had also acquired land for the project. However, they finally abandoned the project because of sustained protest by the local inhabitants who were likely to be displaced if the project had come up.

(b) Strategic surveillance

This is a more generalized strategic control over the entire period spanning from finalization of strategy to completion of the implementation process. This is designed to monitor a broad range of events inside and outside the company that are likely to threaten the course of a firm's strategy. Through strategic surveillance, a company can keep control over organizational factors, industry factors and major environmental factors. Surveillance or monitoring is done with respect to any of these factors. For example, if there is an unexpected development in resource availability, leading to reallocation of resources, strategy implementation may have to be slowed down or some change made in the process. Similarly, strategic surveillance may reveal that a new competitor is emerging in the industry, and this may necessitate review of the strategy or its implementation. In terms of environmental factors, the government may announce a change in its FDI policy. Strategic surveillance will assess its impact on the strategy and accordingly undertake control measures—may be in the form of reformulation of the strategy, either in whole or part and, also its implementation.

(c) Implementation control

Implementation control is focussed on the actual process of implementation. The implementation process consists of programmes, projects, actions, etc., relating to different functional and operational areas. Some of these programmes/projects/actions are undertaken simultaneously, and some other incrementally, in steps or stages, over a period of time. Implementation control evaluates and monitors these steps/stages. If it is observed that these steps are not following the plans and the predetermined course, controls are designed for necessary course corrections.

For effective implementation control, two methods have been suggested: first, monitoring strategic thrust and, second, milestone review. In the strategic thrust approach, critical actions, steps or stages are identified as 'thrusts', which need to be constantly monitored to assess the impact of change in any of these stages on the implementation process. We can give an example here. For launching a new product, the thrusts are concept development, product development (R&D) and test marketing. On the basis of implementation position (deficiency or relative success) in each of these three stages, the product may be modified or product launch may be deferred and in case of too many abnormalities, the product may even be abandoned.

In the milestone review approach, all critical activities (stages) are identified as milestones. Each milestone has a cost factor and time factor associated with it

and it is assessed in terms of these two parameters. Either cost overrun or time overrun or both in any of the milestones will affect the 'critical path' of implementation. The milestone approach is analogous to the PERT/CPM method for project evaluation. This approach renders more exactness to the control process and can also be said to be more objective as compared to monitoring strategic thrust approach.

(d) Strategic alert control

Strategic surveillance and implementation control may not be sufficient for all situations. For extraordinary developments or situations, special alert control may be necessary. Such control is triggered by developments more sudden and serious than mentioned above. In other words, this refers to contingency or crisis situations—an industrial disaster, sudden fall of government and natural catastrophes like floods and earthquakes. Special alert control works through a contingency plan or strategy that partially or wholly replaces the original strategy and the plan of implementation. Contingency or crises management strategy follows certain steps such as signal detection, preparation/prevention, containment/damage limitation and recovery, leading to organizational learning. Special alert controls cover such steps to prevent organizational collapse.

We can now summarize the distinctive features of premise control, surveillance control, implementation control and special alert control in terms of some basic characteristics or features. These are shown in a comparative framework in Table .

***Table 5.10** Distinctive Features of Four Types of Strategic Control*

Characteristic/Factor	*Distinctive Feature*			
	Premise control	*Surveillance control*	*Implementation control*	*Special alert control*
· Information base	Extensive	Extensive	Intensive	Intensive
· Degree of focus	Medium	Low	High	High
· Span of control	Strategy to Implementation	Strategy to Implementation	Implementation	Implementation
· Speed of control	Low	Low	High	Very high
· Time frame	T_1-T_3*	T_1-T_3*	T_2-T_3*	T_2-T_3*
Use of				
· Strategy-specific factors	Rare	Often	Regular	Situational
· Organizational factors	Often	Often	Occasional	Occasional
· Industry factors	Often	Often	Occasional	Often
· Environmental factors	Regular	Regular	Occasional	Situational

(iii) Post-implementation

Post-implementation evaluation shows the actual performance of a company vis-à-vis targets set in the plan. This also becomes an assessment of the strategy, i.e., to what extent it has succeeded or failed. Evaluation of performance is generally done through various quantitative criteria. However, in a comprehensive evaluation system, qualitative criteria are also used in addition to the quantitative criteria. The qualitative criteria usually complement or support the quantitative criteria. We shall

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first discuss various quantitative performance criteria and then qualitative indicators.

Quantitative evaluation criteria

Quantitative evaluation criteria or indicators of performance are primarily financial, but there are also some important non-financial criteria. These criteria can be used to measure results or performance in three ways: first, comparing current performance of the company with its past performance; second, comparing company's performance with industry averages, standards or benchmarks; and, third, comparing company's performance with that of competitors. Because absolute numbers can sometimes be misleading, different evaluation performance criteria are expressed in relative terms or ratios. Ten major financial and non-financial criteria may be used, which are as follows:

I. Financial

1. Return on investment (ROI)
2. Return on equity (ROE)
3. Earnings per share (EPS)
4. Price–earnings ratio
5. Profitability: profit/sales ratio
6. Profitability: relative profit growth

II. Non-financial

7. Market share: absolute market share
8. Market share: relative market share
9. Sales ratio: actual to target sales
10. Sales ratio: relative sales growth

Let us study these financial ratios mentioned above and also the non-financial evaluation criteria.

Return on investment (ROI) is the gross or net income on total investment of a company, including both fixed investment and working capital. Return on equity (ROE) is the gross or net income on equity capital. Earnings per share (EPS) is the gross or net income divided by total number of equity shares. Price–earnings ratio is the market price per share to earnings per share. Profit-to-sales ratio is the gross or net profit to total sales (these are also called gross profit margins or net profit margins). Relative profit growth is the growth of profit of the company relative to that of the market leader or the nearest competitor.

Absolute market share is a traditional measure or indicator of performance of a company. However, relative market share is a better indicator of competitive performance. Relative market share can mean two things. The first is the ratio of the market share of the company to that of the market leader (if the company is the leader or is at No. 2). The second is the ratio of company's market share to its nearest rival or rivals (when the company is ideally at No. 2, No. 3 or No. 4 position). Sales ratio can be the ratio of actual sales or turnover to target sales or relative sales growth, i.e., growth in sales of the company, to that of the leader or nearest rival, as explained in the case of market share.

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Let us understand the post-implementation evaluation system with the help of a hypothetical example. Hypothetical data on targets and performance (with and without strategic intervention) have been used to measure the deviations or variances between the targets and actuals. These are shown in Table 5.11. For post-implementation evaluation of strategy of a particular company, the hypothetical data can be replaced by actual data.

Table 5.11 *Post-implementation Performance Evaluation*

Evaluation	Objective/ Target	Expected performance (without strategic intervention)	Expected performance (with strategic intervention)	Actual performance	Shortfall/ Variance
1. Return on investment	5%	3%	5%	6%	+1%
2. Return on equity	25%	15%	25%	20%	–5%
3. Earnings per share (₹)	20	10	20	15	–5
4. Price/earnings ratio	150%	100%	150%	150%	0%
5. Profit/sales ratio	15%	10%	15%	12%	–3%
6. Relative profit growth	140%	100%	140%	120%	–20%
7. Absolute market share	30%	20%	30%	30%	0%
8. Relative market share*	80%	60%	80%	70%	–10%
9. Ratio of actual sales to target sales	100%	80%	100%	110%	–10%
10. Relative sales growth**	150%	100%	150%	130%	–20%

*Relative to the leader.

**Relative to the nearest competitor/leader/industry average.

As shown in the Table 5.11, there can be mixed results in terms of targets and achievements. The ideal situation would be if actual performances in terms of all major evaluation criteria, matches with targets or budgeted estimates, given certain tolerance limits. There can be some cases of overachievement, i.e., actuals surpassing the targets. However, more common outcomes are underachievements or shortfalls, and this is a matter of serious concern for strategists/top management/ CEO.

By using the four strategic controls mentioned earlier, the deviations or shortfalls can be minimized or, in some cases, eliminated. However, this would depend on how timely and effectively the controls are exercised.

If the shortfalls are still significant, the strategic group or the top management has to ascertain the causes of shortfalls or underperformance. A series of searching questions may help in determining the causes. Some such pertinent questions are as follows.

a. Is the cause of deviation an organizational or management problem?

b. Is the causal factor external or environmental?

c. Is the cause random or could it have been foreseen?

d. Is the deviation temporary or permanent?

e. How far are the plans and strategies still valid?

f. Does the organization have the capacity or preparedness to respond to the changes required?

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Answers to the above questions will help in identifying the focus areas where a corrective action is required and the nature and magnitude of such an action. These may mean revision of targets, plan and strategy; this may sometimes be tantamount to the formulation of a new strategy. The outcome will also provide directions for future planning.

Issues in measurement

One of the major limitations of the quantitative evaluation criteria, as with all quantitative indicators, is associated with the problems of measurement. Difficulties are faced in the choice of unit, gross or net concepts/values; reference period; etc. Information or database is the key to correct measurement, whether it is capital or investment, return on equity, earnings per share, relative sales growth or profitability. An incomplete or inadequate database can always create problems of accuracy. Moreover, different accounting methods may give different results about many quantitative indicators. There is also a bias in terms of annual targets or objectives rather than short-term or long-term targets or variables. Finally, the human factor or subjective element is always associated with the choice of, and/or deriving, quantitative criteria or estimates.

Another important issue pertains to the timing of measurement. The timing problem can occur in two ways: the first one relates to the choice of database period; the second one refers to decision about different time points (T_1 T_2, T_3, etc.), during which evaluation or measurement of performance should be undertaken. In terms of database period, if an abnormal year/period (either extraordinarily high achievement or very poor performance) is chosen as the base period, all relative or comparative assessments will give misleading results. In terms of choice of different time points during implementation, if evaluation is done too early, shortfalls or deviations may not be known clearly. If evaluation or measurements are done towards the end of implementation, it may be too late to take appropriate corrective actions. Depending on the nature of strategy, criticality of the time points should be assessed and evaluation or measurements undertaken accordingly.

The third important factor in measurement is periodicity. This essentially refers to 'how often to measure'. Most of the normal company performance reports, including sales or turnover and financial statements like budgets, balance sheets and profit and loss accounts, are prepared on annual basis. However, for strategic evaluation, measurement of indicators or criteria has to be done more frequently, say, quarterly, to properly monitor and control the implementation process. Criteria related to production and marketing may have to be measured even more frequently—monthly, fortnightly or even weekly. It would also depend on the criticality of the assessment parameters.

Companies sometimes deliberately manipulate either definitions, units, or timing points or periodicity to show the results that will please the stakeholders or shareholders. Some companies, particularly in the public sector, resort to soft targeting, i.e., set targets that are very easily achievable, whatever be the methods of measurement. This is done in the public sector to take care of the accountability criteria, and, in the private sector, to please or satisfy the shareholders. However, large professional companies try to maintain as much neutrality or objectivity as

possible in terms of choice of base year, data base, timing and periodicity for correct strategic evaluation and long-term growth.

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Qualitative evaluation criteria

Because of the inadequacy of quantitative criteria (and also its limitations, as discussed above), qualitative criteria are also used for evaluation of corporate strategy. Certain factors, which are critical for strategy and organizational performance evaluation, are not subject to quantitative measurement. These are strategic clarity, flexibility, skills and capabilities, organizational attitude towards risk taking, management motivation/commitment, employee turnover rates, etc. Qualitative criteria are generally applied before implementing a strategy, but these can be used as useful controls during the process of implementation also. A number of criteria have been suggested by strategic analysts. Tilles has posed six questions which can be useful in evaluating strategies. These are as follows:

(i) Is the strategy internally consistent?
(ii) Is the strategy compatible with the environment?
(iii) Is the strategy appropriate considering the available resources of the organization?
(iv) Does the strategy involve an acceptable degree of risk?
(v) Does the strategy have an appropriate time frame?
(vi) Is the strategy workable or practicable?

David has raised seven additional questions, answers to which can give significant qualitative directions to strategy:

(i) How good is the company's balance of investments between high-risk and low-risk businesses/projects?
(ii) How good is the balance of investments between long-term and short-term businesses/projects?
(iii) How good is the balance of investments between slow-growing markets and fast-growing markets?
(iv) How good is the balance of investments among businesses/ SBUs/divisions?
(v) What are the relationships between the company's key internal and external strategic factors?
(vi) How are major competitors likely to respond to particular company strategies?
(vii) To what extent are the organization's strategies socially responsible?

Glueck and Jauch have suggested three qualitative criteria for strategy evaluation: consistency, appropriateness and workability. Consistency is the compatibility of the strategy with organizational objectives/targets, internal conditions and major environmental factors. Appropriateness of the strategy is assessed with reference to resources, organizational capabilities, risk taking and time frame. Workability is feasibility or practicability in terms of implementation. Rumelt has conducted a more detailed analysis on evaluation of business strategies. He has recommended four qualitative criteria:

(i) Consistency
(ii) Consonance

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(iii) Feasibility

(iv) Advantage

Consistency (also mentioned by Glueck and Jauch) refers to internal consistency and is a basic requirement for any policy or strategy. Every organization has certain missions/visions, policies, goals and objectives. The strategy, in terms of target setting and implementation, should not be in conflict with any of these. For example, corporate policy (which may be embedded in organizational mission/vision) may be not to retrench any employee. If the company is adopting a corporate restructuring or turnaround strategy, its detailed planning and implementation should take into account this policy factor. Sometimes, strategic inconsistency can take the form of inter-functional or inter-departmental conflicts. For instance, success of R&D in terms of development of a high-quality product (with a relatively high cost) may be inconsistent with manufacturing's objective of cost-efficiency and marketing's requirement of low-cost products for market penetration.

Consonance indicates the fit or match between the strategy and the environment. Strategy development should reflect adaptive response to the external environment and critical changes (various trends) taking place in it. This is the test of consonance. According to Rumelt, 'The key to evaluating consonance is an understanding of why the business, as it currently stands, exists at all and how it assumed its current pattern with respect to the environment'. Environmental trends often represent a set of interactions, and the evaluation process should assess the adaptability of strategic response to such interactions.

Feasibility test of a strategy is its implementability in terms of existing physical, human and financial resources of the organization. Physical and financial resources are easily quantifiable. In contrast, human resources—managerial competences, skills and capabilities—are not very easily quantifiable. Here, evaluation of strategy examines/analyses whether an organization has demonstrated in the past managerial capabilities to successfully implement strategies. Although current strategies may be different from past strategies, managerial preparedness, commitment and strategic capabilities would have been tested.

Advantage means the ability of a strategy to create competitive advantage in its business or product. Competitive advantage is usually the result of superiority in one or more of the three areas: resources (tangible), competences/skills and position in the market or industry. Positional advantage can be secured through size or scale of operation, leadership, and intangible resources like company/brand image, and credit rating. Once gained, positional advantage can be self-sustaining. So, in evaluating strategy, organizations should examine/analyse the nature of positional advantage associated with it. Either by itself or in combination with resources and special competence/skills, this can give an organization a clear competitive advantage.

5.3.1 The Balanced Scorecard Approach

The balanced scorecard approach combines both quantitative and qualitative criteria/measures of evaluation, and incorporates expectations of different stakeholders in relating performance to a strategy. This approach has been developed by Kaplan and Norton (1992, 1993 and 1996) and elaborated, updated

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and improved by others, and it is recognized as a modern tool for strategic evaluation of companies. Based on the analysis of some of the shortcomings of earlier implementation and control methods, the balanced scorecard approach has been designed to provide clear guidelines about what companies should assess/measure to balance the financial aspect in implementation and control of strategic plans.

The balanced scorecard approach works through four critical perspectives: financial, internal business process, customer, and learning and growth. These four perspectives are interlinked, and they emanate from or are guided by vision and strategy of the organization. Each of these perspectives is expressed through its own objectives, targets, initiatives, and measures. Together with vision and strategy, these represent an integrated or balanced scorecard of performance and growth (Figure 5.11).

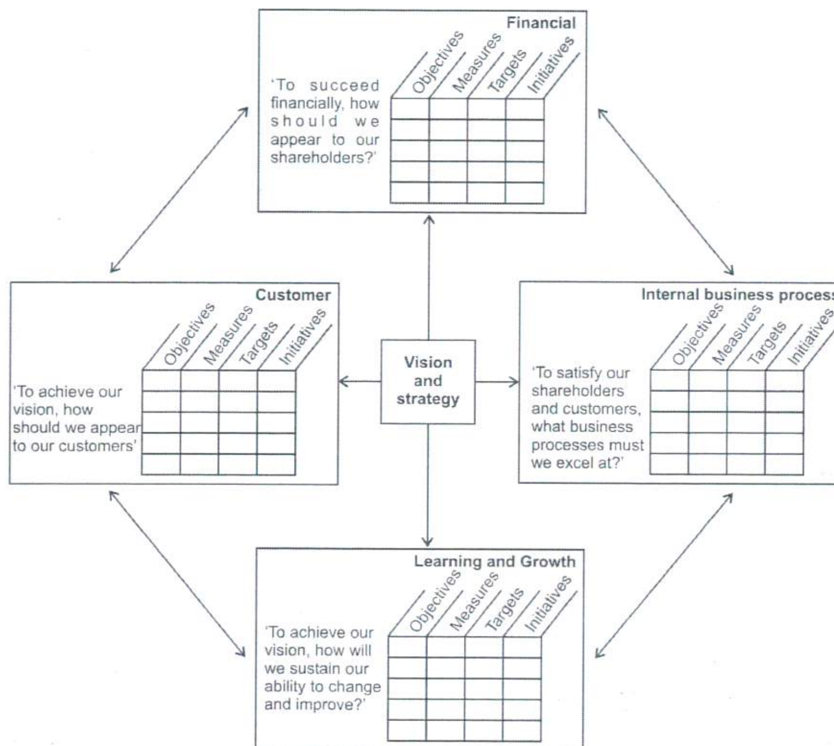

***Fig. 5.11** Balanced Scorecard Approach to Strategy Evaluation*

***Source:** R S Kaplan, and D P Norton, 'Using the Balanced Scorecard as a Strategic Management System',* Harvard Business Review, *(January–February, 1996), 76.*

As shown in Figure 5.11, the objectives/targets, initiatives and measures of the four perspectives are connected through a chain—a sort of cause-and-effect relationships—which leads to successful implementation of strategy. Achievement of one perspective's targets leads to improvements in the next perspective and so on, till the company's overall performance improves. A properly built scorecard is balanced between financial and non-financial measures; internal and external performance perspectives; and short-term and long-term success.

The balanced scorecard approach adapts Total Quality Management (TQM) methods of customer-defined quality, continuous improvement, employee empowerment and incorporation of measurement-based management/feedback into a methodology, which also includes financial indicators and results. The balanced

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scorecard incorporates feedback on internal business process *outputs*, as in TQM and also adds a feedback loop around the *outcomes* of business strategies. This creates a 'double-loop feedback' process. In doing so, the balanced scorecard links together two major areas of concern in strategy implementation—quality operations and financial outcomes closely interwoven as a company implements its strategy. A system that links shareholder interests in terms of return on equity capital and performance management that relates to ongoing operational activities and processes of the company is what balanced scorecard attempts to provide.

The balanced scorecard approach can, therefore, be regarded as a management system and not merely a measurement system, which enables companies to formulate their strategies, allocate resources, implement strategies and provide meaningful feedback. The method generates feedback on both internal business processes and external (stakeholder) outcomes to be able to continuously evaluate and improve strategic performance and results. When fully developed, the balanced scorecard is expected to transform strategic planning from a purely top management function into the 'system centre' in the organization, guiding resources, processes and outcomes.

Kaplan and Norton describe the effect of balanced scorecard on organizational functioning as follows:

> *The balanced scorecard retains traditional financial measures. But, financial measures tell the story of past events, an adequate story of industrial age companies for which investments in long-term capabilities and customer relationships were not critical for success. These financial measures are inadequate, however, for guiding and evaluating the journey that information age companies must make to create future value through investment in customers, suppliers, employees, processes, technology and innovation.*

During the last 10 years, a large number of forward-looking companies have adopted the balanced scorecard approach. Some of the initial experiences were not very good. However, those may be either because the approach and methodology were not understood clearly or not implemented fully. Companies soon realized that an overwhelming dependence on conventional financial performance measures means using only lag indicator (consequences of past actions). As progressive companies, they should concentrate more on lead indicators, i.e., drivers of future financial performance — innovations in business processes, learnings from the past and growth perspectives. Many US companies, including ExxonMobil, Sears, DuPont and Mobil Corporation, have successfully used this approach in their own ways.

DuPont's balanced scorecard attempts to 'balance' shareholder goals with customer goals and operational performance goals. These goals or objectives are interconnected through a chain or causal process. Shareholders' value creation is linked to organization's planning and strategy for return on capital employed (ROCE). This is driven by efforts and outcomes in inventory management, sales, customer mix, customer service, customer satisfaction, etc. These, in turn, are achieved through activities, efforts and results of different departments/operations of the company (internal business processes). In DuPont, all this is strengthened by quality and cost improvement, new product development, new marketing skills and strategies, management excellence, etc. This is learning, innovation and growth.

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Mobil Corporation's balanced scorecard methodology is different from that of DuPont. This was developed for Mobil Corporation's North American Marketing and Refining business (NAM&R), and development of the methodology was guided by Kaplan and Norton. The approach clearly focussed on strategic objective and strategic measures for all the four balanced scorecard perspectives. This is illustrated in Figure 5.12. Mobil Corporation has successfully used the balanced scorecard approach.

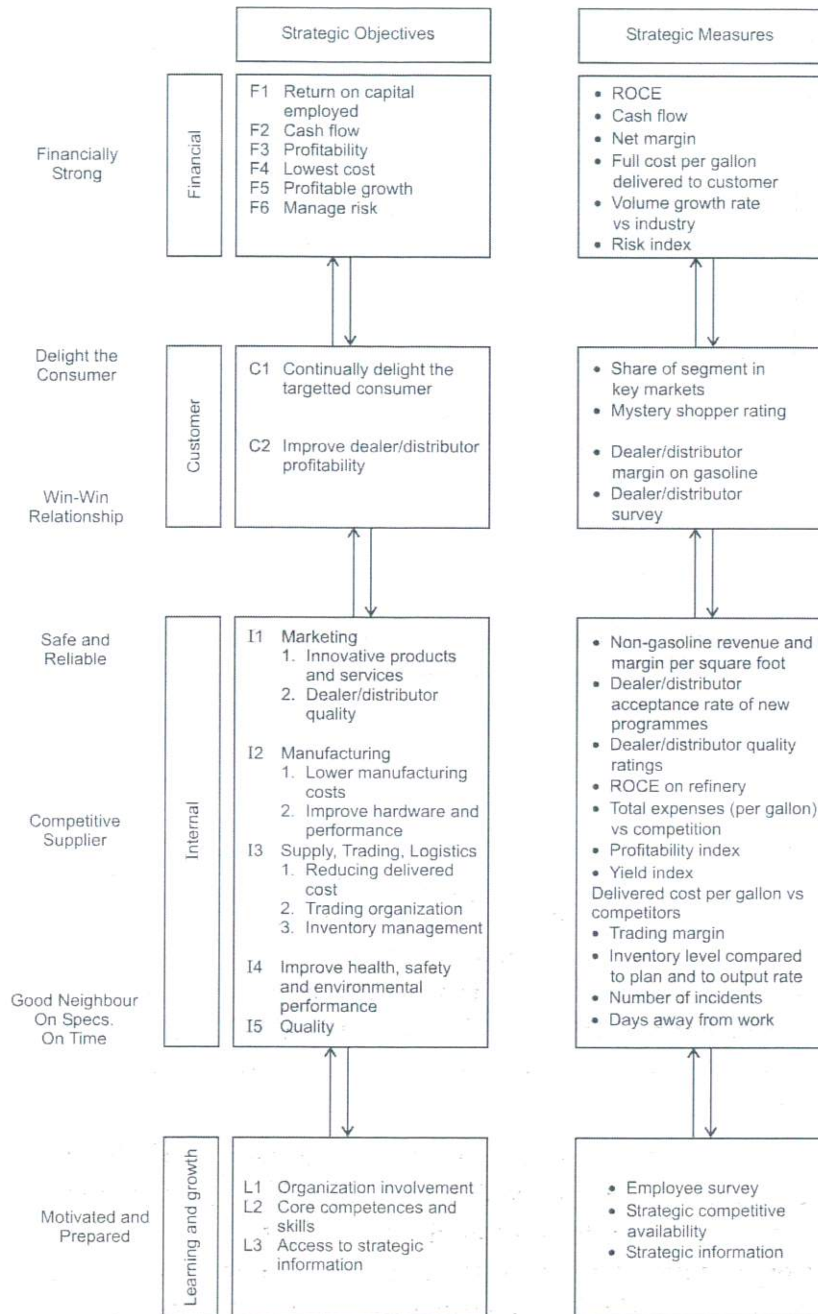

Fig. 5.12 Balanced Scorecard Approach of Mobil Corporation's NAM&R

Source: *J A Pearce II, and R B Robinson Jr,* Strategic Management: Formulation, Implementation and Control, *(2005), 385 (Exhibit 11.8).*

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The methodology was developed to turn an unprofitable NAM&R into a better performing and profitable business. The objective was to link NAM&R's business strategy with financial goals and translate those into physical performance targets. These targets are, in turn, expressed in terms of measures and outcomes in each business, unit, functional departments (manufacturing, marketing, trading, logistics, quality, etc.) and operating processes within them. The customer perspective was fully taken into account through win–win relationships as far as possible. Organizational learning and involvement were ensured through strategic information availability, use and development of core competences and skills, motivation, preparedness for change, etc. All this resulted into an integrated system in which scorecards provided measurable outcomes or results of each functional department or operating unit, team or activity. These were continuously monitored, adjusted and balanced for optimizing performance.

Even smaller companies are adopting the balanced scorecard approach to their advantage. Here is an example of a small company which was supplying light equipment and standard tools to the engineering industry. The owner-manager's financial perspective was just of survival during the start-up period. After the initial investments in plants, buildings and stocks, the company required a positive cash flow for this. The strategy adopted was to compete on customer service for both product delivery and after-sales service and maintenance backup. This required core competences in order processing and maintenance scheduling.

These were enabled by the company's IT system. However, the company realized that these core competences were open to imitation. Therefore, they had to acquire the ability to continuously improve their service standards. This was critical to their success. In fact, the company had identified CSFs in all the four balanced scorecard perspectives. The company's strategic use of the balanced scorecard approach is summarized in Figure 5.13.

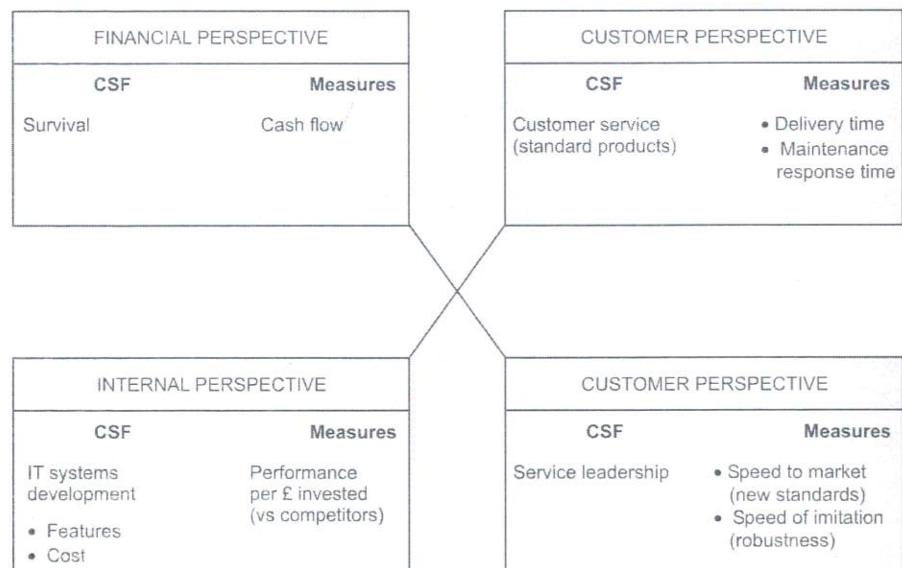

***Fig. 5.13** Balanced Scorecard Approach of a Small Start-up Company*

***Source:** G Johnson, and K Scholes,* Exploring Corporate Strategy *(Sixth Edition).*

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5.3.2 Organizational Controls

Companies use to ensure that they have established both strategic and financial controls to assess their performance. These are two major components of organizational control before, during and after strategy implementation.

Companies rely on strategic controls and financial controls as part of their structures to support implementation of their strategies. Strategic controls are largely subjective criteria applied to ensure that the company is adopting appropriate strategies for securing competitive advantage. Thus, strategic controls are concerned with examining the fit between what the company might do (to exploit opportunities in its external environment) and what it can do (as indicated by competitive advantages). Financial controls, in comparison, are largely objective criteria used to measure the company's performance against predetermined quantitative standards—accounting-based or market-based criteria. The overall organizational control has to enforce complementarity between the two to make an integrated framework like the balanced scorecard.

Financial control focusses on short-term financial outcomes. In contrast, strategic control focusses on the content of strategic actions rather than their outcomes. Some strategic actions can be correct but may still result in poor financial outcomes because of external conditions such as recession in the economy, unexpected domestic or foreign government actions or natural disasters. Therefore, an emphasis on financial control often produces more short-term and risk-averse managerial decisions because financial outcomes may be caused by events beyond managers' direct control. Alternatively, strategic control encourages lower-level managers to take decisions that incorporate moderate and acceptable levels of risk because outcomes are shared between the business-level executives making strategic proposals and the corporate-level executives evaluating them. Strategic controls demand rich communications between managers responsible for using them to judge the company's performance and those with primary responsibility for implementing its strategies (such as middle and lower-level managers). These frequent exchanges can be both formal and informal in nature.

Strategic controls are also used to evaluate the degree to which the firm focusses on the requirements to implement its strategies. For a business-level strategy, e.g., the strategic controls are used to study primary and support activities (discussed under 'Value Chain Analysis' in Ch. 3) to verify that those activities critical to successful implementation of the business-level strategy are being properly emphasized and executed. With related corporate-level strategies, strategic controls are used to verify the sharing of appropriate strategic factors, such as knowledge, markets and technologies across businesses.

Intel is focussed on improving strategic control of its operations. To accomplish this, Paul Otellini, Intel's CEO, has shifted the chip maker's organization and control systems to focus on different product platforms. He has reorganized Intel into five market-focussed units: corporate computing, digital home, mobile computing, health care, and channel products (PCs produced by smaller manufacturers). Each platform brings together engineers, software developers, and marketers to focus on creating and selling platform products for particular

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market-oriented customer groups. In doing this, he has used 'two men in a box', meaning that there are two executives in charge of each of the largest groups, mobile computing and corporate computing. This approach has facilitated improved control; the overall structure has more key executives and affiliated functional teams overseeing the development of each market platform.

Six sigma approach to evaluation and improvement

Six sigma is conventionally known for minimizing errors or defects in manufacturing or quality improvement. However, since its first introduction in Motorola in 1987, Six Sigma has evolved into a highly rigorous tool for the analysis and continuous improvement of corporate performance. Improvement in performance is combined with profitability. This is brought about by 'defect reduction, yield improvement, increase in customer satisfaction and best-in-class performance standards'. Today, Six Sigma approach in many organizations means benchmarking or best practices in quality, which seeks to achieve near perfection in every aspect of business including products, processes, functions, operations and transaction. Many companies including Honeywell (1994), GE (1995) and Polaroid (1998) have adopted the Six Sigma approach as a major business initiative for success. In some companies, Six Sigma is referred to as new 'TQM'.

The Six Sigma approach, like any other effective performance improvement programme, does not ensure easy or automatic success. Top management commitment is vital for its success, and employees must be fully trained in Six Sigma methodologies. Many methodologies—frameworks, models and statistical tools—exist for implementing the Six Sigma programme. One such method for improving a system through incremental, but steady, corrections is the DMAIC process. DMAIC is a five-stage process: define, measure, analyse, improve, control. Figure 5.14.

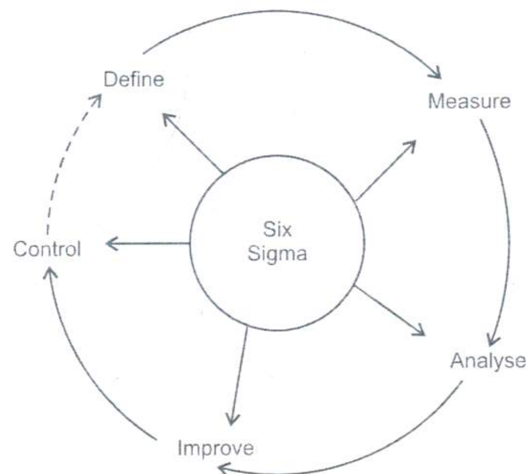

Fig. 5.14 *DMAIC Process of Six Sigma*

The major elements of each stage in the DMAIC process are as follows:

1. Define
    - Project definition
    - Project charter preparation

- Ascertaining customer needs (voice of customer)
- Translating customer needs into specific functional and operational requirements

2. Measure
   - Process mapping
   - Data attributes/characteristics
   - Measurement system analysis/choice
   - Measurement process capability
   - Calculating process sigma level
   - Determining/displaying baseline performance
3. *Analyse*
   - Data tabulation and display (Scatter diagram, Histogram, Pareto chart)
   - Value addition analysis
   - Cause and effect analysis
   - Identification (verification of root causes)
   - Locating opportunity (defects and financial) for improvement
   - Project charter review/revision
4. Improve
   - Brainstorming sessions
   - Quality tool deployment
   - Failure modes and effects analysis (FMEA)
   - Testing (piloting) the solution
   - Implementation planning
   - Culture change planning for the organization
5. Control
   - Statistical process control
   - Developing a process control plan
   - Documenting the process

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Many Six Sigma programmes are based on 'uncompromising' orientation of all business processes towards the customer. The focus is on clear understanding of customer expectations so that appropriate methods can be developed to improve and realign business processes for maximizing customer satisfaction. Six Sigma implementation at Citibank is one such example (Box 5.1).

***Box 5.1** Citibank Improves Customer Satisfaction Level with Six Sigma Programme**

Citibank's mission was to become a premier international financial company in the new millennium, with excellence in every aspect of business. The goal or objective was to improve Citibank operations globally through defect reduction and process timeline improvement while increasing customer satisfaction and loyalty. To achieve this, Citibank had commissioned Motorola University Consulting and Training Services in 1997 for providing extensive Six Sigma training to its employees.

During the initial phase of the Six Sigma programme, Motorola University had trained Citibank employees on both Cycle Time Reduction (CTR) and Cross-

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Functional Process Mapping (CFPM). These had set the stage for mapping and eliminating non-value adding and wasteful processing steps from the business. In a service company like Citibank, almost 90 per cent of activities fall under such processing or category of business. A rating of Six Sigma requires only 3.4 defects per million steps or operations, i.e., virtual perfection.

Achieving complete customer satisfaction was converted into an objective of 10 times reduction in defects and cycle time by December 2000 and 10 times again every two years. Six Sigma classifies a *defect* as anything that results in customer dissatisfaction and unhappiness. To fulfil the objective of defect reduction, Citibank adopted a team approach. A team consisting of bankers and operations staff identified the entire funds transfer process by tabulating defects and analysing them using Pareto charts. At the top of the defects list was the internal call back procedure. This procedure required a Citibank staff to call up a customer to ensure that his/her instructions were correctly understood. Through Six Sigma defect elimination process, monthly call backs were cut from 8,000 to 1,000 and call backs for 73 per cent of transactions were eliminated.

In Citibank's Global Cash and Trade Organization (GCTO), Motorola University's Six Sigma methodology helped to track defects and documented the results by teaching team members 'to identify appropriate matrices, determine a baseline, establish appropriate standards and monitor execution'. Employee teams solved any issues/problems they discovered during this process.

The Six Sigma process was extended to opening of account also. To reduce the time for opening an account, a cross-functional global team of 80 staff members was formed. The team, in turn, constituted a steering committee to direct on their knowledge of the subject and their ability to contribute to the improvement process. Employees were invited to participate in the programme based on their knowledge of the subject and their ability to contribute to the improvement process. 'Team members worked well together since achieving the objectives would make their professional responsibilities easier and would benefit their customers—a win–win situation for everyone', says Citibank. 'The focus on cycle time and deficiencies has made an impact on how we serve customers. It is not just a matter of doing things faster, it is doing thing better. This means eliminating redundancy, minimizing hand-offs and establishing matrices that reflect performance in the eyes of the customer'.

The Six Sigma initiative of Citibank can be summarized in the words of Rastogi, Executive VP, Citibank's eastern European/central Asia and Africa region: 'Introducing quality as a core strategy was viewed as a unique opportunity and differentiating feature not only with regard to our customers, but, also our employees'. 'When implemented correctly, quality increases customer satisfaction, and leads to shorter reaction time and faster introduction of new products — providing a sustainable competitive advantage.'

* Based on 'Citibank Increases Loyalty with the Defect-Free *Processes'. The Journal of Quality and Participation,* Fall 2000, 32–36.

Characteristics of an effective evaluation system

The strategy evaluation and control process is an elaborate and, at times, complex process. It can also be a sensitive process because of the human factor involved. Too much or too rigorous evaluation and control may be expensive and sometimes counterproductive also—authority and flexibility may be challenged, minimized or even eliminated. Too little or no evaluation may create the opposite effect—lack of responsibility and accountability. In some companies, strategy evaluation simply means performance appraisal of the organization. This is also not correct. The

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evaluation system should be balanced and follow some norms and standards. Strategic analysts have laid down certain basic requirements, which evaluation should comply with to be effective.

First, strategy evaluation process or measure should be *meaningful.* These should specifically relate to the objectives/targets and the plan. There should be clear focus and no ambiguity.

Second, strategy evaluation and control process should be *economical.* This means that the process should not be made unnecessarily elaborate and should not incur too much cost on evaluation. Use of too much of information which may not be necessary increases cost, which is avoidable.

Third, the evaluation process should conform to a proper *time dimension* for control and information retrieval or dissemination. Time dimension of control should coincide with the time span of the activity or the implementation phase. Moreover, information on developments or feedback should be timely (not delayed or provided too early) to make evaluation and control more appropriate.

Fourth, strategy evaluation system should give a *true picture* of what is actually happening. The objective of evaluation is not fault finding. Sometimes, performance may be overshadowed by external factors or the environment. For example, during a severe slump in economic/business activity, productivity and profitability may decline in spite of the best efforts by the managers to implement strategy. This should be analysed in the correct perspective.

Fifth, strategy evaluation process should not *dominate or curb decisions*; it should promote mutual understanding, trust and common cause. All functional and operational areas should cooperate with each other in evaluating and controlling strategies. Strategy evaluation process should be simple and not too complex or restrictive. Complex evaluation systems may confuse managers and result in lack of accomplishments.

Elaborateness or complexity of the evaluation system is partly related to the type of strategy under implementation and the size of the organization. For example, if it is a major diversification strategy like acquisition, many post-acquisition integration issues — financial and managerial — are involved and both implementation and evaluation and control process have to be quite elaborate, if not complex. Similarly, in large multibusiness, multilocational organizations with diverse departments and operations, strategy evaluation system may have to be more elaborate than in smaller organizations. In smaller companies, participants in the evaluation process communicate with each other more often in normal course of their business or during implementation of a strategy, and therefore, the evaluation and control process may be more clearly known and made easier and simple.

It is true that there may not be any ideal or the only strategy evaluation system. All organizations are unique in themselves in terms of vision/mission, objectives, size, management style, strengths, weaknesses, organizational culture, etc. All these together determine the exact nature of the evaluation system, just like the implementation process, which is most suitable for the organization. Waterman (1987) has made some useful observations about strategy evaluation system of successful organizations:

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For natural catastrophes like earthquake, special alert controls become necessary to protect business and industry

Successful companies treat facts as friends and controls as liberating... 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.

7S Model

The firm of Mckinsey & Company has proposed the 7S Model, based on the research conducted through consultants, academicians and business leaders. It was concluded that there are seven important factors, all starting with the letter S and these factors affect an organization's ability to implement new strategies. Neglect of any one of these seven factors could adversely affect the successful implementation of strategies and successful change.

While all these seven factors are equally important and they continuously interact with each other, any number of situations could dictate as to which of these factors will be the driving force in the execution of any particular strategy. The following illustration shows the interaction among these seven factors is shown in Figure 5.15.

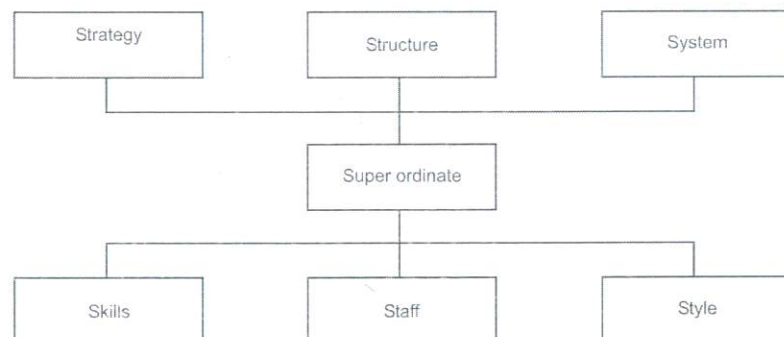

Fig. 5.15 *Mckinsey's Seven-S Model*

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1. **Strategy:** The formulation of strategy is comparatively easy, once the external and internal environmental factors are taken into account. The difficult part comes when management tries to implement such strategy. Accordingly, strategy should be formulated in a manner and in consultation with others, especially those who are going to implement the strategy and those who are going to be affected by it, so that the implementation becomes easy and acceptable to all.
2. **Structure*:*** Whether structure comes before strategy or whether strategy comes before structure may remain debatable. However, both strategy and structure are connected and are a function of each other. For example, decentralization would make it easier to implement a strategy. The organizations may make temporary structural changes to cope with the specific strategic tasks without abandoning the basic hierarchical structure that the organizations have in place. For example, General Motors, while holding on to its traditional structural divisions, incorporated additional project centres during its major downsizing effort.
3. **Systems:** This category includes all the formal and informal systems that allow the organization to function. These systems include budgeting systems, accounting systems, training systems and so on. All these systems are dependent on each other and must operate in conjunction with each other. For example, a low cost consumer commodity manufacturer may find it hard to implement a new portfolio strategy, if the management information system does not provide necessary cost data by segment.
4. **Style:** Style here refers to the leadership style with reference to the pattern of substantive and symbolic actions undertaken by top managers. When top managers pay attention to workers at all levels, the implementation of a strategy becomes easier. The participative management style, taking interest in workers especially at the lower level brings in a harmonious environment within the organization thus facilitating the acceptance of change.
5. **Staff:** People working in the organization at all levels contribute towards the success of the organization. Accordingly, the management must pay special attention to training, nurturing and developing a highly skilled workforce where each worker is assigned to a job that best suits his or her skills so developed. People are happy when they do what they like and look for opportunities to use their skills in a beneficial manner. Proper recognition of their contributions would assist in creating a family environment within the organization resulting in cooperation at all levels. This environment will be very conducive to implementation of any strategy.
6. **Skills:** 'Skills' refers to those activities which organizations do best and for which they are known. Such skills differentiate their products or services and build their reputation and brand loyalty. For example, Hewlett-Packard is known for its innovation in laser printers. Similarly, Dupont is known for its research and development and Proctor and Gamble is known for its product management. Strategic changes and strategies may require organizations to add one or more new skills.

7. **Super ordinate goals:** These goals are not specific, formally stated objectives but general guiding principles, values and aspirations that unite organizations in some common purpose. For example, 'customer service' at IBM and Dell Computers would be a super-ordinate goal for these companies. These goals have deep meaning and these values are ingrained in the
8. **Operating System:** They provide a sense of purpose and it is very often the drive to accomplish super-ordinate goals that separates superior performers from others.

DuPont Control Model

The DuPont model is a timeless and elegant model of financial analysis that has been used by analysts and educators for almost a century. Most academic or professional books on financial analysis use some form of the DuPont model to provide insight into the growth in earnings. The growth in earnings also influences the value of the stock. According to the model, the growth in earnings depends on the earnings retained and reinvested in the firm.

The rate of return on equity also influences the growth rate.

$$\text{Growth Rate} = \text{retention rate (RR)} \times \text{return on equity} = \text{(ROE)}$$

The same can be rewritten as follows:

$$\text{Growth Rate} = \text{RR} \times \frac{\text{Sales}}{\text{Total assets}} \times \frac{\text{Total assets}}{\text{Equity}} \times \frac{\text{Net income}}{\text{Sales}}$$

$$\text{RR} = \text{retained earnings/net income} = RE/NI$$

On substituting and rearranging we get:

$$\text{Growth rate} = \frac{\text{RE}}{\text{NI}} \times \frac{\text{NI}}{\text{Sales}} \times \frac{\text{Sales}}{\text{TA}} \times \frac{\text{TA}}{\text{EQ}} \times \frac{\text{RE}}{\text{EQ}}$$

This analysis is known as the DuPont model because it was popularised by the company named DuPont.

Michael Porter's approach to strategic management

Porter (1985) stated that there are four generic strategic options available to companies. These option are as follows:

(i) Cost leadership

(ii) Focussed cost leadership

(iii) Differentiation

(iv) Focussed differentiation

Porter's theory is based on the concepts of niche marketing, mass marketing and product proposition to be offered by different companies. Two dimensions of the strategy analysis are market coverage and basis of product performance. Porter's theory or the strategy option matrix is shown in Figure 5.16.

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Market Coverage	Basis of Product Performance: Cost leadership	Basis of Product Performance: Superior Performance
Mass Market	Cost leadership	Differentiation
Niche Market	Focussed cost leadership	Focussed differentiation

Fig. 5.16 *Porter's Four Strategy Options Matrix*

Cost leadership strategy is based on exploiting some aspects of the production process, which can be executed at a cost significantly lower than that of competitors. There can be various sources of this cost advantage: (i) lower input costs (e.g., the price paid by New Zealand timber mills for the logs produced by the country's highly efficient forestry industry or cheap source of high-quality bauxite for National Aluminium Company [NALCO] in India from its mines); (ii) in-plant production costs (e.g., lower labour costs enjoyed by Japanese companies that located their video assembly operations in Thailand); (iii) lower delivery cost because of proximity of key markets, (e.g., the practice of major beer producers in Europe to locate microbreweries in or around major metropolitan cities).

Focussed cost leadership exploits the same advantages as the cost leadership strategy, but the company occupies a specific niche or niches serving only a part of the total market. For example, horticulture enterprise, which operates an onsite farm shop, offers low-priced fresh vegetables to the inhabitants in the immediate neighborhood area.

Porter has mentioned that cost leadership and focussed cost leadership represent a 'low-scale advantage' because it is quite likely that eventually a company's capabilities will be eroded by rising costs (labour cost, in particular) or its market position will be challenged by an even lower cost producer of goods (e.g., Russia's post-Perestroika entry in the world arms market offering extremely competitive prices).

Differentiation is based on offering superior performance, and Porter argues that this is a 'high-scale advantage' because first, the producer can usually command a premium price for its product and, second, competitors are less of a threat, because to be successful, they must be able to offer an even higher performance product.

Focussed differentiation, which is typically a strategy of smaller and most specialist companies, is also based on superior performance. The only difference is that in this strategy, a company specializes in serving the needs of a specific market or markets. For example, the Cray Corporation supplies 'supercomputers' to aerospace and defence industries.

Best-cost provider strategy

Thompson, Strickland and Gamble (2005) have extended Porter's framework of four strategic options to include a fifth generic strategy, i.e., the best-cost

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provider strategy. Best-cost provider strategy is deemed to be a central strategy striking a middle course between low-cost advantage and differentiation advantage on the one hand and broad or mass market and narrow or niche market on the other and (Figure 5.17). Best-cost provider strategy is designed to provide customers more value for money by incorporating good-to-excellent product features at lower cost than competitors; the objective is to offer the lowest (best) costs and prices with same or comparable product attributes as those offered by rivals.

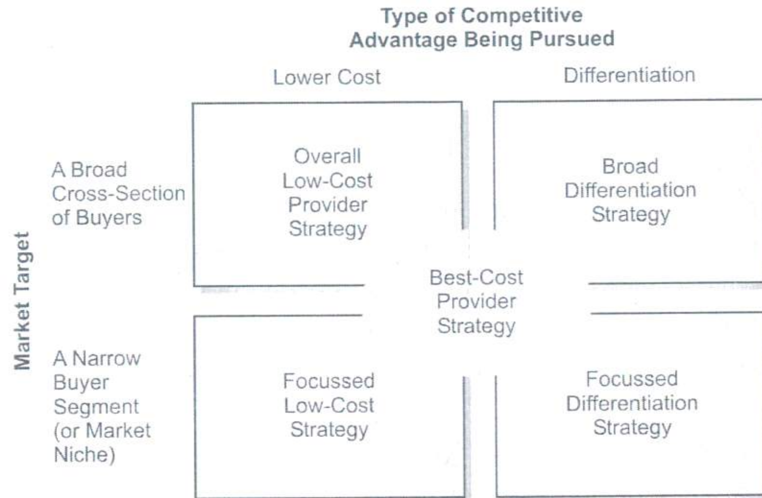

Fig. 5.17 *Five Generic Competitive Strategies*

Source: A A Thompson Jr, A J Strickland III, and J E Gamble, *Executing Strategy: The Quest for Competitive Advantage* (New Delhi: Tata McGraw Hill, 2005), 116.

Success in low-cost provider strategy

To achieve low-cost leadership, companies need to clearly identify each cost drive and manage the cost of each activity meticulously and pursue cost savings throughout the value chain. Many successful low-cost leaders benchmark their costs against the best-in-class performance of an activity in cost management or in the value chain. Low-cost leaders are also usually aggressive in investing in resources or capabilities, that enable them to achieve cost-efficiency. Walmart, a well-known low-cost leader, uses the state-of-the-art technology in all its major operations, and the company invests heavily in this technology. General Electric and Whirlpool are also known for their successful use of low-cost strategies.

A low-cost strategy becomes the most effective under certain market conditions. Thompson, Strickland and Gamble (2005) have identified seven market conditions where the low-cost strategy works the best. These conditions are as follows:

1. Price competition among rival sellers is very intense.
2. Products of different competitors are identical, and supplies are readily available from any of the several sellers.
3. There are very few ways of product differentiation, which can create value for buyers.

4. Most buyers use the product in the same ways, i.e., standardized products.
5. Buyers incur low costs in switching their purchases from one supplier to another.
6. Buyers are many and have significant power to bargain for lower prices.
7. Industry newcomers use introductory low prices to attract buyers (the low-cost leader can create a price barrier for entry).

As a general rule, the more price-sensitive buyers are, the more appealing a low-cost strategy becomes. A low-cost leader's ability to set the industry price floor and still earn profit builds barriers around its market position.

Success in differentiation strategy

In considering a differentiation strategy, there are various factors or dimensions which can be exploited to establish a product or service and make it superior to that of competitors. For industrial products, seven different dimensions of superior product quality may be considered, namely features, conformance to quality standards specified by customers, actual performance, durability, reliability, style and design. In addition to the differentiating factors of a physical product, differentiation strategy can be pursued further through delivery, installation, service, customer training, maintenance, repair and post-purchase product upgrades. For consumer goods and services, core attributes of many products/services are often very similar, (e.g., liquid detergents, life insurance or general insurance) and the customer may find it difficult to distinguish between the performance of various products/services in the market. In such situations, one way to differentiate the company from the competitor is to use promotion as a means of creating a perceived difference in the minds of the customers. For example, Fairy Liquid is promoted in UK as an effective washing detergent, which, because of very mild formulation, promises that 'hands that do dishes can be as soft as your face.'

Here are some more examples of how companies can differentiate their products/brands ; a unique taste (Dr. Pepper and Listerine); multiple features (Microsoft Windows and Microsoft Office); wide selection and one-stop shopping (Walmart, Amazon.com and Shopper's Stop); superior service (FedEx); spare parts availability (Caterpillar guarantees 48-hour spare parts delivery to any customer anywhere in the world or else the part is supplied free); engineering design and performance (Mercedes and BMW); status/prestige and distinctiveness (Rolex); product reliability (Johnson & Johnson in baby products); quality manufacture (Michelin in tyres and Honda in automobiles); and technological leadership (3M Corporation in bonding and coating products).

Effective bases of, or approaches to, differentiation are those which are difficult for competitors to imitate or which involve large investments. History of strategic management and marketing shows that resourceful competitors can 'clone' almost any product, if considered profitable by them. If, for example, Coca-Cola introduces a vanilla-flavored soft drink, so can Pepsi; if Ford offers a 50,000 km

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bumper-to-bumper warranty on its new vehicles, so can General Motors, Volkswagen and Toyota. This implies that, for differentiation to be sustainable, it should be based on core competence or distinctive competence or 'unique competitive capabilities' of a company. Such differentiation should typically be based on product or process innovation, technical superiority, product quality or reliability or customer service (like the Caterpillar example above). In such cases, buyers perceive distinct/differentiating value and this is difficult for competitors to offset easily.

Differentiation strategy may work best under certain specific product and market situations:

(i) There are many ways to differentiate a product, and buyers perceive these differences.

(ii) Incorporating features in the product which increase buyer satisfaction in non-economic or intangible ways (e.g., Goodyear's Aqua tread tyres specially appeal to safety-conscious motorists).

(iii) there are many buyer needs.

(iv) Price is based on maximum perceived value and not on actual value (cost).

(v) Different competitors follow different approaches to differentiation, avoiding one-to-one rivalry or confrontation.

(vi) Fast technological change in the industry and competitors make frequent product changes.

Success in best-cost provider strategy

Best-cost provider strategies, as mentioned earlier, are a hybrid balancing between low cost and differentiation and between a mass market and a niche market. The target market mostly comprises value-conscious buyers. The objective in best-cost strategy is to provide more value for money. This is sought to be done by synthesising many things in one entity. It includes the synthesis of resources and capabilities to achieve good-to- excellent quality, special features to increase perceived value or improve product performance, and good-to-excellent customer service. All these changes are done at a lower cost than the competitors.

Best-cost provider strategy may be most effective in markets that require simultaneous focus on low cost and differentiation. There are markets where diversity of buyers makes product differentiation essential and where majority of the buyers are sensitive to both price and value. The best-cost strategy works with a product which positions itself in the middle of the market with an 'either a medium-quality product at a below-average price or a high-quality product with an average price'. Not many buyers look for or can afford the best product, nor do they like cheap, basic products of low-cost producers. Majority of the buyers in most of the markets prefer mid-ranged products with clear differentiators. A best-cost provider is supposed to have the required resources, know-hows and capabilities to incorporate such product features and simultaneously ensure lower cost.

Check Your Progress

4. What are the four generic strategic options given by Porter?
5. Who have extended Porter's framework to include a fifth generic strategy?
6. How many market conditions were identified where the low-cost strategy works the best?

5.4 ANSWERS TO 'CHECK YOUR PROGRESS'

1. Quality of a product is closely linked to the production process, operational efficiency and the quality control system.
2. The four issues are the size and location of plants, choice of technology, process/job specialisation and mechanisation of operations.
3. Place or distribution is the process by which goods and services are delivered to the customers.
4. Cost leadership, focusses cost leadership, differentiation and focusses differentiation are the four generic strategic options given by Porter.
5. Thompson, Strickland and Gamble (2005) have extended Porter's framework of four strategic options to include a fifth generic strategy, i.e., best-cost provider strategy.
6. Thompson, Strickland and Gamble (2005) have identified seven market conditions where the low-cost strategy works the best.

5.5 SUMMARY

- It is necessary for an organization to have the right structures and systems but the real implementation of a strategy takes place through major functional areas of manufacturing, marketing, finance, etc.
- A functional strategy is related to a particular functional area and follows the business strategy of an organization, either a corporate-level strategy or a business unit-level strategy.
- In any organization, different strategies operate at different levels in terms of scope, coverage and organizational significance.
- A diversification strategy is a higher-level strategy and a product-market strategy is a lower-level strategy.
- In any organization, five major functional areas are production, marketing, finance, HRM and MIS/IT.
- Production processes typically constitute more than 70 per cent of a company's total assets, and therefore have high stakes in terms of roles and activities in strategy formulation and implementation.

- If a company decides to manufacture the product, it has to consider some major policy issues in relation to the production process, which are size and location of plants, choice of technology, process/job specialisation and mechanisation of operations.
- The quality of a finished product depend not only on the production process and quality policy but also on the quality of raw materials and inputs.
- Proper maintenance and repair and replacement of components and parts are the keys to smooth and successful working of plants and equipment.
- For effective implementation of a strategy, policies and plans of individual areas/ operations should be properly aligned and integrated.
- Marketing is the most vital function in an organization because it establishes a link between the company and the market or the customers.
- Marketing policies and plans are expressed though the four Ps: product, price, promotion and place (distribution).
- Product design and changes in product design also imply product differentiation.
- The pricing methods are based on the fundamentals of cost, demand and competition. The fundamental law of pricing states that it is based on cost of production
- In the competition-based pricing approach, companies take their pricing positions more as a reaction to the competitive structure in the market.
- There are many ways to promote a product and most companies use a mix of different promotional tools. The major elements of a promotional mix are advertising, sales promotion, personal selling and public relations.
- Nowadays, point-of-purchase (POP) promotion through displays in retail outlets is one of the most widely used promotional tools.
- The development of a policy or strategy on a distribution channel involves consideration of three major factors—evaluation of channels, selection of channels and channel management.
- The general principle governing determination of cost-benefits of a fixed investment is that the returns, i.e., net present value (NPV) should be higher than the cost of the fixed asset or investment.

5.6 KEY TERMS

- **Functional Strategy:** It involves the actions and goals assigned to various departments that support the business level strategy and corporate level strategy.
- **Diversification Strategy:** It refers to a corporate strategy used to enter into a new products or product lines, new services or new markets, involving substantially different skills, technology and knowledge.

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- **Mechanisation: It** is the process of changing from working largely or exclusively by hand or with animals to doing that work with machinery.
- **Replenishment Period:** It is the time period that is required in the procurement or manufacturing of a product.
- **Forward Integration**: It is a strategy a company uses to expand its business activities to include control of the direct distribution or supply of its products.
- **Backward Integration:** It occurs when a company purchases another company which supplies the products or services required for its production.
- **Marketing Mix:** It is a set of marketing tools or strategies that are used to promote a product or services in the market and sell it.
- **Pricing:** It is defined as process wherein a business sets the price at which it will sell its products and services in the market.
- **Point-Of-Purchase:** It is a term used by marketers and retailers when they plan the placement of products for consumers.
- **Organizational Control:** It refers to the process to influence the employees of an organization to make them behave in ways that lead to the achievement of organizational goals and objectives.

5.7 SELF-ASSESSMENT QUESTIONS AND EXERCISES

Short-Answer Questions

1. What do you understand by marketing mix?
2. What are the factors related to financial policies and plans?
3. Differentiate between fixed assets and current assets.
4. List the factors responsible for the poor outcome in the companies that adopted the balanced scorecard approach.

Long-Answer Questions

1. Discuss 4 Ps of marketing in detail.
2. The failures have to be removed from the product portfolio. Explain the given statement with the help of an example.
3. Analyze the characteristics of an effective evaluation system.
4. Explain the DMAIC process of Six Sigma.
5. Describe the 7Smodel with the help of examples.

5.8 FURTHER READING

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MBA, Second Year

Paper - VII

STRATEGIC MANAGEMENT

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