Master of Business Administration

(Open and Distance Learning Mode)

Semester – I

Strategic Management

Centre for Distance and Online Education (CDOE)

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"A+" Grade Accredited by NAAC

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Edition : 2022 (Restricted Circulation)
Published by : Centre for Distance and Online Education (CDOE), Devi Ahilya Vishwavidyalaya
Printed at : University Press, Devi Ahilya Vishwavidyalaya, Indore – 452001

Strategic Management

CONTENTS

MODULE - 4

INTRODUCTION

NOTES

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

The strategic position of the 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 as well as the wants and expectations of all those associated with the firm. This is where strategic management comes into play.

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

This book explains various aspects of strategic management starting with the concept of strategy, the characteristics of strategic decision making, the difference between strategy and efficiency, the levels of strategic management and the contribution made by various management thinkers to the field of strategic management in the first unit.

In the subsequent units, the book emphasizes that the main function of strategic management is to make decisions related to the major issues facing the organization and also ensure that the strategies are implemented. Unit 2 brings out the importance of environmental scanning, meeting the expectations of stakeholders and the making of strategic choices.

Unit 3 goes on to introduce the concept of strategic intent as the dream of the firm that energizes all those associated with it. While strategic architecture shows the way to the future, it is strategic intent that provides the necessary emotional energy that keeps the organization as a whole on track and ensures that the future becomes a reality.

There are certain tools that an organization requires in order to effectively deal with strategic uncertainty in the long run. Unit 4 gives an insight into these tools highlighting the significance of the PESTEL framework and scenario analysis.

In any industry, the success of a company depends, to a great extent, on how well it handles competition. This requires a proper analysis of the industry. Unit 5 discusses Porter's 'Five Forces Model' which is a framework that allows companies to analyse the business environment especially with respect to the bargaining power of consumers, the threat posed by substitute products, the bargaining power of suppliers, the threat posed by new entrants and the competition amongst existing firms.

The sixth and seventh units concentrate on competitive and internal analyses. The subsequent five units deal with the formulation of strategies at the corporate level and the business level. The implications of adopting a global strategy are brought out and the significance of strategic analysis and choice is also highlighted. The last two modules of the book are devoted to strategy implementation and functional strategies. The operational, financial, marketing and human resource strategies are dealt with in detail

NOTES

here. Strategic leadership and control have also been discussed along with the importance of technology management and the positive effects of designing a technology strategy.

This book comprises text on almost all aspects of strategic management presented in a simple and precise manner in the form of short units interspersed with relevant caselets to enhance understanding.

The book is presented in the SIM format wherein each of the eighteen units begins with an introduction to the topic of the unit, followed by the unit objectives to give an idea of what is being covered in the unit. This is followed by the detailed content with a set of 'Check Your Progress' questions meant for students to test their own understanding of the topics dealt with. Finally, the content of the unit is summarized, a list of key terms is provided and a set of questions and exercises are given for practise and effective recapitulation.

MODULE - 1

UNIT 1 STRATEGIC PLANNING AND MANAGEMENT

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Structure

1.0 INTRODUCTION

Budding businessmen often wonder why and how some businesses perform better than others. Most often, the answer is that successful businesses are built on strategies that result in long-term benefits. Strategy is the channel or direction adopted by an organization with a view to changing its resources with the changing environment and modifying markets and customers in a manner that will benefit the shareholders. Strategy also implies the path adopted to achieve organizational goals. Strategic management can therefore be defined as the management activity that involves making decisions based on various types of analyses and taking relevant action aimed at achieving long-term competitive advantages. The factors to be considered in strategic management are organizational goals, stakeholders, short-term and long-term perspectives and effectiveness vs efficiency.

1.1 UNIT OBJECTIVES

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

- Understand the concept of strategy
- Appreciate the characteristics of strategic decisions
- Differentiate between operational efficiency and strategy
- Get an idea of the evolution of strategic management

- Appreciate the contribution made by strategy gurus
- Understand the various levels of strategic management

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1.2 CHARACTERISTICS OF STRATEGIC DECISIONS

Strategic decisions are decisions that are critical to an organization in the long term. Therefore, they have the following essential characteristics:

1. They are concerned with the scope of an organization in the long term
2. They are aimed at achieving an edge over competition
3. They attempt to ensure that the organizational resources and activities are in harmony with the environment they confront.
4. They call for optimum utilization of resources and creation of opportunities.
5. They usually result in resource changes and are complicated in nature.
6. They often need to be made in uncertain situations
7. They involve a unified approach to managing the organization

A set of critical decisions and actions that results in the creation and implementation of strategies aimed at the achievement of organizational goals can be called strategic management. The critical decisions that strategic management encompasses, are concerned with all the aspects of the organization affecting its performance and existence in the long run, for example, products, resources, organizational structure, etc. The end result of strategic management can be seen in the form of new products, new markets, adoption of the latest technologies and skills.

Managers are expected to be strategists. They are expected to question the current establishment, structure and set-up and think with the future in mind.

1.3 DIFFERENCE BETWEEN OPERATIONAL EFFICIENCY AND STRATEGY

To a layman, a business achieves operational efficiency when it finds the best way to produce what they want and achieve what they desire. This can only happen when the right people (possessing the relevant skills), the right processes and the latest technology are put together to produce the desired product at minimal cost. Operational strategy on the other hand is concerned with making decisions that affect the long-term performance of the business. The difference between the two is that while the former is more concerned with the present, the latter is concerned with the future. Paying too much attention to the present and ignoring the future can spell disaster for an organization. The trick is to achieve a balance.

1.4 EVOLUTION OF THE CONCEPT OF STRATEGIC MANAGEMENT

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The word strategy stems from the Greek word 'strategia', which means a general in the army or a military commander. Battles are fought based on well thought out strategies. Wars are always backed by strategies. Similarly, businesses can be referred to as battles fought with competition; battles that are 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.

In the 1960s, there was little competition for organizations to tackle. Opportunities existed in abundance and all that the companies had to do was concentrate on setting long-term goals and building their capabilities to meet those goals.

In the 1970s, external influence such as the environment was 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 gaining a competitive edge. Businesses considered mergers and acquisitions in order to gain the advantage of size over competition. Organizations formed 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, the markets as well as businesses became more complicated. This was mainly due to advancement in technology, increase in global competition, changing tastes of consumers and fluctuations in exchange rates. Tackling the ever-changing business environment became the main focus of most organizations. Close and continuous monitoring of the external and internal environment became the essence of strategic management.

In the dynamic business environment of the twenty-first century, continual transformation has become the mantra for success. With the progress in information technology and the advent of globalization, businesses need to be more flexible; they need to work on adaptable processes; they need to realize the importance of competitive advantage and select superior functional strategies that add value to the business, the customers and the stakeholders.

1.5 WORK DONE IN THE FIELD OF STRATEGY

The concept of strategy was pioneered by Igor Ansoff and refined and developed by Henry Mintzberg and Michael Porter. Let us look at their versions of the concept.

1.5.1 Ansoff's Strategic Success Paradigm

Igor Ansof 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 acquisitions that were done on the basis of immediate or momentary benefits. His strategic success paradigm points out the conditions that lead to optimum profits. As per this paradigm:

Check Your Progress

1. When does a business achieve operational efficiency?
2. What is the mantra for success in the dynamic business environment of the twenty-first century?

NOTES

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

(b) Depending on the turbulence in the environment, the business can decide on the degree of aggressiveness of the strategy in order 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 as well as sociological variables. These variables, put together, form the internal capability variables.

Following thorough empirical testing, spread over more than a decade, Ansoff translated his success paradigm into a diagnostic instrument. This instrument was named 'Strategic Readiness Diagnosis'. Ansoff's contribution to the development of the concept of strategic management was also made in the form of the books *Corporate Strategy* and *An Analytical Approach to Business Policy for Growth and Expectation*. In the former book, published in 1965, he discussed strategic planning whereas in the latter book he introduced the concept of synergy and 'gap analysis'.

1.5.2 Henry Mintzberg: Strategy as 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 involved the manager's personal side. His view went against the views of the other rational thinkers of his time. He saw the task of formulating a strategy as a very calculated, critical and sensitive process. He propagated a more humane approach to the formulation and implementation of strategies, and came up with the term 'crafting strategy' for the same. According to him, an ideal organizational structure would be one with (i) a simple organization structure, (ii) with machine and professional bureaucracy (iii) with adhocracy and (iv) divisionalized form.

1.5.3 Peter Drucker's Contribution

The practice of using formal strategic thinking in making management decisions began after World War II. For a long time, markets were treated as impersonal forces beyond the control of individual entrepreneurs and organizations. However, in the age of multidivisional organizations, managing came to mean taking responsibility for attempting to shape the economic environment, for constantly pushing back the limitations of economic circumstances on the enterprise's freedom of action. Peter Drucker argued that management translated into taking relevant action to achieve desired results. He opined 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 rather than goals. MBO caused them to shift their concern from processes to goals. Drucker described MBO as not just a management technique but a management philosophy. The basic assumptions of managing were shifted from exercising control to self control.

1.5.4 Michael Porter: Strategy and Competitive Advantage

Michael Porter recommended the use of his 'Five Forces Model' to study the different elements that comprised strategic management, such as the environment in which

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the company operates. Generic strategies such as cost leadership, focus and cost differentiation were introduced by Michael Porter with an aim to reduce the 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 discussed the issue of sustaining competitive advantage and economic development and competitiveness.

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

(i) The threat posed by new entrants

(ii) The suppliers' bargaining power

(iii) The threat posed by substitute products

(iv) The existing rivalry between the current players

(v) The buyers' or customers' bargaining power

In order to survive and succeed in this volatile business environment, it is very important for an organization to understand how the five forces work in the industry and influence the companies. These forces will be discussed in detail in unit 5.

1.6 DIMENSIONS OF STRATEGIC DECISIONS

There are six typical dimensions that are identifiable in strategic issues. They:

(a) Require decisions to be made by top management

(b) Involve the allocation of a large amount of resources of the company

(c) Have a significant impact on the prosperity of the firm in the long run

(d) Are future-oriented

(e) Have multifunctional or multi-business consequences

(f) Make it necessary to consider the external environment factors

1.7 LEVELS OF STRATEGIC DECISIONS

The main hierarchical levels of strategy planning are:

(a) Corporate level

(b) Business level

(c) Functional level

The company gets its direction from the managers at the corporate level. They act as captains guiding the organization and helping it stand up to the challenges of the dynamic business environment. Managers at the business level are responsible for giving shape to the corporate managers' vision. At the third level, that is, the functional level, are the managers who transform the vision into reality. The contribution made by the managers at all three levels is important.

NOTES

Corporate-level strategies are aimed at optimum utilization of the company's competencies in the long term. Decisions made by the managers at the corporate level keep in mind the interests of the stakeholders and the society. These strategies mainly concern the choice of operational areas for the company's business. At this level, strategies are designed with the objectives of the organization in mind. These strategies directly influence the way harmony is maintained in business and the way the business is managed on the whole. will be integrated and managed. It also impacts the way resources are managed and shared and also the manner in which financial resources are invested in the various units.

Business-level strategies involve decisions about the competitive advantage of a single business unit. At this level, the managers form functional objectives and individual strategies for the business divisions on the basis of the general statements of corporate strategic planners. The business-level managers determine the basis of the company's competitive advantage in a particular product or market area. Their goal is to select the most profitable segment and enter it. They also aim to grow in the segment that has the highest potential for growth. In short, this strategy is concerned with using the cost-leadership, differentiation and focus strategies to ensure an edge over competition.

Functional-level strategies consist of short-term strategies with fixed annual objectives in research and development; finance and accounting; marketing; and human resource. Functional-level managers are concerned with problems related to the efficiency and effectiveness of production, success of particular products and services in increasing their market share and quality of customer service. The functional objectives are operational and can be quantified. Depending on the requirements and functioning of the business, the functional objectives can be changed or modified. Risk involved in functional strategies is not very high as the cost of failure is small.

The following table states the characteristics of management decisions at different levels:

	Level of strategy		
Characteristic	**Corporate**	**Business**	**Functional**
Type	Conceptual	Mixed	Operational
Measurability	Value adjustments dominate	Semi quantifiable	Usually quantifiable
Frequency	Periodic or sporadic	Periodic or sporadic	Periodic
Adaptability	low	Medium	High
Relation to present activities	Innovative	Mixed	supplementary
Risk	Wide range	moderate	Low
Profit potential	large	Medium	Small
Cost	major	Medium	Modest
Time horizon	Long range	Medium	Short range
Flexibility	high	Medium	Low
Cooperation Required	Considerable	moderate	Little

NOTES

1.8 FROM LONG-RANGE PLANNING TO STRATEGIC PLANNING AND STRATEGIC MANAGEMENT

From the 1950s to the 1970s, the process of planning and implementation by using budgets and enforcing capital budgeting and MBOs through control systems was used for driving a company into the future. However, this was not adequate for highlighting the future goals and issues. This led to the birth of long-range planning. This too was replaced by strategic planning and again by strategic management. The term strategic management is nowadays used to describe the process of strategic decision making and is an integral part of the theoretical framework of business policy courses.

1.9 SUMMARY

In this unit, you have learned that the long-term direction and scope of an organization is referred to as its strategy. A strategy is aimed at matching the firm's resources to its changing environment—in particular, its markets, customers or clients—so as to meet shareholder expectations.

You have also learnt that the systematic study of strategic management was pioneered by Ansoff. Mintzberg added a new dimension to strategic management by bringing the personal side of the manager into the picture. Peter Drucker introduced the concept of Management by Objectives (MBO). Later, Porter introduced the concept of generic strategies like focus, cost leadership and cost differentiation to reduce the uncertainties of competitive advantage. He also promoted the 'Five Forces Model'.

You have learned that strategic planners take into consideration different components of strategic management while finalizing their business strategy. A comprehensive understanding of these components helps in designing effective plans for the future of the organization.

The unit also explained that corporate-level strategy deals with the challenges posed by the changing external environment and is aimed at making the organization proactive and capable of meeting challenges. Business-level strategy is formulated with the perspective of changes that might be necessary in the future in relation to strategic business units. Functional-level strategy addresses the need for short-term objectives concerned with various functional departments like production, operations, R&D, financial accounting, marketing and human relations.

1.10 KEY TERMS

- **Strategic management:** A management activity involving decision making, based on various analyses, and taking relevant action aimed at achieving long-term competitive advantages.
- **Strategy:** A channel or direction that an organization adopts with a view to changing its resources with the changing environment and modifying markets and customers in a manner that will benefit the shareholders.
- **Strategic decisions:** Decisions critical to an organization in the long term.

Check Your Progress

3. Who pioneered the concept of strategy?
4. List the levels of strategic planning.

NOTES

- **Strategists:** People who question the current establishment, structure and set-up and think with the future in mind.
- **Management by Objectives (MBO):** A management philosophy where the focus is on goals rather than processes, self-control rather than exercising control.

1.11 ANSWERS TO 'CHECK YOUR PROGRESS'

1. A business achieves operational efficiency when the right people (possessing the relevant skills), the right processes and the latest technology are put together to produce the desired product at minimal cost.
2. In the dynamic business environment of the twenty first century, continual transformation has become the mantra for success.
3. The concept of strategy was pioneered by Igor Ansoff.
4. The main hierarchical levels of strategy planning are as follows:
    - Corporate level
    - Business level
    - Functional level

1.12 QUESTIONS AND EXERCISES

Short-Answer Questions

1. Define strategic management.
2. Who were the management thinkers who contributed to this field?
3. What has been the contribution in this field of renowned management thinkers?
4. What are the characteristics of a strategic management decision?

Long-Answer Questions

1. Discuss the evolution of strategic management process.
2. Explain the different levels of strategy and illustrate with industry examples.
3. Write a note on Ansoff's strategic success paradigrm.

1.13 FURTHER READING

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UNIT 2 THE STRATEGIC MANAGEMENT PROCESS

NOTES

Structure

2.0 INTRODUCTION

Often, complications arise out of ambiguous situations or situations that are not routine. Such situations affect the organization's operations. In addition to managing the resources under their control on a daily basis, managers have to face such major challenges almost every other day. This is because managing operational tasks and responsibilities is different from managing strategies. Managers who are used to the former will find that to manage strategies, they need to be able to do much more. They need to develop the skills to look at the bigger picture, to conceive the situation faced by a business as a big whole instead of smaller parts and to make quick decisions on the basis of their conceptualization of the situations or issues.

The main function of strategic management is to make crucial decisions about important issues facing the organization and also see to it that the strategies are implemented. This unit will attempt to familiarize you with the following activities that are also the most important elements of strategic management:

- Discerning the strategic position of an organization
- Implementing the strategies
- Making strategic choices keeping the future in mind

2.1 UNIT OBJECTIVES

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

- Understand the purpose of strategic management
- Identify the elements of strategic management—strategic position, strategic choice and implementation of strategy
- Explain the components of strategic position

- Explain the concept of strategic choice
- Understand what goes into the implementation of strategies

NOTES

2.2 PURPOSE OF STRATEGIC MANAGEMENT

The detailed purpose of the three components of strategic management is enumerated in the following table:

Component	Purpose
Strategic position	• Scanning the external environment • Meeting stakeholders' expectations • Utilizing resources and competencies
Strategic choice	• Identifying alternative strategies • Evaluating the alternatives • Selecting the strategies
Implementation of strategy	• Modifying the organization structure and design • Planning and allocating resources • Managing strategic change

2.2.1 Strategic Position

The strategic position of a company is determined by the influence that the changes in the external environment may have. The strategic position is affected by the advantages that the resources, within the organization may have or the opportunities they may give rise to. It is also affected by the wants and expectations of the stakeholders, managers, shareholders and unions associated with the organization.

Scanning the external environment

The organization exists and functions in an environment that is far from simple. It exists in a continuously changing environment wrought with legal, technological, commercial, social as well as political complexities. These complexities impact some businesses more than others and that too in different ways. In some cases, these changes may lead to opportunities whereas in other cases, these may threaten the very existence of an organization.

Utilizing resources and competencies

The strategic capabilities of an organization largely depend on its competencies and internal resources. These form the internal influences. The organization should be able to identify the factors that are hindering the future strategic choices in order to deal with them accordingly. Some resources such as the core competencies may give rise to competitive advantages. The core competencies generally deal with skills, knowledge and activities.

NOTES

Meeting stakeholders' expectations

The organization is influenced by a number of factors including the stakeholders' expectations. Some strategies designed by the management may not be approved by the stakeholders. If the stakeholders are more powerful, they will influence the management's strategy and even modify it to suit them. In case the management is more powerful, their strategy will ultimately be accepted by one and all. Another factor that influences the organization strategy is the culture followed within the organization as well as by the world outside. The strategic position of an organization can be evaluated and determined by the combined influence of its own capability as well as the political, social and cultural environment within and outside.

2.2.2 Strategic Choice

In order to make strategic choices, you have to first understand the corporate-level factors as well as the business unit-level factors that form the foundation for the strategic choices for the future. You also have to get an idea of the available options for developing strategies, that is, the technique to be followed and the channel or path to be adopted. As already discussed in the previous unit, strategies are formed at various levels. At the corporate level, that is, the highest level, the strategy formulation would mainly take into consideration the various business units and how they can be improved with active contribution from the corporate centre. It is but natural that the small business units look up to the corporate centre as a parent for all their needs—channelizing the resources in the right direction, allocating finances appropriately, building brand image as well as marketing their products or services. Strategic choices at this level are made to provide the organization with a competitive edge based on thorough study of the market and customers' demands and expectations.

2.2.3 Implementation of Strategy

Putting the selected strategies into action is concerned with ensuring that the structure and design of the organization is conducive to the implementation; the resources are planned, managed and allocated in a manner favourable to implementation; the processes are designed in a suitable manner; the relationship between the departments and units facilitates productivity, performance and action.

Once the organization is structured and designed suitably, the next step is to plan and allocate the limited resources available to facilitate strategy implemention and ensure optimum utilization with optimum profit. At the same time, the planning and allocation should adjust with the demands of the external environment in order to provide a competitive advantage.

Finally, strategy implementation also involves effective restructuring and re-engineering, that is, effective management of strategic change. Examples of managing strategic change involves how successfully an organization takes care of a restructuring or reengineering exercise carried out in the company and the fallout of the same. It can also involve how an acquisition process is being integrated with the acquiring company.

2.3 BUILDING SUCCESS THROUGH PEOPLE, PURPOSE AND PERFORMANCE

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The success of an organization is governed by the level of bonding it has with its customers; the techniques it employs to please them, give them value-added services and improve customer satisfaction. In addition, the organization should also stay focused on its strategic business plan and objectives for the future. In other words, it should stay connected to its people, customers as well as its corporate goals and ideas.

- First, to connect there must be an emotional link. Connecting implies building emotion.
- Second, to connect we must create a strong feeling. Most of us do not feel especially connected with our casual acquaintances because we do not feel strongly about them.
- The third part of the definition of connect is to create a positive, uplifting relationship.

Unfortunately in business, people create strong emotional links but the relationship is neither positive nor uplifting. Success is built on connections we make with people and ideas. Whether it is connecting with customers to improve their service experience, or connecting with the strategic business plan and objectives for the coming year, the foundation for success starts with connecting.

Great organizations foster the right kinds of connections between the company, its mission and its employees

2.4 SUMMARY

In this unit, you have learnt that strategic management is different from simple operational management. It is more complex owing to the fact that strategic management has a direct impact on the organization as a whole and determines the performance of the organization in the long run. You have also learnt that strategic management poses major challenges to managers, most of whom are used to mere operational management. You now know that strategic management consists of three major elements, that is, understanding the strategic position, strategic choices for the future and translating strategy into action. The strategic position of an organization is directly affected by the external environment, the internal resources, its competencies and the expectations and influence of stakeholders. This unit also explained that strategic management is concerned with studying and analysing which choice is likely to succeed or fail. Implementation of strategy is mainly concerned with issues of structuring, resourcing, facilitating future strategies and managing change.

Check Your Progress

1. What is the main function of strategic management?
2. What is the determinant of the strategic position of a company?
3. What would you do to make strategic choices?

2.5 KEY TERMS

NOTES

- **Strategic management**: The art of management that involves understanding of the company's strategic position, implementation of the strategies and making strategic choices for future gains.
- **Strategic position**: The position of a company determined by the impact of the external environment, the internal competitive advantages of the resources and competencies and the stakeholders' expectations.
- **Strategy implementation**: The activity that involves putting strategies into action.

2.6 ANSWERS TO 'CHECK YOUR PROGRESS'

1. The main function of strategic management is to make crucial decisions about important issues facing the organization and also see to it that the strategies are implemented.
2. The determinant of the strategic position of a company is the influence that the changes in the external environment may have.
3. In order to make strategic choices, we have to understand the corporate-level factors as well as the business unit-level factors that form the foundation for the strategic choices for the future.

2.7 QUESTIONS AND EXERCISES

Short-Answer Questions

1. How would you define strategic management?
2. Why is 'connecting' important in building success?
3. What is the role of the external environment in determining the strategic position of a company?
4. Why is the planning and allocation of resources important?
5. How do stakeholders' expectations influence organizational strategy?
6. What are the factors that influence strategic choice?

Long-Answer Questions

1. What is meant by the process of strategic management? Explain with the help of an example.
2. What are the different elements in the process of strategic management? Explain with a suitable corporate illustration.
3. Write a note on strategic choice.
4. Discuss the process of implementation of strategy.

2.8 FURTHER READING

NOTES

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UNIT 3 STRATEGIC INTENT:VISION, MISSION AND OBJECTIVES

NOTES

Structure

3.0 INTRODUCTION

Strategic intent is all about clarity, focus and inspiration. It is considered to be the cornerts one of strategic architecture. Vision is a powerful motivator that makes an organization more forward. This unit will introduce you to the terms 'vision', 'mission' and 'objectives' that are commonly found in the company statement of most corporate houses.

3.1 UNIT OBJECTIVES

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

- Define strategic intent
- Understand the purpose of vision and mission statements
- Get an idea of the objectives pursued by companies

3.2 STRATEGIC INTENT

The dream that energizes a company and keeps it going is referred to as the strategic intent. It is the cornerstone of strategic architecture. While strategic architecture shows the way to the future, it is the strategic intent that provides the emotional and intellectual energy necessary for the journey. Strategic intent involves a significant stretch for the organization as the existing skills, capabilities and resources are not considered sufficient for the task. In traditional organizations, efforts are made to ensure a 'fit' between existing resources and emerging opportunities. In contrast, the concept of strategic intent involves the deliberate creation of a 'misfit' between resources and aspirations.

Strategic intent also envisages the company's position in the long run. Thus, intent conveys a sense of direction. Similarly, strategic intent furthers a unique point of view about the future giving the employees an opportunity to feel excited about the feeling of exploring something new. It brings a sense of discovery. Strategic intent also possesses an emotional edge and gives rise to a sense of shared destiny. Employees feel that the pursuit of the company's goals is a worthwhile experience.

3.3 COMPONENTS OF STRATEGIC MANAGEMENT

While finalizing their business strategy, strategic planners keep in mind certain components of strategic management that help them design effective plans for the future of the company. Some of the important components are as follows:

(i) Vision of the company
(ii) Mission of the company
(iii) Profile of the company
(iv) Annual objectives
(v) External environment
(vi) Strategic analysis and choice
(vii) Long-term objectives
(viii) Grand strategy
(ix) Functional and operational strategies
(x) Company's policies
(xi) Control and evaluation

3.3.1 Vision

Organizations generally describe their goals and intentions in a broad and general manner. This description roughly expresses what the company is pursuing or what it wants to become or what goal it wants to achieve. It gives a view of an organization's future direction and course of business activity. It is often communicated through the mission statement. Above all, vision is a powerful motivator and keeps an organization moving forward in the intended direction. Although, to a layman, the vision and the mission of a company may seem overlapping or similar, the fact is that the vision of a company is not always as specific as the mission statement. Usually, the vision is impersonal and not even written down.

Let us look at the company vision of the Zydus Cadila Group. Before you understand the vision of the Group, here is the profile of the Company in brief. The main activity of the group —Cadila Healthcare Ltd, founded in 1952— is to come up with health care solutions. They produce active pharmaceutical ingredients, cosmeceuticals, herbal products, vaccines, etc. The group has plants in Navi Mumbai, Patalganga, Vadodara, Ahmedabad, Andheri, Goa and Ankleshwar. In 1955, the group came to be known as the Zydus Cadila Group following restructuring. While Cadila Healthcare is the Group's flagship company that introduced an IPO in February 2000. The Zydus Group is no tonly aiming to be a global player but is also pursuing an ambition of becoming one of the top three healthcare companies in India. The Group has already made its presence felt in the markets of the US, EU, Brazil, South Africa and Algeria.

Their vision is stated as follows:

> 'Zydus shall be a leading healthcare provider with a robust product pipeline and sales of over $1 billion by 2010. We shall achieve sales of over $3 billion by 2015 and be a research-based pharmaceutical company by 2020.'
>
> ***Source:*** http://www.nutralite.com/about_us.htm

3.3.2 Company Mission

The mission of a company is very important in a company's successful performance not only in the short run, but also in the long run. The mission of a company is not vague as the vision and is designed to ensure that those belonging to the company work together with a uniform purpose. It is slightly more specific and sets apart one company from the other companies in the same area of business. The mission identifies the scope of the company's operations, describes the company's product, market and technological areas of thrust, and reflects the values and priorities of its strategic decision makers. The mission of a business looks towards an endless future as if the firm were immortal. It reflects the intentions that a company hopes to realize some time in the future. The mission statement is formulated after much thought and with great caution keeping in mind the basic product of the company, the market it operates in, the technology used, the image of the company as well as its goals and philosophy. However, despite being more specific than the vision, the mission of the company may not provide specific directions or channels for action or achievement of goals. The mission statement of a company often reflects social responsibility and addresses issues that concern not just its own employees, customers and shareholders but the local community and the society in general. While formulating the mission statement, the ethics and norms to be followed with respect to the general public and the industry as a whole, are also kept in mind. To give you a clear idea, here are a few examples.

(i) Cadila Healthcare, a company that has been discussed in the previous paragraph, states its company mission as follows:

'We are dedicated to life…in all its dimensions. Our world is shaped by a passion for innovation, commitment to partners and concern for people in an effort to create healthier communities, globally.'

Source: http://www.nutralite.com/about_us.htm

(ii) Unilever is a company with almost four hundred well known brands spanning almost fourteen categories of food, personal grooming and home products. Its most popular brands include Axe, Lux and Knorr. The Company's mission reads something like this:

'Unilever's mission is to add vitality to life. We meet everyday needs for nutrition, hygiene, and personal care with brands that help people feel good, look good and get more out of life.'

Source: http://www.unilever.com/ourcompany/aboutunilever

(iii) You can get an idea of Hindustan Unilever's mission from the following lines:

HUL believes that to succeed requires the highest standards of corporate behaviour towards our employees, consumers and the societies and world in which we live.

Source: http://hul.co.in/index.htm

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3.3.3 Company Profile

The profile of a company depicts the quantity and quality of the company's financial, human and physical resources. The profile assesses the strengths and weaknesses of the company's management and organizational structure. It also analyses the company's past successes and traditional concerns in the context of the company's current capabilities, in an attempt to identify its future capabilities. A look at the various corporate websites on the Internet will give you a very good idea of how a company's profile is presented to the outside world.

3.3.4 External Environment

All those forces that affect the organization from the outside or all the conditions that affect an organization's strategic options and define its competitive situation, are referred to as its external environment. It consists of three interactive segments, namely the operating environment, the industry environment and the remote environment. You have already learnt about the external environmental influences earlier.

3.3.5 Strategic Analysis and Choice

Strategic analysis enables a firm to identify a range of possible attractive investment opportunities. Opportunities that are compatible with the company's mission are identified as desired opportunities. If the list of desired opportunities is further weeded out, the potential options or strategic choices can be identified. The entire process of strategic choice is meant to combine long-term objectives and generic and grand strategies, in order to place the firm in an optimal position in the external environment for achievement of the company mission.

Strategic analysis and strategic choice in a single or dominant product business involve the identification of strategies that are most effective at building a sustainable competitive advantage. Such a competitive advantage is based on key value chain activities and capabilities, i.e. The core competencies of a firm. Multi business organizations focus on the best combination of businesses to maximize their shareholder value..

Check Your Progress

1. List any three components of strategic management.
2. Which type of analysis enables a firm to identify a range of possible attractive investment opportunities?
3. What is the purpose of the process of strategic management?

3.3.6 Objectives: Annual, Short-term and Long-term

Objectives refer to the purpose behind an action or activity. As the name suggests, annual objectives are the objectives that a firm aims to achieve in one year. Objectives can be both short-term as well as long-term and belong to the same areas of business. However, the only difference is that the short-term objectives are more specific as they need to be achieved in a short span of time. In fact, the short-term objectives are formed on the basis of the long-term objectives. If a firm's long-term objective is to reduce production costs by 20 per cent within the next five years, then the annual objective could be to reduce its manufacturing costs by 5 per cent every year. Therefore, by achieving its short-term objective, the firm will get close to its long-term objective.

Take a look at the following extract from Pepsico's website which gives us a rough idea of what the company is committed to and what its vision, mission and objectives are.

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PepsiCo's Commitment Our commitment is to deliver sustained growth, through empowered people, acting with responsibility and building trust. Here's what this means:

Sustained Growth is fundamental to motivating and measuring our success. Our quest for sustained growth stimulates innovation, places a value on results, and helps us understand whether today's actions will contribute to our future. It is about growth of people and company performance. It prioritizes making a difference and getting things done.

Empowered People means we have the freedom to act and think in ways that we feel will get the job done, while being consistent with the processes that ensure proper governance and being mindful of the rest of the company's needs.

Responsibility and Trust form the foundation for healthy growth. It's about earning the confidence that other people place in us as individuals and as a company. Our responsibility means we take personal and corporate ownership for all we do, to be good stewards of the resources entrusted to us. We build trust between ourselves and others by walking the talk and being committed to succeeding together.

PepsiCo's Guiding Principles

This is how we carry out our commitment.

We must always strive to:

Care for customers, consumers and the world we live in. We are driven by an intense, competitive spirit in the marketplace, but we direct this spirit toward solutions that achieve a win for each of our constituents as well as a win for the corporation. Our success depends on a thorough understanding of our customers, consumers and communities. Caring means going the extra mile. Essentially, this is a spirit of growing rather than taking.

Sell only products we can be proud of. The test of our standards is that we must be able to personally endorse our products without reservation and consume them ourselves. This principle extends to every part of the business, from the purchasing of ingredients to the point where our products reach the consumer's hands.

Speak with truth and candor. We speak up, telling the whole picture, not just what is convenient to achieving individual goals. In addition to being clear, honest and accurate, we take responsibility to ensure our communications are understood.

Balance short term and long term. We make decisions that hold both short-term and long-term risks and benefits in balance over time. Without this balance, we cannot achieve the goal of sustainable growth.

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Win with diversity and inclusion. We leverage a work environment that embraces people with diverse backgrounds, traits and different ways of thinking. This leads to innovation, the ability to identify new market opportunities, all of which helps develop new products and drives our ability to sustain our commitments to growth through empowered people.

Respect others and succeed together. This company is built on individual excellence and personal accountability, but no one can achieve our goals by acting alone. We need great people who also have the capability of working together, whether in structured teams or informal collaboration. Mutual success is absolutely dependent on treating everyone who touches the business with respect, inside and outside the company. A spirit of fun, our respect for others and the value we put on teamwork make us a company people enjoy being part of, and this enables us to deliver world-class performance.

Source: http://www.pepsico.com/PEP_Citizenship/pepsicoValues/index.cfm

3.4 SUMMARY

In this unit, you have learned that strategic intent is the dream that energizes a company. The unit emphasized that although strategic architecture shows the way to the future, it is strategic intent that serves as the driving force—making the path smooth by providing the relevant emotional and intellectual support and energy.

You got to know about the various components of strategic management of which the main ones, that is, vision, mission and objectives were explained with examples. You have learnt that while the vision of a company may be vague, impersonal and unwritten, the mission statement is more specific and formulated keeping in mind, the philosophy and goals of the company, its image, primary market and its basic product. It reflects the company's responsibility towards its employees, shareholders and the society at large. The unit described the external environment of an organization as the set of forces affecting the organization from the outside. The three interactive segments of the external environment are the operating environment, industry environment and remote environment. You have also learnt that strategic analysis helps a firm identify investment opportunities that are compatible with the firm's mission. The short-term goals of a company are formed on the basis of the long-term goals.

3.5 KEY TERMS

- **Strategic intent**: The dream that energizes a company.
- **Vision**: The description of what a company is trying to do and become.
- **Mission**: A statement identifying the scope of a company's operations, reflecting the values and priorities of its main decision makers and setting a company apart from other companies in the same area of business.
- **Annual objectives**: Quantifiable goals which, company seeks to implement and achieve in one year.

3.6 ANSWERS TO 'CHECK YOUR PROGRESS'

NOTES

1. Three components of strategic management are as follows:
   (i) Vision of the company
   (ii) Mission of the company
   (iii) Profile of the company
2. Strategic analysis enables a firm to identify a range of possible attractive investment opportunities.
3. The process of strategic choice is meant to combine long-term objectives and generic and grand strategies, in order to place the firm in an optimal position in the external environment for achievement of the company mission.

3.7 QUESTIONS AND EXERCISES

Short-Answer Questions

1. How does strategic intent help a company?
2. How can vision be translated into mission?
3. What does the profile of a company indicate?
4. Differentiate between vision from mission.
5. Differentiate between short-term and long-term objectives. Give an example.
6. What is the purpose of strategic analysis?
7. What is meant by the external environment of a company?

Long-Answer Questions

1. Discuss the importance of a company's mission.
2. The vision gives a view of an organization's future direction and course of business activity. Discuss.
3. Write a note on the annual objectives of an organization. Give examples.

3.8 FURTHER READING

Johnson, Gerry and Kevan Scholes. 1994. *Exploring Corporate Strategy: Text and Cases*. New Delhi: Prentice-Hall of India.

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UNIT 4 ENVIRONMENTAL ANALYSIS

NOTES

Structure

4.0 INTRODUCTION

Coping with the uncertainties of a business is the biggest challenge faced by firms today. There are certain tools that help tackle strategic uncertainty in the long run. In this unit, you will learn about environmental analysis including the PESTEL framework and scenario analysis. You will learn about the components of the environment and you will also study the use of SWOT analysis.

4.1 UNIT OBJECTIVES

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

- Understand the significance of environmental analysis
- Explain the constituents of the external environment in the context of the PESTEL framework and scenario analysis
- Understand the characteristics of the political, economic, social, technological, environmental and legal environments
- Understand the purpose of a SWOT analysis

4.2 ENVIRONMENTAL ANALYSIS

An organization's business environment encompasses both the external and the internal environment. An organization has to understand the external environment in order to operate effectively in the marketplace. It should also be able to adapt itself to changing circumstances in order to survive in business. The external environment of a firm essentially includes the environment in respect of political, economic, social and technological factors.

4.2.1 External Environment: PESTEL Framework and Scenario Analysis

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Strategies are not and should not be developed in a vacuum. They must be responsive to the external business environment. They must be responsible to the external business environment. The efficiency or productivity of a firm has to be read in the context of its external environment. One tool for analysing trends is forecasting . In the development of forecasts, environmental scanning and monitoring are important in detecting key trends and events. Managers must also aggressively collect and disseminate competitor intelligence. The information gleaned from these activities is invaluable in developing forecasts and scenarios to minimize the present and future threats as well as to exploit opportunities.

The general external environment will be seen in the context of two frameworks— PESTEL framework and scenario analysis.

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.

Political environment

The government rules and regulations of a country are deeply influenced by the political forces. All firms operating in a country adhere to these government rules and regulations which are formed 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.

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

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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.

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 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.

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.

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 to 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.

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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.

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.

4.3 SWOT ANALYSIS

NOTES

SWOT is an acronym for strengths, opportunities and threats Therefore, SWOT analysis, as the name suggests, is a method that analyses the strengths, weaknesses, opportunities and threats of an individual or a firm. It helps in the formulation of suitable strategies.

The process of strategy formulation begins with situation analysis, i.e., the process of discovering a strategic match between the weaknesses that exist within and the opportunities available outside.

It is a systematic study and identification of those aspects and strategies that best suit the individual company's position in a given situation. The strategy should not only improve an organization's business strengths and utilize the available opportunities, but also get rid of its weaknesses and effectively repel threats.

Strengths

Strengths are the resources, skills or other advantages the firm enjoys relative to its competitors. These are responsible for giving the firm a competitive edge in the market. A company may possess some or all of the following strengths:

- Distinct technical superiority/best technical know-how
- Financial resources
- Skilled manpower
- Goodwill and image in the market for goods and services
- Access to the best distribution network
- Disciplined and well mannered employees with high morale and positive attitude.
- Top position in the market
- Good customer service/relations

Weaknesses

A weakness is a drawback that acts as an impediment to success or growth. This drawback could in terms of deficient skills, lack of resources and death of capability. Weaknesses prevent the firm from gaining competitive advantage. WEakneses could result from any or all of the following:

- Lack of facilities
- Death of funds or finances
- Poor brand image

Absence of good managers

- Ineffective management
- Poor marketing skills

Corporate strength and weakness are a matter of interpretation. Understanding the key strengths and weaknesses of a firm helps to make the search for solutions and alternative strategies narrow. The study of internal strengths and weaknesses provides a useful framework for making the best strategic choice.

NOTES

Opportunities

Any situation that appears to be in favour of the environment of a firm, will be called an opportunity. An environmental opportunity is a situation which makes it possible for a particular company to enjoy a competitive advantage. For example, changes in the EXIM policy may bring opportunities to some export-oriented companies. Some opportunities for a firm may be:

- Introduction of new technology
- Identification of a new market segment
- Modifications in the regulatory environment
- Improvement in seller-customer relationships

Threats

Threats are just the opposite of opportunities. A threat refers to an extremely unfavorable situation in the firm's environment. It is a challenge posed by an unavoidable trend that could lead, in the absence of purposeful action., to the erosion of the company's position. Some threats to a firm may come from:

- Slow market growth
- Entry of resourceful multinational company/ competitors
- Increase in buying power of key customers
- Increase in bargaining power of main suppliers
- Adverse changes in governmental policies, rules and regulations

Opportunities and threats are the external factors and forces in the business environment, which change from time to time. These opportunities and threats affect organizations to a great extent because organizations operate in a business environment influenced by others. The managers of a firm can identify practical alternatives and realistic options for designing an appropriate strategy provided they understand the opportunities available to the firm and the threats that it may face.

4.4 SUMMARY

This unit explained to you the concept of environmental analysis and scenario analysis. You have learnt that environmental influences and trends can be thought of as being in layers around an organization. The most general layer is the macro -environment where an understanding of the political, economic, social, technological, environmental and legal (PESTEL) influences can provide an overall picture of the variety of forces at work around an organization. This can also cast light on the key influences and structural drivers of change and provide the basis for examining the extent to which these will have differential impact on both industries (or sectors) and organizations within industries in the future.

When there are long-term strategic horizons but high levels of uncertainty around key environmental forces, scenarios can be a very useful way of understanding the implications of these influences on strategy. This includes the need for organizations to be ready and prepared to face more than one situation in their future environment. In this unit, you have also learnt about SWOT analysis and its significance.

Check Your Progress

1. Name one tool used for analyzing trends.
2. What is SWOT?
3. What is an opportunity?

4.5 KEY TERMS

NOTES

- **Environmental analysis:** Study of the external environment of a firm which covers the political, economic, social and technological factors.
- **Forecasting:** A tool for analysing key future trends and events.
- **PESTEL framework:** The political, economic, social, technological, environmental and legal framework.
- **Social environment:** The society, in general, covering its changing values, beliefs, attitudes, opinions and lifestyles.
- **Economic environment:** The economic condition of the market and the customers or buyers.
- **Macroeconomic trends:** The trends in the growth of GNP, inflation rates, disposable income, spending capacity and prime interest rates.
- **Technological environment:** Environment that consists of the materials and machines used in the manufacture of goods and services.
- **SWOT analysis:** Study of the strengths, weaknesses, opportunities and threats of an individual or organization.

4.6 ANSWERS TO 'CHECK YOUR PROGRESS'

1. One tool for analysing trends is forecasting .
2. SWOT is an acronym for strengths, opportunities and threats. It is a method that analyses the strengths, weaknesses, opportunities and threats of an individual or a firm.
3. Any situation that appears to be in favour of the environment of a firm is called an opportunity.

4.7 QUESTIONS AND EXERCISES

Short-Answer Questions

1. What tools or techniques would you use to do an environmental analysis of a company?
2. How do you measure the external and internal environment in terms of a company's capabilities.
3. How does a scenario analysis differ from PESTEL analysis?
4. What could be the possible strengths of a company in the business of selling software packages?
5. State some threats that could pose a challenge to a company in the business of water heaters.

Long-Answer Questions

1. Explain the benefits of scenario analysis. Give examples.
2. Explain how the economic environment influences the performance of a company.

3. How does the technological environment affect a business? Give examples to support your answer.
4. What does environmental forecasting entail?
5. What constitutes the political environment?

NOTES

4.8 FURTHER READING

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NOTES

CASE STUDY

Successful invasion of an emerging Telecom market

In 2007, Vodafone, the UK-based telecom company with the largest revenue in the world, made a foray into the telecom market in India by obtaining a 52 per cent stake in Hutchison Essar Ltd. through a deal with HTIL, that is, Hutchison Telecommunication International Ltd of Hong Kong.

HEL was the fourth biggest firm in the Indian telecom sector with a subscriber base of 29.2 million in July 2007. It had a pan-Indian presence and had a strong foothold in thirteen of the total twenty-eight circles in India and it also had the second highest Average Revenue Per User (ARPU) of Rs 340.15. It had interests in other sectors such as steel, energy, communications, shipping and logistics and construction. As of March 2007, the group's revenues were $4 bn.

The main objective in acquiring the stake was the Company's expansion strategy. It planned to expand into markets like India with a high potential for growth. In 2007, India had outdone China to emerge as the fastest growing telecom market in the world. With its low penetration rates, it still remained one of the most lucrative markets for global telecom companies.

The deal faced impediments in the form of aggressive bidding by competition and delay in receiving approval from regulators. Finally, Vodafone clinched the deal, which some critics thought was too expensive. The final deal price was a discounted amount of $10.9 bn. However, the Company considered the deal worth the money, considering the fact that it would ultimately help it strengthen its foothold in the fastest growing telecom market in the world.

Vodafone officially announced the acquisition on February 11, 2007, winning the acquisition battle involving other competitors like Reliance and the Hinduja Group. 33 per cent of the stake was still held by Essar. The deal came close on the heels of the Indian Government raising the limit of foreign direct investment from 49 per cent to 74 per cent.

The deal was welcomed by the Industry as well as the Government as it was expected to give the much-needed boost to the telecom sector. In addition, the Indian telecom market would benefit from the experience that Vodafone had in the operation of telecom networks. Since the markets in the developed countries were already saturated, this acquisition made it possible for Vodafone to invade an emerging market in a significant manner. The Company announced that the brand 'Hutch' would be replaced by 'Vodafone' later the same year. Its main challenge was to tackle the stiff competition offered by Reliance and Bharti Airtel.

Finally, Vodafone and Essar mutually agreed to run HEL jointly. As part of the agreement, Essar was to sell its 33 per cent stake over a period of three to four years (put option). This implied that Vodafone would pay the balance to Essar if it got a price lower than what Vodafone had offered HTIL at the time of acquiring the stake. However, Vodafone did not buy the stake of Essar in HEL for a premium. Vodafone Essar was to be the name of the acquired company.

Questions for Discussion:

1. What was the reason behind Vodafone's for a into the Indian telecom market?

2. Suggest ways in which Vodafone could taekle competition.

MODULE - 2

UNIT 5 INDUSTRY ANALYSIS

NOTES

Structure

5.0 INTRODUCTION

In any industry, competition depends on several factors and the success of a company depends on how efficiently it handles these factors and survives in the face of stiff competition. In this unit, you will learn in detail about Michael E. Porter's 'Five Forces Model' for assessing and analysing the business environment. The unit will discuss the five forces that, according to Porter, play a crucial role in shaping a company's future.

5.1 UNIT OBJECTIVES

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

- Explain the role of customers' bargaining power in industry analysis
- Understand the effect of threats posed by substitute products
- Identify the factors that affect the bargaining power of suppliers in various industries
- Understand the repercussions of competition among existing firms
- Appreciate the role of Porter's 'Five Forces Model' in industry analysis

5.2 PORTER'S INDUSTRY ANALYSIS: THE FIVE FORCES MODEL

Effective formulation of strategy requires a clear understanding of competition. Competition in an industry is determined not only by existing competitors but also by other market forces such as customers, suppliers, potential entrants, and the existence of substitute products. Understanding the level of competition is important because the level of profits depends to a large extent upon the level of competition. The strategist's goal is to position the firm in such a way that it is not vulnerable to the attacks of competitors. The position should give the firm enough space to defend

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itself confidently. Given this, the need to study the underlying sources of competitive pressures is obvious. Understanding the sources of competition can help the firm to gauge its own strengths and weaknesses, and to perceive the trends in the industry so that it can position itself optimally for the best returns. The 'Five Forces Model' is a framework which has been developed by Michael E. Porter of the Harvard Business School to assist managers in analysing the business environment. The five forces that play a crucial role in shaping a company's future are as follows:

(i) Bargaining power of customers
(ii) Threat posed by substitute products
(iii) Bargaining power of suppliers
(iv) Threat posed by new entrants
(v) Competition among existing firms

These five forces are discussed in detail as follows:

1. Bargaining power of customers

Customers are the ones who buy products from the sellers. However, they are not always the final users of the product. For example, for Procter and Gamble, the direct buyers of its detergents are wholesalers and retailers. Bulk buyers such as supermarkets often have greater bargaining power, i.e., they can ask the supplier company for prices lower than single customers or small retailers. If buyers are in a weak bargaining position than the supplier, the supplying company can hike prices and make profits on that basis. Thus, the bargaining power of buyers is one of the factors in industry-level strategic analysis. Porter says that buyers are powerful under the following circumstances:

- When the suppliers are many and the buyers are a few and large.
- When the buyers purchase in large quantities
- When the supplier's business banks on the buyers for the lion's share of its total orders
- When buyers can force prices to go down by switching orders between supplying companies. This is because they pit companies against each other.
- When it is economically feasible for the buyers to purchase the input from several companies at a time.
- When, as a result of the threat, the buyers can attend to their own requirements through vertical integration, forcing the prices to go down in the process.

For example, the buyers of auto components are powerful. In the US, the buyers are General Motors, Ford and Chrysler. There are numerous suppliers of auto components. So, to keep the buyers loyal to them, auto component suppliers must provide quality products to their buyers.

2. Bargaining power of suppliers

The suppliers' power to bargain influences the profits earned by the company. This occurs when the suppliers determine the price that the customers or buyers must pay for the product. Suppliers are powerful under the following circumstances:

- When the product that they sell has few substitutes and is important to the purchasing company or buyer.
- When no single industry is a major customer for the suppliers.
- When products in the industry are differentiated to such an extent that they are not easily substitutable and it is costly for a buyer to switch from one supplier to another.
- To raise prices, the supplier can use the threat of vertically integrating forward into the industry and competing directly with the buying company.
- The buying companies cannot use the threat of vertically integrating backward and supplying their own needs as a means to reduce input prices.

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One example of a powerful supplier is Microsoft, the world's largest provider of operating software. Manufacturers of computers, laptops, etc., are almost totally dependent on Microsoft to run their PCs as it is the most popular and reliable software used universally all over the world.

3. Threat posed by substitute products

Companies in the coffee industry are restricted. If coffee prices are hiked, customers have the option of switching over to tea or soft drinks, which are its substitutes.

A close substitute is a potential threat to the company's product. The existence of a substitute limits the price which can be charged for a product and therefore the profitability of the company.

4. Threat posed by new entrants

Generally, new entrants into any industry tend to capture the market share with their new capacity. As a result, there are more players and more competition. The situation can lead to price wars, which can result in falling returns. This decline in profitability becomes a problem for the new entrants too. That is why new entrants to an industry often take the 'acquisitions' route. There are certain barriers that determine a firm's ability to enter an industry. The six barriers are as follows:

(i) Government policies

(ii) Capital requirements

(iii) Cost disadvantages irrespective of size

(iv) Economies of scale

(v) Product differentiation

(vi) Access to distribution channels

5. Competition among existing firms

Intense competition is referred to as rivalry. It occurs in an industry when one business or many businesses try to increase their market share.

Rivalry may lead to price wars, advertising battles, launch of new products and increased customer services and warranties. Some firms gain the upper hand through intense rivalry, while their competitors suffer a fall in market share. The intensity of rivalry depends upon many factors. Rivalry is usually intense when there are many competitors of similar size. Slowdowns in industrial growth also make firms

Check Your Progress

1. List the five forces that play a crucial role in shaping a company's future.
2. Name any three barriers that determine a firm's ability to enter an industry.
3. What does rivalry lead to?

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keen to grab each other's market share. A lack of differentiation among the products of the players in the industry also leads to intense competition. The absence of switching costs can lead to an unstable market place. In the paper and aluminium industries, manufacturers often resort to underpricing to avoid spoilage of the goods. It is difficult for firms to move out of certain industries, because of their fixed investments. Thus, a variety of factors, ranging from exit barriers to the loyalty of old players to the industry despite low returns, increase the intensity of competition in an industry.

5.3 SUMMARY

In this unit, you have learned about the 'Five Forces Model' propagated by Porter.

An organization operates in an external environment that consists of the political environment, the economic environment, the social environment and the technological environment. Studying the environment, understanding it, employing what is necessary to thwart the threats faced by the firm and capitalizing on the opportunities available are essential for a firm to succeed.

You have learned that Porter's 'Five Forces Model' describes the forces that shape a company's future in the marketplace. The risk of potential entrants, the degree of rivalry among the existing players in the industry, the threat posed by substitute products as well as the bargaining power of buyers and suppliers influence a company's performance in an industry.

5.4 KEY TERMS

- **Five Forces Model:** A framework developed by Michael E. Porter of Harvard Business School stating five major forces that shape a company's future.
- **Bargaining power:** The power, that sometimes rests with the suppliers and sometimes with the buyers, to bring down or hike prices.
- **Substitute product:** A product that can be used in place of another product with nearly the same results.

5.5 ANSWERS TO 'CHECK YOUR PROGRESS'

1. The five forces that play a crucial role in shaping a company's future are as follows:
    (i) Bargaining power of customers
    (ii) Threat posed by substitute products
    (iii) Bargaining power of suppliers
    (iv) Threat posed by new entrants
    (v) Competition among existing firms
2. Three barriers that determine a firm's ability to enter an industry are as follows:
    (i) Government policies
    (ii) Capital requirements
    (iii) Cost disadvantages irrespective of size

3. Rivalry may lead to price wars, advertising battles, launch of new products and increased customer services and warranties.

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5.6 QUESTIONS AND EXERCISES

Short-Answer Questions

1. What are the five forces that act on any firm at any point in time?
2. What tools/techniques would you use to do an industry analysis ?
3. Write a note on Porter's model for industry analysis.
4. What role do the five forces play in the performance of a company?
5. Under what circumstances are buyers more powerful?

Long-Answer Questions

1. How can an understanding of the sources of competition help the firm to gauge its strengths and weaknesses? Discuss.
2. What role does the bargaining power of buyers play in industry-level strategic analysis? Explain with examples.
3. Describe the situations that may give rise to price wars.
4. Discuss the factors that can affect the intensity of rivalry in the market?
5. Under what circumstances can the bargaining power of suppliers be adversely affected? Elaborate with examples.

4.7 FURTHER READING

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Case Study 1

Let us now look at an analysis of the Indian pharmaceutical industry based on Porter's 'Five Forces Model'.

In India, the pharmaceutical industry is known to be very competitive and has numerous players which is evident from the fact that the strongest player has only 6 per cent market share whereas the top five companies together have approx. 18 per cent of the market share. It has high growth prospects and therefore attracts new entrants. Also, it is an industry where the small players find it easy to succeed because they have a better idea of the distribution channel as they are focused in a particular region. Another reason for the steady stream of new entrants is the fact that the pharmaceuticals market is quite stable. The industry is quite easily accessible for an Indian entrepreneur as the requirement of capital is not high and is rather easy to create a regional distribution network. What is actually difficult is to create brand awareness in the medical fraternity. In order to survive in the long run, a pharma brand has to be patronized by the doctors. Also, the Government's quality regulations may put some form of restriction for new entrants as they may have to establish new manufacturing operations.

Bargaining power of buyers

In the pharma industry, the customer has to purchase what the doctor prescribes. Also, the customers do not really have the power to influence the price of the product as they are spread out over a large area. It is the Government that plays a key role in regulating prices through the National Pharmaceutical Pricing Authority or NPPA.

Bargaining power of suppliers

The pharma industry is highly dependent on various organic chemicals. The suppliers of these chemicals have low bargaining power as the chemical industry is also a highly competitive one. Therefore, it is easy and rather inexpensive for the pharma companies to switch suppliers. However, there is always a possibility of the supplier integrating to become a pharma company. There are many examples of companies which started out as chemical companies and later transformed into phrama companies.

Threat of substitutes

The demand for pharmaceutical products hardly ever falls. Therefore, despite the high number of existing players and the existence of innumerable substitutes, the industry continues to do well and has an infinite future. The only threat could be from the rapidly advancing biotechnology sector which may influence the synthetic pharma industry.

Questions for Discussion

1. What are the factors that affect the pharma industry?
2. What are the reasons behind the stability of the pharma industry?

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Case Study 2

Let us now take a look at the analysis of the telecom sector using Porter's 'Five Forces Model'

1. **Threat of new entrants**

   The telecom industry is a capital-intensive industry. Access to sufficient finance to cover the high fixed costs acts as the biggest barrier for new entrants. The competition from new entrants increases when finance is easy to come by. When opportunities for financing are not easily available, the number of new entrants is less. Another barrier to entry is the ownership of a telecom license. Dearth of good management skills and experience also acts as a major barrier for new entrants and puts companies in a weak position in terms of hiring and salaries.

2. **Power of Suppliers**

   Telecom equipment suppliers may appear to be possessing considerable bargaining power whereas actually it is not so. Although transmission of voice and data from one place to another is not possible in the absence of fibre-optic cables, mobile handsets, billing software and high-tech broadband switching tools, there is no dearth of manufacturers who produce these. Therefore, the bargaining power gets diluted. Some of the major suppliers include Alcatel, Tellabs, Cisco, Nokia, Nortel and Lucent.

3. **Power of Buyers**

   The bargaining power of customers is rising with more and more options to choose from. There are many products and services on offer from various companies and there is hardly any different in the commodities offered irrespective of the brand. Customers head for low prices combined with reliable service. The buying power is also affected by the size of the market segment. Sometimes, customers can be individual residential users whereas sometimes they can be big institutions or universities. The switching costs can be quite high for the latter category whereas it may be negligible for the former.

4. **Availability of Substitutes**

   Non-traditional telecom industries pose substitution threats with their products and services. A good example is the competition between cable TV operators and satellite operators. Nowadays, the cable operators possess direct lines into homes and offer broadband Internet services and satellite links that are able to fulfill high-capacity telecom network needs. Even the Railways and other energy utility companies are laying high-capacity telecom network alongside their tracks. The Internet is also a threat to telecom operators as it facilitates voice calls at highly discounted rates. Internet telephony, as it is popularly called, is provided by Internet service providers and is steadily eating into the market of the telecom operators.

5. **Intense Competition**

   With market conditions and industry deregulation favouring new entrants, there is no dearth of competition. In the 1990s, the capital markets became so receptive that a hoard of new companies ventured into the industry. With them came a whole new range of substitute services. The only way customers can be lured is by offering low prices and value-added services. This affects the profitability of the industry as a whole.

Questions for Discussion

1. How does easy access to finance affect the telecom industry?
2. How is the industry affected by deregulation?

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Case Study 3

Toyota's Success in the US Auto Industry

Toyota is a Japan-based leading automaker worldwide which offers a product portfolio of passenger cars, trucks, Sport-Utility Vehicles (SUVs) and minivans. It also manufactures automotive parts, components and accessories. The case talks about the dynamics of the US auto industry as of 2006-07 and the position of the major players in the US market—the US Big 3—General Motors (GM), Ford and Daimler Chrysler. The big three were experiencing huge losses by 2006-07 and closing down some of their US manufacturing plants and rationalizing their staff. In contrast, Toyota was flourishing in its business and expanding its operations in the US. It had become the second largest player in the US in 2006. It also manufactured automotive parts, components and accessories. In 2006, the $178.9 bn Toyota Motor Corporation was a leading auto manufacturer in the world with manufacturing facilities in twenty-seven countries and sold its vehicles in more than 170 countries across the world, but its primary markets were Japan, North America, Europe and Asia. Valued at $27.94 bn, Toyota was the seventh (ninth position in 2005) most powerful brand in the world in 2006. It was the eighth and twelfth largest respectively in the lists of Fortune and Forbes.

As 2007 dawned, Toyota's senior management took stock of its hitherto successful strategy and wondered if they should continue on the same lines or launch a new strategy to become the largest automaker in the US?

The Company was organized into three business segments – automotive, financial services and others.

It produced automotives in two categories —conventional vehicles and hybrid vehicles under both the Toyota brands and non-Toyota brands. Toyota's car portfolio included Camry, Corolla and Avensis. Toyota offered the Corolla sedan and Yaris under its subcompact and compact cars segment while under the SUV and pick-up trucks category, Toyota's offerings included Tacoma and Tundra. In the mini van category, the Alphard, the Noah, Sienna, and Regius Ace were some of the popular models. The Lexus was the luxury car division of Toyota, and was operated as a non-Toyota brand. Under the Lexus division, the company offered sedans, coups, SUVs and hybrids targeted at the premium segment of the market in the price range of $37,000 to $71,000.

Toyota's other businesses comprised telecommunications, intelligent transport systems and a Japanese e-commerce marketplace called Gazoo.com. Gazoo.com provided its members with information on new cars, used cars and related services. When Toyota entered the American market, it was not perceived as a threat by the American auto industry because it was believed that its cars held little appeal for the American consumers. Toyota began manufacturing spare parts in California in 1972. Meanwhile, due to problems such as the 1973 Oil Embargo, environmental regulations, and quality control issues with American cars (Ford Pinto), car consumers in the US started searching for alternatives to polluting cars. In response to these changes, Toyota aggressively marketed its offerings as being fuel-efficient, environmental-friendly, and having better quality than American cars. In addition, Toyota marketed their cars as being hip and fun with memorable slogans like, ' you asked for it, you got it, Toyota' and with commercials involving young Toyota drivers jumping in the air.

By the 1970s, Toyota was the best-selling imported brand in the US and had captured about 20 per cent of the US car market by 1980. During the 1980s, Toyota began manufacturing vehicles in North America. In 1982, Toyota

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Motor Co. Ltd, and Toyota Motor Sales Co. Ltd. were merged into Toyota Motor Corporation. In 1984, the Japanese auto company entered into a joint venture with General Motors (GM) in the US and the new entity was called – New United Motor Manufacturing, Inc.

(NUMMI). In 1988, Toyota extended its manufacturing activities in the US by starting the Toyota Motor Manufacturing, Kentucky, Inc.In 2000, Toyota Financial Services Corporation was established to control and execute Toyota's finance companies worldwide. In 2002, it adopted the 2010 Global Vision, a vision for meeting mobility needs in a way that was beneficial to nature and consumers. By 2003, Toyota expanded its manufacturing operations in the US at Texas and Alabama for the production of its vehicles Tundra and Sequoia.

In 2005, Toyota produced more than 1.55 million vehicles, more than 1.3 million engines and nearly 400,000 automatic transmissions at its North American manufacturing facilities. In April 2006, Toyota Motor Manufacturing North America, Inc., and Toyota Technical Center consolidated to form Toyota Motor Engineering and Manufacturing North America, Inc. (TEMA). TEMA was responsible for Toyota's North American engineering design and development, R and D and growing manufacturing activities in the US, Canada and Mexico.

The US auto industry mainly consisted of the US Big three: General Motors (GM), Ford and Chrysler and Japanese automakers such as Toyota, Honda and Nissan. Ford with its product portfolio – Escape, Explorer, Explorer Sport Trac, Freestyle, Expedition, Lincoln, Mercury, and Mustang brands was competing in cars, trucks and SUV segments. General Motors (GM) was also competing in the above three segments with its brands – Buick, Cadillac, Chevrolet, Hummer, and Saturn. Honda with its Accord, Civic, CR-V, Odyssey Minivan, Pilot SUV and Ridgeline Truck was also competing in the car, trucks and SUV segments. Nissan, another Japanese competitor of Toyota in the US had a diverse portfolio of vehicles: cars - Versa, Sentra, Altima, Maxima; Trucks—Frontier, Titan, SUVs andMinivans—Xterra, Murano, Pathfinder, Quest and Armada. By 2006, interest rates in the US had gone up and gasoline prices (gasoline was used as a fuel for automobiles) were also on the rise.

Domestic US automakers —GM, Ford and Chrysler which had lower emphasis on the fuel-efficient and environment friendly hybrid cars and more emphasis on gasoline powered vehicles, were going through tough times. They were experiencing huge losses and to keep up with declining market share and declining sales, undertook production cuts and retrenchment of labour force.

During the 1990s, Toyota began rationalizing its parts supply operations in the US. It began a system of daily ordering of parts. With daily orders, the company also focused on small batch processing of parts orders rather than handling large batches of orders. This just-in-time method of ordering also helped Toyota's dealers in achieving 20 per cent to 40 per cent savings in floor space utilization and having productivity gains of 20 per cent to 30 per cent in parts management. The company also brought about improvement in its materials handling efficiencies by opening a 770,000 sq. ft., North American parts distribution centre in Ontario, California in 1996.

During 1990-1996, Toyota was successful in outpacing its US competitors. Toyota had reduced the defects in its manufactured vehicle parts and reduced the ratio of inventories as a percentage of sales (which were considered as measures of efficiency of a manufacturing company).

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Toyota achieved these performance advantages despite relying on identical suppliers from the same plants involving the same or similar parts as its US counterparts. Suppliers in North America that provided parts to Toyota's supply chain were required to adhere to standardized processes like electronic ordering of parts, bar code labeling of shipments to Toyota, and Advance Shipping Notices (ASNs).

With daily ordering, Toyota's supplier on-time delivery compliance had risen from 76 per cent in 1997 to 93 per ccent in 2000. And 66 per cent of suppliers on daily order status delivered within five days or less. Toyota also worked on a strategy of reducing the Purchase Order Unit (POU), for the different parts and Toyota had reduced the POU unit number on more than 1,000 different parts. Toyota critically analysed itself with respect to every business process and its competitiveness was based on continuous improvement – called Kaizen. Toyota did not allow its workers to get into complacency mode with respect to their past achievements. Toyota restructured a little bit every day even every shift – for example, it had brought about improvement in the method of painting cars which saved it time, money and material.

Toyota established institutionalized routines for knowledge sharing across its suppliers. Toyota employed six key institutionalized, organizational approaches to facilitate knowledge sharing – a supplier association; teams of consultants; voluntary study groups; problem- solving teams; interfirm employee transfers; and performance feedback and monitoring processes. Toyota also shared knowledge within the company and also within network of suppliers' base and even with those suppliers which were suppliers to the US Big 3. Toyota did not view the production process as proprietary and accepted that in the process of sharing, some valuable knowledge will pass on to its competitors.

By 2003, Toyota was increasing the ratio of built vehicles to imported vehicles in the US. According to Automotive News Data Centre, imported vehicles were 39 per cent of the US sales in 2003 as compared to 41 per cent in 2002. In a bid to capture increasing market share in the US, Toyota had been giving emphasis on building its vehicles locally in the US. In order to overcome the failure of its Project Genesis, in the US, Toyota made another attempt to capture the youth market by launching Scion in 2003. Unlike Lexus, which was positioned as a luxury car, Scion was targeted at young consumers by offering it at relatively cheaper prices and after incorporating the preferences of American young customers in car features and design. By 2003, Toyota had replaced Ford to become the No. 2 automaker in the US.

Toyota's strategy to become No. l player in the US

Toyota aimed for the No. 1 position in the US market for which it launched several initiatives in the US market beginning 2004. Toyota had achieved a number of improvements including reducing the lead-time for die-making of large body panels of its vehicles to 1.7 months as compared to three months in 2002 and aimed to further reduce it to 1.5 months by the end of 2004 and planned to implement it in its overseas plants including the US within next two-three years.

Questions for Discussion

1. What steps did the company take to improve the working of their suplices?
2. What tribulor to its becoming the No. 1 in player in the US?

UNIT 6 COMPETITIVE ANALYSIS

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Structure

6.0 INTRODUCTION

In the previous unit, you learnt that industry analysis helps a firm not only to evaluate the profit potential of an industry, but also to consider various ways to strengthen its position vis-à-vis the five forces. In order to be valuable, a company must collect and evaluate a wide variety of information from many sources.

As the trend towards globalization accelerates, information on foreign markets as well as competitors, suppliers, customers, substitutes and potential new entrants becomes more critical. This unit will focus on the significance of competitive analysis in the survival and success of any business. The unit will introduce you to the Game Theory and the concepts of 'co-opetition' and complementarity.

6.1 UNIT OBJECTIVES

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

- Understand the Game Theory
- Explain the meaning of the term 'co-opetition'
- Understand the concept of complementarity

6.2 GAME THEORY: CONCEPT OF CO-OPETITION

The application of the Game Theory in business strategy was put forward by two authors, Adam M. Brandenburger, a professor of business administration at Harvard, and Barry J. Nalebuff, a professor at the Yale School of Management, who argued that business is a game, just like many think it is. But their argument was that it was a game with a difference. Business is not a sport or card game like baseball or poker. In any other game except business, someone has to lose so that the other(s) can win.

Things are just the opposite in business. In business, for one person to succeed, it is not necessary for the other or others to fail. There can be more than one winner. Therefore, it is a war of a different kind where peace exists if the parties are smart and willing to cooperate. It is an area where war and peace exist simultaneously. It can be aptly said that business reflects cooperation when it is a question of baking the pie whereas it reflects intense competition when it is a question of dividing it.

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Therefore, what business actually needs is a blend of competition and cooperation. It is about co-opetition.

Game theory makes it possible to move beyond simple ideas of competition and cooperation to reach a vision of co-opetition. It shows how to play the game of business and actually change the game into one that you like. This is where the big payoff from game theory comes in.

To change anything as a whole, you first need to change its parts. Similarly, to transform the game of business, you begin by changing its elements or parts. The five essential elements in any game are:

(i) Scope (the framework or boundary of the game)

(ii) Participants (the players)

(iii) Additional values (brought into the game by the participants)

(iv) Rules and regulations (regarding the technique or method of playing)

(v) Moves, tactics or strategies (used by players to gain advantage)

To change the game, you need to change one or more of its elements. This means that each of the five elements — scope, players, added values, rules and tactics – gives you a way to transform an existing game into an entirely new one. In other words, by changing one of the parts, the whole can be changed, for example, by changing the players, the game can be changed; by changing the rules, the game can be changed, and so on. The following caselet will give you an idea of how the game of business can be changed by changing one of its elements.

Microsoft vs Google

Microsoft is the largest software company in the world. However, the Company was facing increasing competition from Google, the number one search engine in the world. Google had been diversifying its businesses into software development, posing a direct challenge to Microsoft. Increasing threat from Google drove Microsoft to restructure its business from seven business units to three. Several analysts saw this as a move to make the company more agile and competitive to counter the threat from Google. Google would probably have been harmless had it been into mere web search but Google became a competitor to Microsoft because they were using web search to get into other parts of software. In December, 2003, Corporation (Microsoft), was startled while surfing Google's website. Google Inc. (Google), the Internet search engine company had posted job openings with job specifications that led Bill Gates, Chairman and Chief Software Architect of Microsoft's core business, software development to immediately send an e-mail to all his top executives to keep a vigil on Google. Google had diversified its businesses into software development, posing a direct challenge to Microsoft. Moreover, over hundred employees of Microsoft quit the company to join Google, including some of the top executives. To add to Microsoft's woes, Google entered into collaboration with Sun Microsystems, Microsoft's major competitor, on various projects.

6.3 CONCEPT OF COMPLEMENTARITY

Brandenburger and Nalebuff argued that the process of creating value in the marketplace involved the following four types of players:

(i) Customers

(ii) Suppliers

(iii) Competitors

(iv) Complementers

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Complementers of a firm are other firms which offer complementary products and services to the customers. Complementers are also firms which receive complementary resources from suppliers.

Brandenburger and Nalebuff are right to point out that the importance of complementers is evident from the amount of attention being given to partnerships and alliances. In fact, the Value Net graph of Brandenburger and Nalebuff emphasizes the equal roles played by competition and complementarity.

Complements are those products or services that have a potential impact on the value of a firm's own products and services. Those who produce complements are usually referred to as complementers. Powerful hardware is of no value to a user unless there is software that runs on it. Similarly, new and better software is possible only if the hardware on which it can run is available.

6.4 SUMMARY

In this unit, you have learned that competitive analysis of the environment—the Game Theory gives organizations a wider view of the business situation and helps them develop a nimble approach to corporate planning. A company profile outlines the quantity and quality of the company's financial, human and physical resources. An analysis of sales, costs and profits is necessary to determine the strengths and weaknesses of the firm. The analysis should include a study of the structure and operation of different functions in the organization. The biggest conceptual advance to Porter's framework was proposed by two strategists concerned with Game Theory—Adam Brandenburger and Barry Nalebuff in the mid 1990s. They argued that the process of creating value in the marketplace involved four types of players: customers, suppliers, competitors and complementers.

6.5 KEY TERMS

- **Game Theory:** A theory that sees business as a game and suggests ways of playing this game as a blend of competition and cooperation and changing the game to La firm's advantage.
- **Complementers:** The firms that offer complementary products and services to customers or receive complementary resources from suppliers.
- **Complements:** Products or services that have a potential impact on the value of a firm's own products and services.

Check Your Progress

1. Who put forward the application of the game theory in business strategy?
2. What are the players that the process of creating value in the marketplace involves?
3. Define co-optition.

6.6 ANSWERS TO 'CHECK YOUR PROGRESS'

1. The application of the game theory in business strategy was put forward by Adam M. Brandenburger and Barry J. Nalebuff.

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2. The process of creating value in the marketplace involves the following four types of players:
   (i) Customers
   (ii) Suppliers
   (iii) Competitors
   (iv) Complementers
3. Co-opetition is a blend of competition and cooperation in business.

6.7 QUESTIONS AND EXERCISES

Short-Answer Questions

1. How do you go about doing a competitive analysis of an industry?
2. What is the game theory and how can it be applied to business?
3. Define complementarity in your own words.
4. What is the meaning of co-opetition?

Long-Answer Questions

1. How can a game be transformed by merely changing a single element? Explain with examples.
2. Discuss the significance of competitive analysis in today's business environment.
3. Complementers are good for a business. Do you agree with this statement? Justify your answer.
4. Competition and complementarity are equally important. Comment.
5. Business is an area where war and peace exist simultaneously. Discuss.

6.8 FURTHER READING

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Case Study

Challenges Posed by Deadlines and Stiff Competition

The following caselet gives a glimpse of the global civil aerospace market, the trends, competitive fight between two competing aircraft manufacturers and their competing models. It highlights the fact that lack of project management skills could lead to a company failing to meet deadlines and ultimately spoiling its image.

The global civil aviation market was a duopoly between Boeing and Airbus and the competition was characterized by bitter rivalry between these two companies. Though both the companies projected a growth of 4.5 per cent during 2005-2010, both had contrasting views for the future nature of their growth. While Boeing was a protagonist of fragmentation in network and 'point-to-point traffic' concept and therefore, supported the development of smaller aircrafts, Airbus favoured the 'hub-and-spoke' model of operation as well as network consolidation and believed in the concept of larger aircrafts.

December 19, 2000 was a memorable day in the history of Airbus, when it unveiled 'Project A380' to manufacture the largest commercial aircraft with an initial investment of $13 bn. Noel Forgeard commented that the aircraft would rule the sky for next three decades. According to the Company, the first A380 was expected to be delivered in October 2007, to Singapore Airlines.

Airbus started production of A380 on January 23, 2002, and unveiled the prototype of the aircraft on January 18, 2005, in Toulouse (France). It positioned the aircraft (nicknamed as super jumbo) in the 555 seating capacity category against Boeing's 747 jumbo, which was called 'the queen of the sky' since it was airborne.

A delay in the schedule was announced in June, 2006. The delivery deadline was extended by six months. On October 3, 2006, when Christian Streiff, the President and CEO of Airbus, addressed the stakeholders of the company to make them aware about the recent development on 'Project A380' he was a bit apprehensive. He needed to announce the postponement of the scheduled date of launching A380, yet again. When the project was unveiled in 2000, it was announced that nine A380s would be delivered by October 2007, followed by thirty-five in 2008, twenty-five in 2009 and forty-five in 2010. As per the revised schedule, only one A380 could be delivered to Singapore Airlines in October 2007, followed by thirteen A380s in 2008 to Singapore Airlines, Qantas and Emirates. The new delivery schedule represented a delay of two years from the original schedule. Christian Streiff admitted that though the announcement of the delay was disappointing, depending upon the in-depth review of the A380 programme, the Company needed to be realistic and needed to follow the most reliable and achievable programme schedule.

Anxious due to the announcement of repeated delays, in the manufacturing process, the company's biggest customers, Singapore Airlines, Emirates, Virgin Airways and Qantas looked out for alternatives. Singapore Airlines, which placed the largest order for A380s, ordered twenty 787 'Dream liner' Boeing aircraft worth $4.5 bn. Analysts opined that Boeing was actually strategizing to leverage the crisis of Airbus. On the other hand, experts debated over the possibility of the market share of Airbus getting reduced,

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and Boeing taking advantage of that. On October 3, 2006, Christian Streiff announced his intention to get Airbus into shape by making A380 airborne soon with the support of all stakeholders. But analysts were skeptical whether he would be able to do the same.

Questions for Discussion

1. What strategy do you think would have helped convince the stakeholders?
2. Evaluate the competitive position of Airbus vis-a vis Boeing.

UNIT 7 INTERNAL ANALYSIS OF THE FIRM

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Structure

7.0 INTRODUCTION

Internal analysis of an organization is the basis for designing its business policy and strategy. For developing a successful strategy, a firm should have a realistic assessment of its internal resources and capabilities. An analysis of the internal resources will reveal what the organization is capable of in terms of its own resources. In this unit, you will learn about value chain analysis and the significance of the learning curve.

7.1 UNIT OBJECTIVES

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

- Understand the concept of value chain analysis
- Understand the significance of Porter's Value Chain Model
- Appreciate the importance of the various activities in the value chain
- Get an idea of the factors to be considered in assessing a firm's support activities
- Understand the use of the learning curve in planning

7.2 VALUE CHAIN ANALYSIS

In value chain analysis, the organization is viewed as an orderly process of activities aimed at creating value. This approach helps study the factors or steps that lead to competitive advantage. The approach is useful for understanding the building blocks of competitive advantage. Value chain analysis was described in Michael Porter's book *Competitive Advantage*. Value is defined as the amount buyers pay to a firm for their products or services. It is measured by total revenue which represents the price that the product of a firm commands and the volumes it can sell.

As long as the value received by a firm is more than the total expenditure involved in creating the product or service, the firm is in profit. In order to find out the competitive position of a firm, you have to study how much value has been created for buyers that is more than the cost of production.

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According to Porter, there are two broad categories of activities – (i) Primary activities and (ii) Support activities.

Primary activities help contribute to the manufacturing of the product or service in physical terms. They include the following:

(a) Operations

(b) Marketing and sales

(c) Inbound logistics

(d) Outbound logistics

(e) Service

These activities help contribute to the manufacturing of the product or service in physical terms.

The support activities either add to the value of the product or service on their own or in combination with primary activities or other support activities. Support activities include the following:

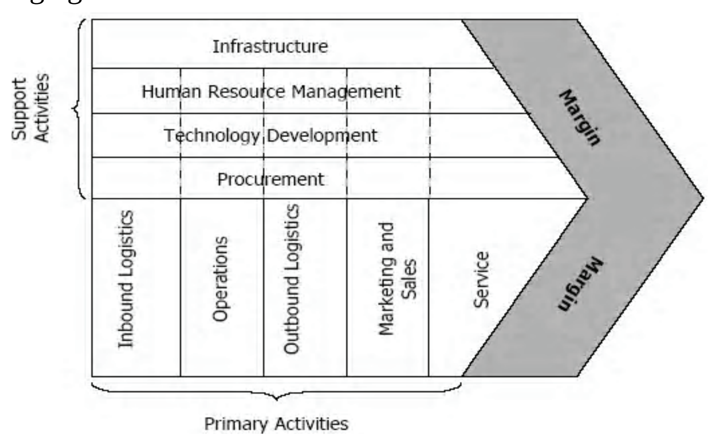
(a) Human resource management

(b) General administration

(c) Procurement

(d) Technology development

The following figure illustrates Porter's value chain



Porter's Value Chain Model

In order to make the most of the value chain analysis, you have to study the concept irrespective of the boundaries of your own organization. That is, you have to place your firm or business within a value chain that covers the clients or customer, partners and suppliers associated with your firm. Therefore, in addition to a thorough understanding of the process of value creation within the firm, you must also learn about how value is created for other firms in the overall supply chain or distribution channel in which your firm is also a participant.

7.2.1 Primary Activities

Each of the five generic categories that form the broad category of 'primary activities' can be divided into a number of subactivities depending on the nature of the industry and the strategy of the firm.

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Operations

Activities in this category are concerned with the efficiency of plant operations which will result in minimizing costs; use of appropriate level of automation in manufacturing; employment of production control systems of quality that will result in reducing costs and increasing quality; ensuring that the plant layout and workflow design is efficient.

Operations include all activities concerned with changing inputs into outputs, that is giving the final form to the product or service. The inputs here refer to activities such as machining, assembly, testing, printing, packaging and facility operations.

Canon, the $30 billion Japanese consumer electronics firm, dramatically improved its operational effectiveness by implementing the Toyota Production System(TPS). The just-in time manufacturing system is focused on avoiding waste and keeping the quality of the product or service high and consistent through continuous improvement.

Marketing and sales

The activities in this area are concerned with coming up with innovative approaches for promoting and advertising the products and services of the firm; identifying the various customer segments and their different needs; selecting the most effective and suitable channels of distribution and ensuring that the sale force consists of highly competent and motivated sales personnel.

Marketing and sales activities are concerned with the buying of products and services by the customers and end-users. It is also concerned with the promotional activities and incentives offered to the end-users to make them buy. Therefore, marketing and sales activities cover channel selection, advertising, pricing, channel relations, sales promotion and even the sales team.

Inbound logistics

This category of activities is concerned with the choice of location of distribution facilities in order to reduce shipping time and costs; ensuring that efficient material and inventory control systems are in place; use of time reduction techniques; to plan the design and layout of warehouse layout with an aim to increase efficiency of operations for incoming materials.

Inbound logistics is mainly concerned with receiving inputs, storing them and arranging for their distribution. It therefore covers material handling, warehousing, vehicle scheduling, inventory control and returns to suppliers.

Just –in-time (JIT) inventory systems, for example, were designed to achieve efficient in-bound logistics. In essence, Toyota epitomizes JIT inventory systems wherein parts are delivered at the plants for assembling purposes just before or a couple of hours before they are required. JIT systems play a vital role in fulfilling Toyota’s commitment to fill a buyer’s new car order in just five days. This standard is in sharp contrast to most competitors that require approximately thirty days’ notice to build vehicles. Toyota’s standard is three times faster than even Honda Motors, considered to be the industry’s most efficient in order follow-through. The five days represent the time from the company’s receipt of an order to the time the car leaves the assembly plant. Actual delivery may take longer, depending on where a customer lives.

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Outbound logistics

The activities under outbound logistics are concerned with the warehousing process of finished goods; time-saving shipping processes to ensure minimum damage and quick delivery; shipping of goods in bulk or lots to reduce cost of transportation; use of good quality material handling equipment to increase order picking.

Therefore, the activities of outbound logistics are concerned with collection, storage and distribution of the product or service to the buyers or customers——scheduling, order processing, material handling, finished goods, warehousing, material handling, delivery process.

Service

Activities under the 'services' category are those that are concerned with ensuring prompt response to customers' requirements and needs; ensuring that replacement parts are furnished as required; effective use of processes and procedures to invite honest feedback from customers; ensuring that corrective action is taken as per the feedback; ensuring that regular trainings are conducted to keep the quality of the personnel high; introducing suitable guarantee and warranty policies; managing parts and equipment inventory efficiently. This primary activity concentrates on providing quality service to the customers and ensuring that the value of the product or service is improved and maintained.

7.2.2 Support Activities

Support activities are those activities in the value chain that are involved with competing. As already mentioned earlier, the four generic categories included under support activities are, general administration, human resource management, technological development and procurement

Human resource management

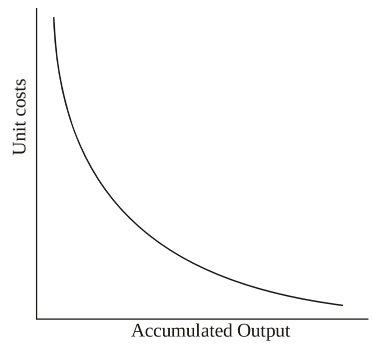
HRM activities are concerned with the recruitment of the right people, development of the existing staff and the mechanisms employed for retaining them. It also covers maintenance of good relations with trade unions, maximization of employee performance on the whole, improving the work environment and reducing absenteeism. Incentive programmes and motivational activities are also part of HRM.

General administration

Activities concerned with employing effective planning systems for the achievement of overall goals and obtaining low-cost funds for capital expenditure and working capital, obtaining. General administration activities have everything to do with the ability of the top management to predict future trends and situations and act on major environmental trends and events. Maintenance of good relationships with stakeholders, integration of activities across the organization and promotion of a healthy organizational culture and upkeep of the reputation and values of the firm are also part of general administration activities.

7.3 LEARNING CURVE AND EXPERIENCE CURVE

After the Second World War, the concept of the 'learning curve' became an important tool for planning. In 1965-66, the Boston Consulting Group developed its version of the learning curve and labelled it the experience curve. The experience curve suggests that as the total accumulated experience of a firm in the industry increases, it incurs less cost for producing a product. Under ideal conditions, the profitability of each firm should be a function of its accumulated experience in producing a particular product. Generally, one competitor has a commanding market share in a market segment for a particular product. It produces high volumes, at low cost and as a result enjoys high margins. The margin depends on the company's ability to control costs efficiently, so that costs go on diminishing as the firm goes down the curve.



Experience Curve

The experience curve helps a company reduce costs due to volume effects as well as learning effects. According to the volume effect, when a firm increases production, its fixed costs do not change because an increase in production brings down the cost per unit. In the semiconductor industry, the volume effect is highly visible. Each time cumulative production doubles, there is bound to be 20-25 % decline in costs. For example , if the first one million chips cost $100 each to produce, an increase in capacity to two million chips may bring down the cost to $ 75 per chip. This cost may fall further to $56 per chip when the production volume increases to four million chips.

But the volume effect cannot help companies reduce costs and increase efficiency; the learning effect (a company's efforts to learn from experience) plays a vital role in achieving this. Over the years, companies can identify inefficient, ineffective and counter-productive procedures. They should then reengineer their processes to achieve efficiency. Improving material and resource management, strengthening supplier relationships, standardizing products- all help companies achieve economies of scale in the long run. For example, GE cut down the number of parts in its refrigerator compressor by switching from a reciprocating to a rotary unit. This led to a reduction in assembly line and failure rates, thus lowering production costs. And as the rotary unit was small, GE could offer more storage space in its refrigerators to customers.

7.4 SUMMARY

In this unit, you have learned about value chain analysis wherein the organization is seen as an orderly process of activities involved in creating value. You have also learnt that in the value chain there are two broad categories of activities, primary and support. While the former is concerned with operations, inbound and outbound logistics, marketing and sales as well as service; the latter is concerned with procurement, human resource development, general administration and technological development.

Check Your Progress

1. What is an organization basis for designing its business policy and strategy?
2. What are the two broad categories of activities according to Porter?
3. What does an experience curve suggest?

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7.5 KEY TERMS

- **Value chain:** The view of the organization as a sequential process of activities aimed at creating value.
- **Value:** The amount paid by the buyers for a product or service.
- **Primary activities:** The activities that contribute to the physical manufacturing of a product of service.

7.6 ANSWERS TO 'CHECK YOUR PROGRESS'

1. An internal analysis of the organization is the basis for designing its business policy and strategy.
2. According to Porter, there are two broad categories of activities:
   (i) Primary activities; (ii) Support activities
3. The experience curve suggests that as the total accumulated experience of a firm in the industry increases, it incurs less cost, for producing a product.

7.7 QUESTIONS AND EXERCISES

Short-Answer Questions

1. What is the purpose of value chain analysis?
2. What are the activities included under 'operations'?
3. List the activities mentioned under primary and support activities?
4. How can a firm gain competitive edge by analysing its value chain activities?

Long-Answer Questions

1. Explain the categories that are included under support activities.
2. Take any industry and analyse the value chain activities at the macro level.
3. How does value chain analysis lead to the competitive advantage of a company?
4. What do you mean by value chain? On a broad basis, how many types of activities exist in a value chain ?

7.8 FURTHER READING

Johnson, Gerry and Kevan Scholes. 1994. *Exploring Corporate Strategy: Text and Cases*. New Delhi: Prentice-Hall of India.

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Case Study

Diversification and Growth Prospects of Amul

Amul is India's largest cooperative society with and also India's largest food products organization and the market leader in whole milk, condensed milk, milk powder, butter, cheese, ice cream, dairy whitener and sweets. This caselet studied how the cooperative integrated approach adopted by Amul was successfully used to dominate the dairy products market and how it utilized its strong brand name to diversify into non-dairy products, processed foods and other products. GCMMF or the Gujarat Cooperative Milk Marketing Federation is India's largest food products organization, responsible for marketing a variety of milk products produced by different milk Every day, millions of Indians wake up to the taste of Amul, the flagship brand name of Gujarat cooperative societies in Gujarat. It had an annual turnover of Rs 29,225 mn for 2004-05. GCMMF links about 11,000 village societies across India which translates into a total of 2.41 million milk-producing families. Its business involves a daily collection of milk at twenty-five supply centers in the state of Gujarat, the production and marketing of milk products through 50 sales offices throughout India, and distribution through a network of around 4,000 stockists who in turn supply to about 500,000 retail outlets.Amul embarked upon its famous journey as a beacon light for the Indian co-operative movement in 1946, as an offshoot of the freedom movement with an aim to do away with the exploitation of intermediaries in milk collection and give the villagers the best returns for milk. Since then, it has been undergoing a multi-dimensional evolution whose objective has been the same throughout—Serving the farmer and catering to consumer requirements. A structural landmark in this evolution process was the formation of the apex cooperative organization, GCMMF in 1974, under the charismatic leadership of V Kurien, the father of milk revolution in India.Under his leadership, the Amul model of co-operatives soon became an example for others to emulate. This model showed that an integrated approach along co-operative lines could enhance the production, procurement, processing and marketing of milk. The success of Amul also resulted in the proliferation of numerous Amul-like cooperatives such as Aavin, Gokul, Him, Mahananda, Milma, Nandini, Omfed, Parag, Sanchi, Saras, Sudha, Verka, Vijaya, Vita-all, Warana, etc., and other private players, including Amrut industries, J K Dairy, Heritage Foods, Indiana Dairy, Dairy Specialties, etc. across India.In the last three years, as many as 1,300 milk societies have been registered. According to industry experts, the scope for growth, especially in the organized dairy industry is huge, since it accounts for less than 15 per cent of the total milk produced and other packaged dairy products. Nevertheless, it cannot be certainly said whether the other diary societies would be able to emulate the success of Amul.In 1991, following delicensing of the dairy industry, GCMMF was faced with a question of whether it should stick to its core business of dairy products or diversify into other products, especially into processed foods such as jams, sauces and fruit juices where it had to compete with other multinationals.In 1996, B M Vyas, Managing Director, GCMMF, commissioned the Indian Market Research Bureau(IMRB) to conduct a market survey to identify the products consumers wanted from Amul. Based on the findings, Amul forayed into non-dairy business for the first time since its inception. It forayed into value-added products like ice creams, baby foods, curds, confectioneries, energy drinks, cheese, paneer, pizza, condensed milk and others. According to an analyst, a part of Amul's diversification is driven by compulsion than anything else.Being a co-operative, Amul was compelled to buy all the milk that was

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produced in Gujarat. Moreover, with milk production having increased since the mid-1990s, GCMMF had to make use of all the additional milk available and hence the pressure to manufacture and market more and more processed milk products. Only 15 per cent of GCMMF's revenues came from these value-added offerings as of 2004-2005. Amul also entered into various overseas markets such as Mauritius, UAE, the US, Bangladesh, Australia, China, Singapore, Hong Kong and a few South African countries.

Questions for Discussion

1. What are the reasons for success that can be attributed to Amul ?
2. How did Amul go about studying the market and become a force to reckon with in almost all categories of dairy products?

UNIT 8 CORPORATE-LEVEL STRATEGY

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Structure

8.0 INTRODUCTION

The central concern in this unit is the strategic decisions made at the corporate level of organizations decisions, which may affect many business units. Managers at the strategic level act on behalf of shareholders and other stake-holders, to provide services and, quite possibly, strategic guidance to business units. These business units themselves seek to generate value by interacting with customers. In such circumstances, a key question is to what extent and how might the corporate level add value to what the business does; or at least how it might avoid destroying value.

8.1 UNIT OBJECTIVES

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

- Understand the role of corporate centres in various businesses
- Differentiate between creating and capturing values
- Discuss the ways in which corporate centres can add value to the business

8.2 CORPORATE CENTRES: WHAT THEY TRY TO DO AND HOW?

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 our further discussion is to focus on the specific nature of the corporate centre or headquarters in diversified corporations and to seek 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.

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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 group- wide 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 centre influences the value creation process.

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 what is 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:

(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 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 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 preceding 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 really do represent the 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.

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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 of itself does not , however destroy the economic rationale for the businesses staying together as a group. Our interest is however drawn to the corporate centre of the group, and 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.

8.3 RATIONALE FOR CREATING OR CAPTURING VALUE

It is very important to understand where does the increased value come 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 capture in some cases comes 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 centre changes the way that the business do things, not what they do. These businesses operate more efficiently due to the presence of the corporate centre.

As an example of increased value capture many of the automotive companies like Tata Motors , Dana Corporation go in for a e- bidding while purchasing in bulk from their vendors. This process which can be compared to a reverse auction delivers a huge cost reduction to these companies as the suppliers are pitted against themselves in getting the share of business. Accordingly the corporate headquarters dictate of reducing costs can be very well justified through the above process.

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How can value be created?

Where the corporate centre apply its skills or knowledge to increase value, the result is much more likely to be the creation of 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.

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

Nature of corporate involvement

Corporate involvement / intervention	***Direct***	*CENTRALISATION OF ACTIVITIES AT LOWER COST*	*LEVERAGE KNOWLEDGE*
	Indirect	*IMPOSE CONTROLS AND FINANCIAL TRAGETS*	*FACILITATE CREATION OF NEW KNOW-HOW*
		Economies of scale	***Knowledge***
		Source of corporate advantage	

The value added by the corporate centre

The two sources of corporate advantage that can be mentioned are –

(a) economies of scale and

(b) knowledge

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

Economies of scale

(a) 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, e.g. 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 through achieving economies of scale in these centralized activities. The role of the corporate centre is that of a **manager.** The corporate centre needs 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 of achieving corporate advantage through a direct intervention could be Wal-Mart , IKEA & in the Indian context, Bajaj Auto, Hero-Honda and Reliance.

(b) The other way the corporate centre can seek to reduce the total costs of the group via 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.

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

Cost reduction principle by an indirect method of intervention can be found in Xerox, Philips and in the Indian context, ICICI bank, Hindalco , etc

Knowledge

(a) 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 added 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 counseling skills, if the group's vision and values are to be widely and accurately adopted

Value addition by the 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 Infosys, etc.

(b) However, there are many other groups where knowledge is also the key source of corporate advantage but where a more direct intervention by the corporate centre is required. The individual businesses within this type of group may have developed individually strong, knowledge based , sustainable competitive advantages, such as brands, customer service processes, differentiated products or process advantages, however the group structure or the management capabilities/ resources of the individual business units may be focused on a specific geographic region of the world, , while its technology advantage or brand may have far broader applicability.

The value adding role of the corporate centre is not therefore to facilitate the development of new technology as this already appears to be happening around the group, but to ensure that the existing knowledge is fully exploited across the group. The role of the corporate centre is that of a **'consultant'.** The key skills required by this type of corporate centre is that of systems and process management skills.

Typical examples of the businesses in which increased value through direct intervention is done can be found in Unilever, Toyota, The Tata Group, etc.

Check Your Progress

1. Define 'how' dimension?
2. From where does value capture come?
3. What are the two sources of corporate advantage?

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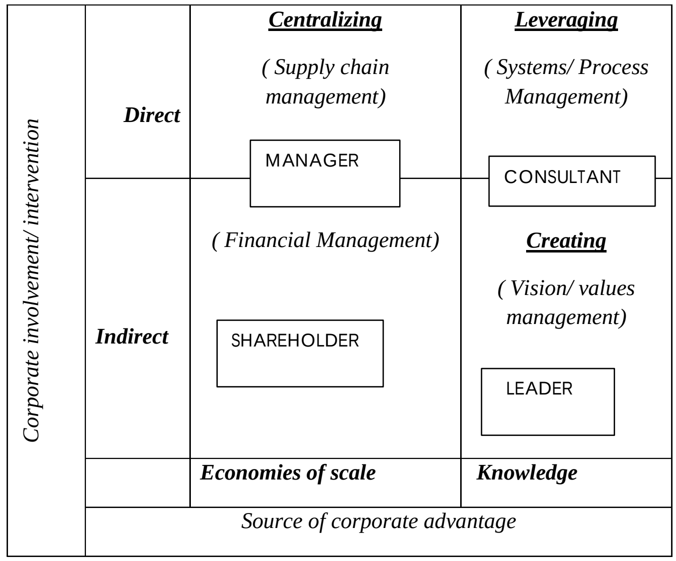
8.4 DIFFERENT ROLES OF CORPORATE CENTRES

The following figure illustrates the primary skills and roles essential at the corporate centre.



Primary roles/key skills needed at the corporate centre

The four possible value- adding combinations indicate significantly different roles for the corporate centre in each of these configurations. These differing roles mean that significantly different key skills are needed at the corporate centre.

The corporate configuration model gives four ways for corporate centres to create value, rather than just add cost and consequently destroy value. It has been found that the most limited value-adding configurations are on the left –hand side of the model as no group has ever 'cost cut its way into sustained greatness'. While both the manager and shareholder configuration can add value to any existing portfolio for some time, there eventually comes a point where the portfolio needs fairly radical change if more value is to be added by the corporate centre.

Similarly, even the consultant configuration can eventually run out of steam once the centre has comprehensively leveraged the existing value- adding knowledge across the group. Either the mix of businesses again needs changing or the centre has to identify a new source of advantage that can be widely applied across the existing business.

The generation of new corporate know-how is the main emphasis of the creative configuration and therefore this can be the most sustainable value- adding role for a corporate centre.

8.5 SUMMARY

This unit explained to you that managers at the corporate level act on behalf of shareholders and other stakeholders to render strategic guidance to business units.

You have read about the ways in which corporate centres can add value instead of just adding to the costs of the business. The unit highlighted the roles and key skills required at the corporate centres for successfully adding value to business operations.

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8.6 KEY TERMS

- **Value capture**: The act of capturing more of already existing values within an industry.
- **Value creation:** The act of creating new values that are otherwise absent.

8.7 ANSWERS TO 'CHECK YOUR PROGRESS'

1. 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.
2. Value capture comes from external suppliers by centralizing the sourcing of support activities or even core business processes.
3. The two sources of corporate advantage that can be mentioned are –
   (i) economies of scale and
   (ii) knowledge

8.8 QUESTIONS AND EXERCISES

Short-Answer Questions

1. What are the ways in which a corporate adds value to its underlying business?
2. What are the roles and key skills needed to ensure that a corporate can add value?
3. How is shareholder configuration different from manager configuration?
4. How is leader configuration different from consultant configuration?

Long-Answer Questions

1. How do corporate centres add value to the underlying group business? Discuss.
2. Describe the roles of a corporate centre.
3. How can value be created? Discuss with examples.

8.9 FURTHER READING

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Case Study Sustainability of Core Competency

Introduction

3M was a $ 21.2 bn diversified company in late 2006 with over 50,000 products ranging from Post-it Notes and Scotch tape to transdermal patches of nitroglycerin and optical films. 3M owed its formidable strength to its unusual corporate culture, which comfortably fostered innovation and interdepartmental cooperation, backed by a massive research and development budget, which typically exceeded $1 bn annually. Because of this, the company was a leader in—and in many cases a founder of—a number of important technologies, including pressure-sensitive tapes, sandpaper, protective chemicals, microflex circuits, reflective materials and premium graphics.

3M operated in the electronics, telecommunications, industrial, consumer and office, healthcare, safety, and other markets. It owned popular brands such as Post-it, Scotch-Brite and 3M Scotchshield. Since the end-user segment for the products were diverse, the company did not fall under any of the normal industry classifications. In December 2005, the company recorded a net profit of $3.2 bn, an increase of 7 per cent over 2004.

When W James McNerney (McNerney), the first outsider at the helm in the company's nearly 100 years of existence, took over as Chairman and CEO in early 2001, he found 3M underperforming and relatively directionless. Its research facilities were turning out fewer and fewer commercial hits, and quarterly results were not meeting shareholders and analysts expectations. Though it still drew many of the world's best chemical engineers, the company's labs had not had a major breakthrough for over two decades. His challenge was to balance the science of management against innovation and control the use of resources for product development without killing the 'hairbrained' ideas that made 3M what it was.

In October 2003, 3M implemented a major realignment of its R&D operations. Fourteen separate technology centres were closed, with the scientists at these centres shifted either to a newly formed Corporate Research Labouratory or to the Company's forty divisions, where they would be able to work closely on products within those divisions. The main goal of this R&D shakeup was to move more of 3M's R&D resources to the divisions where the products were actually developed and thereby bring the scientists closer to customers. In 2003, 3M posted an increase in sales and operating margins. In June 2005, McNerney resigned from 3M. In 2005, George Buckley, another outsider, but this time an engineer, joined as the company's CEO.

He was entrusted with the task of revitalizing 3M's competitive advantages.When George Buckley (Buckley) joined as the CEO of 3M in December 2005, the company was facing criticism from analysts and investors over anemic revenue growth that had slowed to between 1 and 5 per cent through parts of 2004 and 2005, even while the broader markets had been expanding. Buckley realized that he needed to generate growth, maintain premium margins and strategically manage the company's portfolio – all without driving out 3M's culture of innovation on which both the company's fame and its long history of success rested. He needed to develop a growth strategy which was based on and enhanced 3M's core competency. What could he do to ensure that?

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Evaluating 3M

On joining 3M, Buckley did a detailed study of the company and found that it was a highly capable scientific, engineering and manufacturing company with deeply conservative values, participating in many successful niche markets. 3M had incredible inter-segment technology sharing, where new markets were continually built through a virtual 'adjacency machine' technology sharing and transfer across products and markets. For example, Scotch-Brite Sponges, 3M Respirators, Filtrate Filters and Thinsulate Insulation along with dozens of other 3M products, drew on non-woven materials technology – one of more than forty 3M technology platforms.

3M had a strong R&D capability. Its strong knowledge and understanding of technologies such as adhesives, materials science, light management, micro replication and non-woven materials had resulted in several innovative products. Furthermore, the Company had the ability to manufacture these innovative products efficiently and consistently, on a global basis. The company had reduced cycle time four years to two-and-a-half years in order to realize sales faster. R&D expenses totalled $1.2 bn in 2005, $1.19 bn in 2004 and $1.14 bn in 2003. R&D expenditure as a percentage of sales stood at 6.3 per cent in 2003, 5.9 per cent in 2004 and 5.9 per cent in 2005.

3M had diversified operations in terms of the number of industries and geographic regions served.The Company's revenues were spread across its six key businesses, with healthcare (the largestcontributor) and industrial accounting for about 21 per cent and 18 per cent of the total revenues, respectively.Other businesses included display and graphics; consumer and office; electronics and communications; safety, security and protection services. The group had also maintained a regional balance in operations, with the US accounting for 39.1 per cent, Asia Pacific 27.1 per cent, Europe, Middle East and Africa 24.7 per cent and Latin America and Canada 8.9 per cent of total revenues. This diversity across industries and regions enabled the company to protect itself against demand fluctuations in industry segments and regions.

Buckley observed that 3M's history was rooted in an 'invent and experiment' approach or the 'make a little, sell a little' policy. This had led to an incremental approach to capacity and strategic planning, with complex supply chains evolving quite naturally – extrusion processes at one plant, coating in another plant and final conversion at yet another. Though individual plants were run with superb efficiency, interconnecting logistics were often complicated and costly, resulting in higher inventory. Buckley believed that chronic underinvestment in core capacity had led to many upside sales growth opportunities being missed. In fact, this underinvestment in core markets had made readily available growth hard to capture. The Company's strategic planning capability seemed underdeveloped. But this did not underscore the fact that the company possessed world-class manufacturing capability.

3M's world-class materials science and surface chemistry capability was built over many years. It had often entered markets only after privileged Intellectual Property (IP) positions were built. In the early days, the scale was not considered important and demand and capacity were often underestimated. 3M had focused on making 'risk-free' capital investments by using highly flexible machine tools. To encourage innovation, the company had a '15 Percent Rule', which allowed its employees to spend up to 15 per cent of company time on independent projects, a process

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called 'bootlegging' or 'scrounging'.

Buckley felt that the Company's superior manufacturing capability and know-how was equally important and a significant barrier to entry. He believed that one source of the next wave of growth would come from reinvention of the materials science space with nanotechnology. In addition to its core, 3M had six competitive platforms – low cost which gave it a considerable edge over competition; scale and relative share; customer value chain; pristine service and premium brands.

Questions for Discussion

1. What were the problems that 3M faced in late 2000 ? Why was the revamping of the R&D set-up required?
2. What steps did Buckley take to revitalize the Company?
3. What was the real competitive edge of 3M? Give reasons.

MODULE - 3

UNIT 9 BUSINESS-LEVEL STRATEGY

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Structure

9.0 INTRODUCTION

Business-level strategy involves making decisions about the competitive position of a single business unit. The managers at this level translate the general statements of corporate strategic planners into exact, concrete functional objectives and strategies for individual business divisions. Business-level managers determine what the company's competitive advantage is to be based upon in a specific product market area. The goal of business-level managers is to select, enter and grow in the most profitable market segment with the highest potential for growth. In short, this strategy is concerned with using generic strategies such as cost leadership, differentiation and focus to create competitive advantage.

9.1 UNIT OBJECTIVES

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

- Understand the significance of strategy at the business level
- Get an idea of competitive advantage and sustainability
- Explain the tactics required for cost leadership
- Identify the pitfalls of cost leadership strategies
- Appreciate the importance of achieving differentiation

9.2 TYPES OF COMPETITIVE ADVANTAGE AND SUSTAINABILITY

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 the potential to allow a firm to outperform rivals within the same industry. The first, overall cost leadership is based on creating allow-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 a focus strategy must attain advantages either differentiation or a cost leadership approach. Whereas the overall cost leadership and differentiation strategies strive to attain advantages industry wide, focusers build their strategy with a narrow target market in mind.

The following figure illustrates these three strategies on two dimensions: competitive advantage and strategic target.

		Competitive Advantage	
		Uniqueness perceived by the customer	Low Cost Position
Strategic Target	Industry wide	**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’.

9.3 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 , 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 business ‘learns’ how 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.

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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 economics 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 that 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 in-line and paper account statements.

Improving competitive position vis-a –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 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 from following a strategy of overall cost leadership. However, there are some pitfalls to avoid :

- Too much focus on one or a few value- chain activities:

  Firms need to pay attention to all activities in the value chain to manage their overall costs. Too often managers make big cuts in operating expenses, but don't question year-to-year spending on capital projects. Or managers may decide to cut selling and marketing expenses but leave manufacturing expenses untouched. Managers should explore all value-chain activities, including relationships among them, as candidates 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 less able to pass on price increases, 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.

- A lack of parity on differentiation: As noted earlier , firms endeavoring to attain cost leadership advantages need to obtain a level of parity on differentiation.
- Erosion of cost advantages when the pricing information available to customers increases

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9.4 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 several 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.

Siebel Systems, a leader in software that manages customer relations is well known for its customer Service. No software's 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 finding, 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.

Check Your Progress

1. How does a firm achieve above average returns despite strong competition?
2. What is the requirement for cost leadership?
3. What is the strategy of differentiation?

Differentiation: 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

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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 price-sensitive. 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. Last, a firm that uses differentiation will enjoy high customer loyalty, thus experiencing less threat from substitutes than its competitors.

9.5 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 out focus the focuser.

9.6 SUMMARY

In this unit, you have learned that generic competitive strategies enable firms to outperform competitors in the industry. These strategies include overall cost leadership, differentiation and focus. In this unit you have learned that a firm following the cost leadership strategy needs to achieve the lowest cost of production per unit level in the industry. Similarly, differentiation strategies are aimed at maintaining the exclusivity of the product. Hence, the perceived difference in the product serves as a competitive advantage to the firm. Using focus strategies, the firm tries to capture a particular buyer group, segment of the product line or geographic market. This strategy is based on the inherent belief that there is some limit to the overall market share that is achievable.

9.7 KEY TERMS

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- **Experience curve:** This refers to how a business 'learns' the techniques of cost reduction as it gains experience with production processes.
- **Competitive advantage:** The advantage a business has over its competitors in terms of uniqueness perceived by the customer and low cost position.
- **Differentiation:** A strategy that requires a company to create products/ services that are unique and valued.

9.8 QUESTIONS AND EXERCISES

1. A firm achieves above average returns despite strong competition by means of an overall low-cost position.
2. 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
3. The strategy of differentiation consists of creating differences in the firm's product or service by creating something that the industry views as unique and valued by customers.

9.9 QUESTIONS AND EXERCISES

Short-Answer Questions

1. Define competitive advantage in your own words. How do businesses strive to achieve this?
2. What leads to firms being low performers?
3. What is the relationship between cost leadership and the experience curve?
4. How can absolute cost advantage be achieved?
5. What is a focus strategy?
6. What is meant by business-level strategy ?
7. What are generic strategies? What are the three types of generic strategies?
8. What are the pitfalls in cost leadership and differentiation strategies ?
9. What happens if a company uses a combination of all the three generic strategies?

Long-Answer Questions

1. Discuss the advantages of a low-cost position.
2. Discuss the possible pitfalls of an overall cost leadership strategy?
3. Write a note on differentiation and its forms.

4. Discuss differentiation in the context of the five forces.
5. Write a note on overall cost leadership.

9.10 FURTHER READING

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Case Study

Enhancing Competitive Advantage -Acquisition of L&T Cement by Grasim Industries

India is the second largest cement producer in the world with cement production at 144 million tons and consumption at 117 million tons, surpassing developed countries like the US and Japan. But, 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 Rs 5,233.3 cr 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 March 31, 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.

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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 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 areas which were far flung were fed by rail. Clearing and forwarding agents (C&F) were appointed. In some regions such as the Eastern Zone, the collection responsibility also rested with the C and F agent. 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 at 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, etc. were conducted regularly for relationship management. As per calculations, for every bag of cement sold, Rs 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 answers.

UNIT 10 GLOBAL STRATEGY

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Structure

10.0 INTRODUCTION

The global marketplace provides many opportunities for firms to increase their revenue base and profitability. Furthermore, in today's knowledge-intensive economy, there is the potential to create advantages by leveraging firm knowledge when crossing national boundaries to do business. At the same time, there are pitfalls and risks that firms must avoid in order to be successful.

The main strategies used by firms to compete in the global context are international strategy, multi-domestic strategy, global strategy and transnational strategy. Each of these strategies has its merits and demerits. The suitability of each strategy will differ according to the extent of pressure for reducing cost and local responsiveness. In this unit, you will get a fair idea of the types of strategies.

10.1 UNIT OBJECTIVES

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

- Understand the international strategy adopted by firms to create value by transferring skills and knowledge
- Explain the multi-domestic strategy pursued by firms to attain optimum local responsiveness
- Appreciate the global strategy that concentrates on increasing profitability
- Understand the transnational strategy

10.2 INTERNATIONAL STRATEGY

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 the 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 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, Kellog's, 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.

10.3 MULTI-DOMESTIC STRATEGY

A multi-domestic strategy encourages a firm to direct its energies towards attaining optimum local responsiveness. Firms attempt to customize their products and marketing strategy to suit the local needs and conditions of the different nations. They even end up establishing an exclusive set of value creation activities in each of the major markets abroad. These activities include marketing, production and research and development. As a result, they fail to realize value from experience and economies of location. They may not be able to do a good job of leveraging core competencies within the firm.

Some examples of firms that have done well as multi-domestic corporations are General Motors, Hindustan Unilever Limited, etc. These companies have widespread operations in the European nations. A multi domestic strategy should be adopted only when there is a high pressure for local responsiveness and low pressure for reducing costs.

10.4 GLOBAL STRATEGY

Focus on increasing profitability by reducing costs is the prime focus of firms that pursue a global strategy. They adopt a low-cost strategy and their research and development, marketing and production activities are confined to just a small number of favourable locations.

Global firms try to avoid customizing their products, services and marketing strategy to local conditions because this results in duplication of functions and a considerable rise in costs. Global firms try to concentrate on marketing standardized products across the globe so that they can enjoy the profits from the economies of scale from the experience curve. Such firms can use their cost advantage for aggressive pricing in markets across the globe.

The global strategy can be adopted when the demand for local responsiveness is very little and the pressure for reducing costs is more. Therefore, this strategy is usually used in the industrial goods industries, for example, the emergence of global standards in the semiconductor industry has led to firms such as Intel, Texas Instruments, Panasonic pursuing a global strategy.

Take a look at the following case study that tries to bring out the drawbacks of going global:

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Case Study

Drawbacks of going Global

The organizations which expand their market globally, face many drawbacks. Among the major demerits are lack of strategic decision, improper allocation of marketing mix and cultural differences. Globalization has created a new marketplace for marketing products and services for various competitive markets. The strategic objective leverages the business, if there is proper utilization of available resources, an ability to create new resources, the expertise to run overseas business and an ability to create a professional alliance partner for mutual benefits. Despite all these efforts, organizations going global make several mistakes. In order to identify the pitfalls, the organization must scan the internal and external environments which are the root cause of any pitfall. The social issues as well as the political, economic, legal and operating environments play an important role in the success or failure of an organization which decides to go global.The questions that must be answered by the organizations, aiming to run businesses in the global market include the following:

- What are the motives behind going global, is it to increase market share and market revenue?
- Does the organization aim to enhance the research and development activities through overseas activities?
- Can the organization aim to decrease the cost of operation and go for offshoring and outsourcing of its business activities, as seen in most of the BPOs?

Thus, the questions to ponder before going global may be innumerable but the key objectives behind this analysis must be cleared. Mere expansion of business in all corners of the world will not fulfill the vision, mission and objective of any organization, as every organization has limited resources. Furthermore, it takes courage to go global which involves exploring unknown territories. As the decision-making ability increases, the organization delivers a long-term commitment to all stakeholders and the organization gets a better goodwill. Therefore, the important reasons for going global are incentives for export-based firms, monopoly power creation, increase in competition level, saturation of domestic market, growth potential in foreign markets and risk diversification in business.

What are the common pitfalls?

The following are the common pitfalls of organizations that decide to go global:

Pitfalls in strategies of market entry, expansion and partnership. Sometimes, the organization is not able to identify the relevant market strategies and the next level of organization expansion. The organization thus makes a mistake in deciding the right mode of entry into foreign countries such as licensing, contract manufacturing, joint ventures, tripartite ventures, consolidation, foreign assembly, etc. Therefore, before going global, the organization must understand issues such as foreign policy, FDI rules, free trade agreements, tax benefits, other business incentives, project clearance methods and technical procedures to start the business. One of the mistakes that an organization makes while expanding its market is that it goes after creating a monopoly in the global market. This is not desirable in the healthy competitive market. The unsolicited bid offer of Arcelor by Mittal steel was one such example. This bid was rejected by the Board of Directors of Arcelor on the grounds that Mittal steel did not share the same strategy, vision, business model and values and that the proposal was merely a hostile bid offer. Besides, they could not comprehend how an Asian company could rule the whole steel

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market of the world while the European countries watched the whole game of monopolizing strategy. Although the game is now over, it is a lesson to the big giants that they must understand the market expansion strategies, even if the organization sustains the positive motives behind any expansion plan.

Therefore, an organization going global needs to have an alliance. The alliance partner must possess the relevant expertise know-how of the local market. This alliance is obviously created for the long run globalization objectives by signing a Memorandum of Understanding (MoU), sharing intellectual property rights, marketing and sales resources, technology etc. Sometimes, the organization is lured by short-term incentives and the MoU is signed. However, once the time of contract is over, the cost of operation is increased. The alliance partner promises to share contacts and extensive experience of local business, cultural customs and government regulations. At the beginning itself, the alliance partner should be clearly informed about sharing of revenue and profits. In the global business, the organization hires an expert for better know-how of local markets and once the organization gets the expertise it lets the expert agent go. However, the organization makes a mistake here because business processes change over time and every situation is a new challenging task. Therefore, just to save an extra dollar by getting ride of an expert can do more harm than good.

On the other hand, an organization does not anticipate the future problems that may come up with alliance partners. This complicates matters when the crisis actually occurs. Therefore, the conflict issues such as sharing of cost, channel of communication, ownership of intellectual property rights, sharing of revenues etc., must be transparent enough in advance. Finally, the right attitude and sound communication between two parties makes the alliance successful. There may be shortcomings in the understanding of the marketing mix, that is, product, price, place and promotion.

Merely a good idea does not work in the long run in the global market unless one understands the global market very minutely. Many organizations make the mistake of leveraging the business on a few competitive factor such as advertisement, distribution, price, new product development etc. Without doing enough market research, they take for granted, that their products would be sold. Thus, before making any personal judgment, the strategy of global market segmentation should be implemented after the consultation with different team leaders and players.

One such important case that proved that an organization cannot gain market share based on just one factor, was seen in the past in the photography industry, where players such as Kodak, Fuji, Konica and Polaroid had the major market share. Kodak was positioned as the market leader while Fuji had the minimum market share but in the subsequent years, Fujicame out with new products in the colour film segment and gained 10 per cent of the total market share of the photography industry in the US. But the new products of Fuji could not reach the targeted segment, as Kodak had a strong distribution system through supermarkets, drug stores and amusement. Fuji felt that it couldn’t gain much in the US market and then moved into the European markets.

The timing and place of product selling are also important. In 1982, when Kodak tried to sell pocket cameras in the US and Japanese markets, it was found that the market was not so attractive and thus Kodak moved to South-East Asia where a pocket camera was a new product. The right timing and marketing of products not only helped Kodak gain a substantial share of the market but also survive by dumping products in the US and Japan at lowerprices.

Thus, substantial global market share can be gained by a good understanding of marketing mix, global market segmentation, targeting and positioning.

Inability to understand the cultural differences can also be a drawback. Culture must not be interpreted alike in two different countries as education level, ethics, food, taboos, status, language etc. are different in different countries.

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10.5 TRANSNATIONAL STRATEGY

In today's business environment, competition is so intence that survival in the global marketplace requires firms to exploit experience-based cost economies and location economies. They need to transfer their core competencies within the organization at the same time focusing on the pressure for local responsiveness.

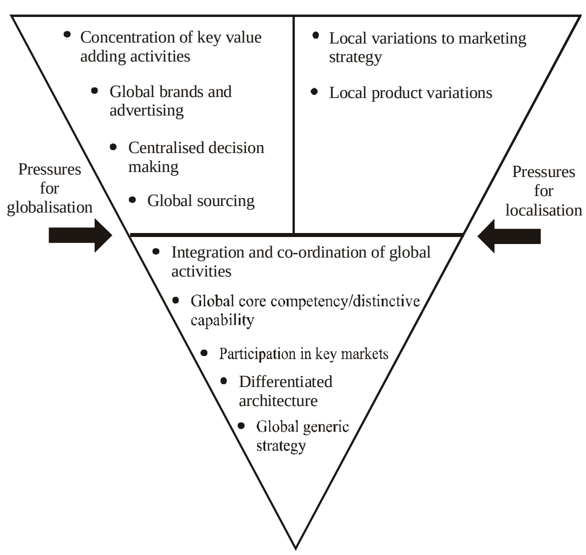
In multinational enterprises of today, core competencies do not reside in the home nation alone. Core competencies can develop in any of the firm's operations across the globe. Some management thinkers feel that the flow of skills and products should take place from the home firm to its foreign subsidiary, from the foreign subsidiary to the home firm and also from foreign subsidiary to foreign subsidiary. That is transfer of competencies should take place globally giving rise to global learning. The strategy adopted by firms in an attempt to attain all these objectives at the same time is referred to as transnational strategy by Bartlett and Ghoshal.

A transnational strategy is pursued when a firm faces high pressure for reducing cost and similar high pressure for local responsiveness. Such firms try to reduce costs and attain differentiation advantage at the same time which is a difficult strategy to follow.

Demand for local responsiveness along with reduction of cost is difficult because efficient local responsiveness leads to rise in costs. In the late 1970s, tough competition from Komatsu and Hitachi of Japan owing to their low costs, forced Caterpillar Inc. to look for greater cost economies. At the same time, national variations in government rules and construction norms required Caterpillar to remain responsive to local demands.

Let us now look at a case study that deals with the strategies for entering the global market.

Transnational Model Strategy



Check Your Progress

1. What are the main strategies used by firms to compete in the global context?
2. How do international companies create value?
3. Write one feature of a multi-domestic strategy.
4. When does a firm pursue a transnational strategy?

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Case Study

Strategies for entering the Global Market

Companies have to go global to sustain their competitive advantage and profitability. They have to constantly look out for new markets and customers and cater to their needs in order to sustain their profitability. While entering the new markets, companies should have a strategic plan, which will help them achieve their goals.

Meticulous planning and execution are important to succeed in international business.

When a domestic company wants to enter an international market, it must carefully select its entry strategy. Wrong entry strategy may sometimes threaten its very existence.

So, entry strategy must be chosen only after a thorough consideration of both situational factors and organizational objectives.

Some of the entry strategies available for firms who want to go global are:

- Exporting
- Strategic Alliances (including joint ventures)
- Licensing
- Mergers and Acquisitions
- Franchising
- Greenfield Investment
- Contract Manufacturing
- Internet Commerce

Exporting refers to producing goods and services in one country and selling in another country. It is one of the easiest ways to go global. However, companies cannot take this route for granted. Althoug it may be an easier option in comparison to other entry strategies, it has its own complexities. Exporting is usually considered to be the first step in the globalization process. The main reason for companies to choose this strategy is that the risks involved in export are less and the investment required is also very low, as compared to other entry strategies.

Companies can export in three ways:

(i) Companies can directly export to other countries, if they are able to market and sell directly to the clients and customers. Knowledge of the market is an essential requirement to achieve this.

(ii) If a company is not familiar with the exporting country market, it can adopt the indirect exporting route under which it can appoint an agent/ distributor to take care of the marketing and selling of its products.

(iii) The third option is to enter into a strategic partnership with another company or other companies. This helps in complementing capabilities. Valuable market access and quick growth in sales can be attained by partnering with a company selling complementary products or services.

Bharat Forge is an example of an Indian company which entered the global market, through exports. It also acquired exporting companies in the US, UK, Germany and China to leverage its share in the global export market. It is the largest exporter of auto components from India and a leading chassis component manufacturer in the world.

Licensing route is effective for companies which have proprietary rights over certain technology and trademarks. By licensing their rights to a foreign firm they can globalize, and in turn receive royalty or other payments. Licensing gives access to multiple markets without having to invest in vast resources.

10.6 SUMMARY

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This unit attempted to explain the strategies to be used by companies in the global marketplace. You have learned that a firm can create value by transferring skills, knowledge and products to foreign markets by pursuing an international strategy. Companies adopt a multi-domestic strategy so that they can direct their energies towards achieving optimum local responsiveness. A global strategy focuses on increasing profitability by reducing costs. You have also learned that transnational strategy attempts to transfer competencies globally.

10.7 KEY TERMS

- **International strategy:** An attempt by firms to create value by transferring their skills, knowledge and products to foreign markets that lack the same.
- **Multi-domestic strategy:** A strategy that attempts to customize products and marketing strategies to suit the local needs and conditions of different nations.
- **Global strategy:** A strategy that focuses on profitability through cost reduction.
- **Transnational strategy:** An attempt to transfer competencies globally encouraging global learning.

10.8 ANSWERS TO 'CHECK YOUR PROGRESS'

1. The main strategies used by firms to compete in the global context are as follows:
   (i) International strategy
   (ii) Multi-domestic strategy
   (iii) Global strategy
   (iv) Transnational strategy
2. International companies create value by transferring various products developed indigenously to new markets abroad.
3. A multi-domestic strategy encourages a firm to direct its energies towards attaining optimum local responsiveness.
4. A transnational strategy is pursued when a firm faces high pressure for reducing cost and similar high pressure for local responsiveness.

10.9 QUESTIONS AND EXERCISES

Short-Answer Questions

1. How can companies pursue a transnational strategy?
2. How does transnational strategy encourage global learning?
3. When should a global strategy be employed? Give reasons.

Long-Answer Questions

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1. Write a note on each of the strategies–global, international and multi-domestic.
2. In your opinion, which strategy should a company with a strong domestic market and a desire to get a foothold in the international market try to adopt?
3. A transnational strategy should be pursued when a firm faces high pressure for cost reduction as well as local responsiveness. Explain.
4. Explain why it is difficult to reduce costs and at the same time achieve local responsiveness.
5. Explain the features of a multi-domestic strategy.

10.10 FURTHER READING

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UNIT 11 ACQUISITION, RESTRUCTURING AND COOPERATIVE STRATEGIES

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Structure

11.0 INTRODUCTION

Mergers and acquisitions or M&As have become a popular strategy in the last two decades. Some strategic thinkers feel that M&As have played a crucial role in the restructuring of the US companies during the 1980s and 1990s. In this unit, you will learn about mergers and acquisitions, the rationale that governs them and the reasons that cause them. In addition, the unit will discuss corporate restructuring and its forms along with the competitive advantage derived from cooperative strategies.

11.1 UNIT OBJECTIVES

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

- Understand the concept of mergers and acquisitions
- Get a historical perspective of mergers
- Understand the rationale for mergers and acquisitions
- Explain cross-border mergers and acquisitions
- Define corporate restructuring and identify the forms of restructuring
- Appreciate the competitive advantage from cooperative strategies

11.2 MERGERS AND ACQUISITIONS

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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.

11.3 RATIONALE FOR MERGERS AND ACQUISITIONS

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

11.3.1 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.

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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.

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

(iv) 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 Level Limited and Tat Tea purchased many tea gardens in Assam and West Bengal.

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. Apart from increasing the market power there are many other reasons that have contributed in the increase of merger and acquisition activities some of which are discussed as follows:

11.3.2 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

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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.

11.3.3 Cost of New Product Development

Developing new products and launching them successfully in the market not only requires commitment of the firm's resources but 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 percent of new products fail to achieve expected results while 60 percent 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 a another company that already has an established product in the market, the acquiring company can enter the market more quickly.

11.3.4 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.

11.3.5 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 and As is that they prevent investments in new product development. Research shows that M and 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.

11.3.6 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.

11.3.7 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.

Check Your Progress

1. Define 'merger'.
2. What are the reasons or the increasing number of cross-border mergers and acquisitions?

11.4 REASONS FOR CROSS-BORDER MERGERS AND AQUISITIONS

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There are various reasons for the increasing number of cross-border mergers and acquisitions. Some of these reasons are growth, technology, government policy, differential labour costs, productivity and source of raw materials.

Growth

Growth is one of the primary motivating factors for cross border M&As as merges and aquistions provide an opportunity for firms to grow fast. 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 cost advantage.

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.

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

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 and As.

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.

11.5 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

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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 precisely at this time 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 people who can be trusted to use the best and fastest decisions for 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 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. It is particularly important to do this for international acquisitions.

11.6 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 was adversely affected. these companies fell drastically, making them soft targets for hostile takeovers. To minimize such risks, firms had to undertake restructuring activities.

11.6.1 Forms of Restructuring

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Restructuring can happen in the form of expansions, sell-offs, corporate control and changes in ownership structure.

Expansion can take place through mergers and acquisitions, tender offers or joint ventures. Sell-offs can take place through spin-offs, split-offs, split-ups, divestitures and equity carve-outs.

Corporate control can be achieved by premium buy-backs, standstill agreements, anti-takeover amendments and proxy contests. Changes in ownership structure can be brought about by going private and through exchange offers, share repurchases and leveraged buy-outs.

The various forms of restructuring are discussed in detail in the following pages:

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 co-equal 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. The various types of mergers have already been discussed in detail earlier.

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.

Sell-offs

There are two major types of sell-offs spinoffs and divestures. A spin-off results in the creation of a separate legal entity, the shares are distributed among existing shareholders of the parent company on a prorate basis. It is a form of dividend to

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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-outs 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 result in the creation of a new legal entity.

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, often a standstill agreement is 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 stockholder with substantial influence agrees not to increase his or her ownership control.

Anti-takeover amendments refer to the changes made in the corporate bylaws 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.

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).

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11.7 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, when the 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.

11.7.1 Increasingly 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 the average large corporation is involved in around thirty alliances today in comparison to fewer than three a decade ago.

Check Your Progress

3. How is corporate control established?
4. How does expansion take place?
5. Why do companies in all types of industries in all parts of the world form strategic alliances and partnerships?

11.8 SUMMARY

The integration of two or more firms on co-equal basis is known as merger. The first and foremost reason for M&As is firm's desire to increase market power. In order to expand the size of the firm, horizontal, vertical and conglomerate mergers are taken up.

Other reasons for the increasing use of M&A are overcoming entry barriers, high cost of new product development, increased speed to the market, lower risk involved in M&As compared to new product development, diversification to other activities and reshaping the firm's competitive scope.

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Integration is a crucial part of any successful acquisition. An efficient integration 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.

The value created through a merger depends on the nature of the deal that has been struck as well as the integration process. A wrongly conceived merger will fail, no matter how good the integration process and a deal based on sound logic might stumble if the integration process is poor.

11.9 KEY TERMS

- **Mergers:** Integration of two or more firms on a co-equal basis.
- **Acquisition:** The process of gaining complete or partial control of a company by another company for some strategic reasons.
- **Restructuring:** A strategy by which a company changes its business or financial structure.

11.10 ANSWERS TO 'CHECK YOUR PROGRESS'

1. Mergers can be defined as the integration of two or more firms on a co-equal basis.
2. There are various reasons for the increasing number of cross-border mergers and acquisitions. Some of these reasons are growth, technology, government policy, differential labour costs, productivity and source of raw materials.
3. Corporate control can be established through premium buy-backs, standstill agreements, anti-takeover amendments and proxy contests.
4. Expansion can take place through mergers and acquisitions, tender offers or joint ventures.
5. 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.

11.11 QUESTIONS AND EXERCISES

Short-Answer Questions

1. What is the basic difference between a merger and an acquisition?
2. What are the major reasons for cross-border mergers and acquisitions?
3. How do you go about integrating an acquisition successfully?
4. What is expansion?

Long-Answer Questions

1. What are the three types of mergers? Discuss briefly.
2. Discuss the various forms of corporate restructuring.
3. How can corporate control be achieved? Explain.
4. Write a note on sell-offs.

5. Strategic alliances and collaborative partnerships have emerged as an attractive and timely means of breaching the technology and resource gaps that firms commonly encounter. Discuss.
6. How do labour costs lead to cross-border mergers and acquisionts? Explain with an example.

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11.12 FURTHER READING

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Case Study

The Retail Acquisition foray of Aditya Birla Group

During the past decade, India has emerged as one of the most favourite destinations for business as The Indian economy is growing at a rate faster than ever before. Economic liberalization of the country led to higher living standards, which ultimately changed the shopping behaviour of the Indian customers. Organized retailing in India is flourishing and offering incredible openings to the retail players to convert the country into a shopper's paradise. This is a time when Indian business groups are interested in entering into alliances with multinationals. The arrival of Aditya Birla Retail and its acquisition of 'Trinethra' can be considered as one of the important milestones in the landscape of Indian retailing. The basic objective of this caselet is to critically examine the acquisition strategy of the Aditya Birla Group with special reference to its recent acquisition of 'Trinethra'. It is also intended to illustrate how a business group ensured its successful entry into an entirely unrelated business, and to comprehend the changing dynamics of Indian retail industry.

We are witnessing the waves of globalization where the entry of organized retail players haschanged the entire shopping behavior of the Indian customers. Now, the fundamental goal of retailers is not only to sell the products but to offer an astounding shopping experience. Nowadays, the Indian retail industry has become very dynamic and sensitive as national and international players in this industry are continuously introducing new cultures, concepts and retail formats to ensure an unmatched experience to the shoppers. This is the time when the Indian retail industry is on the verge of something exceptional – as global retail giants like Wal-Mart, Tesco and Carrefour are looking for ways to enter and dominate the Indian market as well as to detain the huge customer base and colossal profit. The booming economy of this country is offering tremendous opportunity to the retail players to convert the country into a shopper's heaven.

On January 3, 2007, Aditya Birla Retail, a subsidiary of the Aditya Birla Group joined the battlefield of organized retailing by acquiring the Hyderabad-based supermarket chain Trinethra Super Retail Limited (Trinethra), including its fast-growing online shopping unit, Fabmall (nowindiaplaza.com).

The Aditya Birla Retail acquired 90 per cent of the stake of Trinethra leaving the remaining10 per cent in the hand of India Value Limited. India Value Limited is a private equity investment fund that was holding the major stake in Trinethra before the acquisition. As on the day of acquisition, the consolidated turnover of Trinethra Super Retail Ltd, was said to be around Rs 250 crore but the business analysts estimated the cost of acquisition at current valuations to be around Rs 340 crore.

At the same time, Trinethra was on the verge of realizing its expansion plan by opening its store in the tier-II cities of South India. This acquisition of Aditya Birla Group can be thought of as the rise of a new dawn in the Indian retailing industry, which was previously dominated by players like Pantaloon Retail (with brands like Central, Big Bazaar, and Food Bazaar), RPG (with a brand like Spencers), Subiksha, Reliance Retail (with the brand Reliance Fresh), and DFI (with the brand Food World).The Aditya Birla Group had set up its retail subsidiary named Aditya Birla Retail in early 2007 expecting to seize the advantage of the fast-growing retail sector in India. On the same lines, thegroup has been adjudged the best employer in India and among the top twenty in Asia according to the 'Hewitt-Economic Times' and 'Wall Street Journal Study', 2007.

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Trinethra Super Market Limited came into the picture in 1986 as a retail store network in few cities of Andhra Pradesh like Hyderabad, Secunderabad, Vizag, and Vijaywada. The firm started its operation as a partnership firm, later on restructured as a private limited company in 1990 and subsequently converted into a public limited company in 1998 under the name Trinethra Super Market Limited. In the year 2003, the name of the company changed to Trinethra Super Retail Limited. In December 2004, Trinethra acquired Bangalore-based grocery retail chain Fabmall India Pvt. Ltd. The cost of this acquisition was estimated to be Rs 45 crore including an investment of Rs 27 crore in the equity and buying out the stake of ICICI ventures in Trinethra for Rs 17.5 crore. Fabmall started its operation in 1999 as an online retailer owning twelve stores with a turnover of Rs 50 crore. Trinethra established Fabmall as an independent strategic business unit of premium online retailers dealing with online selling of products from various brands. In January 2007, Fabmall acquired the US-based indiaplaza.com, one of the foremost online shopping destination for Indians in the US.

After this acquisition, Fabmall.com started operating under the global brand 'indiaplaza.com'. At present, indiaplaza is operating with its core operation in Austin, Bangalore and Chennai and has become the world's largest India-centric online retailer. It has its own in-house warehousing, logistics, Web technology control with a 24-hour customer service centre in Bangalore offering a catalogue of 3.5 million items for sale.

In 2006, Trinethra had launched a separate store format to sell fresh fruits and vegetables. Thecompany made some alliance with local farmers and set up a processing and sorting unit atdifferent locations in South India viz., Hyderabad, Bangalore, Chennai and Ernakulam in order ofoffer fresh and clean fruits and vegetables to their customers. Trinethra has a well-established private label named 'Quality First' for some of the commodities (viz., rice, wheat and pulses, etc.) and some of the fast moving consumer goods (viz., detergent powder, toilet cleaner, etc.). Trinethra is one of the fastest-growing retail chains of South India, which is currently selling groceries, fresh fruits, vegetables, dairy products, bakery, frozen foods and medicinal products. Almost all the stores of Trinethra (popularized as Quick Shop) own a space size average of 2,500 square feet and are situated in the posh residential locations enjoying a strong base of loyal customers. Some of the larger stores offer various value-added services like Bill Payment and Forex Services.

At the time of acquisition by Aditya Birla Retail, Trinethra was operating with a network ofabout 170 retail stores across different parts of South India (Andhra Pradesh, Karnataka, Tamil Nadu and Kerala) with an employee base of 2,500 with annual revenue of Rs 2.5 bn.

The continued economic development and the growing middle class have fortified the position of organized retailing in the country. On the one hand, many retail players have not tasted the fruit of this industry as requirement of high capital investment made it difficult to reach the break even point. On the other hand, the Indian retailing industry is on the verge of offering a promising future as the marketing forces as well as government policies are becoming more flexible, expedient and encouraging to the retailers. Due to this prominent reason, not only domestic players but a number of global players are also keen to enter the Indian retail market in order to exploit the bare land that is full of opportunities. The industry is on the vergeof offering a promising future as the marketing forces as well as government policies are becoming more flexible, expedient and encouraging to the retailers. Unlike

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mom and pop stores, the fresh breed of retail stores is greatly dependent on information technology. Although organized retailing in India is still in the introductory stage, the extensive and escalating consumer base and high retail density of the country have given the required push to the Indian retail industry to ensure terrific growth.

The demographics of Indian population are changing as a major portion of Indian population is in the age group of 25-35 years. The dominance of nuclear families where both the partners (wife and husband) are earning is working as a catalyst for the growth of the organized retail sector in India. The purchasing power of the young middle class is on the rise since the time of economic liberalization (1991) of the country. At present, retailing in India contributes 10 per cent to the country's GDP and around 8 per cent to the total country's employment. The present worth of this industry is valued at about $300 bn and is expected to grow to $427 bn in 2010 and $637 bn in 2015.

The boom in the Indian organized retailing is likely to craft a competitive market situation that is supposed to offer more options, value for money, quality products, value-added services and more bargaining power to the customers.This time the organized retailing in India is at the crossroads expecting a major transformation in Indian retailing as one of the world's largest retail giants, Wal-Mart has already entered into a joint venture deal in retail with Indian partner Bharti Enterprise. The world's largest toy shop owner Hamley (owned by Iceland-based investment company, the Baugur Group) has already decided to enter into the Indian retail market and UK-based retail house Allen Cooper has also planned to set up 500 stores in India.

Although Aditya Birla Group is one of the most diversified and strongest business conglomerates, the group needs to establish its position and prove its worth in the retailing market. Different players are struggling to capture the foremost slice of the market with different retail formats like departmental stores, convenience stores, super markets, hyper markets and shopping malls. Although Trinethra's retail format is similar to Reliance Fresh, Spencer's and Subhiksha, AB's acquisition of Trinethra is just the beginning of the game as Aditya Birla Retail is interested in offering a variety of retail formats across the country.

The first supermarket of the group was launched on 31 May 2007. After getting a phenomenal response from the customers, the company expanded the network of 'More' super markets. 'More' is dealt with branded products along with groceries and catered to the multiple needs of customers. A plan to open 1,000 stores in the next three years (with an investment of Rs. 7,000 to 9,000 cr) in the top fifty-seven cities across the country was unveiled. Thecompany also owned a hypermarket named 'Fabcity' in Mysore spread across 40, 000 sq. ft., offering products across categories that include food and grocery, apparel, home linen and homeware, footwear,beauty accessories, stationery, toys, high-tech equipment and household appliances. The products offered in the hypermarket are sourced from India and South East Asia, including branded and private labels. The priority of the company was to dominate the retail market with its efficient retail format of supermarkets. These are quicker to roll out whereas hypermarkets take

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more time to execute. In future, it is up to the Aditya Birla Group to continue with the brand name of 'Trinethra' for its superstore or to kill this brand and continue with a single brand name for all the retail formats. The acquisition of 'Trinethra' revealed the intention of Aditya Birla Group to be one of the leading players in the Indian retail industry, as a part of its master plan to execute multi-format retailing in order lead the Indian retailing market by offering an outstanding retail experience to the Indian consumers.

Not only did acquisition give the company an easy access to the organized retailing sector, it also gave competitive advantage over its rivals like Reliance Retail and Subiksha, as Trinethra holds a strong brand value and a strong base of loyal customers.

Questions for Discussion

1. Comment on the acquisition strategy of Aditya Birla group with special reference to the acquisition of Trinethra.

UNIT 12 STRATEGIC ANALYSIS AND CHOICE

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Structure

12.0 INTRODUCTION

Strategic analysis is done at corporate and business levels using tools such as the Boston Consulting Group (BCG) Growth-Share Matrix and the GE Nine-Cell Planning Grid to examine each business as a separate entity and as a contributor to the organization's total business portfolio. Strategic analysis offers three potential advantages. First, it encourages the framing of good strategies at the business unit level. Second, it provides a neutral basis for resource allocation. Third, it leads to better implementation of strategy because intensified focus and objectivity increases the commitment of workers at all levels. Once business units are classified into invest, hold and harvest categories, a SWOT analysis is employed to identify grand strategy options at the business level.

12.1 UNIT OBJECTIVES

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

- Understand the purpose of the BCG Growth-Share Matrix
- Understand the classification of business units
- Explain the GE Nine-Cell Planning Grid
- Understand strategy planning based on the Arthur D. Little's life cycle approach
- Understand the purpose of a SWOT analysis

12.2 BCG GROWTH-SHARE MATRIX

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BCG Growth-Share matrix is widely used in corporate strategic analysis. This matrix helps in analysing likely 'generators' and optimum ' users' of corporate resources. Organizations have to take decisions regarding the allocation of resources between competing business units. However, an organization is required to take decisions based on some fundamental criteria. The Boston Consulting Group came up with a model for managing a portfolio of different business units(or major product lines), in the 1970s. This matrix takes into consideration, the growth rate of the market and the relative market share of the business unit. It is important to pay attention to the market growth rate because it is a crucial factor that determines whether the organization should stay in a particular industry or not. Rapid growth and maximum returns are possible for a firm only in booming industries. Hence, it is prudent for an organization to enter and continue to operate in a growing industry. High market share gives some special benefits to the organization such as economies of scale and bargaining power in relation to buyers and sellers. The BCG growth-share matrix displays the positions of business units on a graph of the market growth rate against their market share relative to competitors.

Resources can be allocated to business units on the basis of their classification into categories. Business units are classified into four categories, namely cash cows, stars, question marks, and dogs.

Cash Cows

These business units hold a large market share in a mature and slow-growing industry. They have a strong business position and negligible investment requirements and hence the returns from these businesses are often more than their investment requirements. Organizations often tap their cash cows in order to draw out resources required elsewhere in the organization.

Stars

These business units have a large market share in the fast growing market or industries. Firms need to invest in stars as the industry is still emerging and the market is also growing. Often, the investment requirements of stars are greater than the revenues they generate. But once the industry reaches the stage of maturity, the stars hardly need any investment and become major sources of revenue for the firms.

Question marks

These business units have a small market share in a high growth market. They demand significant investment because their cash needs are high, a norm in a growing industry. As the market grows rapidly, acquiring market share is easier than in a mature market. However, the stage of growth in the industry is characterized by a lot of uncertainty that results from changes in technologies, distribution channels, and the players themselves. Hence, there are only a few question marks that are able to grow into stars.

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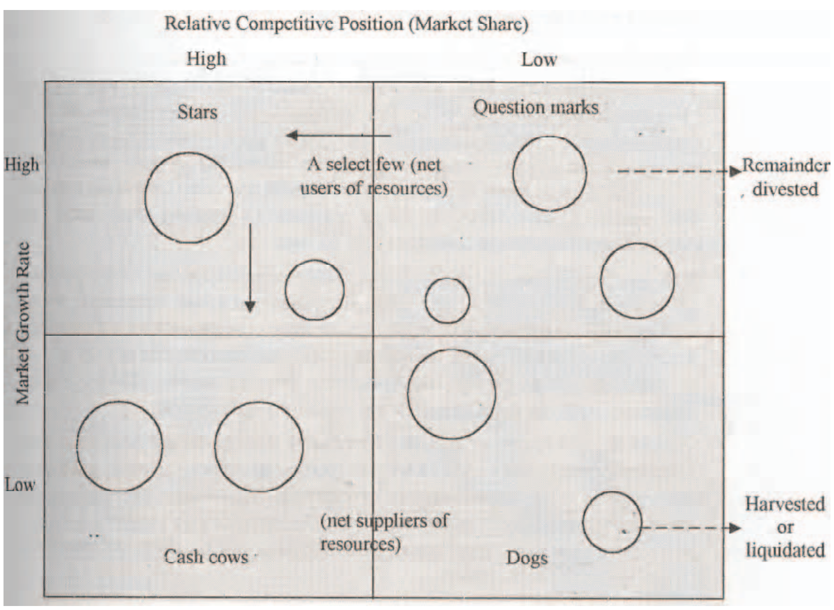
Dogs

These business units have low market share in an intensely competitive mature industry characterized by low profits. A dog does not need much of investment, but it ties up capital that could be invested in industries with better returns. Hence, organizations concentrate on recovering as much as possible from these units in terms of returns on investment and often undertake ruthless cost cutting. Unless there is larger purpose in keeping such units, an organization should divest of dogs at the earliest.

However, recent research suggests that well-managed dogs can have a positive effect on the organization, and be highly reliable revenue generators. These well-managed dogs have a narrow business focus, concentrate on high product quality and moderate prices, have strong control over costs, and advertise only to a limited extent. Though these units can generate surplus returns, yet the possibility of being transformed into a cash cow does not exist.

Though the BCG matrix provides a framework for allocating resources among different business units and allows one to compare many business units, it is criticized for oversimplification. For example, the relation between market share and profitability is questionable, and the emphasis on improving market share may lead the organization in a direction which does not meet the objectives of the organization.



BCG Growth-Share Matrix

12.3 THE GE NINE–CELL PLANNING GRID

This grid as shown in the next figure , is an adaption of the BCG approach and was popularized by General Electric. Hence, the name GE Nine-Cell Planning Grid. This grid makes an effort to overcome some of the limitations of the BCG matrix. The GE grid deploys multiple factors to measure business strength and industry

Check Your Progress

1. Name any two tools used for strategic analysis.
2. What are cash cows?

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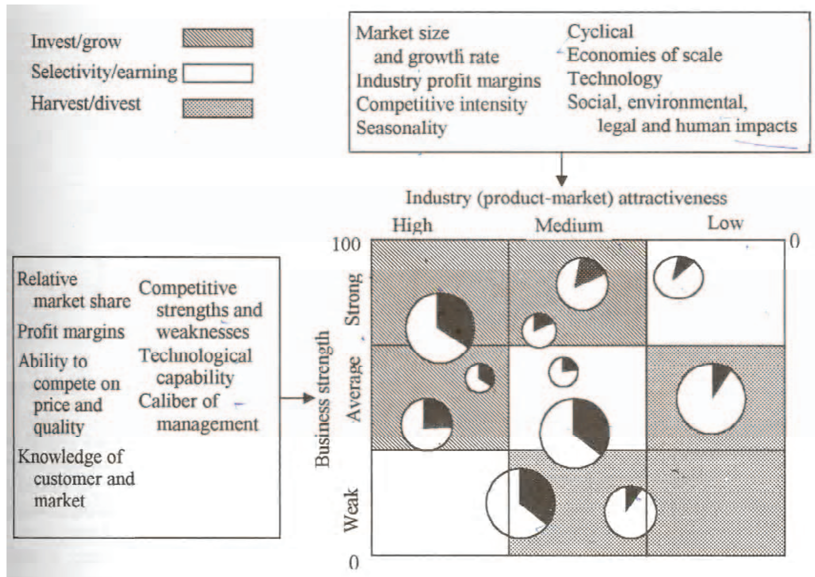
attractiveness. This grid uses factors such as market share, profit margin, customer and market knowledge, ability to compete, technology, competitive position and management caliber to asses business strength. It also gives due importance to industry attractiveness, factors such as market growth, competition, seasonality and cyclical qualities, size and industry profitability, economies of scale, technology, and various social, environmental, legal and human factors. Next, the position of the business is determined by calculating subjective values of the two dimensions of the grid.



General Electric's Nine-Cell Planning Grid

The strategist first identifies the factors contributing to the industry attractiveness. Next, he assigns weights to each industry attractiveness factor based on its perceived importance relative to the other attractiveness factors. Favourable to unfavourable future conditions are forecasted and rated based on a 0-1 scale. Thus, the strategist obtains a weighted composite score for the business's overall industry attractiveness as shown in the following table.

Industry attractiveness factor

Industry attractiveness factor	Weight	Rating	Score
Market size	20	0.5	10.0
Projected market growth	35	1.0	35.0
Technological requirements	15	0.5	7.5
Concentration(a few large competitors)	30	0	0
Political and regulatory factors	Must be restrictive	–	–
Total	100		52.5

High/favourable =1.0; Medium = 0.5; Low/unfavourable = 0

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A similar procedure is followed in assessing the business strength as shown in the following table-

Business Strength factor	Weight	Rating	Score
Relative market share	20	0.5	10
Production			
capacity	10	1.0	10
Efficiency	20	1.0	10
Location	20	0	0
Technological capability	20	0.5	10
Marketing			
Sales Organization	15	1.0	15
Promotion advantage	5	0	0
Total	100		55

High =1.0; Medium = 0.5; Low = 0.0

Once the comprehensive score has been calculated, the scores are classified into ratings such as high, medium, or low in terms of the projected strength of the business and the projected attractiveness of the industry. Next, the business units are classified into three categories. First, invest/grow; second, invest selectively and manage for earnings; and third, harvest or divest for resources.

Business units classified as invest/grow are given the same preference of stars as given in the BCG matrix. Resources are then allocated to pursue growth-oriented strategies. The harvest/divest category is managed like the dogs in the BCG matrix. Organizations are encouraged to divest from these businesses to finance other businesses. Businesses classified in the selectivity/earnings category are treated either as cash cows or as question marks.

12.4 ARTHUR D. LITTLE LIFE CYCLE APPROACH

Developed by the the Arthur D. Little Consulting company in the 1970s, the ADL Matrix helps develop about a strategy based on the following two questions:

(i) At what stage of its life cycle is the industry? (Industry maturity)

(ii) How strong is your strategic position? (Competitive position)

If your business possesses a product line that is newly emerging and has a strong presence in the market, you will prefer to push your business forward and try to capture as much of the market share as possible. However, this approach will not work if your business has a strong competitive position in a declining market. In such situations it is better to focus on new and growing or emerging markets and concentrate on maintaining your existing position in a declining industry.

This matrix recommends certain general strategies for various combinations of competitive position and industry maturity.

Industry maturity

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Industry maturity is also commonly referred to as the industry life cycle. It consists of the following categories:

1. **The embryonic industry –** This is the introductory phase of the industry where the market growth is rapid, there is hardly any competition, the technology employed is new, the investment is high and so are the prices.
2. **The growth industry –** At this stage, the market strengthens steadily, sales increase steadily, competitors are few and the firm earns the advantages and rewards of introducing a new product.
3. **The mature industry –** This stage is characterized by stability in the market, the customer base is well-established, the market share is stable, many competitors exist, and the focus is on being different from competition.
4. **The aging industry –** At this stage of the life cycle, there is a fall in demand, firms start leaving the market, the fight for market share becomes a costly exercise for the remaining players and firms begin abandoning the market or consolidatin till the market is totally finished.

Competitive position

The five categories under competitive position are as follows:

(i) Dominant

This is a rare position that doesn't last long. lived. There's hardly any competition and the position is obtained as a result of introducing a new product into the market. It could also result from a very good market image or reputation.

(ii) Strong

Your market position will be strong if the market share is stable and strong irrespective of what the competitors are up to.

(iii) Favourable

Your business will be said to be in a favourable position if it gets competitive advantage in certain sectors of the market. However you will have to toil to maintain this position as there will be equally strong rivals.

(iv) Tenable

At this position, your business clearly has a very small presence in the market. Your market share is dependant on a niche, a very strong location or some product differentiation. Some competitors will be attempting to take over your market share by developing their products and defining clear competitive advantages.

(v) Weak

Your business will be in a weak position if it is steadily losing market share and your product line is too narrow to maintain profitability.

12.4.1 Application of Life Cycle Approach

The Life cycle Approach is applied in steps as follows:

(i) **Identifying each line of business u**sing criteria such as common rivals, customers, sustainability, prices, quality/style, and divestment or liquidation.

(ii) **Assessing the life cycle stage of each business** on the basis of the business market share, investment and profitability or cash flows.

(iii) **Identifying the competitive position of the firm as** dominant, strong, favourable, tenable or weak.

(iv) **Identifying the strategy for the SBU on the basis of the** life cycle stage and competitive position.

(v) **Assigning a strategic thrust to the natural strategy.**

(vi) **Selecting one of the following twenty-four generic strategies:**

(a) Background integration	(b) Forward integration
(c) Marekt rationalization	(d) Pure survival
(e) Develop business overseas	(f) Hesitation
(g) Method/functions efficiency	(h) Same products/new markets
(i) Develop overseas facilities	(j) Initial market development
(k) New products/new markets	(l) Same products/same markets
(m) Distribution rationalization	(n) Licensing abroad
(o) New products/same markets	(p) Technological efficiency
(q) Excess capacity	(r) Complete rationalization
(s) Production rationalization	(t) Traditional cost cutting
(u) Export/Same product	(v) Market penetration
(w) Product line rationalization	(x) Unit abandonment

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12.5 SWOT ANALYSIS

The process of strategy formulation begins with situation analysis, i.e. the process of finding a strategic fit between external opportunities and internal weaknesses. SWOT is an acronym for strengths, weaknesses, opportunities and threats. It is a systematic study and identification of those aspects and strategies that best suit the individual company's position in a given situation. The strategy should not only improve an organization's business strengths and make use of opportunities but also reduce its weaknesses and stave off threats.

SWOT analysis was discussed in detail in unit 4 earlier. Strengths are the resources, skills or other advantages that a firm enjoys relative to its competitors. Weaknesses on the other hand, are the deficiencies or limitations of a firm in terms of skills, capabilities and resources. Opportunities present themselves in the form of favourable situations in the firm's environment which make it possible for a firm to enjoy a comparative advantage. Threats refer to the unfavourable situations in the firm's environment or harmful trends that pose a challenge. Opportunities and threats are the external factors and forces in the business environment , which change from time to time.

Check Your Progress

3. What would you use to overcome the limitations of the BCG matrix?
4. What is an embryonic industry?

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Let us take a look at the overview of the global pharmaceutical industry and thereafter arrive at the SWOT Analysis of the Indian pharma market.

Overview of the global pharmaceutical industry

The global pharmaceutical market grew by 7 per cent in 2005. North America, which accounts for 47 per cent of global pharmaceutical sales, grew by 5.2 per cent to $265.7 bn, while Europe experienced somewhat higher growth of 7.1 per cent to $169.5 bn. Sales in Latin America grew at an exceptional 18.5 per cent to $24 bn, while Asia Pacific (outside of Japan) and Africa grew by 11 per cent to $46.4 bn. Japan, the world's second largest market, which has historically posted slower growth rates, performed strongly in 2005, growing by 6.8 per cent to $60.3 bn. Nearly 40 per cent of the total market growth was fuelled by the introduction of new products, including thirty new molecular entities launched in key markets. It also augurs well for the industry that more than 2,300 products were in clinical development, up 9 per cent from 2004, and up 31 per cent over the past three years. IMS forecasts that the total pharmaceutical market will expand at a compound annual growth rate of 5–8 per cent over the next five years. North America and Europe are each projected to grow at a 5–8 per cent pace; Asia Pacific/Africa, 9–12per cent; Latin America, 7–10 per cent; and Japan, 3–6 per cent.

Indian pharma market

'The Indian pharmaceutical industry is a successful one providing employment for millions and ensuring that essential drugs at affordable prices are available to the vast population of this subcontinent.

The pharmaceutical industry, which is a subset of the healthcare industry, is the lifeline industry in any economy. Its contribution towards the growth and development of the economy, and towards building a strong human capital and intellectual property rights in a country cannot be undermined.

The foundation of the Indian Pharma Industry was laid exactly a century ago when in 1901, the Bengal Chemicals and Pharma works was set up in Calcutta. The growth of industry was slow till 1970. The overall production of bulk drugs and formulations was of the order of Rs 3 billion. The Patent Act of 1970 and government investment in the drug industry infused life into the pharma sector resulting in its span from decade to decade.

The Indian pharmaceuticals market is serviced by over 25,000 manufacturing units – large and small– manufacturing all forms of pharmaceuticals. Over 15,000 units fall in the small-scale sector.

The overall turnover of the industry during the year 2000 had gone up to the tune of Rs 200 Billion from Rs 3.00 billion in 1970. The pharma industry is now a net foreign exchange earner, which has investments both by the Government as well as private sector and is growing at an annual rate of 9 percent p.a.

The revenues of the Indian pharmaceutical industry are estimated at $ 5.5 bn; and according to a survey conducted by the management consultant McKinsey for FICCI, the industry is expected to grow at a phenomenal compounded annual growth of 19 per cent to touch $25bn in revenues by 2010.

The Indian pharmaceutical market is estimated as an $8,790 million market. The growing population, demand for specialty healthcare, and the need for medicines to combat lifestyle-related diseases are leading to increased demand for quality pharmaceuticals and new medicines. In March 2005, the Indian Patents Third Amendment Bill established patent protection for pharmaceutical products in India. This has ushered a change in this highly fragmented industry. Growing demand along with product patent regulations have made the Indian market an attractive proposition for international companies.

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SWOT analysis

Strengths

- Cost Competitiveness
- Well developed Industry with strong manufacturing base
- Access to pool of highly trained scientists, both in India and abroad.
- Strong marketing and distribution network
- Rich Biodiversity
- Competencies in Chemistry and process development.

Weaknesses

- Low investments in innovative research and development and lack of resources to compete with MNCs for New Drug Discovery Research and to commercialize molecules on a worldwide basis
- Lack of strong linkages between industry and academia
- Low medical expenditure and healthcare spend in the country
- Production of spurious and low-quality drugs tarnishes the image of the industry at home and abroad

Opportunities

- Significant export potential
- Licensing deals with MNCs for NCE's and NDDS.
- Marketing alliances to sell MNC products in the domestic market
- Contract manufacturing arrangements with MNCs
- Potential for developing India as a centre for international clinical trials
- Niche player in global pharmaceutical research and development
- Supply of generic drugs to developed markets.

Threats

- Product patent regime poses serious challenge to domestic industry unless it invests in research and development
- R and D efforts of Indian pharmaceutical companies hampered by lack of enabling regulatory requirement, for instance, restrictions on animal testing and outdated patent office.
- Drug price control order puts unrealistic ceilings on product prices and profitability and prevents pharmaceutical companies from generating investible surplus.

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- Lowering of tariff protection
- The new MRP-based excise duty regime threatens the existence of many small- scale pharma units, especially in the states of Andhra Pradesh and Maharashtra, which were involved in contract manufacturing for the larger, established players. These companies are now shifting their manufacturing from these states to states like Jammu and Kashmir that enjoy tax holidays.

12.6 PROFIT IMPACT OF MARKET STRATEGIES (PIMS)

During the period when the GE-Nine Cell Planning Grid was developed, another more quantitative approach to portfolio planning was developed under the aegis of the Profit Impact of Market Strategies (PIMS) programme. By the mid 1970s, PIMS had data on 620 SBUs from fifty-seven diversified companies. This data was used to understand the determinants of returns on investment. This was done by regressing historical returns on variables such as market share, product quality, investment intensity, marketing and expenditure on research and development. The regression established benchmarks for the potential performance of SBUs and their characteristics which were then compared with the actual performance.

12.7 PRODUCT MARKET MATRIX

The debate on whether a firm should gamble on its ability to build distinctive competence to pursue opportunities continued throughout the 1960s. This was mainly because during the 1960s, corporate strategies were heavily tilted towards growth and diversification. According to Theodore Levitt, firms should not be too focused on delivering products based on distinctive competence. Rather, they should consciously serve the customer. According to Levitt, companies fail when their products fail to do the following:

(i) Adapt to the changing tastes and needs of consumers

(ii) Develop new marketing initiatives

(iii) Keep pace with product development in complementary industries

However, Ansoff argued that firms would take unnecessary risks by developing new products that might not fit the firm's distinctive competence. According to Ansoff, a firm should first ask whether a new product has a 'common thread' with its existing products. Ansoff defined the common thread as a firm's mission or its commitment to exploit an existing need in the market as a whole. According to Ansoff, sometimes the customer is wrongly identified as the common thread of a firm's business. In reality, a customer will frequently have a range of unrelated product missions or needs. Ansoff suggested certain categories for defining the common thread in a firm's business/corporate strategy.

Check Your Progress

5. What are the strengths of a firm?
6. Why do companies fail as per Levitt?

Ansoff's Product/Market Matrix

	Present Product	New Product
Present market	Market Penetration	Product Development
New market	Market Development	Diversification

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- **Market penetration**: The firm aims at achieving growth with the existing products in their current market segments.
- **Market development**: The firm aims at achieving growth by targeting its existing products in the new market segments.
- **Product development**: The firm develops new products targeted at its existing market segments.
- **Diversification**: The firm diversifies into new businesses by developing new products for new markets.

12.8 SUMMARY

In this unit, you have learned that strategic analysis involves identifying the business units that are to be maintained as a part of the business portfolio. Tools such as the BCG Growth-Share Matrix, the GE Nine-Cell Planning Grid, Arthur D. Little's Life cycle Approach and SWOT analysis are used in strategic analysis.

Strategy choice is also affected by behavioural considerations such as the role of past strategy, the firm's attitude towards risk, expected reaction of competitors, the degree of the firm's external dependence, values and perceptions.

12.9 KEY TERMS

- **BCG Growth-Share matrix:** A matrix used as a tool in corporate strategic analysis to analyse the likely generators and optimum users of corporate resources.
- **GE Nine-Cell Planning grid:** A tool adapted from the BCG approach for measuring business strength and industry attractiveness.
- **ADL approach:** The Arthur D. Little life cycle approach helps plan strategies based on industry maturity and competitive position of the business.

12.10 ANSWERS TO 'CHECK YOUR PROGRESS'

1. Two tools used for strategic analysis are Boston Consulting Group (BCG) growth-share matrix.
2. Cash cows are the business units that hold a large market share in a mature and slow-growing industry.

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3. We would use GE Nine-Cell Planning Grid to overcome the limitations of the BCG matrix.
4. An embryonic industry is the introductory phase of the industry where the market growth is rapid, there is hardly any competition, the technology employed is new, the investment is high and so are the prices.
5. Strengths of a firm are the resources, skills or other advantages that a firm enjoys relative to its competitors.
6. According to Levitt, companies fail when their products fail to do the following:
   (i) Adapt to the changing tastes and needs of consumers
   (ii) Develop new marketing initiatives
   (iii) Keep pace with product development in complementary industries

12.11 QUESTIONS AND EXERCISES

Short-Answer Questions

1. Mention the three different types of portfolio planning tools which can aid in resource allocation.
2. How does a GE- matrix differ from a BCG matrix?
3. When do you use the Arthur D. little Matrix?
4. How was the PIMS data used to determine returns on investment?
5. What are the reasons for the failure of companies?

Long-Answer Questions

1. What do you mean by strategic analysis? How do you go about doing a strategic analysis? Discuss
2. Discuss the Product Market matrix of Ansoff.

12.12 FURTHER READING

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Case Study

Growth and Leadership in action at Sundram Fasteners

As part of their reform process, the Chinese Government aimed at tackling its population problem, developing infrastructure, providing investor-friendly policies and generally promoting the country as the latest destination for trade. Today, this gigantic dragon has succeeded to lure MNCs towards it.

India's Sundram Fasteners is all set to cross the Great Wall of China to tame this Chinese dragon. But what supremacy do they command? Where do their strengths lie?

It is the largest manufacturer and exporter of High-Tensile Fasteners (HTF). It is the leader in the domestic markets with 50 per cent of the market share. Sundram Fasteners Ltd. (SFL) is the leading player in the fasteners segment and exports fasteners to most of the Original Equipment Manufacturers (OEMs) in the US, Europe and Asia Pacific. For the year 2004-05, the company is expected to cross Rs 200 cr (US$45 mn) export in sales. Sundram Fasteners is the most respected auto ancillary company that has been consistently receiving 'Best of the Best Suppliers Award' from General Motors, USA, from 1996-2001 and has also achieved 'Zero Parts per Million Defect' status. Sundram Fasteners has always focused on two key areas of manufacturing—cost and technology which includes value addition to its products.

In 1966, Sundram Fasteners was established at Ambattur industrial area in the outskirts of Chennai as a small-scale industry to manufacture nuts and bolts. Today, this company has six manufacturing units across South India (Chennai, Madurai, Pondicherry, Hosur, Hyderabad, Gummudipoondi), besides Greenfield ventures in Cramlington (UK) and Zhejiang province (China). The offshore plant in Zhejiang province has made Sundram Fasteners the first engineering company in India to set up an operating base in China.

Background of the Company

Sundram Fasteners was incorporated in 1962 as Kasjax Engineering Ancillaries Pvt. Ltd. The company's primary objective was to manufacture high-tensile, cold formed/extruded parts for auto/non-auto applications and automotive powder metal parts. Some of which it still manufactures even today. As the company concentrated solely on the fasteners segment it was renamed as Sundram Fasteners in 1965.

Growth and leadership in action

Pvt. Ltd. (SFL). Sundram Fasteners belongs to the TV Sundram Iyengar—(TVS) group, which has a 51 per cent stake in the Company. Sundram Fastener's first manufacturing facility was set up at Padi in the outskirts of Chennai with 6000 TPA capacity. The company was inclined to manufacture high-tensile fasteners for OEMs. From 1966 to the 1980s, the Company established its presence in the domestic market. What started with a meager turnover of Rs 0.4 mn in 1966 grew rapidly over the years. However, it's during 1982-83, that the growth was accelerated. The establishment of Maruti Udyog Limited (MUL) brought in a crucial shift in the Indian automotive industry. Thus, began the era of growth for Sundram Fasteners capitalizing its position as a preferred supplier to MUL. Sundram Fasteners established an additional plant in Madurai to cash in on this opportunity. In 1987-88, it

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recorded a turnover of Rs 565.4 mn and became a Rs 100 cr company by 1990. Since then it has never looked back.

During 1986-87, Sundram Fasteners decided to go global. It paved a twofold way for exports which included consolidating the domestic business and establishing their credentials in the export market.

To meet the increasing domestic requirement and supply to international markets, the company had established six other manufacturing units in India. To make their presence in the export market and catch the customers, they went in for ISO standards and implemented the Total Productive Management (TPM) of Japan. By the end of the 1990s, the company started making acquisitions to ensure a global presence.

As the fasteners industry was not growing fast enough, Sundram Fasteners decided to expand their product portfolio from fasteners to cold extrusion, powder metal among others during the 1990s.Today, its range of products include auto ancillaries like fasteners, cold extruded parts, powder metal parts, precision formed gears, iron powder, radiator caps, gear shifters, tyre carrier assemblies and hot and warm forged parts.

Sundram Fasteners proposed to enter the new millennium as a vibrant, dynamic, customer-oriented company that is truly global. Thus, in 1999, the company acquired Autolec, which is a leading manufacturer of pumps. In 2000-01, the company subscribed to the entire share capital of TVS International Inc., Michigan, USA its new subsidiary. The subsidiary is into software development. In December 2003, Sundram Fasteners acquired Cramlington Precision Forge Limited (CPFL). In 2004, it set up a factory named Sundram Fasteners (Zhejiang) Ltd in China. Today, the company has three plants overseas—UK, Malaysia and China. The major initiatives of growth for Sundram Fasteners were through strategic acquisitions and diversifications into new product areas. It's a vision that positioned the company globally in order to deliver value to its clients.

Sundram Fasteners recognized that motivated people make the difference—between development and stagnation, between success and failure. Perhaps that's the reason this Company has not lost even a single person-hour due to any kind of industrial action since its inception.

Industry profile

Indian fasteners were not very competitive because of their high raw material costs, low labour productivity and poor product standardization. The fastener manufacturing industry involves tool-intensive processes that require high working capital. Hence, any new entrant would have to invest heavily in tool-making capabilities. Since start-up costs were very high, there were very few players in the organized sector. The largest end-user of fasteners is the automobile industry while the rest comes from sectors like textile machinery, railway locomotives, construction, computer hardware and general engineering.

Questions for Discussion

1. What were the factors that contributed to the global success of the Company?
2. Was it a good decision to expand their product portfolio? Give reasons for your answer.

MODULE - 4

NOTES

UNIT 13 STRATEGY IMPLEMENTATION: STRUCTURAL AND BEHAVIOURAL ISSUES

Structure

13.0 INTRODUCTION

It is not possible for firms to implement their strategies successfully unless they have proper organizational structures. Organizational structure here covers the processes and integrating mechanisms that are essential for ensuring the flexibility of boundaries between external parties such as partners, customers and suppliers and internal activities.

Organizational structure refers to the formalized patterns of interaction that link the tasks, technologies and people of a firm. Structures are designed to ensure that resources are used most effectively to accomplish an organization's mission. Structure provides managers with a means of balancing two conflicting forces — a need for the division of tasks into meaningful groups and the need to integrate such groups in order to ensure organizational efficiency and effectiveness. Structure identifies the executive, managerial and administrative organization of a firm and indicates responsibilities and hierarchical relationships. It also influences the flow of information as well as the context and nature of human interactions. Most organizations begin very small and either die or remain small. Those few that survive and prosper, embark on strategies designed to increase the overall scope of operations and enable them to enter new product-market domains. Such growth places additional pressure on executives to control and coordinate the firm's increasing size and diversity. The most appropriate type of structure depends on the nature and magnitude of growth in a firm. In this unit, you will be introduced to the various types of structural forms, their advantages and disadvantages and their relationships with the strategies that organizations undertake. In addition, you will study about attaining behavioural aspects of strategy implementation.

13.1 UNIT OBJECTIVES

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

- Get an idea of the growth patterns of large companies
- Understand the various types of organizational structures
- Appreciate the advantages and disadvantages of each of type of structure

13.2 PATTERNS OF GROWTH OF LARGE CORPORATIONS

There is a change in the structure of the organization as it grows and expands into new geographical locations and diversifies into new product markets.

A new firm with a simple structure typically increases its sales revenue and volume of output over time. It may also engage in some vertical integration to secure sources of supply (backward integration) as well as channels of distribution(forward integration). After a time, the simple-structure firm implements a functional structure to concentrate efforts on both increasing efficiency and enhancing its operations and products. This structure enables the firm to group its operations into either functions, departments or geographic areas. As its initial markets mature, a firm looks beyond its present products and markets for possible expansion. Such a policy of related diversification requires a need to reorganize around product lines or geographic markets. This leads to a divisional structure. As the business expands in terms of sales revenues, and domestic growth opportunities become somewhat limited, a firm may seek opportunities in international markets. At this time, a firm has a wide variety of structures to choose from including geographic area, global product division, international division, worldwide functional division and worldwide matrix. Deciding upon the most appropriate structure when a firm has international operations depends on three primary factors:

(i) Extent of international expansion

(ii) Type of strategy (global, multidomestic, or transnational)

(iii) Degree of product diversity

There are some other common growth patterns. For example, some firms may find it advantageous to diversify into several product lines rather than focus on strengthening distributor and supplier relationships through vertical integration. Thus, they would organize themselves according to product lines by implementing a divisional structure. Also, some firms may choose to move into unrelated product areas, typically by acquiring existing businesses. Frequently, their rationale is that acquiring assets and competencies is more economical or expedient than developing them internally. Such an unrelated or conglomerate strategy requires relatively little integration across businesses and sharing of resources. Thus, a holding company structure becomes appropriate. As we would expect, there are many other growth patterns, but the most common types of organizational structures are:

(i) Simple
(ii) Functional
(iii) Divisional
(iv) Matrix

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13.3 SIMPLE, FUNCTIONAL AND DIVISIONAL STRUCTURE

Simple Structure

A simple structure is the oldest and most common organizational form. After all, most organizations are very small and have a single or very narrow product line in which the owner-manager controls all activities, and the staff serves as an extension of the top executive's personality.

A simple structure is characterized by a high degree of informality. Tasks are coordinated by direct supervision. Decision making is highly centralized and there is hardly any specialization of jobs. The performance evaluation and system of rewards is also informal. There are hardly any rules and regulations. Usually it is the owner who is actively involved in all the stages and departments of the business, at times a manager may be appointed to supervise operations on a daily basis.

Such small firms with a simple and straightforward structure tend to encourage creativity. The lack of rigidity and rules also fosters individualism. However, such an informal environment may also create problems. Employees may not take their responsibilities seriously or may not understand them at all. This may result in unnecessary confusion and conflicts. The absence of strict rules may encourage employees to become selfish and act in their own interest. Such actions can erode motivation and satisfaction as well as lead to the possible misuse of organizational resources. Further, small organizations have flat structures (i.e., few vertical, hierarchical levels) that limit opportunities for upward mobility, Without the potential for future advancement, recruiting and retaining talent may become very difficult.

Functional structure

When an organization is small with fifteen or less employees, it is not necessary to have a variety of formal arrangements and grouping of activities. But with the steady expansion of firms, it may prove to be too much for an owner manager to handle all the processes of the business, because the owner may not be skilled in all the areas or tasks. He may not have enough knowledge of marketing, production, accounting and engineering to run the business successfully on his own. Thus, he or she will need to hire specialists in the various functional areas. Such growth in the overall scope and complexity of the business necessitates a functional structure wherein the major functions of the firm are grouped internally and led by a specialist. The coordination and integration of the functional areas becomes one of the most important responsibilities of the chief executive of the firm.

Check Your Progress

1. What is organizational structure?
2. What are the factors deciding upon the most appropriate structure when a firm has international operations depends on?

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Functional structures are most suitable for firms wherein there is just one product or a single product along with a closely-related service; volume of production is high and there is some vertical integration. At first, firms tend to expand the overall scope of their operations by penetrating existing markets, introducing similar products in additional markets, or increasing the level of vertical integration. Such expansion activities clearly increase the scope and complexity of the operations. The functional structure facilitates a high level of centralization that ensures integration and control over all the related activities in the value chain– primary and support. Companies such as Videocon Industries, Hindalco and Bajaj Auto follow such a functional organization structure.

Divisional structure

Also called the multidivisional structure, it refers to a structure that revolves around the markets, projects and products. Each division has departments with their respective functional specialists. This type of structure consists of relatively autonomous units centrally governed by a corporate office. The different divisions enjoy a fair degree of independence and deal with their respective products and services that are different from the other divisions.

In such an operational structure, there is too much responsibility on the top management with regard to decision making. Therefore, it may become essential for the top management to delegate their responsibilities and decision making powers to lower-level managers in order to be able to attend to issues concerning the organization in the long run. This makes divisional executives crucial. In conjunction with corporate-level executives, they help to determine the product market, and financial objectives for the division as well as their division's contribution to overall corporate performance.

General Motors was among the first to adopt the divisional organizational structure. In the 1920' the company formed five major product divisions (Cadillac, Buick, Oldsmobile, Pontiac and Chevrolet) as well as several industrial divisions. Since then, many firms have discovered that as they diversified into new product-market activities, functional structures–with their emphasis on single functional departments– were unable to manage the increased complexity of the entire business.

There are many advantages associated with the divisional structure. By creating separate divisions to manage individual product markets, there is a separation of strategic and operating control. That is, divisional managers can focus their efforts on improving operations in the product markets for which they are responsible, and corporate officers can devote their time to overall strategic issues for the entire corporation. The focus on a division's products and markets by the divisional executives- provides the corporation with an enhanced ability to respond quickly to important changes in the external environment. Since there are functional departments within each division of the corporation, the problems associated with sharing resources across functional departments are minimized. Finally, because there are multiple levels of general managers (that is, executives responsible for integrating and coordinating all functional areas), the development of general management talent is enhanced.

A divisional structure also has potential disadvantages. First, it can be very expensive; i.e. there can be increased costs due to the duplication of personnel, operations and investment since each division must staff multiple functional departments. There can also be dysfunctional competition among divisions since each division tends to become concerned solely with its own operations. Furthermore, divisional managers are often evaluated on common measures such as return on assets and sales growth. Therefore, if goals are conflicting, there can be a sense of a ‘ zero-sum’ game that would discourage sharing of ideas and resources among the divisions for the common good of the corporation.

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Another drawback could be that with so many divisions providing a variety of products and services, there are chances of differences arising in the quality and image of the products. There are two variations of the divisional form of organization structure:

(i) Strategic business unit (SBU)

(ii) Holding company structures

13.4 STRATEGIC BUSINESS UNIT (SBU) STRUCTURE

Corporations that are highly diversified may consist of dozens of different divisions, e.g. Unilever. Now, if Unilever were to use a purely divisional structure, it would be nearly impossible for the corporate office to plan and coordinate activities because the span of control would be too large. Instead of attaining synergies, Unilever has put its diverse businesses into few primary SBUs.

With an SBU structure, divisions with similar markets, and /or technologies are grouped into homogeneous groups in order to achieve some synergy. These include related diversification, such as leveraging core competencies, sharing infrastructures, and market power. Generally speaking, the more related the businesses are within a corporation, the fewer will be the SBUs required. Each of the SBUs in the corporation operates as a profit centre.

The main benefit of the SBU structure is that it simplifies the planning process and makes it easy for the corporate office to control and plan tasks. As it facilitates decentralization of authority, individual businesses can react more quickly to important changes in the environment than if all divisions had to report directly to the corporate office.

There are also some disadvantages to the SBU structure. Since the divisions are grouped into SBUs, it may become difficult to achieve synergies across SBUs. That is, if divisions that are included in different SBUs have potential sources of synergy, it may become difficult for them to be realized. The additional level of management increases the number of personnel and overhead expenses, while the additional hierarchical level removes the corporate office further from the individual divisions. Thus, the corporate office may become unaware of key developments that could have a major impact on the corporation.

13.5 HOLDING COMPANY STRUCTURE

Also called a conglomerate, the holding company structure is somewhat similar to the divisional structure. While the SBU structure is used when there are obvious similarities between the individual businesses units (or divisions), the holding company structure is appropriate when the businesses in a corporation’s portfolio do not have much in common. Thus, the potential for synergies is limited.

Holding company structures are most appropriate for firms that follow a strategy of unrelated diversification. Companies have relied on the holding company structure

Check Your Progress

3. When are functional structures most suitable?
4. What is the main benefit of the SBU structure?

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to implement their unrelated diversification strategies. Since there are few similarities in the businesses, the corporate offices in these companies provide a great deal of autonomy to operating divisions and rely on financial controls and incentive programs to obtain high levels of performance from the individual businesses. Corporate staffs at these firms tend to be small because their involvement in the overall operation of their various businesses is limited.

The most important benefit of the holding company structure is that it saves cost because of fewer personnel and lower overhead resulting from a small corporate office and fewer levels in the corporate hierarchy. Also, the autonomy motivates the heads of the divisions and encourages them to respond promptly to opportunities and threats.

The main drawback of this structure is that the corporate-level executives are not able to exercise any control on the division executives and are quite dependent on them. Major problems could arise if key divisional executives leave the firm, because the corporate office has very little 'bench strength'- that is, additional managerial talent ready to fill key positions on short notice. If problems arise in a division, it may become difficult to turn around individual businesses because of limited staff support in the corporate office.

13.6 MATRIX STRUCTURE

Often, managers may find that it is difficult to find a suitable structure to fulfill all their requirements. If none of the approaches discussed so far work, the managers have the option of trying the matrix structure which makes up for the drawbacks of the other structures. It is actually a blend of the functional and divisional structures.

Here, the functional departments are called upon to work with product groups depending on the project that requires attention. If a product group wishes to develop an addition product, it could turn to the functional departments such as engineering, marketing or production for personnel.

These personnel will assist the product group as required by the manager of the group, till the project is completed. Such borrowed personnel are answerable to their own functional heads as well as the heads of the product group they are assisting. In some multinational companies, the matrix structure helps bring together product groups as well as geographical units. This is required when product managers are responsible for the global development, management and distribution of their product line; and the heads of geographical regions are responsible for the profits of their business units in their respective regions.

The matrix structure is successfully used in companies such as Disney, Caterpillar Inc. and ABB.

The benefit of a matrix structure is that it makes it possible to take advantage of specialized personnel, special equipment as well as facilities. Instead of duplicating functions, the resources are shared as required. Such sharing and collaboration of resources ensures efficient and effective utilization of resources. This also ensures prompt response to changes in the competitive environment.

Another benefit is that a matrix structure is flexible providing professionals with a wide ranger of responsibility, giving them more experience and the opportunity to develop their skills and competencies.

Matrix structures also have many drawbacks. Their dual reporting structure leads to uncertainty and conflict with regard to allocation of resources. This in turn causes complicates relationships at the workplace. Therefore, there is increasing reliance on group processes and teamwork. Responsibilities are diffused which may lead to delays in decision making.

13.7 ATTAINING BEHAVIOURAL CONTROL: BALANCING CULTURE, REWARDS AND BOUNDARIES

The competitive environment is getting increasingly complex and unpredictable, demanding both flexibility and quick response to its challenges. As firms simultaneously downsize and face the need for increased coordination across organizational boundaries, a control system based primarily on rigid strategies and rules and regulations is dysfunctional. Thus, the use of rewards and culture to align individual and organizational goals becomes increasingly important.

Second, the implicit long-term contract between the organization and its key employees has been eroded. Today's younger managers have been conditioned to see themselves as ' free agents' and view their career as a series of opportunistic challenges. In today's competitive work environment, the importance of culture and rewards in building organizational loyalty has found greater importance.

Building a strong and effective culture

Organizational culture is a system of shared values and beliefs that shape company's people, organizational structures and control systems to produce behavioural norms. Over the years, numerous best-sellers have emphasized the powerful influence of culture on what goes on within organizations and how they perform.

Role of culture

Culture wears many different hats, each woven from the fabric of those values that sustain the organization's primary source of competitive advantage. Culture sets implicit boundaries, that is, unwritten standards of acceptable behaviour: in dress, ethical matters, and the way an organization conducts its business. By creating a framework of shared values, culture encourages individual identification with the organization and its objectives.

Sustaining an effective culture

Powerful organizational cultures just don't happen overnight, and they don't remain in place without a strong commitment: both in terms of words and deeds: by leaders throughout the organization. A viable and productive organizational culture can be strengthened and sustained. However, it cannot be built or assembled. Instead, it must be cultivated, encouraged and fertilized.

Motivating with rewards and incentives

Reward and incentive systems represent a powerful means of influencing an organization's culture, focussing efforts on high-priority tasks, and motivating individual and collective task performance. Just as culture deals with influencing beliefs, behaviours and attitudes of people within the organization, the reward system:

specifying who gets rewarded and why: is an effective motivator and a control mechanism.

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Potential disadvantage

Generally speaking, people in organizations act rationally, each motivated by his or her personal interest. However, the collective sum of individual behaviours of an organization's employees does not always necessarily result in what is best for the organization. In other words, individual rationality does not always guarantee organizational rationality.

As corporations grow and evolve, they often develop different business units with multiple reward systems. They may differ based on industry contexts, business situations, stage of product lifecycles, and so on. These subcultures within the organization may reflect differences among an organization's functional areas, products, services and divisions . Reward systems reinforce such behavioural norms, attitudes, and belief systems; reduce organizational cohesiveness; important information is hoarded rather than shared and individuals begin working at cross-purposes losing sight of overarching goals and objectives.

Such conflicts are commonplace in many organizations. For example, sales and marketing personnel promise unrealistically quick delivery times in business, much to the dismay of operations and logistics. Overengineering by research and development creates headaches for manufacturing, and so on. Conflicts also arise across divisions when divisional profits become a key compensation criteria. As ill will and anger escalate, personal relationships and performance may suffer.

Impact of culture on two different groups of organizations

Dimensions of corporate culture	***Multinational subsidiaries and professional managed companies***	***Family business and NRI's companies***
Nature of desired managerial skills and capabilities	Emphasis on professional qualifications and rank	Emphasis on demonstrated skills , depth and quality of knowledge
Actual performance or results achieved	Emphasis on seniority, conformity to organizational values, loyalty, and a relative fit between desired managerial behaviour and position in hierarchy	Emphasis on originality of action and thinking, innovation, and upgradation of knowledge and skills by personal efforts.
Managerial style of planning and decision-making	Emphasis on information gathering, bureaucratic mode of functioning, risk-aversion, and non-entrepreneurial decision-making	Emphasis on selective information usage, and intuitive and qualitative decision-making of an entrepreneurial nature
Management systems adopted	Emphasis on the use of elegant, sophisticated and rational systems which degenerate due to low usage	Emphasis on reliance on business sense and no-frills systems geared to quick action
Nature of management control	Emphasis on comprehensive, formal and written reporting and rationalization of failures rather than resolution of problems	Emphasis on primary use of verbal reporting and remedial action

13.8 STRATEGY-CULTURE RELATIONSHIP

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Having discussed what constitutes corporate culture and how it affects corporate life, it is important to understand its relationship with strategy. Since each strategy creates its own set of managerial tasks, strategy implementation has to consider the behavioural aspects and ensure that these tasks are performed in an efficient and effective manner. Managerial behaviour arising out of corporate culture, can either facilitate or obstruct the smooth implementation of strategy. Therefore, the basic question before strategists is, how to create a strategy-supportive corporate culture. In other words, a major role of the leaders within an organization is to create an appropriate strategy- culture fit.

13.8.1 Approaches to Creation of Strategy-Supportive Culture

The strategists have four approaches to create a strategy-supportive culture.

1. *To ignore corporate culture*: This approach may be followed when it is nearly impossible to change culture. This is advisable because it is really difficult to change a nebulous phenomenon such as corporate culture. Besides, cultural changes, when enforced in a short duration, may be traumatic for members of an organization.
2. *To adapt strategy implementation to suit corporate culture*: It is easier to change implementation to suit the requirements of corporate culture. This is possible because the behavioural aspects of implementation offer a range of flexible alternatives to strategists in terms of structure, systems and processes. These variables could be adjusted to subserve the interests of corporate culture. However, each situation in the organization would call for an innovative solution and would test the capabilities of managers as strategists.
3. *To change the corporate culture to suit strategic requirements*: As stated earlier, it is extremely difficult to change corporate culture. But in some cases, it may be imperative.
4. *To change the strategy to fit the corporate culture*: Rather than changing culture to suit strategy, it is better and more economical to consider the cultural dimension while formulating strategy in the first place. If an impregnable cultural barrier is faced after strategy implementation, it may be better to abandon the strategy or use a combination of the above three approaches.

13.8.2 Corporate Politics and use of Power

All corporate cultures include a political component. Therefore, all organizations are political in nature. Strategists should understand that organizations are a microcosm of the society in which they exist. Organizational members bring with them their likes and dislikes, views and opinions, prejudices and inclinations when they enter organizations. Managerial behaviour cannot be purely rational. Therefore, an understanding of how how politics works and how power is to be used, is required.

13.8.3 Creating Effective Reward and Incentive Programmes

To be effective, incentive and reward systems need to reinforce basic core values and enhance cohesion and commitment to goals and objectives. They also must not be at odds with the organization's overall mission and purpose.

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Effective reward and incentive systems share a number of common characteristics as follows:

- Objectives are clear, well understood and broadly accepted
- Rewards are clearly linked to performance and desired behaviours
- Performance measures are clear and highly visible
- Feedback is prompt, clear and unambiguous
- The compensation 'system' is perceived as fair and equitable
- The structure is flexible; it can adapt to changing circumstances

The perception that a plan is 'fair and equitable' is critically important. Similarly, the firm must have the flexibility to respond to changing requirements as its direction and objectives change.

13.8.4 Setting Boundaries and Constraints

In an ideal world, a strong culture and effective rewards should be sufficient to ensure that all individuals and subunits work towards the common goals and objectives of the whole organization. In the real world, however, this is not usually the case. Counter-productive behaviour can arise because of motivated self-interest and lack of clear understanding of goals and objectives.

Boundaries and constraints, when used properly, can serve many useful purposes for organizations as follows:

- Focussing individual efforts on strategic priorities
- Providing short-term objectives and action plans to channel efforts
- Improving efficiency and effectiveness
- Minimizing improper and unethical conduct

Focusing efforts on strategic priorities

Boundaries and constraints play a valuable role in focussing a company's strategic priorities. A well-known strategic boundary as set by GE's Jack Welch was that any business in the corporate portfolio should be ranked first or second in its industry. The concentration of effort and resources provides the firm with greater strategic focus and the potential for stronger advantages in the remaining areas.

Boundaries also have a place in the non-profit sector. Boundaries clearly go beyond simply taking the moral high road. Rather, they are essential for maintaining legitimacy with existing and potential benefactors.

Providing short-term objectives and action plans

To be effective, short-term objectives must have several attributes. They should:

- Be specific and measurable
- Include a specific time horizon for their attainment
- Be achievable, yet challenging enough to motivate managers who must strive to accomplish them.

Research has found that performance is enhanced when individuals are encouraged to attain specific, difficult, yet achievable, goals.

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Short-term objectives must provide direction and at the same time provide enough flexibility for the firm to keep pace with and anticipate changes in the external environment.

Improving operational efficiency and effectiveness

Rule- based controls are most appropriate in organizations with the following characteristics:

- Stable and predictable environments
- Largely unskilled and interchangeable employees
- Consistency in product and service

Take the example of McDonald's Corp. It has extensive rules and regulations that regulate the operation of its franchises. Guidelines can also be effective in setting spending limits and the range of discretion for employees and managers.

Minimizing improper and unethical conduct

Guidelines can be useful in specifying proper relationships with a company's customers and suppliers. For example, many companies have explicit rules regarding commercial practices, including the prohibition of any form of payment, bribe, or kickback.

13.9 BEHAVIOURAL CONTROL IN ORGANIZATIONS: SITUATIONAL FACTORS

The focus here is on ensuring that the behaviour of individuals at all levels of an organization is directed towards achieving organizational goals and objectives. The three fundamental types of control are culture, rewards and incentives as well as boundaries and constraints. An organization may pursue one or a combination of them on the basis of a variety of internal and external factors.

Not all organizations place the same emphasis on each type of control. For example, in professional organizations such as high-technology firms engaged in basic research, members may work under high levels of autonomy. Here, an individual's performance is generally quite difficult to measure accurately because of the long lead times involved in research and development activities. Thus, internalized norms and values become very important.

In organizations where the measurement of an individual's output or performance is quite straightforward, control depends primarily on granting or withholding rewards.

Control in bureaucratic organizations has long been recognized as dependent on members following a highly formalized set of rules and regulations. In such situations, most activities are routine and the desired behaviour can be specified in a detailed manner because there is generally little need for innovative or creative activity. In business organizations, for example, managing an assembly plant requires strict adherence to many rules as well as exacting sequences of assembly operations.

13.9.1 Evolving from Boundaries to Rewards and Culture

Most environments should strive to provide a system of rewards and incentives, coupled with a culture strong enough for boundaries to become internalized. This reduces the need for external controls such as rules and regulations.

Check Your Progress

5. How does culture encourage individual identification with the organization and its objectives?
6. What are the purposes served by boundaries and constraints?
7. Which is the system that reduces the need for external controls such as rules and regulations?

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Approach	Some Situational Factors
Culture : A system of unwritten rules that forms an internalized influence over behavior	Often found in professional organizations Associated with high autonomy Norms are the basis for behaviour
Rules : Written and explicit guidelines that provide eternal constraints	Associated with standardized output Tasks are generally repetitive and routine Little need for innovation or creative activity
Rewards: The use of performance-based incentive systems to motivate.	Measurement of output and performance is rather straightforward. Most appropriate in organizations pursuing unrelated diversification strategies. Rewards may be used to reinforce other means of control.

13.10 SUMMARY

In this unit, you have learned that it is important for organizations to ensure that they adopt an appropriate organizational structure. It is also essential to ensure flexibility of their internal and external boundaries. The unit attempted to explain the various types of organization structures, that is, simple, functional and matrix. Their relative merits and demerits were also stated. You learnt that organization structures have to be changed to suit the changing needs of growing organizations.

This unit concentrated on achieving behavioural control in organizations by balancing culture, rewards and boundaries. Culture has a powerful influence on the performance of organizations. It also drove home the fact that powerful cultures and organizations cannot be built or assembled. They need to be cultivated and encouraged over time. Implementation of strategy should take into consideration the behavioural aspects of the employees. You got to know that there are four approaches to creating a strategy-supportive culture: ignoring corporate culture, adapting strategy implementation to suit corporate culture, changing the corporate culture to suit strategic requirements and changing the strategy to fit the corporate culture. The unit also emphasized that in order to be effective, incentive and reward systems need to reinforce basic core values and enhance cohesion and commitment to goals and objectives.

13.11 KEY TERMS

- **Organizational structure:** The formalized patterns of interaction that link the tasks, technologies and people of a firm or organization.
- **Simple structure:** An informal organizational structure characterized by direct supervision, centralized decision making and absence of specialization.

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- **Functional structure:** A relatively formal organizational structure, used in firms producing a single product along with a closely-related service, that facilitates a high level of centralization, integration and control.
- **Divisional structure:** A multidivisional structure that revolves around the markets, projects and products.
- **SBU structure:** The strategic business unit structure where similar markets and/or technologies are grouped together, thereby simplifying the planning and controlling process.

13.12 ANSWERS TO 'CHECK YOUR PROGRESS'

1. Organizational structure refers to the formalized patterns of interaction that link the tasks, technologies and people of a firm.
2. Deciding upon the most appropriate structure when a firm has international operations depends on three primary factors:
   (i) Extent of international expansion
   (ii) Type of strategy (global, multidomestic, or transnational)
   (iii) Degree of product diversity
3. Functional structures are most suitable for firms wherein there is just one product or a single product along with a closely-related service; volume of production is high and there is some vertical integration.
4. The main benefit of the small business unit (SBU) structure is that it simplifies the planning process and makes it easy for the corporate office to control and plan tasks.
5. Culture encourages individual identification with the organization and its objectives by creating a framework of shared values.
6. Boundaries and constraints, when used properly, can serve many useful purposes for organizations as follows:
   - Focussing individual efforts on strategic priorities
   - Providing short-term objectives and action plans to channel efforts
   - Improving efficiency and effectiveness
   - Minimizing improper and unethical conduct
7. A system of rewards and incentives, coupled with a culture strong enough for boundaries to become internalized, reduces the need for external controls such as rules and regulations.

13.13 QUESTIONS AND EXERCISES

Short-Answer Questions

1. What are the basic characteristics of organizational design?
2. Mention the different types of structures and the differences between them.
3. What is the difference between an SBU and a holding company structure?
4. List the characteristics of a simple structure.

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5. How is the functional structure related to the growth of the firm?
6. Why does too much responsibility fall on the top-level managers in a divisional structure?
7. When should a company go for a matrix structure?
8. Why is it important to understand how politics works and how power is to be used?
9. Suggest ways to create an effective incentive and reward system.
10. How can boundaries and constraints be used effectively to avoid counter-productive behaviour?
11. How can the need for external controls such as rules and regulations be eliminated?
12. What is the impact of culture on different groups of organizations?
13. What is the relationship between strategy and culture?
14. How can situational factors affect behavioural control in organizations?
15. How can operational efficiency and effectiveness be improved by using behavioural methods?

Long-Answer Questions

1. Discuss the benefits of a matrix structure.
2. What is organizational structure? Compare the simple and the functional structures.
3. Discuss the disadvantages of a divisional structure.
4. Discuss the two variations in the divisional form of organization.
5. Discuss the relationship between corporate culture and strategy.
6. Explain the four approaches to creating a strategy-supportive culture.
7. Discuss the attributes of effective short-term objectives.
8. Write a note on effective behavioural control in organizations.

13.14 FURTHER READING

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Case Study

Transformation of an Organization through Effective Leadership

Carlos Ghosn, CEO of Nissan Motors who was proclaimed the Automotive News' Industry Leader of the year 2003,by *Fortune*, was the man behind one of the most astonishing corporate turnarounds in the world. Ghosn had set new trends of leadership style by turning around three different companies with his dynamic strategies and convincing negotiations. He was also named Asia's businessman of the Year.

Before Ghosn joined Nissan Motor Company Limited, the Company had experienced losses for eight successive years. In the fiscal year 2000, Nissan posted an annual loss of $5.5 bn. The company had a debt of approximately $22 bn. Before joining Nissan, Ghosn took a pledge that if he were not able to turnaround the company within three years of his joining, he would resign. Ghosn being a non-Japanese, the task was seemingly very tough for him. His dynamic leadership and well-planned strategy for revival brought about a miraculous turnaround in the company, much before the stipulated deadline. He brought about a cultural shift in the business practices at Nissan. He took it upon himself to break the old, traditional and obsolete practices of the company. He believed that motivation of the employees was the greatest tool that led to the Nissan turnaround. Doing away with the tradition of promoting the employees on the basis of age and experience, he gave priority to talent and expertise. He believed that an organization could only be effective if the followers believed that what the leaders thought, said, and did were all the same. Ghosn laid emphasis on transparency across the organization and consensus among the management in decision-making. He believed that execution was 95 per cent of the job whereas strategy was only 5 per cent. He linked organizational prosperity directly to improving quality, costs, and customer satisfaction. His leadership provided a vision to the management and employees of Nissan. As a result of his turnaround strategy called the 'Nissan Revival Plan' or NRP, the Company posted a profit of $2.7 bn in the year 2000.

Ghosn was good at understanding the problems of cross-cultural mix in an organization, which helped him tackle acquisition-related problems for the companies he worked with. His other assets that helped him succeed were his negotiating and lobbying skills.

As his first step towards Nissan's revival, he sorted out the strengths and weaknesses of Nissan. He could feel clearly that the employees and the management at Nissan had lost confidence in the Company's performance. Kieretsu is a business understanding in Japan, according to which, various companies will have cross share holding of various companies. It was formed in Japan after World War II. Ghosn first targeted understanding the culture and the people of Japan and Nissan. He had the specialty of adapting to any new culture quickly; Nissan's was not an exception. He realized the important of adapting without which he believed a person would lose his identity. The employees could feel his sense of urgency towards the company's situation and his liking for the culture of the country that made him an acceptable leader across the organization. He did not have to tell them that he liked the country, they could see it.

Ghosn could infer that the internal communication mechanism at Nissan was poor and it did not have proper infrastructure for communication. He created a well-established communication system across the organization.

Despite being an outsider at Nissan and unfamiliar with Japan, he Ghosn had to act meticulously, as he was an outsider at Nissan and was not familiar with Japan he ensured that his instructions to the management and employees did not sound like dictations. He came up with the idea of establishing cross-functional teams. The CFT concept had already proved to be successful

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during his turnaround at the Michelin Group. The CFT groups included mostly the middle-level managers who were in continuous touch with Ghosn with their observations, concerns and suggestions. Ghosn emphasized on the empowerment of the managers and the workers which helped in reducing bottlenecks at the departmental level. He allowed the members to think freely and challenged the employees to find ways to solve the crisis at Nissan.

Teams were allowed to operate with authority and the executive committee decided that the idea of CFTs was recommendable. The concept of CFT allowed a free flow of ideas and out of the box thinking. Earlier, the people of one department had a tendency of shying away from the people of another department. CFT encouraged inter-disciplinary thinking and a better understanding of various problems across the organization. Various departments that participated in CFTs were business development, purchasing, manufacturing, logistics, research and development and the sales and marketing departments.

The organization witnessed a gradual transformation in the style and pace of functioning of the managers and the staff. After three months of formation, all the CFTs together had come up with as many as 2000 ideas, which were presented to the executive committee. The executive committee, in turn, presented the final recommendations to Ghosn. As a result of a thorough study of all the ideas and his ownanalysis, Ghosn came up with the tough Nissan Revival Plan (NRP).

Carlos Ghosn's leadership style

The following are the important points associated with his leadership style:

- Retirement by natural attrition
- Early retirement by offering
- Seniority was eliminated as a means of company advancement
- Senior executive positions found to be redundant were incentives
- Transfer of the remaining to other healthy plants.
- Revamping compensation schemes to reflect higher pay, based on strong performance.
- Bonus pay was tied to NRP's success for all employees
- Frivolous expense accounts were eliminated

With this, the productivity of Nissan went up by around 20 pe cent. Nineteen months after theannouncement of the Nissan Revival Plan, Nissan produced the best results in its history. At the financial year-end 2000, the sales of Nissan grew by 4 per cent. The same year witnessed the launch of 22 new models of Nissan.In addition to Nissan, Ghosn was also responsible for several other turnarounds in the US andSouth America (Brazil). He affected the turnaround of a company of the Michelin Group. He wasplaced at both the South American and North American operations of Michelin, and he broughtabout major changes at both places. Besides, he was also responsible for improving conditions at Renault Group . These major turnarounds made him famous as a 'turnaround specialist' among the corporate parliaments. His action plan focused on transparency. He always assured his employees that he did not enter the Company with any preconceived plans and expected them to be as transparent as he himself was. He emphasized on working fast, avoiding assumptions of any sort and earning trust and respect.

Questions for Discussion

1. What were the critical leadership traits of Carlos Ghosn? Did a good understan of culture help Ghosn in his task? Explain.
2. Enumerate ding how Carlos Ghosn transformed Nissan.

UNIT 14 OPERATIONAL, MARKETING, FINANCIAL AND HUMAN RESOURCE STRATEGIES

Structure

14.0 INTRODUCTION

In order to reduce costs and maintain quality, a company should choose a good location for its manufacturing facilities. A successful organization's marketing strategies should keep in mind the different aspects of product, pricing, distribution and promotion. A long-term strategy of diversifying across products, markets and suppliers might involve more initial investment, but subsequently lower short-term hedging costs. In this unit, you will learn about the operational, financial, marketing and human resource strategies employed by successful organizations.

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14.1 UNIT OBJECTIVES

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

- Understand the importance of strategies in an organization
- Understand the operational, marketing, human resource and financial strategies adopted by successful firms

14.2 OPERATIONAL STRATEGY

Cost reduction and maintenance of quality can be brought about by effective operational strategies. The first and foremost factor to be taken into consideration is the choice of a good location for the firm's manufacturing facilities.

14.2.1 Location of Manufacturing Facility

In order to achieve the twin objectives of cost minimization and quality maintenance, a company should choose the most efficient locations for its manufacturing facilities. The location of a manufacturing facility depends on the country, the technology and the product.

Country

The host country, i.e., the country receiving the investment, should be economically and politically stable. The company is vulnerable to exchange rate risk when raw materials are sourced from many countries, for manufacturing activity in one or a few countries, and subsequent export to many markets. The parent company might lose its cost competitiveness if the factory is located in a country with volatile exchange rates. Political stability is another important factor in decision making. Changes in government may entail changes in investment policies. The FDI policy of a country deals with the extent to which foreign individuals and companies can participate in domestic production activity. The policy also covers local content and sale requirements. The prevalent exit policy and the jurisdiction of courts are other important features of a country's FDI policy. Frequent changes in any of these will affect the functioning of an MNC. Political factors include the lobbying power of domestic industrialists.

Another factor affecting the location of the factory is the level of infrastructural development of the country. Continuous supply of power, sound telecommunication systems, well developed roads and transport facilities make for a favorable destination. Free trade Zones(FTZs), Export Processing Zones(EPZs), Software Technology Parks(STPs) and Special Economic Zones(SEZs), which provides tax or other incentives, are facilities created by governments to attract exporters and FDI.

Another important factor in the location decision is the factor costs and productivity in various countries. The factors of production are land, labour, capital and enterprise. The payments for these take the form of rent, wages, interest and profits respectively. MNCs expect to earn some specified Return on Investment (ROI).. capital and enterprise have become perfectly mobile with the growth in technology and developments in Financial markets. So land and labour remain the crucial factors in deciding the location of factories. The literacy rate in the country, the proportion of women and children in the literate population, industrial laws regulating payment of wages, working conditions and employee health and safety laws are other important factors.

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Technology

By technology we mean manufacturing technology. The cost of the technology can be important in determining the location of a manufacturing facility. The higher the investment required, the stronger the case for manufacturing in a single or a few locations. If the fixed costs of setting up a manufacturing facility are low, then companies can have locations closer to the market and thereby respond faster to market demands. Apart from fixed costs, economies of scale can also help in deciding plant locations. Economies of scale can be defined as the reduction in the per-unit cost of production as a result of an increased scale of operation. Thus, the unit cost of production decreases with increase in production.

Customization and cost efficiency

Standardization of products and mass production were till recently considered undeniably cost effective. However, this idea has led to many difficulties particularly in industries like automobiles where the manufacturing process is long. The most serious problem relating to standardization is the inability to change designs in response to market requirements. Taiichi Ohno, the engineer at Toyota developed and implemented a lean manufacturing system in Toyota. The new system removed many of the drawbacks of the conventional manufacturing system and reduced the time required to change dyes on stamping equipment from one day to three minutes.

Product

There are two features of a product that determine the location of the manufacturing plant.

Value-to-weight ratio: Weight of the product has an impact on the transportation costs. Thus, transportation costs for goods of heavy industries are high and justify the location of plants closer to the market. On the contrary, electronic goods have high- value-to weight ratio, i.e. They are expensive but less costly to transport since they are not heavy. In order to achieve economies of scale, electronic goods can be produced at centralized locations. Products such as cement are usually manufactured at locations close to the market since they involve huge transportation costs.

Nature of need—universal or local: Personal computers and certain industrial products can be manufactured at centralized facilities, for sale in several markets. On the other hand, consumers often have different tastes and preferences relating to food and personal care products. For these products, manufacturing facilities are usually located nearer to the market.

14.2.2 Global Sourcing

Companies are often confronted with ‘ make or buy’ decisions. By sourcing components from other manufacturers, companies can reduce financial and operational risks and avoid the fixed costs of investments in people, plant and machinery. They can also make use of state- of- the –art manufacturing technology available with certain manufacturers. For example, Sundaram Clayton in India specializes in manufacturing radiator caps. It has been awarded the Deming Prize for quality in this

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item. Rather than investing in the production of this item, automobile manufacturers worldwide prefer to source radiator caps from Sundaram Clayton since it makes them most efficiently. The main risk in outsourcing component requirements is the resulting dependence on the supplier. Companies could lose time and money in production delays as a result of delays at the suppliers' end. The risk of such dependence has led companies to integrate business activities. The three types of integration are backward, forward and horizontal integration.

To generate economies of scale and reduce the risk of dependence on suppliers, for example, Ford established plants that specialize in a single component, say, air conditioners and supplies them to other locations for the final assembling of cars. Similarly, Airbus Industries, the aircraft manufacturer sources components from numerous locations across Europe and performs the final assembling of aircraft in France and Germany. An alternative to investment in in-house manufacturing of components is for the company to hold equity in the suppliers' firms, giving the company effective control over the cost, reliability and quality of supplies.

14.2.3 Logistics Management in MNCs

Logistics management helps achieve reliable and speedy delivery to manufacturing plants as per the desired need. Logistics management is primarily concerned with the efficient transportation of goods. The challenge of international logistics lies in coping with different time zones, transport modes, different infrastructural facilities at various ports and airports, and different laws regulating movement of goods. Time and cost considerations are of utmost importance in selecting the mode of transport. Foods of perishable nature and goods with high value-to-weight ratio may be transferred by aircraft though it is more expensive than transport by ships..

Logistics is a strategic, not an operational decision since it involves careful planning and has cross-functional applicability, and since the decision impacts the value of the firm as a result of savings in cost. Moreover, the amount and nature of materials and components, packaging, storage and distribution infrastructure requirements can affect the design of the product.

14.2.4 Global Supply Chain Management (GSCM)

Supply chain management is a more comprehensive function than logistics management. It integrates the activities of demand forecasting, procurement, manufacture, distribution and inventory management. MNCs with manufacturing facilities in several countries use Logistics Information Systems(LIS) to reduce delivery time and inventory costs. The challenge of SCM is to mitigate the bull-whip effect. The bull-whip effect is the distortion of actual demand information that occurs as a company moves further away from its customers.

SCM is facilitated by the use of the Internet. Networking tools that connect individual customers and suppliers or provide e- commerce portals have helped improve the information flow between the buyer and supplier thereby strengthening SCM. SCM, in turn, has helped boost the growth of e-commerce transactions. Enterprise Resource Planning (ERP) helps in connecting suppliers and buyers and helps in managing manufacture, inventory and quality. The widely acclaimed procurement mechanism of Wal-Mart, USA, is an example of the growing partnership between suppliers and buyers.

Transfer of knowledge from home country to the host country

In the context of MNCs, technology transfer involves sharing knowledge and resources developed by the MNC with subsidiaries or with partners in the host country. Technology includes technical know-how and machinery. As a result of the implementation of Trade Related Intellectual Property Rights (TRIPS), transfer of Technology has become more expensive since the owners of technology claim more royalty payments. One outcome of TRIPS is that MNCs have started locating manufacturing facilities in developing countries to benefit from cheap labour. Thus there is no actual transfer of technology, but only a relocation of the production facility. Until recently, the flow of ideas was one-way from the home country to the host country, but now a few MNCs are encouraging research activities in their foreign subsidiaries.

Other issues that can come up are:

Parent-subsidiary relationship

Control over subsidiaries is an important factor in the transfer of technology and affects the relationship between parent and subsidiary. Based on their level of involvement, subsidiaries can be classified into four types—local supplier, international supplier, local developer and product developer.

Product development

Product development involves both new product development and improvement in existing products and manufacturing processes. R & D and product development are futile if they do not generate revenues. One notable exception was IBM, which till the early 1990s focussed on long-term research and not on short-term innovation, and assessed the performance of its scientists by their publications and academic honors..

Unleashing innovation in subsidiaries

Innovative ideas do not arise only in headquarters. Therefore, companies should encourage their subsidiaries to innovate. If the parent company focusses on the short-term performance of its subsidiaries, the subsidiaries may avoid new investment avenues and concentrate on protecting wealth. If the parent emphasizes long-term growth and innovation, the subsidiaries may make excessive and unreasonable investments in R & D. Thus, there has to be a balance between the two. To ensure that fruitful ideas are encouraged, companies should follow a three-pronged strategy:

- Encourage employees to innovate. Providey incentives for innovation.
- Be a venture capitalist— provide funds to build prototypes and to test-market products.
- Network with subsidiaries and enable interaction.

14.3 MARKETING STRATEGY

Strategies for marketing must take into consideration different aspects of product, pricing, distribution and promotion.

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Check Your Progress

1. Which type of strategies can bring about cost reduction and maintenance of quality?
2. Name the two features of a product that determine the location of the manufacturing plant.

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14.3.1 Product

A product may be considered as a set of attributes. A firm should take account of all the major attributes of its products. But all the attributes may not be assigned equal importance in all the markets. Consumers in different countries may want different features according to their economic and cultural environments.

Cultural differences

According to some management experts, consumers' tastes around the world are converging due to the revolution in technology that has improved the scope and speed of communication, transport and travel. The global acceptance of McDonald's burgers , Coca-Cola, MTV programmes and Levi's jeans are indications of convergence of tastes.

However, culture still has a significant bearing on consumer behaviour, which in turn, affects the marketing environment. Taste in food varies from culture to culture. Hot spicy foods are popular in many Asian countries, less spicy food is popular in America. Pork consumption is forbidden in Islamic countries. The interpretation of colours is also significantly different. While white is associated with purity and cleanliness in the West, it signifies death in Asian countries. Sometimes, cultural differences may arise for historical reasons.

Economic differences

Consumer disposable income also influences the purchasing decisions of customers. The marketability of luxury cars, convenience goods, etc., in developing countries suggests that most consumer products have a universal market. People would like to buy them if they can afford them.

In emerging markets like China, India, Brazil, Indonesia, Mexico, etc., business risks are high but there is a huge potential market. Though the role of marketing in low–income countries is the same as in high income countries, the focus is different. Market research and marketing have to identify and respond to people's needs and wants appropriately. People in low-income countries are likely to attach importance to basic attributes and low prices, while people in developed countries demand additional attributes even if prices go up. In the US, the high-income levels, large distances, low cost of petrol, and lifestyle factors (e.g. spending more time out doors), all lead to greater demand for additional luxuries and comforts in cars. The demand for sports utility vehicles (SUVs) is high in the US, but negligible in the developing countries like India. Affordability is the prime consideration, followed by fuel efficiency and product durability, in developing markets. For example, in India, four-stroke bikes compete more on mileage than on any other performance attribute.

In Japan, though the standard of living is high, people prefer small appliances that fit into their small houses and consume less electricity.

Technical standards

Products designed for one country may not be appropriate for another country due to the differences in technical standards. In the 1950s and 1960s, different countries in Asia had different technical standards for television signal frequency. Therefore, television and video equipment had to be customized. When companies failed to adhere to these standards, their televisions did not sell.

14.3.2 Distribution

Distribution refers to the choice of the mode of delivery of products to the customer. It is a crucial part of an MNC's marketing mix and may vary from country to country.

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Typical distribution system

In a typical distribution system, there are two tiers between the manufacturer and the final consumer– the wholesale distributor and the retailer. If the manufacturer is outside the country, the product may be sold to an export agency, which then supplies the product to the wholesaler. A distribution channel could have additional tiers or fewer tiers than this. An MNC may sell directly to wholesale distributors or retailers or even to consumers in some countries, whereas in other countries it may employ a lengthier channel.

Differences in distribution channels in different countries: Retail system

The retail system in some countries is highly concentrated, while in others, it is extremely fragmented. In a fragmented system, no one particular retailer caters to a significant fraction of the market. When the system is concentrated, a small number of retailers serve a majority of the consumers. In the US and Germany, a small number of retail chains control most of the market for food products and groceries. In India, retail distribution is highly fragmented and no particular chain caters to a significant percentage of the market. While one of the reasons for the differences in retail system is the level of economic development, history and tradition may also contribute to the differences in retail systems. In many developed countries, people shop only on weekends. To serve such customers, large shopping malls with several facilities are located at places where customers can park their cars and shop in comfort. The retail outlet concentration is high in these countries, whereas retail outlets are highly dispersed in countries like China, Japan and India, where lifestyles are different.

Channel length

Channel length refers to the number of intermediaries between the producer and the final consumer of the product. If afirm sells its product directly to the consumer, the channel is short, i.e., there is only the producer and the consumer. If the product passes through intermediaries like the import agent, wholesaler and retailer before reaching the customer, the channel is long. The choice of channel is a strategic decision for the firm. The firm's decision depends on the type of retail system in the country. In a country where the retail system is highly fragmented, firms cannot afford to make sales calls to each retailer. Firms, therefore, prefer to deal with a few wholesalers rather than employ a huge salesforce to supply to widely scattered retailers.

Channel accessibility

This refers to the ease with which a new firm can access shelf space in the retail outlets of a country. Sometimes, manufacturers and distributors have long-standing trading relationships. Sometimes, a manufacturer promises attractive margins to a distributor who doesn't stock a competitors' product. Such agreements are common in Japan, making it difficult for foreign firms to gain access to distribution channels.

- **Choosing a distribution strategy:** The firm may choose a short or long channel depending on the relative costs and benefits of each. A firm's decision

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to choose a distribution strategy is based on three factors— type of retailing system, channel length and channel accessibility.

- **Choosing a distributor:** An MNC should follow a well-designed strategy to penetrate markets, particularly in emerging markets. An MNC hires local distributors, as it is not familiar with local markets and business practices. The MNCs should be able to anticipate potential problems in distribution and take steps to avoid them. The distributor may not invest in expanding his business because of lack of funds or for other reasons

An MNC should assess potential markets and identify the right distributor rather than waiting for a distributor to approach it with a proposal. An MNC may select a distributor on the basis of market surveys indicating the preferred suppliers of a majority of the retailers.

Though the major concern of an MNC when it enters an emerging market is to select distributors and to acquire a customer base, it should also work on developing a network among its distributors within a country. It may also work on developing a network among its distributors within a country. It may also encourage distributors to form an association to exchange ideas, product plans and designs. This brings about consistency in products manufactured by national licenses, customization for local markets and economies of scale.

14.3.3 Pricing

An MNC has to consider a wide range of factors when determining the price of a product. Product-specific, market-specific and environmental factors influence international pricing. Further, price setting is also influenced at three levels— the internal level, the macro level and the micro level. At the internal level, the firm is concerned about the return on investment, sales volume and costs. The price should cover the costs of producing and marketing the product in different countries. At the same time, the price should not exceed the perceived value of the product.

At the macro level, government restrictions influence international pricing. The business cycle stage, exchange rate and cultural factors also influence pricing decisions. For example, firms have to depend on competitive pricing strategies in China. , as the market has just entered the growth stage of its life cycle. The internal and macro levels together influence the international pricing of a product in the microenvironment, i.e., at the industry level. An MNC should take into account the following factors before pricing its products in different countries.

Competitive structure

The competitor's prices have to be carefully evaluated before setting prices. The level of competition in the country depends on the stage of the product's life cycle in that country.

Price discrimination

Products can be positioned as premium products in one country and as low-price products in another. Heineken markets its beers in some countries at the average market price, while in several other countries, it uses the premium price strategy. The difference is mainly due to the differences in the pricing structure of various countries.

14.3.4 Distribution Structure

The structure of the distribution network is also a major determinant of pricing policy. The structure varies from country to country depending on the relative power of buyers and suppliers. In some countries, suppliers may dominate and have the power to determine prices, while in others buyers may have more influence on prices. For example, the distribution structure of the frozen ready meal market in Germany is a major determinant of pricing.

Consumer behaviour

Consumer perception of the quality of a product is an important element in pricing. In India, most purchasing decisions are extremely sensitive to the price of the product. Marketers of food products, toilet soaps, cleaning powders, consumer electronics, etc. get a very positive response in terms of sales generated when they offer discounts. In contrast, particularly for food products, in developed countries, demand is less price-sensitive as food takes up a very small proportion of the income of individuals. For consumer electronics too, people in developed countries may not respond as positively to price reductions, since in many cases, it is old stocks that are discounted in this fashion.

Strategic pricing

MNCs have to adapt their pricing according to the country's preferences. The Italian automobile market has no room for imported cars positioned on price because of the presence of low-cost domestic manufacturer, Fiat. Fiat's competitive advantage lies in its ability to manufacture cheap cars for price-sensitive consumers in Latin America and North Africa. Fiat's cost leadership strategy acts as an entry barrier.

Government policies, subsidies and regulations also influence pricing strategies. The high excise duties on liquor in some countries like Australia and India, compel liquor producers to set high prices for profitability.

From a strategic perspective, the success and survival of a company depends on its understanding of the differences in the countries in terms of price structure, distribution structure and consumer behaviour. The company's management has to identify, appreciate and accommodate these differences in order to use price as a strategic tool.

14.3.5 Promotion

MNCs should not only have a clear understanding of how to position their product but also should be able to communicate well with prospective customers. For effective promotion, MNCs need to choose an appropriate channel– direct selling, sales promotion, direct marketing, advertising in different media, or a combination of two or more of these. The choice of communication strategy is determined by various factors such as cultural differences, customer awareness, lifestyles, etc.

14.3.6 Barriers to International Communication

Differences in culture are a major hurdle in international communication. A marketing message that is considered quite subtle in one country may be considered offensive to the extent of damaging the company's image in another.

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MNCs can avoid such risks by employing local advertising agencies to recast the message without changing the intended meaning or image and to incorporate local input. It is also advisable to employ a local sales force or train sales personnel in local languages for direct selling.

Pull vs push strategy

A 'push' strategy emphasizes personal selling as part of the promotional mix, rather than advertising in the mass media. The company needs a huge sales force for personal selling, and this results in high costs. A ' pull' strategy employs the mass media to communicate the message to target customers. Some firms employ a combination of push and pull strategies to optimize the effectiveness of communication. The extent of customer awareness, the length of the channel and the availability of media, influence the firm's choice of strategy.

Customer awareness

A pull strategy is used to sell non-durable consumer goods, in order to target a large segment of the market, as costs are relatively low. For example, the costs involved in employing a sales force for door-to-door selling of products such as hair oils, soaps, etc, are high as compared to advertising in the mass media. On the other hand, direct selling is more advantageous than mass media advertising for consumer durables for which customer awareness is low. Eureka Forbes, the household appliance manufacturer, was able to create awareness and establish a market for vacuum cleaners in India, in a relatively short span of time. It used direct door-to-door sales personnel to target potential customers with the required purchasing power in households and offices.

Length of the channel

As the number of intermediaries increases, the length of the channel increases. If an MNC wants to reach the customer directly, the task of convincing the intermediary at each level to stock its product is not only difficult but also expensive. When there are two many layers in the distribution channel, the company can advertise the product heavily, familiarize customers with its product and create demand. Once the demand is created, distributors will come forward to stock its products.

Media availability

A pull strategy depends on the company's access to the advertising media. In developed countries and some of the developing countries, both the print media(newspaper and magazines) and electronic media (television and radio) are available. In countries where the pull strategy is limited by media availability, MNC's can use the push strategy. In some countries, media availability is restricted by law. For example , in India, advertising alcohol and tobacco products on television and radio is prohibited by law. MNCs have to consider all these factors before deciding on the media mix.

Advertising across borders

An MNC has to choose between the different types of advertising like comparative, direct, aggressive, defensive, etc. The message of the advertisement refers to the facts or impression the advertiser wants to convey to potential customers. The choice of the message is an important indication of how the firm sees its own products and how it wants them to be seen by the public. Products used differently in different countries need to be advertised differently. In the US, motorcycles are seen primarily as recreational products, but in countries like China and India, they are seen mainly as means of transportation.

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Configuring the marketing mix

An MNC may change its marketing mix from one country to the next for several reasons including cultural differences, economic conditions, competitive conditions, product and technical standards, distribution systems, government regulations, etc. Depending on these differences, an MNC may change its product attributes, distribution strategy, communication strategy or pricing strategy.

Though MNCs can realize substantial cost economies by standardizing the marketing mix, they have to customize it in order to cater to local preferences. Therefore, MNCs need to strike a balance between the extent of customization and standardization.

14.4 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.

Check Your Progress

3. Which is the strategy that emphasizes on personal selling?
4. List any three reasons for an MNC to change its marketing mix from one country to the next.

14.4.1 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

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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.

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.

14.4.2 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.

14.4.3 Training and Development

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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:

Cultural, language and 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.

14.4.4 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.

14.4.5 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.

14.4.6 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.

NOTES

14.4.7 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.

14.5 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.

14.5.1 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

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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 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.

14.5.2 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 45 Rs/ $. So an Indian importer will have to pay Rs 13, 50000(30000*45), excluding other costs. If the rupee falls to 46/$, importer will have to pay Rs 23, 80000(30000*46). But if the rupee appreciates to 44/$ then the importer will have to pay Rs 13, 20000(30000*46).

14.5.3 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. Hedging (protecting) instruments and strategies for managing these exposures are discussed later on in the chapter.

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.

14.5.4 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

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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**

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.

14.5.5 Corporate Response to Exchange Rate Fluctuations

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.

Check Your Progress

5. What is meant by staffing?
6. What are swaps?

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14.6 SUMMARY

This unit gave you a fairly good idea of the marketing, financial, operational and human resource strategies followed by firms. You have learned that marketing strategies are designed on the basis of various aspects such as product, pricing, distribution and promotion. End-users belong to various countries and their wants will differ according to their cultural and economic differ as well as their technical standards. The distribution channels also differ from country to country. The pricing of the product is based on the competitive structure, consumer behaviour, distributive structure and pricing strategy. The unit discussed staffing policy, performance appraisals and labour relations as part of human resource management. It emphasized that human resource policies serve as guidelines for, among other things, recruitment, differentiation among workers in terms of compensation, and social responsibility in terms of policies against child labour, etc. Under financial strategy, the unit discussed the role of foreign exchange, the meaning of currency risk and the types of exposure, that is, economic, transaction and translation. It also discussed derivative instruments and their uses, forward and future contracts, options and swaps under currency risk management alternatives. Among other financial aspects, you have learned about corporate response to exchange rate fluctuations. Under operational strategy, the unit explained that choice of location of a manufacturing unit depends on the economical and political stability of the host country, the manufacturing technology involved, the nature of the product and the nature of the need. You have also learned that logistics management helps achieve reliable and speedy delivery of materials to the manufacturing plants whereas supply chain management integrates the activities of demand forecasting, procurement, manufacture, distribution and inventory management.

14.7 KEY TERMS

- **Logistics management:** Management primarily concerned with the efficient transportation of goods.
- **Supply chain management:** Management that integrates the activities of demand forecasting, procurement, manufacture, distribution and inventory management.
- **Channel length:** This refers to the number of intermediaries between the producer and the final consumer of the product.
- **Channel accessibility:** This refers to the ease with which a new firm can access shelf space in the retail outlets of a country.
- **Staffing:** The exercise of finding the right person for the right job and for the right pay.
- **Polycentric approach:** An approach to globalization wherein the world is viewed as a differentiated marketplace requiring customization in every aspect of business.
- **Geocentric approach:** An approach to globalization wherein MNCs identify best practices from within and outside the organization and implement them through the organization.

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- **Expatriate managers:** The managers who are the residents of one country working in another country for the organization's subsidiary.
- **Arbitrage:** Riskless profits made by buying and selling the same securities in two different markets simultaneously.
- **Exposure:** The sensitivity of a firm's cash flows to changes in exchange rates is called exposure.
- **Forward contracts:** Agreements to buy or sell a product at a future date at an agreed price.
- **Swaps:** 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.

14.8 ANSWERS TO 'CHECK YOUR PROGRESS'

1. Cost reduction and maintenance of quality can be brought about by effective operational strategies.
2. The following two features of a product that determine the location of the manufacturing plant:
   (i) Value-to-weight ratio
   (ii) Nature of need
3. A 'push' strategy emphasizes personal selling as part of the promotional mix, rather than advertising in the mass media.
4. A multinational company (MNC) may change its marketing mix from one country to the next for the following three reasons:
   (i) Cultural differences
   (ii) Economic conditions
   (iii) Competitive conditions
5. Staffing means finding the right person for the right job for the right pay.
6. 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.

14.9 QUESTIONS AND EXERCISES

Short-Answer Questions

1. Differentiate between logistics management and supply chain management.
2. Differentiate between pull and push strategy.
3. What is the role of performance management in the hurman resource strategy of any company?
4. What are the factors influencing the distribution of power between the parent and the subsidiary.

5. What is meant by economic exposure? How is it different from transaction exposure?

Long-Answer Questions

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1. Write a short note on how an organization can adopt an effective operational strategy.
2. Discuss the factors to be kept in mind while choosing a location for its manufacturing unit.
3. Discuss the features of a product that determine the location of the plant.
4. Write a note on logistics management in MNCs.
5. Discuss how cultural differences can affect marketing strategies.
6. Discuss the approaches to globalization that affect the staffing policy of a company.
7. Forecasting exchange rates is an important function of a corporate finance manager. Discuss.

14.10 FURTHER READING

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Case Study

The Failure of a Retail Giant

This caselet describes the downfall of one of the most widely recognized and well-established retail giants of the US, Kmart. It further delves into the real reasons behind its fall such as bad management and big dreams of its misguided leaders. It provides a lesson or two for today's managers and CEOs to learn and not to repeat it.

Kmart was started off as a retail store which used to offer goods at a discounted price way back in the year 1899 by Sebastian S Kresge. However, the name of the company was changed from SS Kresge, to Kmart in the year 1962. As a matter of fact, its biggest competitor Wal-Mart opened its first store in the same year. Kmart's customers were offered goods at a discount of 20%. Its initial success motivated the company to look out for further growth and what better way of growing than increasing the number of stores. It kept on increasing the number of its stores as many as it was possible for them in the city areas.

While Wal-Mart aimed at gradual development, Kmart was happy making huge leaps forwardwhich without any precise focus. On its way to expanding, it committed many mistakes. Subsequently, it failed to attract new customers and maintain good relationships with its old customers. It further failed to maintain a healthy relationship with its suppliers too. All these had a negative effect on Kmart's performance and it incurred huge losses even as its competitors became more profitable. Finally, in January 2003, it filled for bankruptcy and sent shock waves through the whole retail industry.

Reasons for debacle

Although the prime reason was bad management, it was not the only reason which led to its demise. There were several other reasons which contributed to the fall of the giant. Some of the reasons are as follows:

Poor brand management

Kmart, in a rush to expand itself, ignored the importance of having a good brand management strategy. It lacked in its approach to customer care and brand building. Kmart, instead of assessing its strengths and moving in that direction, went on signing in more and more private label brands to its kit, in order to earn more concession, which proved fatal for its growth in the later stages. The management team failed to organize the marketing efforts which were required to improve the brand's awareness and image in the minds of the target segment. It got stuck with its old tag line of 'Buy decent goods at great prices' and ignored the importance of changing the value proposition for its customers with the changing times. It failed to position its brands to suit particular segments/groups. It found itself tied up in between the low-income and high-income customer groups which unfortunately were better served by its two major competitors, Wal-Mart and Target. It also failed to absorb the brand Martha Stewart with Kmart. This allowed the Martha Brand to create its own identity and grow bigger than the brand Kmart. In the later stages, customers who were interested in the Martha Brand only were seen coming to the stores of Kmart. It showed a drastic fall in the sales of other branded products which were available at Kmart. All in all, the management failed to create a brand strategy, it failed to target a particular customer segment and it failed to stop Martha Stewart from becoming a bigger brand name than Kmart.

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They failed to identify their target customer segment

Kmart clearly failed to identify its customer segment. They were doing their business as if anybody and everybody was their customer. They never tried to know who exactly their customers were, which segment they were targeting and what are the buying patters of customers. They were not at all bothered to know what the customer's expectations from the store. They even failed to appeal to a particular customer segment when its competitors were busy promoting their brands.

Attracting customers was not the motto of their business. After some time, all of a sudden, feeling the heat from Wal-Mart, Kmart thought of increasing its customer base, without even knowing their target segment and that too by hiring new people from outside for the Senior Management positions. Here also, they failed to go strategically as they ignored the million-dollar experience of their employees who have been working for the firm for many years. They overlooked their biggest asset, their employees.

They underestimated their competitors

Kmart got busy with its meaningless activities and kept ignoring Wal-Mart. At a time when Kmart kept itself busy in other activities, Wal-Mart continuously excelled by building on its core strength of 'competitive intelligence'. Kmart's biggest fault was ignoring Wal-Mart. They thought of Wal-Mart as too small to even consider it as their competitor. As a matter of fact, it had to compete with Wal-Mart in its later stages for the low income group customers. Kmart lacked the determination in order to make it big. It was always pretty happy with its position. Their motto was 'happy –go–lucky', whereas on the other hand, Wal-Mart had with it the vision of becoming the biggest and best retail store chain in the world. Kmart lacked any particular strategy, i.e., the way they should be going. Athough Kmart tried to bounce back and beat Wal-Mart in the race by cutting price on thousands of its products and by making an increase in the sales, only a few of its suppliers were aware of this move of Kmart. They didn't even bother to discuss their plan with the suppliers. Wal-Mart, knowing this move of Kmart in advance, negotiated the prices with its own suppliers, tactfully and was thus able to offer products at a discounted price. The strategy of slashing prices did not work for Kmart in the manner desired. This is what happens when you allow your competitors to get in so close of you. Had Kmart not got complacent of its position and ignored the importance of competition, the story would have been different. The fact is Wal-Mart accelerated because it always had a broader vision associated with its long-term strategies. Sadly for Kmart they were more interested in working out their short-term goals.

Questions for Discussion

1. What should Kmart have done to maintain good relationships with its customers?
2. How could Kmart have averted its decline.

UNIT 15 STRATEGIC LEADERSHIP

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Structure

15.0 INTRODUCTION

To compete in the global marketplace, organizations need to have strong and effective leadership. This involves the active process of both creating and implementing proper strategies. In this unit, key activities are introduced in which leaders throughout the organization must be involved to be successful in creating competitive advantages. The unit will provide insights into how organizations can effectively manage, change and cope with increased environmental complexity and uncertainty.

15.1 UNIT OBJECTIVES

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

- Understand the concept of leadership
- Identify the sources of problems faced by leaders
- Appreciate the role and significance of strategic leadership
- Explain the development of a learning organization

15.2 LEADERSHIP: THREE INTERDEPENDENT ACTIVITIES

In today's chaotic world, few would argue against the need for leadership, but how do we go about encouraging it? Let us focus on business organizations. Is it merely enough to keep the organization afloat, or is it essential to make steady progress toward some well defined objective? Custodial management is not leadership. Rather leadership is proactive, goal oriented, and focused on the creation and implementation of a creative vision. Leadership is the process of transforming organizations from what they are to what the leader would have them become. The definition implies a lot: dissatisfaction with the status quo, a vision of what should be, and a process for bringing about change.

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Richard D' Aveni, author of *Hyper Competition*, argued that in a world where all dimensions of competition appear to be compressed in time and heightened in complexity, sustainable competitive advantages are no longer possible.

Leaders are thus change agents whose success is measured by how effectively they implement a strategic vision and mission.

Accordingly, many authors contend that successful leaders must recognize three independent activities that must be continually reassessed for organizations to succeed. These are:

(i) Determining a direction

(ii) Designing the organization

(iii) Nurturing a culture dedicated to excellence and ethical behaviour

The interdependent nature of these three activities is self-evident. Consider an organization with a great mission and a superb organizational structure and design, but a culture that implicitly encourages shirking and unethical behaviour. Or a strong culture and organization design but little direction and vision. Or one with a sound direction and strong culture but counterproductive teams and a zero-sum reward system that leads to the dysfunctional situation in which one party's gain is viewed as another party's loss, and collabouration and sharing are severely hampered.

Much of the failure of today's organizations can be attributed to a lack of consideration of these three activities. Lets have a look at the three interdependent activities.

Setting a direction

Leaders need a holistic understanding of an organization's stakeholders. This requires an ability to scan the environment to develop a knowledge of all the company's stakeholders (e.g. customers, suppliers, shareholders) and other salient environmental trends and events and integrate this knowledge into a vision of what the organization could become. It necessitates the capacity to solve increasingly complex problems, become proactive in approach and develop viable strategic options. Developing a strategic vision provides many benefits: a clear future direction; a framework for the organization's mission and goals; and enhanced employee communication, participation and commitment.

Designing the organization

At times ,almost all leaders have difficulty implementing their vision and strategies. Such problems stem from a variety of sources, including-

- Lack of understanding of responsibility and accountability among managers
- Reward systems that do not motivate individuals towards desired organizational goals
- Inadequate or inappropriate budgeting and control systems
- Insufficient mechanisms to coordinate and integrate activities across the organization

Successful leaders are actively involved in building structures, teams, systems and organizational processes that facilitate the implementation of their vision and strategies.

A firm would generally be unable to attain an overall cost-leadership without closely monitoring its costs through detailed and formalized cost and financial control procedures. In a similar vein, achieving a differentiation advantage would necessitate encouraging innovation, creativity, and sensitivity to market conditions. Such efforts would be typically impeded by the use of a huge set of cumbersome rules and regulations, as well as highly centralized decision making. With regard to corporate level strategy, a related diversification strategy would necessitate reward systems that emphasize behavioural measures to promote sharing across divisions within a firm, whereas an unrelated strategy should rely more on financial indicators of performance, such as revenue gains and profitability, since there is less need for collabouration across business units because they would have little in common.

Nurturing a culture dedicated to excellence and ethical behaviour

Organizational culture can be an effective and positive means of organizational control. Leaders play a key role in developing and sustaining as well as changing, when necessary, an organization's culture.

Clearly, a leader's ethical behaviour can make a strong impact on an organization- for good or for bad. Managers and top executives must accept personal responsibility for developing and strengthening ethical behaviour throughout the organization. They must consistently demonstrate that such behaviour is central to the vision and mission of the organization. Several elements must be present and reinforced for a firm to become a highly ethical organization : role models , corporate credos and codes of conduct, reward and evaluation systems , and policies and procedures.

15.3 OVERCOMING BARRIERS TO CHANGE AND EFFECTIVE USE OF POWER

What are the barriers to change that leaders often encounter, and how can they use power to bring about meaningful change in their organizations? After all, people generally have some level of choice about how strongly they support or resist a leader's change initiatives. Why is there often so much resistance? There are many reasons why organizations and managers at all levels are prone to inertia and are slow to learn, adapt, and change.

1. Many people have vested interests in the status quo.
2. There are systemic barriers.
3. Behavioural barriers are associated with the tendency of managers to look at issues from a biased or limited perspective.
4. Political barriers refer to conflicts arising from power relationships.
5. There are personal time constraints.

Successful leadership requires effective use of power in overcoming barriers to change. Power refers to a leader's ability to get things done in away he or she wants them to be done. It is the ability to influence other people's behaviour, to persuade them to do things that they otherwise would not do, and to overcome resistance and opposition to changing direction. Effective exercise of power is essential for successful leadership.

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A leader derives his or her power from several sources or bases. The simplest way to understand the bases of power is by classifying them as organizational and personal.

Organizational bases of power refer to the power that a person wields because of holding a good management position. These include legitimate power, reward power, coercive power and information power. Legitimate power is derived from organizationally conferred decision-making authority and is exercised by a manager's position in the organization. Reward power depends on the ability of the leader or manager to confer rewards for positive behaviours or outcomes. Coercive power is the power a manager exercises over employees using fear of punishment for errors of omission and commission. Information power arises from a managers access, control and distribution of information that is not freely available to everyone in an organization.

Apart from the organizationally derived power, a leader might be able to influence subordinates because of his or her personality characteristics and behaviour. These would be considered as the personal bases of power. The personal bases of power are referent power and expert power. The source of referent power is a subordinate's identification with the leader. A leader's personal attributes of charisma might influence subordinates and make them devoted to that leader. On the other hand, the source of expert power is the leader's expertise and knowledge in particular field. The leader is the expert on whom subordinates depend for information that they need to do their jobs successfully.

RECIPE FOR SUCCESS

A study of the working culture at Kao Corporation, Japan

Creating a sense of stretch – It is an important characteristic exhibited by Kao corporation. Stretch is not just about top management redefining its strategic vision in more grandiose terms or substituting seemingly impossible targets for the usual budget objectives. The bigger challenge is to encourage those at the middle levels and in the frontline operations to see themselves and the organization not through the lens of past achievements or current constraints but in terms of future possibilities.

However liberating the organization from the restrictive patterns of the past and lifting the employee's expectations of themselves and of others is not easy. But Kao was able to do so by building the following characteristics into its culture –

i. Building a shared responsibility
ii. Developing a collective identity
iii. Creating personal commitment

i. Building a shared responsibility – Few people want to work for an organization that aspires to be average. It is part of human nature to want to excel, to be part of a winning team. Although all good managers recognize this simple truth, surprisingly few have been able to respond to the need it creates within their own organization. The problem has usually been that they have tried to engage their employees intellectually through the logic of rational strategic analysis rather than emotionally through the seduction of bold ambition. At the broadest level this can be an overarching ambition that gives more personal meaning to the company's long term objectives. For kao such a shared ambition was instilled into the organization by Dr. Maruta from the moment he became president in 1971 till his retirement in 1994. Maruta wanted every employee to understand that Kao was obliged to develop its technologies and apply them in innovative ways. He created within the organization a winning ambition to create a broad portfolio of products that were useful to society and offered good value to

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consumers. Kao's statement of purposeful ambition was in sharp contrast to the banality of so many other companies superficial mission statements printed in annual reports and then ignored completely. Within Kao the creation of useful new products became the driving engine of all activities.

ii. **Developing a collective identity** – Setting one's sights on highly ambitious objectives can be an intimidating prospect for many companies and people, since the bolder and more aggressive the goals, the greater the likelihood is that they will not be reached. Yet, acting in concert with others, most individuals develop a sense of courage and commitment they are unable to muster on their own. This is the potential that we saw various companies capture as they generated a sense of collective identity around the ambitious targets of becoming the best they could be. Kao's open and mutually supportive learning environment, framed by Maruta's concept of the company as an educational institution created just such a collective commitment to the company's technology and new product development ambitions.

iii. **Creating personal commitment** – Involving the people in every aspect of the company's business so that they feel a sense of personal commitment towards achieving the company's mission can be seen as a common thing in Kao. In Kao literally every employee was involved in the decision making process of the company. The employees were encouraged to give their views on various aspects.

15.4 EMOTIONAL INTELLIGENCE: A KEY LEADERSHIP TRAIT

A vast amount of literature is available on the successful traits of leaders, including business leaders at the highest level.

For simplicity, these traits may be grouped into three broad sets of capabilities:

- Purely technical skills (like accounting and operations research)
- Cognitive abilities (like analytical reasoning or quantitative analysis)
- Emotional intelligence (such as the ability to work with others and a passion for work)

One attribute of successful leaders that has become popular in both the literature and management practice in recent years is 'emotional intelligence'. Two of Daniel Goleman's recent books, *Emotional Intelligence* and *Working with Emotional Intelligence* were both on the New York Times' best-seller lists. Goleman defines emotional intelligence (EI) as the capacity for recognizing one's own emotions and those of others.

Recent studies of successful managers have found that effective leaders consistently have a high level of emotional intelligence. Findings indicate, for example , that EI is better predictor of life success(economic well being, satisfaction with life, friendship, family life), including occupational attainments, than IQ. Such evidence has been extrapolated to the catchy phrase: 'IQ gets you hired, but EQ (emotional quotient) gets you promoted.' And surveys show that human resource managers believe this statement to be true, and perhaps even for highly technical jobs such as those of scientists and engineers.

This is not to say that IQ and technical skills are irrelevant. Obviously, they do matter, but they should be viewed as 'Threshold capabilities'. That is, they are the necessary requirements for attaining higher-level managerial positions. EI on the other hand, is essential for leadership success. Without it, Goleman has argued , a manager can have excellent training, an incisive analytical mind, and many some ideas but will still not be a great leader.

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There are five components of EI: self-awareness, self-regulation, motivation, empathy, and social skill.

Value Creation and Role of Strategic Leadership

A better appreciation of the concept of strategic leadership can be obtained by comparing it with managerial leadership and visionary leadership. Managerial leadership is the onethat is exhibited by majority of the executives in most of the organizations. In fact, nearly all the organizations including those of the government have a system of training executives in managerial leadership. Managerial leadership is rule-bound, it is process-based; it relates people according to their roles in the decision-making process. It is impersonal and passive, with a focus on goals.

- Events take place more rapidly than ever; most of them are bringing about irreversible changes.Old order of things, products, processes and systems are continuously being destroyed; they arebeing replaced by technologically superior, faster and smarter ones4 .
- Knowledge work and knowledge-workers are becoming increasingly the order of the day. Products and processes are becoming technology-driven and hence smarter; this is pressurizing the people to become continuously smarter.
- Intellectual assets and their ownership have begun to replace physical assets and their ownership as the primary basis of economic wealth creation and competitive advantage6.
- The new era is ushering in tremendous growth opportunities. It is driven by technology, innovation, enterprise, etc. The era has marked the death of permanency: Life-cycles are becoming shorter.
- Managing in such situations requires a new competitive mindset – mental agility, organizational flexibility, speed, innovation, global view, strategic thinking etc.

How do we carry our organizations into this cataclysmic, turbulent era? How do we ensure theirlong-term sustainability? How do we sustain their strategic competitiveness over the coming years?

This is the context of exploring the contours of strategic leadership, in clear contrast to the conventional leadership, as the critical resource to steer the organizations into a new era.

What is strategic leadership?

Strategic Leadership can be distinguished from leadership on two basic aspects Strategic leadership theory relates to the study of people at the top of the organization while leadership theory relates to the study of people at any level of the organization. Leadership theory focuses on the behaviour and relationship between leaders and followers. Strategic Leadership theory covers a wider spectrum; it studies the executive work as a relational activity; it examines the context of the interactions in terms of strategic and symbolic activities. Strategic leadership can be defined as the leader's ability to anticipate, envision, maintain flexibility, to think strategically and to work with the members of the team to initiate changes that will create a viable future for the organization. It is the ability of the leader to influence others to voluntarily make day-to-day decisions that enhance the long-term viability of the organization while at the same time maintaining the short-term financial stability.

Check Your Progress

1. What is leadership?
2. List the components of emotional intelligence.

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Two perspectives on strategic leadership

There are different perspectives on strategic leadership. One of these perceives that organizations are reflections or extended shadows of their founding fathers; and later on their chief executives. In this perspective, top managers are armed with substantial decision-making responsibilities and capabilities and they have the ability to significantly influence the direction of the firm and the firm's strategic management process. The top management has the sole influence on the people within the organization and their behaviour towards the organizationalgoals. This is the Great Leader view of Strategic Leadership described The CEO, under this perspective, would be a titan full of strategic wisdom, initiative, innovation etc. Given this role and responsibility, he could turn out to be a lone ranger out of touch, out of sync with the people under his leadership. There is an element of great risk when the organization lands up with a CEO who does not fit this perspective of the role; because the people below are ill-equipped and ill-trained to contribute to the noble task of leading and directing the organization. This perspective is fine when the strategic environment in which the organization has to function is reasonably predictable. In a situation that is dynamic and influenced by a multiplicity of forces that are fairly unpredictable it is too much to expect that the top management has all the decision-making capabilities, all the abilities to influence the direction of the firm and to lead the people towards the goals.

This leads us to the next major perspective: The Great Groups Perspective of Strategic Leadership.

Under this perspective the organization is perceived not as a piece of property by its current set of shareholders but it is perceived as a community of people involved in the organization and this community remains together to pursue the common purpose. In any community, each member has something to contribute towards the common purpose; each is inter-dependant on the other. This leads to leadership being "distributed among diverse individuals who have the responsibility to create a viable future for the organization" . This would lead to the emergence of a variety of networks within the organization.Innovations are created with help from one another; knowledge creation takes place across theorganization and it gets dispersed very easily. Strategic thinking and innovation also happens across the organization. There is a higher sense of involvement and ownership and it is a lot easier to bring about any major change in the organization and its processes. These Great Groups have some interesting characteristics:

a. The members of the groups have accepted their responsibilities and are highly committed to the organizational goals.

b. The groups learn from a variety of functions and parties including those from outside the firm like suppliers, customers, etc.

c. The groups have a commitment to information and knowledge as well as their compilation; there is a definite urge to work smarter through collective insights and competenciesOne of the important Great Groups in any firm is the Top Management Team [TMT] created bythe CEO. This is generally a small, but a core team comprising of senior executives from heterogeneous functions and competencies; this team has great potential in providing the strategic leadership to the firm. The Great Groups perspective does not rule out the need for highly competent top manager/s.

The role of the top managers is to facilitate the development of great groups where strategic leadership gets distributed among a variety of people with different competencies. These groups with facilitation from the top managers develop

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adaptive solutions to the problems that emerge from time to time. The CEO is accountable to the board of directors for the firm's performance.

A better appreciation of the concept of strategic leadership can be obtained by comparing it with managerial leadership and visionary leadership. Managerial leadership is the one that is exhibited by most of the executives in most of the organizations. In fact, most of the organizations including government have a system of training executives in managerial leadership. Managerial leadership is rule- bound, it is process-based; it relates people according to their roles in the decision making process. It is impersonal, passive with a focus on goals. Consequently, managerial leadership is mechanistic. Managerial leaders need orderliness; their need for structures and systems is very high; they find it difficult to cope with unstructured situations.

They can manage an organization, sustain normal growth rates; but they are less equipped to propel supernormal growth; they are less suited to facilitate innovations and changes. They do not belong or exist in the present; they belong to the future. They are not constrained by the present structure or systems or process or people; they do not draw their sustenance from the present. Visionary leaders are more proactive, creative, innovative and idea generators; they influence the thinking process of the organization and its people; they create fresh approaches to long-standing problems; they generate lot of excitement in the organization. Since they are least rooted in the existing structures and systems, they are very often on a plane of high risk and seek out ventures characterized by high-risk-high-returns. They are least systematic as they relate to ideas and people intuitively, emotionally and empathetically. Visionary leaders are good at creating new ideas and grandiose visions for the organization; but they are very weak when it comes to executing or realizing those dreams.Strategic Leader is a synergistic combination of the 'managerial leader' and the 'visionary leader'.

Strategic leadership presumes that the leader understands the emergent competitive environment and is able to create strategic directions for the

organizational excellence on one side; on the other side it presumes that the leader is able to create, nurture and sustain organizational competencies to translate and implement the strategic directions into tangible organizational outcomes. The strategic leader needs to be as maverick as the visionary leader and as stoic and matter-of-fact as the managerial leader. Visionary leadership focuses on the long-term perspective and long-term viability of the organization; managerial leadership focuses on the short-term viability of the organization.He needs to balance between the future and the present; this appears to be contradictory in nature as the expectations and competencies are quite different. This is the paradox of leading and managing.

Successful leader would let managerial leaders to flourish in the organization to take care ofday-to-day matters; at the same time, he would let visionary leaders flourish to create strategic options for the future.

Leading and managing

A strategic leader would lead the organization into the future and change; simultaneously he would manage it for its short-term viability. This is a very challenging task. Some leaders achieve this by nurturing separate groups of people with responsibilities to manage long-term perspectives of the firm and to manage the day-to-day affairs of the company. The attitude and skills required for two tasks are different and hence it would be a lot easier to identify separate set of people for the two tasks.

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A strategic leader

What factors support the nurturance of strategic leadership? It is would lead the generally observed that a liberal organizational culture and flexible structure are more likely to support the emergence of strategic leadership than a rigid, hierarchical structure with too much emphasis on current performance. When there is too much focus on current operations and profits, there is hardly any scope for visioning. This leads to a situation of managerial leadership only. When the organization is too hierarchical and rigid, there is very little scope for innovation, creativity or change. This also prohibits the nurturance of strategic leadership. These are inhibiting factors to the emergence of strategic leadership in the organizational context. There can also be a situation where the CEO does not encourage creativity, innovation or change leading to a situation where emergence of strategic leadership is stifled or discouraged.

In widely diversified organizations, it is found that executive development tends to focus on managerial leadership. The attempt is to develop managers who can manage the businesses of the firm, whether it is steel making or shipping, with equal comfort and ease. There is a strong possibility that in such situations the process of visioning gets de-emphasized leading to precluding the development of strategic leadership in the long run. This is the situation of loss of strategic control.

Government is another type of organization where the long-term view is at a discount. This is for a variety of reasons. It could be that the focus is on performance for the immediate or current term of the government with little or no focus on the time horizon beyond the current term. In such a situation the leadership of the organization tend to be managerial only. There can be a situation where the objective of the organization is not adequately translated into operational parameters. In government, the output is mostly of social nature; very often there is inadequate efforts in correctly valuing them in financial terms resulting in obfuscation of the focus and hence loss of strategic control.

Among small and medium firms the inability to grow and to a large extent bankruptcies can alsosignificantly attribute to the absence of strategic leadership. For a variety of reasons there is too much of focus on the management of day-to-day affairs, which is managerial leadership. There is conspicuous lack of vision either due to ignorance or due to excessive pre-occupation with the present or due to lack of resources. These combine with imperfect capital structures, poor use of external resources and advisors, inadequate emphasis on succession planning and poor management skills. On careful analysis , the prime cause invariably emerges out to be the lack of vision and strategic leadership.

15.5 DEVELOPING A LEARNING ORGANIZATION

The implicit message that learning, information sharing, adaptation, decision making and so on are not shared throughout the organization . In contrast, leading-edge organizations recognize the importance of having everyone involved in the process of actively learning and adapting.

In an increasingly dynamic, interdependent, and unpredictable world, it is simply no longer possible for anyone to ‘figure it all out at the top’. The old model, ‘the top thinks and the local acts,’ must now give way to integrating thinking and acting at all levels. While the challenge is great, so is the potential payoff. ‘The person who figures out how to harness the collective genius of the people in his or her organization', according to former Citibank CEO, Walter Wriston, 'is going to blow the competition away'.

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Successful learning organizations create a proactive, creative approach to the unknown, actively solicit the involvement of employees at all levels, and enable all employees to use their intelligence and apply their imagination. Higher levels skills are required of everyone, not just those at the top. A learning environment involves organization wide commitment to change, an action orientation, and applicable tools and methods. It must be viewed by everyone as a guiding philosophy and not simply as another change programme.

A critical requirement of all learning organizations is that everyone feels and supports a compelling purpose. Inspiring and motivating people with a mission or purpose is a necessary condition but sufficient condition for developing an organization that can learn and adapt to arapidly changing, complex, and interconnected environment. There are four critical ongoing processes of learning organizations:

- Empowering employees at all levels
- Accumulating and sharing internal knowledge
- Gathering and integrating external information
- Challenging the status quo and enabling creativity

Strategy Spotlight

Under the direction of Dr. Yoshio Maruta, the then president of Kao Corporation, Kao became one of the most admired companies in Japan regularly rated by Nikkei Business ahead of well known companies like Canon and Toyota in terms of corporate originality, innovativeness and creativity.

Many of the company's innovativeness in the field of super concentrated detergents and shaped diapers were benchmarks in its field, when compared to its much mightier rivals like P&G and Unilever. It consistently came up with new products ahead of its local competitors such as Lion to emerge as the largest branded and packaged goods company in Japan and second largest in terms cosmetics.

It received the Nikkei Monozukuri Award in November 2006 for promoting product development and manufacturing capabilities. The award is given to outstanding companies for research centers and systems in Japan and overseas.

Women's Wear Daily – a fashion magazine awarded it the breakthrough product of the year 2006 in USA for its Luminous Colour glaze sold under the John Frieda brand in the United States.

THE KAO WAY – BUILDING THE FOUNDATION

The Kao Way serves as the core index of its business to pursue the mission, 'to strive for the wholehearted satisfaction and enrichment of the lives of people globally.'

In line with its mission the company strives to work with passion in the core domains of cleanliness, beauty, health and chemicals to provide products and brands of excellent value created from the customer's perspective.

The company is truly driven by the values of innovation and integrity and the principles of consumer driven, respect and team, work and global perspective.

BACKGROUND NOTE

Founded in 1887 in Japan, the Kao company was built on the basis of a simple strategy; produce soaps of equal quality to imported brands but at more affordable prices. The management and the employees of Kao soap company believed strongly in the rather grand motto they developed for their tiny company, 'Cleanliness is the foundation of a prosperous society.' For over half a century the company grew, improving its products and building its distribution. Then, in the immediate postwar era, following an explicit policy of imitating and adapting foreign technology and marketing approaches, Kao launched the first Japanese laundry detergent. In following years the company expanded into dishwashing detergents and household cleaners, establishing itself as one of the three major Japanese companies that dominated the domestic household cleaning market.

It was not until the 1970s and 1980s that Kao began to pull ahead of its competitors and inflict some humiliating market defeats on the newly arrived foreign players Unilever and Procter and Gamble. It was in this era under the two decade leadership of Dr Yoshiro Maruta that Kao developed a management philosophy and organizational capability that wove continuous renewal into the fabric of the company's ongoing activities.

When he assumed the presidency of Kao in 1971, Maruta brought with him a management approach that reflected his deep involvement in Buddhist philosophy. His beliefs were based on the principles of human equality that was expressed as a profound respect for the individual. The philosophy manifests itself in a commitment not only to give employees their own voice but to help them achieve their full potential.

Starting from this philosophy introduced a radical concept. He insisted that his managers view Kao not as a soap and detergent company but as an educational institution. He convinced them that the most basic responsibility of every member of the organization was to teach and to learn. As he created his learning organization, Maruta developed sophisticated information systems that allowed managers to capture and process vast amounts of data, adding value and transforming it into usable knowledge. The traditional focus of Kao was shifted from adaptation to creativity and innovation. Maruta also insisted that knowledge building and the learning focus on the future rather than reflect on the past. In order to avoid complacency he discouraged his managers from talking about past achievements.

15.6 CREATING AN ETHICAL ORGANIZATION

What is ethics? Ethics may be defined as a system of right or wrong. Ethics assists individuals in deciding when an act is moral or immoral, socially desirable or not. There are many sources for an individuals' ethics. These include religious beliefs, national and ethnic heritage, family practices, community standards and expectations, educational experiences, and friends and neighbors. Business ethics is the application of ethical standards to commercial enterprise.

Individual ethics vs. organizational ethics

Many leaders may think of ethics as a question of personal scruples, a confidential matter between employees and their consciences. Such leaders are quick to describe any wrongdoing as an isolated incident, the work of a rogue employee. They assume the company should not bear any responsibility for an individual's misdeeds- it may

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not even enter their minds. After all, in their view, ethics has nothing to do with leadership.

In fact, ethics has everything to do with leadership. Seldom does the character flaw of a lone actor completely explain corporate misconduct. Instead, unethical business practices typically involve the tacit, if not explicit, cooperation of others and reflect the values, attitudes, and behaviour patterns that define an organization's operating culture. Clearly, ethics is as much an organizational as a personal issue. Leaders who fail to provide proper leadership to institute proper systems and controls that facilitate ethical conduct share responsibility with those who conceive, execute, and knowingly benefit from corporate misdeeds.

The ethical orientation of a leader is generally considered to be a key factor in promoting ethical behaviour among employees. Ethical leaders must take personal, ethical responsibility for their actions and decision making. Leaders who exhibit high ethical standards become role models for others in the organization and raise its overall level of ethical behaviour. In essence, ethical behaviour must start with the leader before the employees can be expected to perform accordingly.

Over the last few decades, there has been a growing interest in corporate performance. Perhaps some reasons for this trend may be the increasing lack of confidence regarding corporate activities, the growing emphasis on quality of life issues, and a spate of recent corporate scandals at such firms as Enron, Tyco, World Com and not forgetting the role of Arthur Andersen. Clearly, concerns about protecting the environment, fair employment practices, and the distribution of unsafe products have served to create powerful regulatory agencies such as the Environmental Protection Agency, the Equal Opportunity Commission, and the Federal Drug Administration.

CSR and the Tobacco Companies

Myth or reality? Major Tobacco Companies are trying hard to swim against the tide of anti-tobacco activists. Governments and other NGOs are convinced about the killer effects of tobacco and are aggressively campaigning for a tobacco free environment. Comapnies are trying to face this aggression in many ways and Corporate Social responsibility is one of the ways adopted. The article discusses how the companies, over a period of time, adopted CSR as a tool and the various initiatives that are being taken for the benefit of the people. Corporate Social Responsibility (CSR) can be defined as how businesses align their values and whole. It is about what a company gives back to the society. Considering the negative effects of smoking, tobacco companies are the most vulnerable to attacks from the social activists. There is an increasing hostility between people for and against tobacco production and sales. The lobbies that are favoring tobacco companies include the tobacco farmers, the national tobacco associations, and the multinational tobacco companies; and opposing these people are the health workers, the NGO's (consumer groups, media), the academia, and the multilateral organizations like WHO, UNICEF and World Bank.

Issues involved

Most tobacco companies attract constant attention for their line of business. Tobacco is a health hazard. It is also one of the cheapest and most easily available forms of addiction. The sheer magnitude of diseases attached to tobacco addiction is shocking. Most of them are lethal, like cancer and tuberculosis. Over the years, the tobacco companies have been the target of health activists, social workers and other media persons. They are accused of selling life taking substances. For the companies established in this business, it is a catch 22

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situation. They also score high on the grounds of employment provided by their operations to millions of people. For the government, tobacco and related products rank among the highest revenue earners.

Advertising is another issue where most tobacco companies are under constant supervision. With a surge in regulations to ban direct advertising in any form, the attempt is to move towards surrogate advertising and more of sponsorships. As an increasing number of countries are banning various forms of direct advertising of tobacco products, tobacco companies have been shifting their attention to indirect promotion of their products by such means as sponsorship of social causes, sports and arts events. For a relatively minor donation to culture, tobacco companies buy their way into the advertising market, where they spend millions of dollars ensuring that the public remains familiar with the colors, logos and images of their brands. ITC sponsoring music conferences and cricket under its Wills brand is a good example.

In light of the above scenario, this article explores some social responsibility initiatives taken by the top tobacco majors like BAT, Phillip Morris and R. J. Reynolds.

Major initiatives

Most tobacco companies are heavily into sponsoring of cultural, social and sports events. Social causes like education, medical grants and help to victims of sexual, drug abuse generally top their list. What remains a common initiative among all the tobacco companies is an effort to prevent youth from smoking. Nationwide surveys of stores selling cigarettes over the counter have shown that three out of four sell them to children as young as 11. Between 60-90% of children buy their own cigarettes. In the US, vending machines dispense cigarettes to an estimated 450,000 children every day. More than a million annually become regular smokers, tobacco chewers, or cigars chompers. In the US, tobacco sales to minors are illegal in 44 states. The laws, however, are weak and poorly enforced. In this regard, most of the tobacco majors try and do what they can to prevent retail access of tobacco to children.

Some even have punitive charges for retailers, who violate this law. Companies like R.J.Reynolds, Philip Morris, etc., have been practicing social responsibility since their inception. R.J. Reynolds' history of corporate responsibility began with the company's founder, Richard Joshua Reynolds. He donated generously to the community where he built his business. His first documented gift was in 1891, when he gave $500 (in today's dollars that would be around $10,000) toward the establishment of the Slater Industrial School. Slater Industrial is now known as Winston-Salem State University.

Most tobacco companies are heavily into sponsoring of cultural, social and sports events.

The British-American Tobacco Company Ltd. (BAT) does not employ children in their operations. In 2001, it helped establish the Eliminating Child Labour in Tobacco Growing Foundation, following an awareness-raising campaign, which they had begun a year previously, together with the International Tobacco Growers' Association (ITGA) and the trade unions in their sector, the IUF (International Union of Food, Agricultural, Hotel, Restaurant, Catering, Tobacco and Allied Workers' Associations).

For Philip Morris, corporate social responsibility begins with their products. They believe in telling people about the dangers of smoking, doing their best in keeping children away from this product, and at the same time developing

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potentially less harmful products. But their responsibility doesn't end there. Philip Morris is convinced that a company thrives only when the community around it thrives.

So they generally work with the community and address issues that are of utmost concern. In 2004 they made charitable contributions in 70 different countries, totaling more than $13.6 mn.

During the 1890s and early 1900s, Reynolds continued giving private donations to such causes as hospitals, orphanages, new churches, agricultural contests and higher education. Today, R.J. Reynolds employees are given the chance to help direct funds to nonprofit organizations through plans sponsored by the R.J. Reynolds Foundation. Philip Morris set up the Casa di accoglienza delle donne maltrattate or CADM, in 1986. It is one of Italy's oldest and most active anti-domestic violence organizations. Staffed by a team of volunteers and professionals, it offers refuge, counselling, legal support and practical help to victims of domestic violence. Philip Morris Italy has supported CADM since 2001, and for the last

15.7 INTEGRITY-BASED VS COMPLIANCE-BASED APPROACHES TO ORGANIZATIONAL ETHICS

It is important to understand the essential links between organizational integrity and the personal integrity of an organization's members. There cannot be high-integrity organizations without high-integrity individuals. At the same time, individual integrity is rarely self sustaining. Even good people can lose their bearings when faced with pressures, temptations and heightened performance expectations in the absence of organizational support systems and ethical boundaries. Organizational integrity, on the other hand, is beyond personal integrity. It rests on a concept of purpose, responsibility, and ideals for an organization as a whole. An important responsibility of leadership in building organizational integrity is to create this ethical framework and develop capabilities to make it operational.

15.8 SUMMARY

Strategic leadership is vital in ensuring that strategies are formulated and implemented in an effective manner. Leaders must play role in performing three critical and interdependent activities: setting the direction, designing the organization and nurturing a culture committed to excellence and ethical behaviour. These three activities are like a 'three legged stool'. If leaders ignore or are ineffective at performing any one of the three, the organization will not be very successful. Leaders must also use power effectively to overcome barriers to change.

For leaders to effectively fulfill their activities, emotional intelligence (EI) is very important. Five elements that contribute to EI are self awareness, self-regulation, motivation, empathy and social skills. The first three elements pertain to self-management skills, whereas the last two are associated with a person's ability to manage relationships with others.

Leaders must also play a central role in creating a learning organization. With the rapidly changing, unpredictable and complex competitive environments that

Check Your Progress

3. What is the key factor in promoting ethical behaviour among employees?
4. Suggest an important responsibility of leadership in building organizational integrity.

characterize most industries, leaders must engage everyone in the ideas and energies of people throughout the organization. Great ideas can come from anywhere in the organization—from the executive suite to the factory floor. The five elements, which are central to a learning organization are inspiring and motivating people with a mission or purpose, empowering people at all levels throughout the organization, accumulating and sharing internal knowledge, gathering external information and challenging the status quo to stimulate creativity.

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15.9 KEY TERMS

- **Leadership:** The process of transforming organizations from what they are to what the leader wants them to become.
- **Power:** The ability to influence other people's behaviour, to persuade them to do things that they otherwise would not do and to overcome resistance and opposition to changing direction.

15.10 ANSWERS TO 'CHECK YOUR PROGRESS'

1. Leadership is the process of transforming organizations from what they are to what the leader would have them become.
2. Emotional intelligence comprises the following five components:
   (i) Self-awareness
   (ii) Self-regulation
   (iii) Motivation
   (iv) Empathy
   (v) Social skill
3. The ethical orientation of a leader is generally considered to be a key factor in promoting ethical behaviour among employees.
4. An important responsibility of leadership in building organizational integrity is to create an ethical framework and develop the capabilities to make it operational.

15.11 QUESTIONS AND EXERCISES

Short-Answer Questions

1. What are the three interdependent activities of effective leadership?
2. What is meant by emotional intelligence? In what way it is valid for effective leadership?
4. How do you go about creating an ethical organization?

Long-Answer Questions

1. What is a learning organization? Discuss briefly.
2. Describe the pros and cons of integrity based vs compliance-based approaches to organizational ethics.

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15.12 FURTHER READING

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UNIT 16 STRATEGY: EVALUATION, CONTROL AND TECHNOLOGY MANAGEMENT

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Structure

16.0 INTRODUCTION

Strategic control focuses on monitoring and evaluating the strategic management process to ensure that it moves in the right direction. In other words, strategic control is concerned with tracking the strategy when it is implemented, detecting problems or changes in underlying premises, and making necessary adjustments. In this unit, you will learn about strategic control and implementation control. You will read about strategic surveillance, which is designed to monitor internal and external events that are likely to threaten an organization. Among other things, the unit will introduce you to crisis management and also discuss special alert control, operational control systems, schedules and key factors for success.

In this unit, among other things, you will learn about the designing of a technology strategy, the choice of a strategy, the choice of the right licensee and technology forecasting.

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16.1 UNIT OBJECTIVES

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

- Understand the process of establishing strategic control systems
- Appreciate the role of operation control systems in guiding, monitoring and evaluating progress
- Understand the role of a special alert control
- Realize the importance of matching the structure and control system with the corporate strategy
- Get an idea of the steps for managing crisis
- Identify the key success factors
- Understand the importance of a technology strategy
- Explain the need for aligning generic strategies with research and development
- Appreciate the role of technological leadership
- Understand the factors that determine the sustainability of technological leadership

16.2 ESTABLISHING STRATEGIC CONTROLS

Strategic control answers questions such as the following:

- Are the organization's internal strengths still holding good?
- Are its internal weaknesses still present?
- Has the organization added other internal strengths?
- Does it have other weaknesses?
- Are their new opportunities?
- Do the threats to the organization still exist, and are there any new threats?
- Are the decisions consistent with the organizational policy?
- Are their sufficient resources to achieve the objectives?
- Are goals and targets being met?
- Are the organizational vision, mission and objectives appropriate for the changing environment?

Thus, strategic control provides feedback about the various steps of strategic management. It enables the management to find out whether the strategic management process is appropriate and compatible with organizational goals and whether it is functioning in the desired direction. Sometimes, strategic controls may initiate changes in objectives as well. The four types of strategic controls are discussed as follows:

16.2.1 Premise Control

Premise means an assumption. Every strategy is based on some assumptions. A firm's strategy is built around these assumptions. Premise control helps to check, systematically and continuously, whether or not the assumptions set during the planning and implementation process are still valid. If a premise or an assumption is no longer valid, then the strategy is changed along with the assumptions. Premises are primarily concerned with two types of factors¯environmental and industry factors.

Environmental factors

Environmental factors have a considerable influence on the success of a strategy. Examples of environmental factors are inflation, technology, interest rates, government regulation , demographic/social changes, etc. A company has little or no control over such factors and strategies are usually based on key premises about these factors.

Industry factors

Industry factors affect the performance of companies in a given industry. Strategic assumptions are made about factors such as competitors, suppliers, substitutes, barriers to entry, etc. These factors differ from industry to industry. So a company should be aware of the factors that influence success in the industry in which it operates.

Various premises are made about numerous industry and environmental variables. Tracking every premise is expensive and time- consuming. So managers should select only those premises that are likely to change and those that are likely to have a major impact on the company and its strategy. After the key premises are identified, they should be monitored, and responsibility should be assigned to the persons/ departments who are qualified to provide information. Premises should be updated, on the basis of new information. Finally, key areas of the strategy that are likely to be influenced by the changes in assumptions should also be identified. For example senior managers have to be aware of changes in a competitor's pricing policies. This is required so that they can bring about necessary changes in their own pricing or other types of strategies. In the same way, managers have to be aware of technological changes such as the growth of the internet, which has enabled many companies to market their products internationally without even knowing their customers. Awareness and willingness to change can help create strategic advantages for the organization.

16.2.2 Implementation Control

The action phase of strategic management consists of a series of steps, programmes and moves undertaken over a period of time to implement the strategy. In this phase, managers undertake programs, add people, and mobilize resources. In other words, managers translate broad strategic plans into concrete actions. These actions act as goals for specific units and individuals as they go about implementing the strategy. These actions take place over the intended period of time and are designed to achieve long-term objectives.

Monitoring strategic thrusts

The implementation of broad strategies involves undertaking several new strategic projects that represent part of what needs to be done if the overall strategy is to be accomplished. Through these projects or thrusts, managers can obtain feedback that helps determine whether the overall strategy is progressing as planned, or whether it needs to be adjusted or changed.

Milestone reviews

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Managers often identify the critical milestones that will occur over the time period when the strategy is being implemented. These milestones may be critical events or major resource allocations. A milestone review involves a full-scale reassessment of the strategy and the advisability of continuing or refocusing the direction of the company. Thus the critical purpose of a milestone review is to undertake a thorough review of the firm's strategy at a critical juncture, so as to control the direction of the strategy and the company.

16.2.3 Strategic Surveillance

Strategic surveillance is designed to monitor a broad range of events inside and outside the company that are likely to threaten the course of firm's strategy. It is a form of general monitoring through multiple information sources. The strategic intent of strategic surveillance is to uncover important, yet unanticipated information. Surveillance must be kept unfocussed as much as possible and should be designed as a loose environmental scanning activity. Trade magazines, trade conferences, intended and unintended observations are sources for strategic surveillance. Thus the purpose of strategic surveillance is to provide an ongoing vigilance of daily operations so as to uncover information that may prove relevant to the firm's strategy.

16.2.4 Special Alert Control

A special alert control reflects the need to thoroughly reconsider the firm's basic strategy based on a sudden, unexpected event. Such an occurrence should trigger an immediate and intense reassessment of the company's strategy and its current strategic situation. Many firms delegate crisis teams to handle the initial response and coordination needed when faced with unforeseen occurrences. When unforeseen occurrences have an immediate effect on the firm's strategy, companies develop contingency plans which are put into operation by crisis teams, under such circumstances.

Thus, strategic controls are concerned with 'steering' the company's future direction. These are useful to the top level management for monitoring and determining the basic strategic direction of the company.

16.3 OPERATIONAL CONTROL SYSTEMS

Operational controls are action controls. Operational control systems help operating managers to implement strategy at their level. These systems help to guide, monitor and evaluate progress in meeting the annual objectives of the company. They provide post- action evaluation and control over short time periods (usually one month to one year). For operational control systems to be effective, the following four steps should be taken:

- Set standards of performance
- Measure actual performance
- Identify deviations from standards
- Initiate corrective action or adjustment

The three types of operational control systems are budgets, schedules and key success factors.

16.3.1 Budgets

A budget is a plan to show how much money a person or organization will earn and how much they will need or be able to spend. It states planned organizational activities for a given period of time in quantitative terms. A budget is simply a resource allocation plan that helps managers coordinate operations, and facilitates managerial control of performance. Though budgets differ from organization to organization, they can be classified into three general types of budgets, i.e. revenue, capital and expenditure.

Revenue budgets

A revenue budget provides for the daily management of financial resources. It also provides key feedback as to whether the strategy is working or not. A sales budget is one such revenue budget; it gives a formal and detailed expression of the sales forecast. This sales forecast is the cornerstone of planning and also acts as the foundation for budgetary control. Sales revenue budgets give feedback on the effectiveness of a firm's approach. If the deviation is more than expected, managers can re-evaluate and adjust the firm's operational or strategic posture.

Capital budgets

Capital budgets outline specific expenditure for plants, equipment, machinery, inventories and other capital items needed during the budget period. Preparation of these budgets needs great care, as these budgets give a definite form to the spending plans of an enterprise.

Expenditure budgets

An expenditure budget presents the financial plan for each department during the budget period. The expenditure budget for each functional unit and for sub-functional activities guides and controls the execution of strategy for each function. For example firms prepare separate expenditure budgets for marketing activities and advertising activities.

16.3.2 Schedules

Scheduling as a planning tool involves allocation of time and constrained resources, and their arrangement into a sequence of interdependent activities. Scheduling helps managers by providing a plan about when the work commences, when it concludes, in what sequence the work will be accomplished, what part of the work will be accomplished by what time. Clarity in the work schedule ensures a systematic flow of work.

16.3.3 Key Success Factors

Operational managers can ensure control over their operations by focusing on key success factors. Key success factors identify performance areas that must receive continuous management attention. Some key success factors are:

- High employee morale
- Improved product service quality

- Increased earnings per share
- Growth in market share
- Completion of new facilities

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The achievement of these standards is possible only through successful teamwork. Operating control systems require the establishment of performance standards. In addition, in implementing the strategy, managers identify deviations in the strategy, determine the underlying causes, and make corrections to get the most out of the strategy.

Reward systems

The execution and control of strategy ultimately depends on individual members of the organization. Motivating and reward good performance are the key ingredients in effective strategy implementation. Based on the organization's strategy, managers decide which behaviors to reward. They create a control system to measure these behaviors and link the reward systems to them. Both positive reinforcements and negative reinforcements are useful in controlling and adjusting performance. Examples of various reward mechanisms for motivating and controlling individual efforts include:

- Compensation
- Raises
- Bonuses
- Stock options
- Incentives
- Promotions / demotions
- Recognition and praise
- Criticism
- More or less responsibility
- Performance appraisal
- Tension and fear

16.4 CRISIS MANAGEMENT

Crisis management addresses certain risks and uncertainties that arise over period of time. Crisis can be of different types: accidental(e.g. fires, and computer failure), deliberate (e.g. poisoning scares, contamination of food products). Wherever possible, firms prepare contingency plans to mitigate the effect of these crises. Sometimes, strategic changes can also lead to a crisis of confidence. For example, rumours that a firm is going to be acquired by some other company might lead to falling sales, reduction of profits, etc. Three decisions are important in ensuring that crisis strategy is effective.

(i) Decisions concerning what can go wrong, the probability of it happening, and the impact it will have if it does happen

(ii) Decisions about investing in preventive measures, in order to reduce or minimize the risk

(iii) Decisions on mechanisms for contingency management

Check Your Progress

1. What is the purpose of strategic surveillance?
2. Name the three types of operational control systems.

Steps for managing crisis

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The various steps in the process of crisis management are:

(i) Identification of the most obvious areas of risk.

(ii) Establishment of policies and procedures to avoid chances of risks becoming crisis.

(iii) Identification of trained crisis management teams to take care of a crisis situation whenever it arises

(iv) Stakeholder analysis is another crucial aspect of the process. It is important to identify which stakeholders are most likely to be affected by a particular crisis and how. Where stakeholders perspectives and expectations differ, it may be necessary to deal with each group on an individual basis.

(v) Formulation of a clear communication strategy is essential. Sometimes ethical issues may be involved and the company is expected to be cooperative, open, honest and consistent. The company should be in control but should not attempt to cover up its failings.

16.5 MATCHING STRUCTURE AND CONTROL TO STRATEGY

Successful implementation of strategy is possible only when the strategy is backed by the appropriate organizational structure and control systems. For example, strategy at the business level needs a backing structure that helps manage relationships among functions, to enable the firm to benefit from distinctive competencies in attaining the business level objectives. Similarly changes in corporate strategy must be followed by change in the structure. For example, the profitability of mergers and acquisitions depends on the structure and control systems that are adopted to manage them, and the way in which the new firms are integrated with the existing businesses.

The importance of appropriate structure and control systems in some of the major functions in a business organization is outlined below-

Manufacturing

Strategy in manufacturing concentrates on improving efficiency, quality and responsiveness to customers. A company has to create an organizational setting where managers can use the experience curve of the firm to minimize costs. In order to move down the curve quickly , companies exercise tight control over work activities. Companies are also using behavior and output controls to reduce costs and improve efficiency. Managers also use output controls such as operating budgets to monitor and contain costs.

Research and development

Research and development strategy aims at developing a distinctive competency in innovation. It also underscores the importance of developing technology to produce products that fit customers needs. Hence the R & D department's structure and control systems must help scientists and engineers in bringing the products to the market quickly. Further these systems must motivate R &D personnel in developing new products and processes.

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Sales

The sales function operates with a flat structure. Flat structures are useful because this function doesn't depend only on direct supervision. The sales function usually employs output and behavior controls. Output controls such as specific sales goals or goals for increasing responsiveness to customers, can easily be set and monitored. Further, these output controls can be linked to bonus rewards and be used to standardize sales people's behavior and make performance evaluation process easy.

16.6 CHOICE OF TECHNOLOGY: ALIGNING GENERIC STRATEGIES WITH RESEARCH AND DEVELOPMENT

A firm's technology strategy depends on the type of competitive advantage it seeks to develop. Such a strategy can complement the firm's generic competitive strategy. A technology strategy seeks to make research more focused by aligning research done by R&D with the firm's overall generic strategies. For example, such a strategy can ensure that the R&D activities of a cost leader focus on reducing the manufacturing cost per unit as well as the cost of product design.

A firm's technology strategy is not concerned with giving a focus and direction to product and process R&D , it is also concerned with giving a focus to the value chain of an organization. A through analysis of all the firm's technologies is conducted to identify areas where there is scope for cost minimization or product differentiation. Coordination among different departments such as information systems, R&D, transportation, communications, office automation, and materials handling is necessary to ensure consistency, and exploit interdependencies among the departments.

The extent to which an organization's competitive advantage depends on technological change determines the selection of specific technologies and their development. The firm must concentrate on technologies that must have the most sustainable impact on cost or differentiation. Also the firm should balance the cost of improving technology against the benefits that might occur and the probability that they occur. Sometimes firms are forced to choose between conflicting options; for example, a firm may have to choose between investing in an established technology or a new technology. As technologies go through a life cycle the benefit/ cost tradeoff in mature technologies may be less (though the returns are more certain) than that in newer technologies.

Most products use a combination of many technologies or subtechnologies. Therefore, maturity in particular technology means it is maturity only in a particular combination of sub technologies., and not individual sub technologies themselves. Any improvement in any sub technology going into a product or process might result in significant improvements, such as those attained in low- speed diesel engines. For example, improvements in microelectronics, a sub technology, are influencing industries in a big way by generating various new technological combinations.

Hence a firm trying to be selective in its investments in technology should base its decisions on the overall impact that a particular technology is going to have

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on the company's activities. Technologies are most of the times innovations (technologies different from and unrelated to existing technologies). In some cases they are improvements in existing technologies. However these improvements in existing technologies are not always possible. When improvements are not possible, a firm should leapfrog the existing technology. When a firm leapfrogs a technology, it discards existing technology and adopts next generation technology.

The technology strategy at Hewlett Packard: Hewlett Packard operates in several markets. The products division of HP is responsible for current and next generation products. HP labs is responsible for stretching existing technologies, creating breakthrough technologies, transferring these technologies to the product organization, and creating platforms for new businesses of HP.

A firm must not limit its technology choice to only those options that offer avenues for major breakthroughs. Even small improvements in existing technologies, though unrelated to the product or production process, can result in competitive advantage. Cumulative improvements in many activities are more sustainable and are more difficult for competitors to replicate than any major improvement. The success of Japanese firms, for example can be attributed to improvements throughout the value chain, and not to any single pathbreaking advance in technology.

16.7 TECHNOLOGICAL LEADERSHIP

When a firm develops a technology strategy, it must determine whether it wants to become a technological leader. Technological leadership is much more than a leading position in a product or process technology. A technological leader introduces technological changes that support its generic strategy, that is, it indulges in technology forecasting. Firms that are not leaders and disregard technological changes are known as followers. Any firm choosing to be a follower should take that decision carefully, after considering all the implications, because firms that innovate tend to dominate the market and acquire crucial market share. This market share can further lead to economies of scale, which might turn out to be a competitive advantage in the long run for the innovating firm. The decision to become a technological leader or follower can actually further the generic strategy of a firm as shown in the following table:

Technological Leadership and Competitive Advantage

	Technological Leadership	**Technological Followership**
Cost Advantage	Pioneer the lowest cost design Be the first firm down the learning Curve Create low cost ways of performing value activities	Lower the cost of the product or value activities by learning from the leader's experience Avoid R&D costs through imitation
Differentiation	Pioneer a unique product that increases buyer value Innovate in other activities to increase buyer value	Adapt the product or delivery system more closely to buyer needs by learning from the leader's experience

Check Your Progress

3. What is crisis management meant to address?
4. List the four factors that determine the sustainability of technological leadership.

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A technology leader aims at (most of the times) differentiation, whereas a technology follower seeks to achieve cost leadership using a well tried technology. However , if a technology leader is the first to choose a low cost process approach, then it definitely has an advantage over others. Similarly a technology follower can achieve differentiation. This can be done by learning from the leader's mistake and altering the product technology to serve the needs of the consumer. When different technologies are available and different competitive advantages are pursued, there can be more than one technology leader in the industry. A firm should decide to be a technology leader after considering the following three factors:

(i) Sustainability of the technological lead
(ii) First mover advantages
(iii) First mover disadvantages

These factors are discussed in greater detail as follows:

Sustainability of the technological lead

This refers to the degree to which a firm can sustain its technological leadership. If a follower can easily duplicate the differentiation achieved by the leader, then there is no advantage in being a technology leader. Technological leadership is advantageous to a firm when competitors cannot duplicate the technology, and when the firm is ahead of its competitors in innovating. Maintaining leadership position can be difficult, particularly when the technology diffuses, as other firms usually target the technology leader. Kodak, for example , maintained its leadership in amateur photography by introducing a succession of camera systems and film chemistries instead of designing a single technology that competitors could imitate.

Four factors determine the sustainability of technological leadership:

(i) Source of technological change
(ii) Sustainable cost or differentiation advantage in technology development activity
(iii) Relative technical skills
(iv) Rapidity of technology diffusion

16.8 FIRST MOVER ADVANTAGES AND DISADVANTAGES

These are the advantages a firm hopes to gain from being the first firm to adopt a new technology. To a large extent the sustainability of these advantages influences firm's decision regarding whether to become a first mover or late entrant. A firm needs to have technological leadership to exploit first mover advantages. These technology advances can be used to gain other competitive advantages that last even after the technology gap has disappeared. The first mover gets the opportunity to define the rules in the industry. Potential first mover advantages are discussed As follows.

Reputation

The first to enter the industry establishes itself as a pioneer. This unique position bestows long-term benefits unavailable to others. The first mover can also establish exclusive relationships with all potential customers. The substantiality of these long term returns depends on the credibility of the firm as well as its ability to market itself.

Preempting a positioning

A first mover has the opportunity to introduce an attractive product or obtain a very good market position and define the rules of competition. This firm is free to shape the product and market the product in the way it desires. A first mover can also put its capacity as an entry barrier for other firms. It can invest in R & D to improve the features of its products according the response received from the consumers.

Costs of switching

A first mover can enter into favorable agreements with its clients and use the switching costs advantage to continue its successful relationships.

Selection of channels

A first mover may get exclusive channel access for a new product. It has the choice to select the best brokers, distributors and retailers, while followers have to adjust with others, or establish new channels, or convince the first mover's channels to shift to loyalties.

Proprietary learning curve

A first mover can obtain cost advantage if there is a proprietary learning curve in the activities of the firm. This is possible only when the activities of the firm are influenced substantially by the early move. The first mover is the first one on the learning curve. By keeping its learning exclusive, the firm can develop a cost or differentiation advantage.

Favourable access to facilities, inputs or other scarce resources

The first entrant enjoys special advantages in accessing inputs or other resources. The firm achieves these advantages through exclusive contracts. In some cases these advantages can be temporary, as market forces will allow other players to nullify these advantages in various ways. For example, a firm might get best facilities for its manufacturing activities.

Definition of standards

A first mover can create and define technology standards, thus forcing late movers to adopt them. The standards defined by the firm will help the firm in maintaining its stable position. Intel, for example, defined standards for microprocessors and that means competitors have to go through the same learning curve Intel has gone through. While these firms try to adopt these standards, Intel would be creating similar technology standards for these firms.

Institutional barriers

Patents are one of the institutional barriers that firms use to stop other players from imitating their products. This way, institutional factors influence a firm's ability to define standards positively.

Early profits

A first mover may be in a position to enjoy high profits for a limited period of time. This may be possible because there are few players offering the same product. Technology leaders aggressively pursue first mover advantages and make efforts to maintain their technological leadership. These firms also invest substantially in their marketing efforts to enhance their reputation. In addition, they follow aggressive pricing to sell products early to buyers in order to create high switching costs.

16.8.1 First Mover Disadvantages

First movers also have to suffer many disadvantages. These disadvantages arise from the costs of pioneering and the risk of changing conditions.

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Pioneering costs

A pioneer also has to suffer many disadvantages. These disadvantages arise from the costs of pioneering and the risk of changing conditions.

A pioneer has to bear some costs, which include:

(i) Obtaining regulatory approvals

(ii) Ensuring code compliance

(iii) Educating buyers

(iv) Building infrastructure in areas such as service facilities and training

(v) Creating needed inputs such as raw material sources and new types of machinery

(vi) Investing in developing complementary products

(vii) High costs of early inputs because suppliers are few and inexperienced

Demand uncertainty

A first mover has to contend with uncertain future demand. The firm has to invest in production facilities without a clear idea about the demand. Late entrants, however, have the opportunity to understand the dynamics of the market and then make prudent moves.

Changing buyer needs

Buyer needs change with time. As needs change, the first mover's technology becomes outdated. Consequently, the first mover will lose the reputation he acquired as a pioneer in the industry.

Exclusivity of investments to early generations or factor costs

A first mover will be at a disadvantage if its early investments were specific to a particular technology and cannot be modified for later generation technologies.

Technological discontinuities

Technological discontinuities occur when there are major changes in technology. A first mover is unprepared to respond because its major investments have been made in the old technology. These discontinuities are a major disadvantage for the first mover.

Low cost imitation

A first mover also has the disadvantage of imitation by followers. These followers are generally low cost manufacturers without the capacity to do original research and design innovative products.

16.9 ACQUISITION AND ABSORPTION OF TECHNOLOGY: LICENSING OF TECHNOLOGY

A critical issue in technology strategy is technology licensing. Firms always need to aquire technology at some point or other. Firms license other firm's technology in order to get access to technology. Firms with unique technology often license their technology on their own. Sometimes, they are forced to do so by governments. Licensing help firms to gain access to technology. Licensing assumes significance when technology is the most important basis of competition. Firms should be careful in their licensing decisions to avoid costly mistakes.

Need for licensing

When technology is a firm's only source of competitive advantage, the firm must license its technology only under special circumstances. The royalties received through licensing rarely compensate for loss of competitive advantage. A firm should consider licensing of technology under the following circumstances:

Inability of the firm to exploit technology

A firm may license its technology when it is unable to exploit the technology because of lack of skills and resources for establishing a sustainable position. Many biotechnology and electronics firms lack the expertise and resources to commercialize innovations. Even when the firm has enough resources, it may not gain substantial market share because of highly competitive rivals, or the promotion of local ownership of technology by the government.

Exploiting unavailable markets

A firm can get access to some markets that would otherwise have been unavailable by licensing its proprietary technologies. These unavailable markets include industries where technology can be a valuable contributor but a firm cannot enter.

Rapidly standardizing technology

Licensing accelerates the process of technology standardization in industry. Licensing establishes firm's technology as the standard. In the video cassette recorders industry, the pioneers of the VHS and Beta formats licensed them to many players in the industry to promote standardization. This standardization promoted the availability of software in the market.

Poor industry structure

When the industry structure is unattractive and not clearly defined licensing will benefit firms. In such a situation it is more beneficial to license technology and collect royalties than invest in an uncertain market where positioning does not yield any additional advantages. A firm's ability to bargain for high licensing fees determines the extent of licensing. If a firm has high bargaining power, it can go for more licensing.

Creating right competitors

A firm can use licensing to create good competitors, who in turn will stimulate demand for the product, block the entry of other firms, and share the costs of pioneering.

Give and take

A firm can license one technology in return for another technology. ATT and IBM often make such technology exchanges. Such exchanges should be beneficial to both firms.

16.10 CHOOSING THE RIGHT LICENSEE

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A firm licensing the technology will be in a comfortable position when it licenses its technology to a non- competitor or a good competitor. It is also possible that a non competitor might become competitor. A firm can avoid this threat through terms of license. A firm should also ensure that the potential licensee remains a non competitor. This can be ensured by considering not only the existing markets or segments it serves but also the markets it wants to enter in future.

16.10.1 Pitfalls in Licensing

By licensing their technology, firms might create competitors and lose their position in the market. Although licensing helps firms increase short-term profits, it may lead to loss in the long term.

Firms often fail to recognize their potential competitors. Intel, for example licensed its chip manufacturing technology to its arch rival AMD. AMD made use of Intel's processor numbers to market its own products. BY offering their chips at comparatively much cheaper prices, AMD captured 52 % of the market by 1990. Intel however assumed that its 386 and 486 processors were protected trademarks and no other company could make use of them. When Intel tried to protect its 386 and 486 processors, AMD sued INTEL for breach of contract. INTEL lost the case after the court stated that the processor numbers were not its trademarks. This judgment opened the doors for other firms to use Intel's processor numbers.

Similarly, many firms license technologies in other industries who subsequently enter the licenser's own industry. A firm licenses its product with the expectation that the long-term alliance will be useful to both firms. But it often happens that as the licensee learns about the licenser's technology and value activities, it becomes a serious competitor. Many Asian firms that licensed technology from American companies became their serious competitors.

16.11 DESIGNING A TECHNOLOGY STRATEGY

A technology strategy aims at strengthening the technological position of the firm. Hence while formulating a technology strategy, a strategist must carry out the steps explained below:

Identify technologies

The strategist must identify technologies that underlie the value activities of the firm and its competitors. He must also identify technology that is part of the supplier's and buyer's value chains. Most firms focus on product technology or technology in basic manufacturing operations. They ignore technological development in other value activities.

Explore outside technologies

Outside technologies are a source of discontinuous change and competitive disruption in an industry. Hence, firms must study their value activities carefully to find applications which can take advantage of technologies that further organizational goals. Information systems, new materials and electronics are capable of having

Check Your Progress

5. Suggest any three costs that a pioneer may have to bear.
6. What is required for the optimum utilization of resources?

revolutionary impact on the creation of new technologies or the usage of old technologies.

Identify the direction of technological change

Firms must study the direction of technological change in value chains of buyers, suppliers and technologies whose sources are outside the industry. There is no technology as such that is mature. Even in a mature technology, the sub technologies often change. Maturity often indicates that there has been little effort at technological innovation.

Determine important technologies significant for competitive advantage

Different technologies have unequal effects on the value chain of a firm. Similarly, they don't have an equal impact on competition. Hence the firm should identify technologies that create sustainable competitive advantages, lead to cost or differentiation advantages, ensure first mover advantage, and improve the overall industry structure. Identifying and understanding these technologies will help the firm in attaining its objectives.

Assess strengths and weaknesses

A firm must assess its relative strengths in key technologies. A realistic assessment of capabilities and future attainments is necessary for the optimum utilization of resources. Otherwise, the firm may waste its resources on technologies that give little competitive edge.

Select a technology strategy

A technology strategy reinforces the competitive advantage a firm seeks to establish. The firm can obtain competitive advantage if it follows the following steps:

- A firm must prioritize R&D projects based on the contribution to the competitive advantage. A project must get approval only if it has positive effect on cost or differentiation of the firm's products.
- It must be clear about seeking technological leadership or followership in important technologies.
- Licensing policies must be aimed at creating competitive advantage position rather than short term profits.
- When necessary, the firm must be ready to obtain technologies through licenses or other ways.

16.12 SUMMARY

This unit explained to you that strategic control is concerned with tracking the corporate strategy when its is implemented, detecting problems or the changes required in underlying premises, and making necessary adjustments. Premise control, implementation control, strategic surveillance, and special alert control, are some of the control mechanisms.

In this unit, you have learned that proper alignment of strategy, structure and control mechanisms is necessary to implement a strategy successfully.

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You read that operating control systems help operating managers in implementing strategy at the operational level. These systems help in guiding, monitoring and evaluating progress in meeting the annual objectives of the company. Budgets, scheduling and key success factors are some ways to ensure proper operational control.

The unit emphasized that motivating and rewarding good performance helps strategy to be implemented effectively. Based on the organization's strategy, managers decide which behaviors to reward. They create a control system to measure these behaviours and link the reward structure to them. You also studied that crisis management addresses certain risks and uncertainties that arise over period of time. An effective crisis management mechanism is necessary to address the uncertainties that often arise in the process of implementation.

This unit explained to you that technology influences the intensity of competition in an industry. Technological changes determine industry structures, and sometimes create new industries. A firm's technology strategy depends on the type of competitive advantage the firm seeks to build. A firm can use a technology strategy to pursue its generic strategy.

The degree to which a firm can sustain its leadership determines its decisions related to innovation. If a follower can easily duplicate the differentiation achieved by the leader, then there surely is no incentive to become a technological leader.

You have learnt that first mover advantages are the advantages a firm hopes to gain by being the first firm to adopt a new technology. A firm needs to have technological leadership to successfully exploit first mover advantages. These first mover advantages can be used to gain other competitive advantages that last even after the technology gap has disappeared. The first mover has the opportunity to define the rules of the game in the industry. However, there are some disadvantages a firm will have to bear with for being the first mover in the market place—the costs of pioneering and the risk of changing conditions.

The unit explained that licensing is similar to entering into a coalition with other firms. Licensee firms license technology to get access to new technology. Firms with unique technology sometimes license it to others. In some cases, governments force firms to license their technology. Licensing assumes significance when technology is the basis of competition. Firms should be careful in their licensing decisions to avoid costly mistakes.

You have also learned that while designing a technology strategy, a firm must identify technologies that underlie the value activities of the firm, identify the direction of technological change, and determine important technologies on the basis of the firm's strengths and weaknesses. Selecting an appropriate technology strategy is important as technology can provide a competitive advantage to firms in the long run.

16.13 KEY TERMS

- **Strategic control:** A process that provides feedback about the various steps of strategic management.
- **Strategic surveillance:** A process designed to monitor external and internal events that are likely to threaten a firm's strategy.
- **Special alert control:** Controls concerned with steering a company's future direction.
- **Operational control systems:** Systems that help to guide, monitor and evaluate progress in meeting the annual objectives of a company.
- **Budget:** A plan that shows how much money a person or organization will earn and how much they will need or be able to spend.
- **Schedules:** Tools for planning that involve the allocation of time and constrained resources and their arrangement into a sequence of interdependent activities.
- **Technology strategy**: A strategy that seeks to strengthen the technological position of a firm by making research more focused by aligning research done by R&D with the firm's overall generic strategies.
- **Technological leader:** A person who introduces technological changes that support its generic strategy.
- **First mover advantage:** The advantage gained by a firm from being the first to adopt a new technology.

16.14 ANSWERS TO 'CHECK YOUR PROGRESS'

1. The purpose of strategic surveillance is to monitor a broad range of events inside and outside the company that are likely to threaten the course of firm's strategy.
2. The three types of operational control systems are budgets, schedules and key success factors.
3. Crisis management addresses certain risks and uncertainties that arise over period of time.
4. The following four factors determine the sustainability of technological leadership:
   (i) Source of technological change
   (ii) Sustainable cost or differentiation advantage in technology development activity
   (iii) Relative technical skills
   (iv) Rapidity of technology diffusion
5. A pioneer has to bear some costs, which include:
   (i) Obtaining regulatory approvals
   (ii) Ensuring code compliance
   (iii) Educating buyers
6. A realistic assessment of capabilities and future attainments is necessary for the optimum utilization of resources.

16.15 QUESTIONS AND EXERCISES

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Short-Answer Questions

1. What are the types of strategic control?
2. What are the factors that affect operational control systems?
3. What are key success factors?
4. How can an organization go about managing a crisis?
5. What are the different types of budgets that can be used under operational control systems?
6. It is true that successful implementation of strategy is possible only when the strategy is backed by the appropriate organizational structure and control systems?
7. What are the factors involved in technological leadership or followership?
8. How can technology help in creating competitive advantage?
9. What are the advantages and disadvantages of a first mover?
10. What are the critical areas by which licensing of technology can be done?
11. What are the factors to be considered while formulating a technology strategy?
12. How are first movers in a position to earn high profits?
13. How can technological lead be sustained?

Long-Answer Questions

1. Explain the need for licensing.
2. What are the factors to be considered while designing a technology strategy? Discuss.
3. What is the role of research and development in technology strategy? Discuss with examples.
4. How can being a first mover be disadvantageous? Explain with examples.
5. Explain the steps involved in managing a crisis. How can you ensure the effectiveness of a crisis strategy?

16.16 FURTHER READING

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Case Study

Steady Rise of Samsung Electronics

The electronics giant, Samsung, is making its way to the top swiftly. Samsung is second to none in the manufacturing of CDMA phones, LCD monitors, etc.

In 2004, Samsung Electronics (Samsung) was the world's number one manufacturer of CDMA cellphones, LCD and CRT monitors, DRAM memory chips and microwave ovens. With worldwide electronic product sales of $27 bn, over 64,000 employees in eighty-nine facilities, and a global network in forty-seven countries, Samsung has emerged as a global giant.

Samsung makes various consumer devices including DVD players, big-screen televisions, and digital cameras; computers, colour monitors LCD panels, and printers; semiconductors such as DRAM SRAM, and flash memory and communications devices ranging from wireless phones (number 3, behind Nokia andMotorola) to networking switches. Samsung also makes microwave ovens refrigerators, airconditioners, and washing machines. Veteran Jong-Yong Yun (Yun), who became CEO in 1996, had cut costs and streamlined the company's operations. He had also invested heavily in establishing Samsung as a top worldwide brand. The company's huge marketing efforts (Samsung was a highly visible sponsor at the Sydney and Athens Olympic Games) were meant to showcase Samsung's premium electronic ware. The campaign was backed up by intensive product development that focused on developing innovative high-end designs for cell phones, LCD displays, and large screen TVs. Analysts estimate that Samsung's brand value doubled between 2001 and 2003, to more than $10 bn. Despite the downturn in the semiconductor industry during 2001-03, Samsung invested heavily in new factories, including state-of-the-art chip plants in South Korea and huge flat-panel display facilities in China. Samsung moved away from low-margin commodity DRAMs for PCs to high-margin DRAMs for specialized applications. In the process, Samsung established a strong global R&D network that drove its efforts to develop leading technologies in digital media, telecommunication, digital appliances and semiconductors. At the end of 2002, 17,000 researchers, accounting for about 34 per cent of Samsung's total employees, were dedicated to developing cutting-edge digital products. By 2004, Samsung had manufacturing facilities in Brazil, China, Hungary, India, Indonesia, Malaysia, Mexico, the Philippines, Slovakia, South Korea, Spain,Thailand, UK, the US, and Vietnam. It had sales offices in more than twenty countries worldwide.

Source: Hoovers Online

Going global

Samsung entered the semiconductor market in 1983. By the end of the 1990s, it had become the first company to manufacture 16-MB DRAM chips on a large scale. However, the company found itself burdened with huge debt following the 1997 Korean financial crisis, a crash in memory-chip prices, and a $700 mn write-off after an ill-advised takeover of AST Technologies, a US PC maker. Yun closed Samsung's TV factories for two months to clear old inventory. Yun also decided Samsung would sell only high-end goods though many cellular operators resisted. Samsung realized that a strong presence was needed in the US to become a global player.

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Though the company offered various products in the US, it did not enjoy market leadership in any category. Samsung then reshuffled its top management. The company tasted success in 1997 when the Sprint PCS Group began selling its handsets. Sprint's service was based on CDMA. Samsung remained diversified and vertically integrated. Its chips and displays went into its own digital products. Analysts believed that this model may not have worked in the long run. The average price of a TV set had dropped by 30 per cent in five years; DVD players had become much cheaper than what they were few years back. The Chinese were driving prices lower and lower. Meanwhile, the Japanese were building factories to lower costs. Samsung has already withdrawn fromthe low-margin market for TV sets of 27 inches and under. But the company realized the need for a constant stream of well-timed hits to stay on top. Even Sony has stumbled in this race. It now depended Play Station to support a declining consumer-electronics business. Other legendary hardware makers such as Apple, Motorola, Ericsson, all had a bad experience with primary focus on hardware. Samsung did not sell stereos and laptops in the US market, a major drawback compared to Sony, when it came to increasing brand awareness. Another area of weakness was lack of software and content.Samsung has no plans to branch out into music, movies, and games, as Sony and Apple had done. It remained to be seen if this strategy would work, especially in an age when content and distribution seemed to be coming together. Sony had Columbia Tristar Studios, to augment its numerous products. But Samsung remained convinced that it was better off collaborating with content and software providers. In June 2004, Samsung signed an agreement with New Line Cinema (Owned by Warner Bros.) to start using its products in New Line's cinemas. Kim, the man who was credited the most for revamping Samsung's branding left the company in September 2004 to join Intel.

Question for Discussion

1. What according to you was the smartest more on Samsung's part?
2. Can premary focus on hardware be a disadvantage to all electronic goods manufactures?