

## MODULE 9

### 9.1. Strategy Formulation : An Overview

The corporate world is in the process of a global transformation. Mergers, acquisitions, outsourcing and downsizing are becoming common word everywhere. Privatization is allowing free enterprise to take on functions that previously were the domain of government. International boundaries are fading in importance as businesses take on a more global perspective and the technology of information age is telescoping the time it takes to communicate and make decision. Strategic management takes a panoramic view of this changing corporate terrain and attempts to show how large and small firms can be more effective and efficient not only in today's world but tomorrow as well.

Strategic management is the set of managerial decisions and action that determines the way for the long-range performance of the company. It includes environmental scanning, strategy formulation, strategy implementation, evaluation and control. It emphasizes the monitoring and evaluation of external opportunities and threats in light of corporation's strength and weakness. Business policy has a general management orientation and tends primarily to look inward with its concern for properly integrating the corporations many functional activities. But strategic management as a field of study integrates the business policy with the environmental opportunities and threats. Therefore strategic management has tended to replace business policy as the preferred name of the field.

## Why Strategic Management?

Strategic management provides the route map for the firm. It lends a framework, which can ensure that decisions concerning the future are taken in a systematic and purposeful way. Strategic management also serves as a hedge against uncertainty, a hedge against totally unexpected developments on the business horizon. It lends a frame of reference for investment decisions. It aids the concentration of resources on vital areas of best potential. It offers a methodology by which the firm could anticipate and project the future and be internally equipped to face it. It helps to develop processes, systems, mechanisms and managerial attitude that are essential for this purpose.

## Defining Strategy:

Management is an art as well as science. Many of the concepts used in building management theory have been derived from the practical experience of the managers.

Chandler defined strategy as: "The determination of the basic long term goals and objectives of an enterprise and the adoption of the courses of action and the allocation of resources necessary for carrying out this goals".

Andrews defined strategy as: "The pattern of objectives, purposes, goals and the major policies and plans for achieving these goals stated in such a way so as to define what business the company is in or is to be and the kind of the company it is or it is to be".

Ansoff explained strategy as: "The common thread among the organization's activities and product markets, that defines the essential nature of business that the organization was or planned to be in the future"

Glueck define the strategy as: "A unified, comprehensive, and integrated plan designed to assume that the basic objectives of the enterprise are achieved"

To put it precisely, strategic management is the set of managerial decisions and actions that determines the long run performance of an organisation that includes environmental scanning (both external and internal), strategy formulation, strategy implementation, evaluation and control.

**Levels Of Strategy:** Strategy may be formulated at the corporate level, business level and functional level.

### **Corporate strategy:**

Corporate strategy is one, which decides what business the organization should be in, and how the overall group of activities should be structured and managed. Porter has described it as the overall plan for a diversified business. The strategies are then evolved for each strategic business unit and strategic business area.

### **Strategic business unit:**

As the number and diversity of products increases the structure is likely to be centered upon division called Strategic Business Unit (SBU). SBU are responsible individually for developing, manufacturing and marketing their own product or group of products.

### **Strategic Business Area (SBA):**

SBA is a distinctive segment of the environment in which the firm does want to do business. A company instead of trying to compete in all the area, it selects the area of its competitive advantage and invest its money and strategies

in that area. This helps the company to concentrate its strategies in a particular area and to reduce the unnecessary expenses in non-profitable area.

### **Functional Strategy:**

Strategy that is related to each functional area of business such as production, marketing and personnel is called functional strategy. It is designed and managed in a coordinated way so that they interrelate with each other and at the same time collectively allow the competitive strategy to be implemented properly.

### **Competitive Strategy:**

Competitive Strategy is concerned with creating and maintaining a competitive advantage in each and every area of business.

### **Strategic Management Process:**

Strategic management consists of four basic elements-

#### **Environmental scanning:**

If an organization understands the environment in which it operates, half the problem is solved. This requires an analysis of what is happening outside the organization and an evaluation of current resources (strength and weaknesses) and an assessment of opportunities and threats present in the environment. Environment could be classified as external and internal.

#### **External:**

The external environment consists of variables that are outside the organization and not typically within the short-run control of top management. They may be general forces and trends within the overall societal environment,

which consists of socio cultural, economic, technological, political and legal force. There may be specific forces called task environment that operates within the organization's specific which includes suppliers, employers, competitors, trade association, communities, creditors, customers, special interest groups, Government and shareholders. The method widely used to analyze the external environment is Porter's Five-Forces Model. This method involves analyzing the threat from the new entrant, rivalry among the existing players, pressure from the buyers, pressure from the suppliers and pressure from the substitutes.

### **Internal:**

The internal environment of a corporation consists of variables (strengths and weaknesses) that are within the organization and are not usually within the short run control of top management. This includes the corporation's culture, structure and resources. One of the widely used method for internal analysis of the firms is Value Chain analysis which assess the strengths and weaknesses that divides a business into a number of linked activities, each of which may produce value to the customers.

### **Strategy formulation:**

Strategy formulation is the development of long range plans for the effective management of environmental opportunities and threats in light of corporate strengths and weaknesses. It includes defining the corporate mission, specifying achievable objectives, developing strategies and setting policy guidelines. It begins with situational analysis. The simplest way is to analyze through is SWOT analysis. This is the method to analyze the strengths and weakness in order to utilize the threat and to overcome the threat. SWOT is the acronym for Strength, Weakness, Opportunities and Threats. The TOWS matrix

illustrates how the external opportunities and threats facing a particular corporation can be matched with that company's internal strengths and weaknesses to result in four sets of possible strategic alternatives.

### **Mission:**

An organization's mission is the purpose or the reason for the organization existence. A well conceived mission statement defines the fundamental, unique purpose that sets a company apart from other firms of its type and identifies the scope of the company's operation in terms of the products offered and markets served. A mission statement may be defined narrowly or broadly in scope. A broadly defined mission statement keeps the company from restricting itself to one field or product line, but it fails to clearly identify what it makes or which product/market it plans to emphasize. A narrow mission very clearly states the organizations primary business, but it may limit the scope of the firm's activities in terms of product or service offered, the technology used and the market served.

### **Objectives:**

Objectives are the end result of planned activity. They state what is to be accomplished by when and should be quantified if possible. The achievement of corporate objective should result in the fulfillment of a corporate mission. In contrast to an objective, a goal is an open ended statement of what one wants to accomplish with no quantification of what is to be achieved and no time criterion for completion. The areas in which a company might establish its goals and objective are profitability, growth, shareholder's wealth, utilization of resources etc.

## Strategies:

A strategy of a corporation forms a comprehensive master plan stating how the corporation will achieve its mission and objectives. It maximizes competitive advantage and minimizes competitive disadvantage.

## Types of strategy:

The typical business firm considers three types of strategy:

### Corporate strategy:

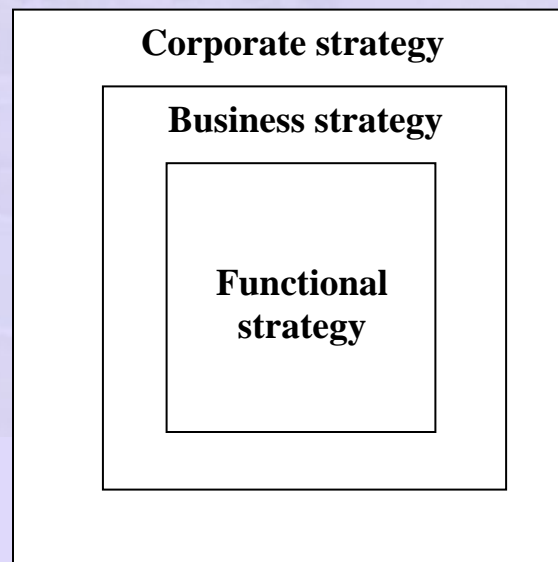
It describes a company's overall direction in terms of its general attitude towards growth and management of its various business and product lines. Corporate strategy deals with three key issues facing the corporation as a whole.

1. Directional strategy – the firm's overall orientation towards growth, stability and retrenchment. The two basic growth strategies are concentration and diversification. The growth of a company could be achieved through merger, acquisition, takeover, joint ventures and strategic alliances. Turnaround, divestment and liquidation are the various types of retrenchment strategy.
2. Portfolio analysis – The industries or markets in which the firm competes through its products and business units. In portfolio analysis, top management views its product lines and business units as a series of portfolio investment and constantly keep analyzing for a profitable return. Two of the most popular strategies are the BCG Growth Share matrix and GE business screen

3. Parenting strategy – the manner in which the management coordinates activities and transfers resources and cultivate capabilities among product lines and business units.

### **Business strategy:**

It usually occurs at the business unit or product level and it emphasizes improvement of the competitive position of a corporation's products or services in the specific industry or marketing segment served by that business unit. It may fit within two overall categories of competitive or corporate strategies. Competitive strategy is the strategy battle against all competitors for advantage. Michael Porter developed three competitive strategies called Generic strategies. They are cost leadership, differentiation and focus. Cooperative strategy is to work with one or more competitors to gain advantage against other competitors.



**Hierarchy of strategy**

### **Functional strategy:**

It is the approach taken by a functional area to achieve corporate and business unit objectives and strategies by maximizing resource productivity. It is concerned with developing nurturing a distinctive competence to provide a company or business unit with a competitive advantage.

A hierarchy of strategy is the grouping of strategy types by levels in the organization. This hierarchy of strategy is a nesting of one strategy within another so that they complement and support one another. Functional strategies support business strategies that in turn support the corporate strategy.

### **Policy:**

A policy is a broad guideline for decision making that links the formulation of strategy with its implementation. Companies use policies to make sure that employees throughout the firm make decisions and take actions that support the corporation's mission, objectives and strategies.

### **Strategic choice:**

Strategy choice is the evaluation of alternate strategies and selection of best alternative.

### **Strategy Implementation:**

Strategy implementation is the process by which strategies and policies are put in to action through the development of programs. This might involve changes within the overall culture, structure and/ or management system of the entire organization. Strategies are implemented through a set of programs, budgets and procedures.

## Strategy Evaluation and control:

Evaluation and control is the process in which corporate activities and performance can be compared with desired performance. Managers at all levels use the clear, prompt, unbiased information from the people below the corporation's hierarchy to take corrective action and resolve problems. It can also pinpoint weaknesses in previously implemented strategic plans and this stimulates the control of performance. The evaluation and the control of performance complete the strategic management model. Based on the performance results, management may need to make adjustments in its strategy formulation or implementation or both.

Thus, a strategic decision making process involves the following seven steps:

*Evaluate current performance results* in terms of return on investment, profitability in the light of current mission, objectives and policies.

*Scan and assess the external environment* to determine the strategic factors that pose opportunities and threats.

*Scan and assess the internal corporate environment* to determine the strategic factors that are strengths and weaknesses.

*Analyze strategic factors* to pinpoint a) problem areas and b) review and revise the corporate missions and objectives as necessary.

*Generate, evaluate and select the best alternate strategy* in light of the analysis conducted in step 4.

*Implement selected strategies* via programs, budgets, and procedures.

*Evaluate implemented strategies* via feedback systems and the control of activities to ensure their minimum deviation from plans.

## 9.2 PEST Analysis & Porter's Industry Analysis

To formulate effective strategies, managers in an organization need to be aware of realities in the business environment. Strategy formulation thus begins with a scanning of the external as well as internal environment. Analysis of external environment helps to identify the possible threats and opportunities while analysis of internal environment helps to identify strengths, weaknesses and the key people within the organisation.

### Characteristics Of Environment:

#### Environment is complex:

The environment consists of number of factors, which are not isolated but interact with each other to create a new set of influence. Hence it would be complex to comprehend the environment in totality but relatively easier to understand in parts.

#### Environment is dynamic:

Due to many and varied influences operating; there exists a constant dynamism in the environment and there is continuous change as well as impact.

#### Environment is multifaceted:

The shape and character displayed by environment depends on the perception of the observer. A similar development in an environment may be viewed as an opportunity by some company and as a threat by some other company.

## Importance Of Environmental Scanning:

The environmental survey is necessary to:

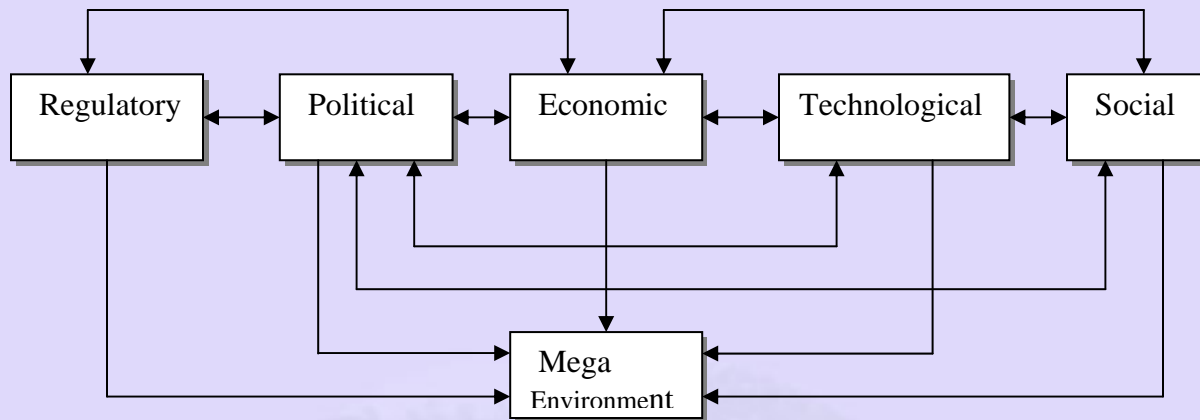
- *Learn about events and trends in the environment and project the future position in each factor of environment.*
- *To identify the favorable and unfavorable factors in the environment from the standpoint of the firm.*
- *To figure out opportunities and threats hidden in environmental trends and events.*
- *To assess the scope of various opportunities and shortlist ones which have the potential of becoming promising business*
- *To formulate strategy in line with opportunities.*

## Identifying External Environmental Variables:

Understanding the environment necessitates identifying the variables within a organisation's societal and task environment. A PEST analysis. i.e., Political, Economic, Social and Technological environment analysis is normally used for scanning the environment.

### External environment factors:

The societal environment otherwise called as macro environment includes general forces that do not directly affect the short-term activities of the organization but those can and often do influence its long-term decisions. This includes economic, political, technological, cultural, legal environment etc.



**Constituents of Societal Environment**

### **Economic environment:**

The economic environment consists of macro level factors related to the means of production and distribution of wealth that have an impact on the business of the organization. Some of the economic environment factors to be analyzed are:

- General economic conditions
- Economic conditions of different segments of population
- Trends in income distribution and consumer spending patterns
- Rate of growth of each sector of economy
- Rate of inflation
- Behavior of capital market
- Interest rate/exchange rate
- Tax rates
- Prices of materials/energy
- Labour scene

Changes in economic environment can have an obvious impact on business activity. For example, an increase in the interest rates translates into fewer sales of major home appliances. Higher increase in interest rates results in higher mortgage rates and higher cost of buying a house. Most of the household goods are bought when people shift their houses. Higher costs of buying the house eat into the budget in appliances.

## **Technological environment:**

The technological environment consists of the factors related to technology used in the production of goods and services that have an impact on the business of an organization. Technological factors to be considered are:

- Source of technology like company, external and foreign sources, cost of technology acquisition, collaboration and transfer of technology.
- Technological development, rate of change of technology and research and development.
- Impact of technology on human beings, the man-machine system and the environmental effects of technology.
- Communication, infrastructure and managerial technology.

For a business firm technology affects its final products by changing processes in raw material sourcing, production and distribution. Technology, when rightly used can bring about huge changes in the productivity of firms. Computer Industry is one example where the technology in the industry keeps pushing competition to the brink.

## Political environment:

Politico-legal forces allocate power and provide laws and regulation that may constrain or protect the business. The factors to be considered are:

- The political system and its features like nature of the political system, ideological forces of the political parties and sentries of power
- The political structure, its goals and stability
- Political process like party systems, elections, funding of elections and legislation in economic and industrial matters and regulations
- Political philosophy, role of government in business and its policy approach towards economic and business development.

With the developments on the political front affecting the economy all the time, the economic environment often becomes a byproduct of the political environment. Legislations regulating the business are the byproduct of the political configuration. In addition to government and legislative measures, media, social and religious organizations and lobbies of various kinds are also a part of the political environment. They collectively exercise a huge influence on the conduct of business in a country.

## Legal framework:

- The constitutional framework, directive principles, fundamental rights and divisions of legislative power between central and state government
- Policies related to licensing, monopolies, foreign investments and financing to industries
- Policies related to distribution and pricing and their control
- Policies related to imports and exports

- Other policies related to PSU, SSI, sick industries, and development of backward areas and control of environmental pollution.

Businesses have to operate within the framework of the prevailing legal environment. They have to understand the general legal aspects and those particular to the industry the company is in. Businesses have to understand the implication of such legislations and adapt themselves accordingly.

### **Sociocultural environment:**

Socio cultural environment are the forces that regulate the values, morals and customs of society. Important factors to be considered are:

- Demographic characteristics
- Social concerns
- Social attitudes
- Family structure and changes in it
- Role of women in society, position of children and adolescents in family and society
- Educational level, awareness and consciousness of rights and work ethics of members of the society.

The social environment primarily affects the strategic management process within the organization in the areas of mission and objective setting and decision related to products and markets.

### **Task environment:**

The task environment, otherwise called as microenvironment includes those elements or groups that directly affect the corporation and in turn are affected by

it. These are demand-related factors, consumer, supplier, competitors, government etc. A corporate task environment is typically the industry within which those firms operate.

### **Demand related factors:**

By monitoring the demand related factors of one's industry a firm gather vital clues on consumption pattern, buying habits, invasion of substitute products, growth potential, attractiveness of the industry, expansion, divestment etc. The aspects to be considered are:

- Nature of demand
- Demand potential
- Current level of demand
- Changes in demand, consumption pattern, buying habits etc.

### **The consumer:**

Monitoring the customer's taste may result in attractive business opportunities. Hence customer analysis is very important during environmental survey. The factors that have to be monitored in relation to the customers are:

- Purchasing power
- Buying motives, attitudes and habits
- Lifestyle and need
- Brand awareness, brand loyalty and brand switching
- Reasons/motives for customer's patronage of specific brands

## **Industry and competition:**

Industry and competition constitutes an important component of the specific environment of the firm. Knowledge about industry and competition is a fundamental requirement for developing strategy. It is essential for developing an objective of the firm and even building competitive advantage and is dependent on proper grasp of the industry and competition.

## **Government policies:**

Government policies significantly affect the way business operates. Unregulated economies, the impact of government on business is really immense. In market economies too, government policies are an important factor even though the constraints are much less here. Government policies usually affect the strategic choice of the firm because

- Government is the large purchaser of goods and services
- Government subsidises firms and industries
- Government protects home products against foreign competitors
- Government bans fresh entry into select industries
- Government restricts use of certain technology and products

## **Supplier related factors:**

Suppliers constitute a major force, shaping competition in any industry with their own bargaining power. They influence the cost of the raw materials and other inputs of the firm. Suppliers adapt changes in their product, process and business practices, and can stay independent of the sourcing firm. Sometimes suppliers themselves may go for forward integration and could become a real competitor.

## Industry Analysis

In order to have a better understanding of the external environment, analyzing the industry in detail is critical. In conducting an industry analysis managers need to analyze seven aspects carefully:

- **General features and basic conditions of the industry:**

General features/basic conditions of the industry include factors such as current size of the industry, product categories/sub categories, their relative volumes, performance of the industry in recent years, etc.

- **Industry environment:**

Industries can be classified based on their settings/environment. Porter classified industries as fragmented, emerging, matured, declining and global industries.

- **Industry structure:**

Industry structure essentially means the underlying fundamental economic and technical forces of an industry. Each company will have its own key structural features such as number of players, market size, relative shares of the player, nature of the competition, differentiation practiced by the various players in the industry, cost structure of the players etc. These features determine the strength of competitive forces operating in the industry and thereby serve as direct indicators to the attractiveness or profitability of the industry.

- **Industry attractiveness:**

The various determinants of industry attractiveness are industry potential, industry growth, industry profitability, future pattern of the industry barriers and forces shaping the competition in the industry.

- **Industry performance:**

Industry performance entails looking at production, sales, profitability and technological development.

- **Industry practices:**

Industry practices refer to what a majority of the players do in the industry with respect to essential aspects of the business such as distribution, pricing, promotion, methods of selling, service field support, R&D and legal tactics.

- **Emerging trends and likely future:**

The emerging trends/likely future pattern of the industry can be discerned by analyzing issues such as the product life cycle, stage of the industry, rate of growth, changes of buyer needs, innovation in product/process, entry and exit of firms and emerging changes in the regulatory environment governing the industry.

## **Analysis Of Competition:**

Usually competition analysis is done along with the industry analysis. This is so because competition and competitive forces are a part and parcel of industry structure. As a part of strategy formulation the firm must analyze and size up all the forces that shape competition in the industry. Most of the firms

suffered from what was referred to as 'strategic myopia'. It was Michael Porter who gave a new thrust to the ideas associated with the competition.

### PORTER'S FIVE FORCES MODEL:

Porter argues that there are five forces that determine the profitability of an industry. They are:

- Threat of industry,
- Bargaining power of suppliers,
- Bargaining power of buyers,
- Rivalry among existing players and
- Threat of substitute products.

Porter contends that "The collective strengths of these forces determines the ultimate profit potential in the industry, where profit potential is measured in terms of long run return on investment capital". Let us see each of them in detail:

#### **Threat of new entrants:**

New entrants to an industry typically brings to it new capacity and desire to gain market size and substantial sources. They are therefore threats to established corporations. Threat of entry depends on the entry barriers and the reaction that can be expected from the existing companies. An entry barrier is an obstruction that makes it difficult for a company to enter into an industry. Major entry barriers include:

#### **Economies of scale:**

These exist whenever large volume firms enjoy significantly lower production cost per unit than smaller volumes operator do. This discourages new

firms, which have less volume and high production cost from entering into the market.

**Cost disadvantage independent of scale:**

Established competitors may have cost advantage even when the new entrant has comparable economies of scale. This advantage may include proprietary product knowledge such as patents, favourable access to raw materials, favourable locations, government subsidies etc.

**Product differentiation:**

Differences in physical or perceived characteristics must make incumbent's product unique in the eyes of customer and force customers to overcome existing brand loyalty.

**Capital requirement:**

If the amount of investment required to enter into an industry is high, the number of entrants who could afford it would be less.

**Switching cost:**

Sometimes the cost that would be incurred by the customers to switch from one supplier to another supplier makes it difficult for the new entrants to gain market share.

**Access to distribution channel:**

Existing relationship and agreements between manufacturers and key distributors in a market may also create barriers to entry. Companies aspiring to enter a market may look for unique distribution channel to provide access as well as to differentiate their products.

Finally in addition to these barriers firms may also deter entrants by harsh retaliation.

**Bargaining power of suppliers:**

Suppliers can affect the industry through their ability to raise price or to reduce the quality of the purchased product and services. Following are the conditions that make suppliers powerful:

**Dominance by few players and lack of substitutes:**

A few players might become strong enough to dominate the suppliers industry. Substitutes might not be readily available as well. These two factors limit customer's option and increase the supplier's power.

**Greater concentration among suppliers than among buyers:**

A concentrated industry is one in which only a few large firms dominate. Firms in highly concentrated industry that supply material to highly fragmented industry can exert power over the buyer.

**Relative lack of importance of the buyer to the supplier group:**

Some customers are more important than others because of their size of their purchase or the prestige that comes from supplying them.

**High differentiation by the supplier and high switching cost:**

A buyer could be tied to a particular supplier if other suppliers can't meet his requirements. Any switching that might be incurred by the buyer will strengthen the position of the suppliers.

**Threat of forward integration:**

Forward integration involves a supplier moving into a later stage of the manufacturing process or distribution i.e. moving into direct competition with its customers.

### **Bargaining power of buyers:**

Buyers can exert bargaining power over a supplier industry by forcing its prices down, by reducing the amount of goods they purchase from the industry or by demanding better quality for the same price.

Factors that makes the buyer more powerful:

### **Undifferentiated or standard supplies:**

If the product being supplied is a commodity good or service then customers can shop around for the most favourable terms.

### **Credible threat of backward integration:**

Backward integration involves a buyer moving to an earlier stage of manufacturing or distribution, thus becoming a competitor for the supplier's business.

### **Accurate information about the cost structure of the supplier:**

This allows the customers to exercise more precision in negotiating the price of the supplier.

### **Price sensitivity:**

Buyers are likely to be more price-sensitive if a) Suppliers represent the significant fraction of the total cost incurred by the buyers b) The supplier product is unimportant to the overall quality or cost of the buyer's final product and c) The buyers already earn a low profit.

A growing trend among small businesses is to augment their bargaining power as customers through joining or forming buying groups.

### **Threat of substitute products:**

Substitute products are those products that appear to be different but can satisfy the same need as another product. The availability of substitutes places a

ceiling on price limit of an industry product. When the price of the product rises above that of the substitute product customers tend to switch over to the substitutes. Deregulation and technology revolution has given rise to a lot of substitutes.

### **The intensity of rivalry among existing players:**

In most industries individual firms are mutually dependent. Competitive moves by one firm can be expected to have noticeable effects on its competitors and cause retaliation or counter efforts. Competition can be in the form of pricing, product differentiation, product innovation etc. Factors that increase competitive rivalry are:

#### **Equally balanced competitors:**

The most intense competition results from well-matched rivals in a situation that doesn't allow any particular firm to dominate.

#### **Slow industry growth:**

In slow growth markets, growth has to come by taking market share from rivals.

#### **High fixed cost:**

Additional sales volume can help to offset high fixed cost. Hence competitors might be willing to fight for any possible sales.

#### **Lack of differentiation or lack of switching cost:**

These two factors ensure that customers can easily switch over to a rival product and to retain them is a constant struggle.

#### **Large increase in manufacturing capacity:**

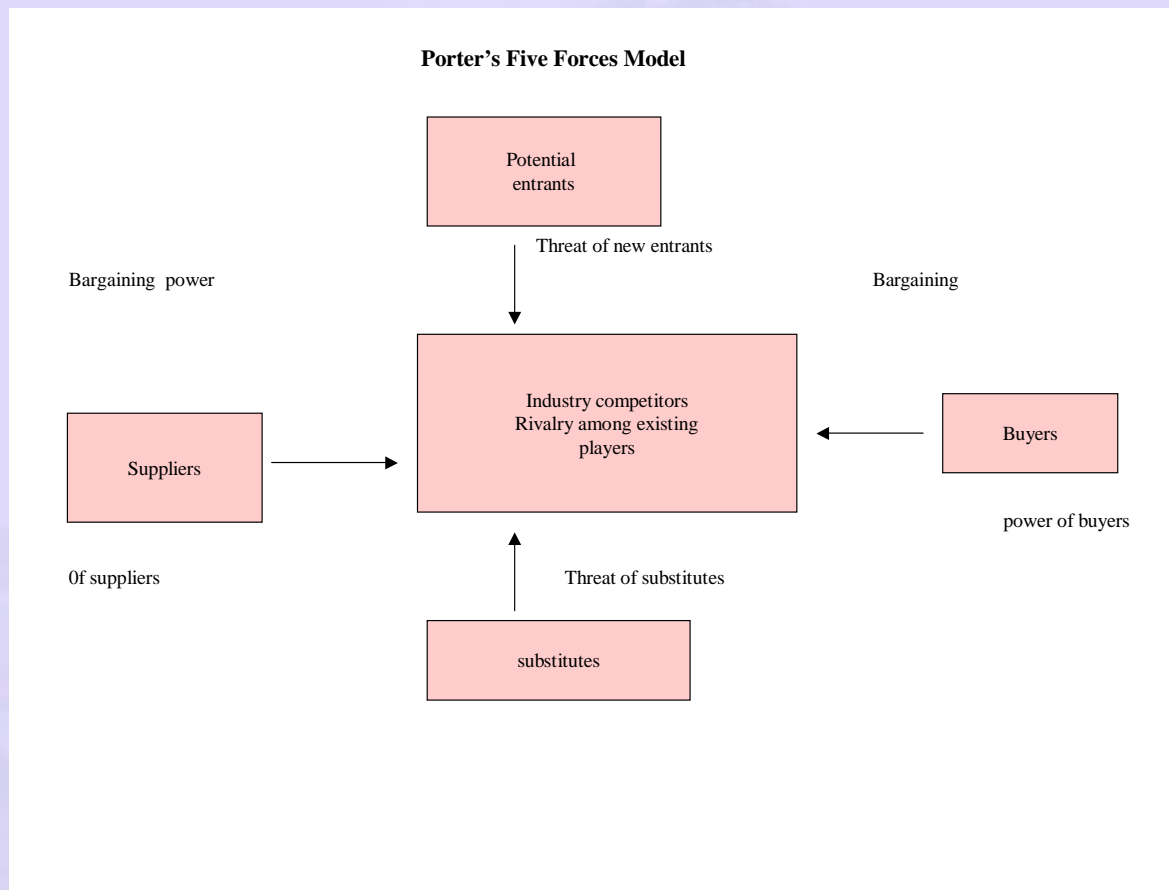
If a manufacturer can increase capacity by a large increment, by building a new plant, it will run it at full capacity to keep the unit cost less - thus producing so much that the selling price falls throughout the industry.

### High strategic stakes:

The market is well worth fighting for because of its profit potential or the opportunities it creates elsewhere.

### High exit barriers:

For economic, strategic or emotional reasons, individual players might consider it difficult to leave the industry.



The outcome of industry and external environment analysis results in identifying the relevant and important opportunities and threats the organisation has to face in the future.

### III. SWOT AND ORGANISATION CAPABILITY ANALYSIS

SWOT analysis is the assessment of comparative strengths and weaknesses of a firm in relation to its competitors; and environmental opportunities and threats, which a company may have to face in the future. It should be based on logic and rational thinking such that a proper strategy improves an organization's business strength and opportunities and at the same time reduces the weaknesses and threats.

Strength and weakness are internal forces and factors that are to be assessed from continuously since more and more competitive organizations with state of the art technology and services are entering into the market and competition is getting intensified day by day.

Opportunities and threats are the external factors and forces in the business environment which are also changing day by day with the change of government policy, industrial policy, monetary policy, political situation at national and international levels, formation of various trade blocks and trade barriers including the changes in legal and social environment in the business world.

#### *Strength:*

Strength is the power and excellence with the resources, skills and advantages in relation to the competitors. A strength is a distinct technical superiority with best technical know-how, financial resources and skill of the people in the organization, goodwill and image in the market for the product and services, company's access to best distribution network, the discipline, morale, attitude and mannerisms of the employees at all levels with a sense of belonging.

*Weakness:*

Weakness is the incapability, limitation and deficiency in resources such as technical, financial, manpower, skills, brand image and distribution pattern. It refers to constraints or obstacles, which check movement in a certain direction and may also inhibit an organization in gaining a distinct competitive advantage.

*Opportunities:*

Environmental opportunity is an alternative area for company's action in which the particular company would enjoy a competitive advantage. An opportunity is a major favorable advantage to a company. Proper analysis of the environment and identification of new market, new and improved customer group with better product substitutes or supplier's relationship could represent opportunities for the company.

*Threat:*

Environmental threat is the challenge posed by the unavoidable trend or development that would lead, in the absence of purposeful action to the erosion of the company's position. Slow market growth, entry of resourceful multinational companies, increase bargaining power of the buyers or sellers because of a large number of options, quick rate of obsolescence due to major technological change and adverse situation because of change of government policy rules and regulation is disadvantageous to any company and may pose a serious threat to business operation.

**SOURCES OF INFORMATION FOR ENVIRONMENTAL SCANNING:**

The sources of information could be classified as formal and informal. They could be:

**Documentary or secondary sources** – Companies collect information on environmental factors through bulletins of Government, Banks and their competitors. Many organizations often release periodic internal reports analyzing the environment

**Mass media** – Mass media like TV, Radio etc could be used to collect information like the taste, social values, and standard of life of the public.

**Internal sources** – Companies could use internal sources like employees to collect the information about the public and the competitor.

**External agencies** – The company could use various external agencies like Associations, clubs etc also to collect the environmental information. It could also use its own sales force to collect the information.

**Formal studies** – Company could do the formal study either themselves or through some research agencies to collect the information to reevaluate their strategies.

**Spying and surveillance** - Companies could use their own employees, sales agents, and retired employee etc to collect the information.

### **IDENTIFYING EXTERNAL ENVIRONMENTAL FACTORS:**

A feasible approach in identifying environmental factors is to study the impact and the probability of impact of such factors on the business organization. The following matrix helps to identify the high priority environmental factors.

**Impact on business**

←

		High	Medium	Low
Probability of Impact	High	Critical	High priority	Low priority
	Medium	High priority	High priority	Low priority
	Low	To be watched	Low priority	Low priority

### Identifying High Priority Environmental Issues

The importance of the factors that were identified by the environmental scanning could be judged by the intensity of their impact and their relative probability of impact on the organization. According to the matrix above the environmental factors could be distributed across nine cells. The issues that are having high probability of impact and high intensity of impact are critical which the company has to give more attention, while high priority should be given to issues having medium impact with medium probability. All the other issues having low intensity and low probability of impact are low priority issues, which need to be watched at regular moments since the environment may keep changing. Thus, the strategists get a clear picture of the environmental factors and their impact and could narrow down the factors that need special attention.

### Structuring Environment Appraisal:

Structuring environmental factors is complex since the factors cannot be clearly classified into the particular environment. The strategist should use personal experience and judgment to place the various factors under each type of environment so that a clear picture of threat and environment can be obtained. One such technique is Environment Threat Opportunity Profile (ETOP).

The preparation of ETOP involves dividing the environment into different sectors and then analyzing the impact of each sector on the organization. A comprehensive ETOP requires subdividing each environmental sector into sub factors and then the impact of each sub sector on the organization is described in the form of a statement. An example of the ETOP prepared for a two wheeler manufacturer is given below:

### ETOP for a two wheeler company

Environmental Sectors		Impact of each sector
Social	↑ →	Customer preference for two wheelers to public transport
Political	↑	No significant change
Economic	↑	Growing affluence among urban consumers; export potential high
Regulatory	↑	Two wheeler industry is a thrust area for exports
Market	↑	Industry growth rate is 7 to 8 % per year;
Supplier		Mostly ancillaries and associated companies supply parts and components; Availability is increasing
Technological		Technological upgradation of industry in progress

Up arrows indicate favorable impact, down arrows unfavorable impact, while horizontal arrows indicate neutral impact

The preparation of an ETOP provides a clear picture to the organization to know where it stands with respect to the environment.

### Assessing The Impact Of Opportunities And Threats:

The impact of each threat and opportunity could be analyzed with the help of opportunity threat matrix. A company after identifying various threats, can use its judgments to place the threats in any of the four cells in the following matrix:

	Major Threats	Moderate threats
<b>Attractiveness</b>	Moderate threats	Minor Threats
	High	Low

Similar to the threat matrix we have an opportunity matrix that the opportunities are placed according to their attractiveness as given below:

	Very Attractive	Moderately Attractive
<b>Attractiveness</b>	Moderately Attractive	Less Attractive
	High	Low
	<b>Probability of occurrence</b>	

The matrix helps in prioritization of opportunities and threats that need to be focused by the organization immediately.

### **The Impact matrix:**

The impact of the trend on various strategies could be visualized using an impact matrix. After identifying the emerging trends in mega, micro and relevant environments, the degree of their impact can be assessed with the help of the impact scale. The matrix enables us to have a consolidated view of the impact on different strategies, which a firm may be following. The strategies may relate to various functional areas within a specific business unit or they may relate to overall company for all its business units.

To assess the degree and quality of impact of each trend on different strategies a five-point impact scale could be used. The pattern of scoring can be:

- +2 extremely favorable impact
- +1 moderately favorable impact
- 0 no impact
- 1 moderately unfavorable impact
- 2 extremely unfavorable impact

Trends	Probability of occurrence	Impact on strategies			
		S1	S2	S3	S4
T1					
T2					
T3					

A proper scanning of internal and external environment enables generation of strategic alternatives to utilize the strengths and overcome the weaknesses in the light of the opportunities and threats that operate in the environment.

#### IV. STRATEGIC ALTERNATIVES AND STRATEGIC CHOICE

The efficiency of the strategic planning process lies in the formulation of the strategy. A firm's strategy determines the path that it takes towards its goals and objectives. The degree of the aptness of the strategy formulated decides the extent of the firm's success. Hence, generating strategic alternatives and making a strategic choice form the crux of the strategic planning process.

#### Generating Alternative Strategies Using A Tows Matrix

The formation of TOWS matrix results in four sets of possible strategic alternatives after matching the company's internal strengths and weaknesses with the external opportunities and threats. It forces strategic managers to create growth as well as retrenchment strategies. It can be used to generate corporate as well as business strategies.

In the **Opportunities (O)** block, list the external opportunities available in the company's or business unit's current and future environment.

In the **Threats (T)** block, list the external threats facing the company or unit now and in the future.

In the **Strengths (S)** block, list the specific areas of current and future strengths for the company or the unit.

In the **Weaknesses (W)** block, list the specific areas of current and future weakness for the company or the unit.

Generate a series of possible strategies for the company or the business unit under consideration based on particular combinations of the four sets of strategic factors.

<b>INTERNAL FACTORS (IFAS)</b> <b>EXTERNAL FACTORS (EFAS)</b>	<b>Strengths (S)</b> List 5 – 10 internal strengths here	<b>Weaknesses (W)</b> List 5 –10 internal weaknesses here
<b>Opportunities (O)</b> List 5 – 10 external opportunities here	<b>SO Strategies</b> Generate strategies here that use <b>strengths</b> to take <b>advantage</b> of <b>opportunities</b>	<b>WO Strategies</b> Generate strategies here that take <b>advantage</b> of <b>opportunities</b> by <b>overcoming weaknesses</b>
<b>Threats (T)</b> List 5 –10 external Threats	<b>ST Strategies</b> Generate strategies here that use <b>strengths</b> to <b>avoid threats</b>	<b>WT Strategies</b> Generate strategies here that <b>minimize weaknesses</b> and <b>avoid threats</b>

- **SO Strategies** are generated by thinking of ways in which a company or business unit could use its strengths to take advantage of opportunities.
- **ST Strategies** consider company's or unit's strengths as a way to avoid threats.
- **WO Strategies** attempt to take advantage of opportunities by overcoming weaknesses.
- **WT Strategies** are basically defensive and primarily act to minimize weaknesses.

Thus TOWS matrix generates four set of strategies that could be used for the organization as a whole or for any specific business unit within the organisation.

## **BUSINESS STRATEGY**

Business strategy focuses in improving the competitive position of a company or a business unit's product or service within its industry or within the market segment the company serves. Business strategy can be competitive (battling with all the competitors for advantage) or cooperative (combining with one or two competitors to compete with the other competitors).

## **PORTER'S GENERIC COMPETITIVE STRATEGY:**

Porter has defined three generic strategies to cope up with the five competitive forces and to outperform other companies in the industry<sup>1</sup>:

- Overall cost leadership
- Differentiation
- Focus

To outperform other companies in the industry, the company has to follow any of the above said three strategies. Total commitment and supporting organizational arrangements are necessary for effective implementation of any of these three strategies.

### **Overall cost leadership:**

The objective of this kind of strategy is to achieve overall cost leadership in the industry through cost focus on various functional areas. It requires aggressive construction of efficient and scalable facilities, vigorous pursuit of cost reduction from experience, tight cost and overhead control, avoidance of marginal customer accounts, and cost minimization in areas like R&D, service, sales force, advertising etc.

The low cost position gives the firm a defense against the rivalry since it could still be able to earn above-average returns. It defends the firm from the

buyers since they could pressurize the firm do bring down the price further like any other competitors. It provides more flexibility to cope with input cost increase and hence could withstand the pressure from the suppliers. It also gives the player an advantage of economies of scale so that no other new players or substitutes can enter to in its territory.

The low cost strategy requires the player to gain relatively higher market share than any other competitors, which requires production in higher volumes. This requires higher initial investment of the company for state-of-the-art production, aggressive pricing and start up price losses to build the market share. The company needs to maintain varied range of related products to serve wide range of customers. Once achieved, the margin earned out of cost leadership enables the company to reinvest for sustaining the competitive advantage.

### **Differentiation:**

The objective of the second type of strategy is to achieve uniqueness either in the product or the service offered by the company. This differentiation could be achieved in technology, design or brand image, features, customer service, dealer network etc.

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

The company requires extensive R&D, product design, high quality products intensive customer support etc. to differentiate either their product or their service which hinders the policy of maintaining low cost for their product or

services. In some industry this may become a handicap since there won't be many customers ready to pay heavy price for a differentiated product or service.

### **Focus strategy:**

The final generic strategy is focusing on a particular buyer group, segment of the product line, or geographic market. The entire focus or niche strategy is built around serving a particular target fully. The firms are thus able to serve narrow targets than its competitors who choose to serve the market widely. As a result the firm is able to achieve low cost position or differentiation or both the advantages in its narrow market.

Hence focus strategy, if achieved, is able to win through the competition from all the five competition forces. It necessarily involves a trade off between profitability and sales volume.

### **Other Requirements Of The Generic Strategies:**

Implementing the above said strategies need different resources and skills. The generic strategies also imply differing organizational arrangements, control procedures and incentive systems. The requirements that are required in various areas are:

<b>Generic strategy</b>	<b>Commonly required skills and resources</b>	<b>Common organizational requirements</b>
<b><i>Overall cost leadership</i></b>	<ul style="list-style-type: none"> <li>• Sustained capital investment and access to capital</li> <li>• Process engineering skills</li> </ul>	<ul style="list-style-type: none"> <li>• Tight cost control</li> <li>• Frequent detailed control reports</li> <li>• Structured organization</li> </ul>

	<ul style="list-style-type: none"> <li>• Intense supervision of labour</li> <li>• Products designed for ease in manufacture</li> <li>• Low cost distribution system</li> </ul>	<ul style="list-style-type: none"> <li>• Incentives based on meeting strict quantitative targets</li> </ul>
<b><i>Differentiation</i></b>	<ul style="list-style-type: none"> <li>• Strong marketing abilities</li> <li>• Product engineering</li> <li>• Creative flair</li> <li>• Strong capability in basic research</li> <li>• Corporate reputation for quality or technological leadership</li> <li>• Long tradition in the industry or unique combination of skills drawn from other businesses</li> <li>• Strong cooperation from channels</li> </ul>	<ul style="list-style-type: none"> <li>• Strong coordination among functions in R&amp;D, product development and marketing.</li> <li>• Subjective measurement and incentives instead of quantitative measures</li> <li>• Amenities to attract highly skilled labor, scientists or creative people</li> </ul>
<b><i>Focus</i></b>	<ul style="list-style-type: none"> <li>• Combination of the above policies directed at the particular strategic target</li> </ul>	<ul style="list-style-type: none"> <li>• Combination of the above policies directed at the particular strategic target</li> </ul>

Source: Michael E. Porter, Competitive Strategy, The Free Press, 1980

## **Risks Of The Generic Strategies:**

Fundamentally the risks in pursuing the generic strategies are two. Firstly, failing to attain or sustain the strategy and secondly, the value of the strategic advantage provided by the strategy may erode with industry evolution.

### **Risks of Overall cost leadership:**

Cost leadership imposes severe burdens on the firm to keep up its position, which means reinvesting in modern equipment, ruthlessly scrapping obsolete assets, avoiding product line proliferation and being alert for technological improvement. Some of the risks are:

- Technological development that makes the past obsolete
- Learning or imitating the strategy could be at a cheaper cost or ability of investment in low cost state of the art facilities
- Inability to foresee the development either in the product or the market fronts due to the narrowed focus on cost
- Inflation of cost that may upset the cost advantage of the player

### **Risks of differentiation:**

Differentiation also involves the following risks:

- The differentiation in the cost between the low cost players and differentiation players is too high to sustain the strategy. The customers may sacrifice the feature of differentiation to gain the price advantage.
- Buyers need for differentiation falls as the buyers becomes more sophisticated
- As industries mature, the imitation could happen which narrows down the differentiation.

## Risks of focus:

Focus involves the following series of risks:

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

## Cooperative Strategy:

Cooperative strategies are used to gain competitive advantage by joining with one or two competitors against other competitors of the industry. The two general types of cooperative strategies are collusion and strategic alliance.

### Collusion:

Collusion is the strategy by which the firms join together to reduce the output and hence results in the increase of prices by the normal economic law of supply and demand. It could be either explicit in which the companies cooperate through direct communication or negotiation or tacit in which the firms cooperate through informal signals. Both the types of the collusive strategies are illegal in most of the countries.

According to Barney, tacit collusion in the industries is most likely to be successful if (1) there are a small numbers of identifiable competitors (2) costs are similar among firms (3) one firm tends to act as the “Price leader” (4) there is

a common industry culture that accepts the cooperation (5) sales are characterized by high frequency of small orders (6) large inventories and backlog are the normal pattern to be followed at the time of demand and (7) there are high entry barriers to keep out the new competitors.<sup>1</sup>

### **Strategic Alliances:**

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

- To obtain technology or manufacturing capabilities – A company having competitive advantage in one field could forge alliance with another company of different competitive advantage to gain over the other competitors.
- To obtain access to specific markets – Instead of buying or building its own companies the firm could give rights to companies in other countries to market its product.
- To reduce the financial risk – By means of strategic alliance the company could reduce the loss that may happen if the new project fails.
- To reduce political risk – the company could get rid of the political disturbance by forming the partnership with the company that is having good relation with the political parties of the particular country
- To achieve or ensure competitive advantage – by forming the strategic alliance the company would be able to achieve new or increase its existing competitive advantage.

## Various types of strategic alliances:

The various types of strategic alliance are:

### Mutual service consortia:

A mutual service consortium is a partnership of similar companies in similar industries who pool their resources to gain a benefit that are too expensive to develop alone such as access to advance technology. It is fairly weak and distant alliance due to very little interaction between the players.

### Joint venture:

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

### Licensing Arrangement:

A licensing arrangement is the strategic alliance by which the firm in one country grants license to a firm in other country to produce and/or sell its product. The licensee pays the compensation to the licensing firm in exchange of the technology. This is more useful where a company could not enter due the investment restriction in the particular country.

The various other Strategic alternatives that can be considered are:

<b>Strategy</b>	<b>Definition</b>
Forward integration	Gaining ownership or increased control over distributors or retailers
Backward integration	Seeking ownership or increased control of a firm's suppliers.
Horizontal integration	Seeking ownership or increased control over competitors
Market penetration	Seeking increased market share for present products or services in the present markets through greater marketing efforts.
Market development	Introducing present products or services into new geographic area.
Product development	Seeking increased sales by improving present products or services or developing new ones.
Concentric development	Adding new but related products or services.
Horizontal diversification	Adding new but related products or services for present customers
Retrenchment	Regrouping through cost and asset reduction to reverse declining sales and profit
Divestiture	Selling a division or part of an organization.
Liquidation	Selling all of a company's assets, in parts, for their tangible growth.

### **Strategic Choice**

Strategic choice is the evaluation of alternative strategies and selection of the best alternative. With firms conscious of the realities of a dynamic world,

arriving at the strategy through consensus gives way to strategic choice by extensive and conflicting arguments. With more & more flat organization structure coming into play, the strategy is arrived after heated deliberations and conflict.

## Process Of Strategic Choice

Making a Strategic Choice is essentially a decision making process. It consists of the following four steps:

### Focusing on alternatives:

The aim of focusing on alternatives is to narrow down the choice of alternatives. To narrow down the choice the process should start from the business definition. With the help of the business definition the company could generate alternative strategies by working forward from the present to the future position it wishes to be in. Focussing on alternatives could also be done by visualizing the future state and working backwards through a **Gap analysis**. By analyzing the difference between the projected and desired performance, the gap could be found.

### Considering the selection factors:

After narrowing down the alternatives the company has to select the factors based on which it has to evaluate the alternatives. The criteria on the basis of which evaluation has to be done can be determined through an objective or subjective approach. The *objective approach*, which could be termed as rational, normative or prescriptive is based on analytical techniques that are hard facts or data used to facilitate a strategic choice. The *subjective approach*, also

termed as intuitive or descriptive is based on one's personal judgment, consensus and non-numerical data.

### **Evaluation of strategic alternatives:**

There is no set procedures or prescribed approach for the evaluation for the various alternatives. Evaluation has to done by bringing the analysis done by both the subjective and objective factors. Successive iteration is done to evaluate the various alternatives.

### **Making the strategic choice:**

After evaluating various alternatives the management could arrive at the best alternative. The company has to make a strategic choice that will lead the company towards growth in the future, based on its goals and objectives.

### **Strategic Plan**

The final step, before a strategy is implemented, is formulation of a strategic plan. A strategic plan (also corporate, group, or perspective plan), is a document which provides information regarding the different elements of strategic management and the manner in which an organisation and its strategists propose to put the strategies into action. A comprehensive strategic plan document could contain the following information.

- A clear statement of business definition, mission, purpose, and objectives.
- Results of environmental appraisal, major opportunities and threats, and critical success factors
- Results of corporate appraisal, major strengths and weakness, and distinctive competencies.

- Strategic choice made and assumptions under which strategies would be relevant. Contingent strategies to be used under different conditions.
- Strategic budget for the purpose of resource allocation for implementing strategies and schedule of implementation.
- Measures to be used to evaluate performances and assess the success of strategy implementation.

The formulation of strategic plan document provides a means not only to formalise the effort that goes in strategic planning but also for communicating to insiders and outsiders what the company stands for, and what it plans to do in the given future time period.

A strategic plan should be implemented through procedural implementation, proper resource allocation, structural implementation, functional implementation and behavioural implementation plans. The implementation of the strategy should be evaluated and controlled through strategic and operational control to realize the objectives and mission of the organisation.