

# STRATEGIC MANAGEMENT

## [MGMT 4272]



DEPARTMENT OF MANAGEMENT  
COLLEGE OF BUSINESS AND ECONOMICS  
ARBA MINCH UNIVERSITY  
COLLEGE OF CONTINUING AND DISTANCE EDUCATION

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WRITTEN BY:  
HABTAMU MESERET (MBA)

REVISED BY:  
HABTAMU MESERET (MBA)

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Written By: Habtamu Meseret (MBA)

Revised By: Habtamu Meseret (MBA)

Arba Minch  
Ethiopia

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## MODULE INTRODUCTION

Dear learner! Welcome to the module entitled ‘Strategic Management’. This course is devoted to identifying and describing the various strategies a company can pursue to achieve superior performance. Many of these strategies are generic – that is, they apply to all organizations, large or small, manufacturing or service, and profit seeking or not for profit. The central aim of this course is to give a thorough understanding of the analytical techniques and skills necessary to identify and exploit strategies successfully. Specifically, the course covers; the meaning & role of strategic management, nature of strategic management, strategy formulation & implementation, environmental scanning, understanding of corporate, competitive functional and operating level strategies, strategy implementation, evaluation and control.

The module is prepared so as to enable the reader comprehend its substance without having to refer to other materials, but if you find any portion of it to be a bit difficult or if you need further explanation than what is provided, do not hesitate to refer to other relevant materials that are easily accessible in your vicinity. You can also list down the portions which you think are a bit difficult to understand and consult your tutor to explain them thoroughly during the tutorial session of the course.

Moreover, you have to go through the sub topics of each chapter and make sure whether you have clearly understood what is emphasized in the section. With this regard, you can use the self check questions, chapter summary and the chapter end self check exercises which are designed to facilitate your self learning effort. Therefore, just after reading a given section of the module you have to check your understanding by performing the quick check items. Upon the completion of the entire chapter, you may answer the self test exercise and cross check your answer with those answers given at the end of the module.

As stated in the introduction to the course section, this module consists of eight chapters which deal with various aspects of strategic management. Go through the entire chapters one after the other and try to grasp the gist of each sub section within the chapter.

Reading the material repeatedly is highly recommended as it enables the reader to understand the subject matter in greater detail. Enjoy reading and thereby expanding your knowledge of management in general and strategic management in particular.

## COURSE OBJECTIVES

- ⊕ When you complete the study of this module, you are expected to:
- ⊕ Comprehend the evolution strategic management as a discipline
- ⊕ Be acquainted with the meaning and nature of strategic management
- ⊕ Describe the benefits and pitfalls of strategic management
- ⊕ State the scope of strategic management
- ⊕ Specify the features and functions of business policy
- ⊕ Describe the strategic management process.
- ⊕ Describe the nature and role of vision and mission statements in strategic management.
- ⊕ Explain how strategic decision making is different from other types of decisions
- ⊕ Describe the three levels at which strategy can be formulated along with the alternative strategies pursued at each level.
- ⊕ Know how internal environment analysis is conducted and what is emphasized during the analysis.

- ⊕ Discuss 10 major external forces that affect organizations: economic, social, cultural, demographic, environmental, political, governmental, legal, technological, and competitive.
- ⊕ Explain how to develop an EFE and CPM
- ⊕ Discuss the Resource-Based View (RBV) in strategic management.
- ⊕ Develop an IFE Matrix.
- ⊕ Explain how to develop a SWOT Matrix, SPACE Matrix, BCG Matrix, IE Matrix, and QSPM.
- ⊕ Discuss the importance of annual objectives and policies in achieving organizational commitment for strategies to be implemented
- ⊕ Describe a practical framework for evaluating strategies.
- ⊕ Discuss the importance of contingency planning in strategy evaluation.
- ⊕ Identify 16 types of business strategies.
- ⊕ Discuss the Balanced Scorecard.
- ⊕ Be familiar with the five forces of industry analysis proposed by Michael Porter.
- ⊕ Describe how strategy evaluation and control is carried out.

## MODULE OBJECTIVES

- ⊕ This module is prepared with the major objectives described below among others:
- ⊕ To facilitate self learning effort of the distant student
- ⊕ To enable the student apply various concepts emphasized in different sections of the module in his/her daily life as well as at work place and thereby become more productive/successful.
- ⊕ To equip the student with the knowledge of business policy and strategy

- ⊕ To satisfy the need to learn while being engaged in various activities without necessarily joining a college or a university
- ⊕ to introduce the student with the alternative strategies formulated at different levels of a given organization
- ⊕ To let students know major activities undertaken in the course of strategy implementation, evaluation and control.

## ICONS USED IN THE MODULE



**Chapter Objectives**



**Self Check Exercises**



**Key for Self Check Exercises**



**Summary**



**Chapter Review Exercises**

## CHAPTER

## 1

THE NATURE OF  
STRATEGIC MANAGEMENT

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## LEARNING OUTCOMES

By the end of this topic, you should be able to:

- ⊕ Explain the concept of strategic management;
- ⊕ Describe the brief history of the strategic management concept;
- ⊕ Define strategic management;
- ⊕ Describe the context in which strategic management occurs;
- ⊕ Identify the scope of strategic management;
- ⊕ Describe the benefits and pitfalls of strategic management;
- ⊕ Describe the strategic management process.

## Introduction

**D**ear distance learners, welcome to the first chapter of the course strategic management!

This introductory chapter is intended to familiarize you with strategic management. I shall begin with the description of the evolution of

strategic management as a discipline. Next, you will be introduced to the meaning and nature of strategic management where its various definitions are provided. Importance and purpose of strategic management will be our subsequent point of discussion. In the remaining section of the chapter, strategic management models, benefits of strategic management and business ethics and strategic management will be taken care of.

Enjoy reading this chapter as it equips you with general background knowledge which is imperative for easy understanding of the chapters that follow it.

## 1.1 THE EVOLUTION OF STRATEGIC MANAGEMENT

Dear learners, Strategic management are a concept that originated from the military field. The concept of strategic management was first applied in ancient battles. The period around 500 B.C. saw numerous battles that took place in Greece and China as illustrated in figure 1.1. The early written record on strategic management can be traced back during this war-ringing period.



Figure 1.1: Battle Fields of Ancient China and Greece

Source: [http:// www.mootee.typepad.com/photos/uncategorized/warriors\\_3.jpg](http://www.mootee.typepad.com/photos/uncategorized/warriors_3.jpg)

The term strategy is derived from the Greek word ‘strategos’. According to Heracleous (2003) the word ‘strategos’ comprised two Greek words, ‘stratos’ and ‘agein’. The term ‘stratos’ refers to the army and ‘agein’ means to lead. Thus strategy in this sense means the art of leading the army. This concept is illustrated in figure 1.2 (strategos). To some scholars the word ‘strategos’ also implies the art of the general.



Figure 1.2: Strategy is derived from the Greek word ‘strategos’

At this stage strategy also carry several related concepts. The early Greek and Chinese writers on strategy identified related concepts of strategic management among others such as what are the good qualities of a general, principles in the deployment of troops, strategic goals, thinking and attitudes of the general, drawing battle plans and leading troops in battle.

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## 1.2 DEFINITION OF STRATEGY

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Dear learner, can you define strategy and strategic management?

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Almost everyone thinks that they know what strategy is. However, if you ask what the word strategy means to them, the range of replies is surprisingly varied. To some the term ‘strategic’ is no more than a synonym for ‘important’; to others it may be a plan of action and

for a third group it might be a blueprint for success. More considered replies are likely to reveal different shades of meaning within this broad range. To us, strategic management is about envisioning and realizing the future. Note that this definition requires that strategy should both provide an idea of the future and generate the action necessary to realize that idea. Implementation is part of strategy and not a separate activity.

Strategy is defined as “a unified, comprehensive and integrated plan designed to assure that the basic objective of the enterprise is achieved” According to Ansoff, “Strategy is a rule for making decisions”. Definitions by other authors are given below.

**Alfred D. Chandler:** “Strategy can be defined as the determination of the basic long-term goals and objectives of an enterprise and the adoption of courses of action and the allocation of resources necessary for carrying out these goals”.

**Kenichi Ohame:** “Strategy is the way in which a corporate endeavors to differentiate itself positively from its competitors, using its relative strengths to better satisfy customer needs”.

**William F. Glueck:** “Strategic management is a stream of decisions and actions which leads to the development of an effective strategy, which helps to achieve corporate objectives”.

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### 1.3 DEFINITION OF STRATEGIC MANAGEMENT

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This section will show you that there are many definitions of strategic management. There are various definitions of strategic management because strategic management deals with numerous issues and covers a wide scope as will be shown in section 1.4.

Today there is no standard definition of strategic management. The definition of strategic management by scholars may vary depending on the perspective subscribed by each scholar. Regardless most scholars agree that the strategic management process consists of strategy formulation, strategy implementation and strategy evaluation and control.

Some of the definitions of strategic managements are given as follows:

- Ansoff (1984) who was also known as the father of strategic management viewed strategic management as a systematic approach to a major and increasingly important responsibility of general management: to position and relate the firm to its environment in way which will assure its continued success and make it secure from surprises. Further the author added that strategic management is a process for managing a firm's relationship with its environment, and this encompassed capability planning and management of change.
- Viljoen (1994) defined strategic management as the process of identifying, choosing and implementing activities that will enhance the long-term performance of an organization by setting direction and by creating ongoing compatibility between the internal skills and resources of the organization, and the changing external environment within which it operates. To Viljoen (1994) the core activity of strategic management is the development and implementation of a plan of action for an organization to ensure the long-run success.
- Lynch (2000) used the term corporate strategy to denote strategic management. The author refers to corporate strategy as the pattern of major objectives, purposes or goals and essential policies or plans for achieving those goals, stated in such a way as to define what business the company is in or is to be in and the kind of company it is or is to be.
- Thompson and Strickland (2001) described strategic management as a managerial process of forming a strategic vision, setting objectives, crafting a strategy, implementing and executing the strategy, and then over time initiating any corrective adjustments in the vision, objectives, strategy, and execution as deemed appropriate.
- David (2003) defined strategic management as the art and science of formulating implementing, and evaluating cross-functional decisions that enable an organization to achieve its objectives. Accordingly this definition of strategic management focuses on integrating firm's functional areas to achieve success with the purpose to exploit and create new and different opportunities for tomorrow.

- Harrison (2003) viewed strategic management as a process through which organization analyze and learn from their internal and external environments, establish strategic direction, create strategies that are intended to move the organization in that direction, and implement those strategies, all in effort to satisfy key stakeholders.
- Bateman and Snell (2004) referred to strategic management as involving managers from all parts of the organization in the formulation and implementation of strategic goals and strategies. According to the authors the need for the involvement of managers in the strategic management process is a result of the traditional strategic planning practices that had earlier alienated managers other than top management and their planning staff from getting involved in the strategy process.
- According to Hitt, Ireland and Hoskisson (2005), the strategic management process is the full set of commitments, decisions, and actions required for a firm to achieve strategic competitiveness and earn above average returns.
- Hashim (2008) defined strategic management as the entrepreneurial process by which a firm accomplishes its objectives through the formulation and implementation of effective strategies based on its distinctive capabilities and business environment.
- Dess, Lumpkin and Eisner (2008) refer to strategic management as consisting of analyses, decisions and actions organizations undertake in order to create and sustain competitive advantage. There are two main elements of the definition. First, strategic management is concerned with the analysis of vision, mission and strategic objectives together with the analysis of internal and external environment. Strategic management is also concerned with decision on what industries should an organization compete in, and how to compete. An organization must also take the necessary action to implement the decision. Second, the managers need to determine how and organization should compete in order to obtain advantages over that is sustainable over a period of time.
- In the lesson we will adopt the definition of strategic management by Wheelen and Hunger (2008) which is the set of managerial decisions and actions that determines the

long-run performance of a corporation. Based on this definition strategic management covers strategy formulation, strategy implementation, and strategy evaluation and control.

Displayed below are the tasks for strategic management.

- ✎ Develop the organization's vision, mission, and goals.
- ✎ Analyze the organization's internal situation's to identify its strengths and weaknesses.
- ✎ Analyze the organization's external environment which comprises both the task environment.
- ✎ Match the organization's resources with the needs of the external environment in order to establish long-term objectives and to generate strategies.
- ✎ Select the long-term objectives and strategies that best meet the requirement of the organization's mission.
- ✎ Establish annual objectives and short-term strategies that are in accord with the long term objectives and strategies.
- ✎ Implement the selected strategies through proper resource allocation within the implementation capability of the organization such as supportive leadership, organizational culture, structure, reward system and technologies.
- ✎ Measure and evaluate the performance and initiate corrective action to reposition the firm for the future.

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## 1.4 THE CONTEXT OF STRATEGIC MANAGEMENT

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According to Hashim (2008) by understanding the context in which strategic management occurs would facilitate its adoption in an organization. Strategic management process takes place within the contextual components of organization, management, strategy and external environment as illustrated in figure 1.3. The interplay of the four components would determine the success of the strategic management process. Therefore it is also essential for you to understand the role of the four contextual components as related to the strategic management process.



Figure 1.3: The strategic management process within the four contextual components

## ORGANIZATION

In general an organization is established by its founder with a specific vision and mission in mind. As an example, a pharmaceutical company can be established with a vision to maintain a healthy world population, and to accomplish the vision the company may set up pharmaceutical outlets in major cities all over the world. In line with the vision and mission, the management of the organization will set its objectives and strategies taking into account the requirement of the external environment.

## THE MANAGEMENT

In the context of strategic management, the management of an organization refers to the personnel entrusted to make strategic decisions. The management is actually the strategic decision makers who are involved in setting the direction for the organization, crafting

strategies, and ensuring the strategies are being implemented. The management is responsible for the overall performance of the organization.

The management is responsible for setting up the strategic management process in an organization. Based on the strategic management process the management will carry out the strategic management tasks mentioned earlier.

The management who are responsible for making strategic decisions are the board of directors, top management, and middle management. Figure 1.4 demonstrates the management of an organization.



Figure 1.4: The management of an organization

### A) Role of the Board of Directors

- Board of directors who are the representatives of the shareholders are entrusted with the authority and responsibility to set up corporate policies and successful implementation of the policies. The board of directors is also entrusted by the shareholders to approve all decisions pertaining to the long-term performance of the organization.

- ➔ The following responsibilities and the role of the board of the directors and top management in strategic management are based on Wheelen and Hunger (2008). Figure 1.5 describes the responsibilities of the board of directors.



Figure 1.5: Responsibilities of the board of directors

| Monitor                                                                                                                                           | Evaluate                                                                                                                                          | Initiate                                                                                                 |
|---------------------------------------------------------------------------------------------------------------------------------------------------|---------------------------------------------------------------------------------------------------------------------------------------------------|----------------------------------------------------------------------------------------------------------|
| Board of Directors can monitor changes within and outside of the organisation and inform top management any development that they might overlook. | Board of Directors can monitor changes within and outside of the organisation and inform top management any development that they might overlook. | A board can also draw out an organisation's mission and suggest strategic options to the top management. |

Figure 1.6: Role of the board of directors



- What is the difference between business policy and strategic management?
- In your opinion, do the benefits of strategic management outweigh the Pitfalls? Justify your answer.

## **B) Top Management**

The top management is lead by the CEO who is assisted by the Chief Operating Officer or president, executive vice president and other division heads. The top management set the specific objectives, formulates strategies and allocates the necessary resources to implement them.

The top management is responsible for getting things accomplished through others in order to achieve the corporate objectives. The tasks of top management vary from organization to organization and derived from the vision, mission, objectives, strategies and essential activities of the organization. The three key characteristics of successful CEOs, are given as follows:

### **i) Strategic Vision**

The CEO should provide strategic vision for the corporation. The strategic vision acts to galvanize employees in discharging the duties. The strategic vision allows the employees to see beyond their daily routine and provide meaning to their work in relation to the total corporation.

### **ii) Role Model**

The CEO also acts as role model for the employees through their action, behaviour and dress. The values and attitudes of the CEOs, will affect the attitudes and values of the employees as well.

**iii) Set Performance Standard**

Third key characteristics of successful CEO is to set goals that provide challenges for the employees. In this way a CEO communicate his high expectation to the employees that can lead to high performance for the whole organization.

**STRATEGY**

Strategy is the third contextual component of strategic management. Strategy is an important component as it is a master plan that guides an organization to interact with the competitive environment to achieve its objective.

Most strategic management scholars agree that there are three levels of strategies.

**i) Corporate Strategy**

Corporate strategy also known as the grand, master or general strategies which are the highest level of strategy is formulated by the board of directors and top management.

Corporate strategy addresses issues such as:

- a) What portfolio of business or the different kind of businesses should an organization involved in?
- b) What is the logic of selecting of having a certain portfolio of business?
- c) How are the resources to be allocated for the various businesses
- d) What is the expected return from each business?

**ii) Business Strategy**

Business strategy usually takes place at the Strategic Business Unit (SBU) or the subsidiary level. Business strategy dwells on how an organization competes or how an organization positions itself relative to its competitors to achieve sustainable competitive advantage.

### iii) Functional Strategy

Functional strategy takes place at the functional level or the departmental level. The functional strategy is to support both the corporate and business strategy by enhancing efficiency and effectiveness at the functional level.

## EXTERNAL ENVIRONMENT

The fourth contextual component of strategic management is the external environment. The external environment is important in the strategic management process as organizations operate within the external environment depends on the external environment for most of its resources such as human resource and raw materials. At the same time organizations also supply its products to market which form part of the environment. In this sense the strategic management process assist organization to operate successfully in the environment.

The environment is not static. There are environment forces that may change the competitive landscape. For instance advances in information technology which made information readily accessible all over the world had resulted in greater competition.

This in turn will adversely affect companies that are not ready to face changes in the environment. It is in such a situation that the strategic management would prove to be useful. Having a proper strategic management process, top management will monitor the environment for changes and align the organization through having the appropriate strategy to handle the threats from the environment.



- ☐ List three characteristics of successful CEOs.
- ☐ Describe about the roles and responsibilities of Board of Directors.

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## 1.5 THE SCOPE OF STRATEGIC MANAGEMENT

The various definitions of strategic management given earlier suggest that the scope of strategic management is wide. The scope of strategic management covers a wide range of strategic management issues. Based on the literature of the most important aspect of strategic management is discussed below in table 1.1.

Table 1.1: The Important Aspects of Strategic Management

|   |                      |                                                                                                                                                                                                                                                                                                                                                                 |
|---|----------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 1 | Oriented             | <p>Strategic management is future oriented in the sense that the strategic decisions are based on assumption about the future. Top management evaluates and select strategic options based projection about the future. An organization needs to be proactive instead of reactive in order to be successful in a competitive environment.</p>                   |
| 2 | Long term Impact     | <p>The strategic decision made by the top managers will have a long-term impact on the organization. Once the decisions are made there is no turning back and the consequence of the decision will be felt over the long-term.</p>                                                                                                                              |
| 3 | Focus on Competition | <p>The focus on competition is another essential aspect of strategic management. The strategic management process assists an organization to craft business strategies to outperform competition and maintain competitive advantage over competitors. It is by continuously managing competition that an organization can sustain its competitive position.</p> |
| 4 | Top Management       | <p>As strategic management process encompasses the numerous functional activities and strategic business units it is only natural that the top management would have a broad enough perspective to make decisions. Further, the top management has the authority to approve the allocation of resources.</p>                                                    |

|   |                                  |                                                                                                                                                                                                                                                                                                                                                                  |
|---|----------------------------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 5 | Firm Resources                   | In implementing strategies an organization will have to commit substantial amount of resources. The resources can be in the form of human resources, tangible and intangible assets as well as funds. These resources will be committed over a period of time during implementation.                                                                             |
| 6 | Organizational-Wide Consequences | Strategic decisions have wide ranging consequences for the whole organization. In other words strategic decisions for a particular function or subsidiary will not only be limited for that particular unit but it will also affect other operational units within the organization.                                                                             |
| 7 | External Focus                   | Organizations exist in an open system. Operating in an open systems Organizations affect and are affected by forces in the environment. As such organizations need to be vigilant in monitoring forces of change in the environment that can affect the organizations.                                                                                           |
| 8 |                                  | Achieving superior performance is another important aspect of strategic management. Organizations installed strategic management process in order to achieve superior performance. In doing so organizations must continuously strive to create value for customers and other stakeholder of the organizations : including shareholders, suppliers, and workers. |

## 1.6 STAGES OF STRATEGIC MANAGEMENT

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

- i) **Strategy formulation:** includes developing a vision and mission, identifying an organization's external opportunities and threats, determining internal strengths and weaknesses, establishing long-term objectives, generating alternative strategies, and choosing particular strategies to pursue. Strategy-formulation issues include deciding what new businesses to enter, what businesses to abandon, how to allocate resources,

whether to expand operations or diversify, whether to enter international markets, whether to merge or form a joint venture, and how to avoid a hostile takeover.

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

- ii) **Strategy implementation:** requires a firm to establish annual objectives, devise policies, motivate employees, and allocate resources so that formulated strategies can be executed. Strategy implementation includes developing a strategy-supportive culture, creating an effective organizational structure, redirecting marketing efforts, preparing budgets, developing and utilizing information systems, and linking employee compensation to organizational performance.

Strategy implementation often is called the “**action stage**” of strategic management. Implementing strategy means mobilizing employees and managers to put formulated strategies into action. Often considered to be the most difficult stage in strategic management, strategy implementation requires personal discipline, commitment, and sacrifice. Successful strategy implementation hinges upon managers’ ability to motivate employees, which is more an art than a science. Strategies formulated but not implemented serve no useful purpose.

Interpersonal skills are especially critical for successful strategy implementation. Strategy-implementation activities affect all employees and managers in an organization. Every division and department must decide on answers to questions, such as “What must we do to implement our part of the organization’s strategy?” and “How best can we get the job done?”

The challenge of implementation is to stimulate managers and employees throughout an organization to work with pride and enthusiasm toward achieving stated objectives.

- iii) **Strategy evaluation:** is the final stage in strategic management. Managers desperately need to know when particular strategies are not working well; strategy evaluation is the primary means for obtaining this information.

All strategies are subject to future modification because external and internal factors are constantly changing. Three fundamental strategy-evaluation activities are;

- (i) Reviewing external and internal factors that are the bases for current strategies
- (ii) Measuring performance, and
- (iii) Taking corrective actions. Strategy evaluation is needed

Because success today is no guarantee of success tomorrow! Success always creates new and different problems; complacent organizations experience demise.

Strategy formulation, implementation, and evaluation activities occur at three hierarchical levels in a large organization: corporate, divisional or strategic business unit, and functional. By fostering communication and interaction among managers and employees across hierarchical levels, strategic management helps a firm function as a competitive team. Most small businesses and some large businesses do not have divisions or strategic business units; they have only the corporate and functional levels. Nevertheless, managers and employees at these two levels should be actively involved in strategic-management activities.

Peter Drucker says the prime task of strategic management is thinking through the overall mission of a business:

. . . that is, of asking the question, “What is our business?” This leads to the setting of objectives, the development of strategies, and the making of today’s decisions for tomorrow’s results. This clearly must be done by a part of the organization that can see the entire business; that can balance objectives and the needs of today against the needs of tomorrow; and that can allocate resources of men and money to key results.

## 1.7 KEY TERMS IN STRATEGIC MANAGEMENT

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### 1. COMPETITIVE ADVANTAGE

Strategic management is all about gaining and maintaining competitive advantage. This term can be defined as “anything that a firm does especially well compared to rival firms.” When a firm can do something that rival firms cannot do, or owns something that rival firms desire, that can represent a competitive advantage. For example, in a global economic recession, simply having ample cash on the firm’s balance sheet can provide a major competitive advantage.

Some cash-rich firms are buying distressed rivals. For example, BHP Billiton, the world’s largest miner, is seeking to buy rival firms in Australia and South America. Freeport-McMoRan Copper & Gold Inc. also desires to expand its portfolio by acquiring distressed rival companies. French drug company Sanofi Aventis SA also is acquiring distressed rival firms to boost its drug development and diversification. Cash-rich Johnson & Johnson in the United States also is acquiring distressed rival firms. This can be an excellent strategy in a global economic recession.

Having less fixed assets than rival firms also can provide major competitive advantages in a global recession. For example, Apple has no manufacturing facilities of its own, and rival Sony has 57 electronics factories. Apple relies exclusively on contract manufacturers for production of all of its products, whereas Sony owns its own plants. Less fixed assets has enabled Apple to remain financially lean with virtually no long-term debt. Sony, in contrast, has built up massive debt on its balance sheet.

Normally, a firm can sustain a competitive advantage for only a certain period due to rival firms imitating and undermining that advantage. Thus it is not adequate to simply obtain competitive advantage. A firm must strive to achieve *sustained competitive advantage* by;

- 1) Continually adapting to changes in external trends and events and internal capabilities, competencies, and resources; and by
- 2) Effectively formulating, implementing, and evaluating strategies that capitalize upon those factors.

An increasing number of companies are gaining a competitive advantage by using the Internet for direct selling and for communication with suppliers, customers, creditors, partners, shareholders, clients, and competitors who may be dispersed globally. E-commerce allows firms to sell products, advertise, purchase supplies, bypass intermediaries, track inventory, eliminate paperwork, and share information. In total, e-commerce is minimizing the expense and cumbersomeness of time, distance, and space in doing business, thus yielding better customer service, greater efficiency, improved products, and higher profitability.

## 2. STRATEGISTS

*Strategists* are the individuals who are most responsible for the success or failure of an organization. Strategists have various job titles, such as chief executive officer, president, owner, chair of the board, executive director, chancellor, dean, or entrepreneur. Jay Conger, professor of organizational behavior at the London Business School and author of *Building Leaders*, says, “All strategists have to be chief learning officers. We are in an extended period of change. If our leaders aren’t highly adaptive and great models during this period, then our companies won’t adapt either, because ultimately leadership is about being a role model.”

Strategists help an organization gather, analyze, and organize information. They track industry and competitive trends, develop forecasting models and scenario analyses, evaluate corporate and divisional performance, spot emerging market opportunities, identify business threats, and develop creative action plans. Strategic planners usually serve in a support or staff role. Usually found in higher levels of management, they typically have considerable authority for decision making in the firm. The CEO is the most visible and critical strategic manager. Any manager who has responsibility for a unit or division, responsibility for profit and loss outcomes, or direct authority over a major piece of the business is a strategic manager (strategist).

## 3. VISION AND MISSION STATEMENTS

Many organizations today develop a *vision statement* that answers the question “What do we want to become?” Developing a vision statement is often considered the first step in strategic planning, preceding even development of a mission statement.

Many vision statements are a single sentence. For example, the vision statement of Stokes Eye Clinic in Florence, South Carolina, is

***“Our vision is to take care of your vision.”***

Mission statements are “enduring statements of purpose that distinguish one business from other similar firms. A mission statement identifies the scope of a firm’s operations in product and market terms.” It addresses the basic question that faces all strategists: “What is our business?” A clear mission statement describes the values and priorities of an organization. Developing a mission statement compels strategists to think about the nature and scope of present operations and to assess the potential attractiveness of future markets and activities. A mission statement broadly charts the future direction of an organization. A mission statement is a constant reminder to its employees of why the organization exists and what the founders envisioned when they put their fame and fortune at risk to breathe life into their dreams.

Examples of mission statements include the following:

***Be the best employer for our people in each community around the world and deliver operational excellence to our customers in each of our restaurants (McDonald’s)***

***Our mission is to be recognized by our customers as the leader in applications engineering. We always focus on the activities customers desire; we are highly motivated and strive to advance our technical knowledge in the areas of material, part design and fabrication technology (LNP, a GE Plastics Company)***

#### 4. EXTERNAL OPPORTUNITIES AND THREATS

External opportunities and external threats refer to economic, social, cultural, demographic, environmental, political, legal, governmental, technological, and competitive trends and events that could significantly benefit or harm an organization in the future.

Opportunities and threats are largely beyond the control of a single organization—thus the word external. In a global economic recession, a few opportunities and threats that face many firms are listed here:

- ↳ Availability of capital can no longer be taken for granted.
- ↳ Consumers expect green operations and products.
- ↳ Marketing has moving rapidly to the Internet.
- ↳ Consumers must see value in all that they consume.
- ↳ Global markets offer the highest growth in revenues.
- ↳ As the price of oil has collapsed, oil rich countries are focused on supporting their own economies, rather than seeking out investments in other countries.
- ↳ Too much debt can crush even the best firms.
- ↳ Layoffs are rampant among many firms as revenues and profits fall and credit sources dry up.

The types of changes mentioned above are creating a different type of consumer and consequently a need for different types of products, services, and strategies. Many companies in many industries face the severe external threat of online sales capturing increasing market share in their industry.

Other opportunities and threats may include the passage of a law, the introduction of a new product by a competitor, a national catastrophe, or the declining value of the dollar. A competitor's strength could be a threat. Unrest in the Middle East, rising energy costs, or the war against terrorism could represent an opportunity or a threat.

A basic tenet of strategic management is that firms need to formulate strategies to take advantage of external opportunities and to avoid or reduce the impact of external threats. For this reason, identifying, monitoring, and evaluating external opportunities and threats are essential for success. This process of conducting research and gathering and assimilating external information is sometimes called *environmental scanning* or industry analysis. Lobbying is one activity that some organizations utilize to influence external opportunities and threats.

## 5. INTERNAL STRENGTHS AND WEAKNESSES

*Internal strengths* and *internal weaknesses* are an organization's controllable activities that are performed especially well or poorly.

They arise in the management, marketing, finance/accounting, production/operations, research and development, and management information systems activities of a business. Identifying and evaluating organizational strengths and weaknesses in the functional areas of a business is an essential strategic management activity. Organizations strive to pursue strategies that capitalize on internal strengths and eliminate internal weaknesses.

Strengths and weaknesses are determined relative to competitors. *Relative* deficiency or superiority is important information. Also, strengths and weaknesses can be determined by elements of being rather than performance. For example, strength may involve ownership of natural resources or a historic reputation for quality. Strengths and weaknesses may be determined relative to a firm's own objectives. For example, high levels of inventory turnover may not be strength to a firm that seeks never to stock-out.

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

## 6. LONG-TERM OBJECTIVES

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

## 7. STRATEGIES

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

## 8. ANNUAL OBJECTIVES

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

## 9. POLICIES

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

Policies are most often stated in terms of management, marketing, finance/accounting, production/operations, research and development, and computer information systems activities. Policies can be established at the corporate level and apply to an entire

organization at the divisional level and apply to a single division, or at the functional level and apply to particular operational activities or departments. Policies, like annual objectives, are especially important in strategy implementation because they outline an organization's expectations of its employees and managers.

Policies allow consistency and coordination within and between organizational departments.

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## 1.8 BENEFITS OF STRATEGIC MANAGEMENT

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Strategic management allows an organization to be more proactive than reactive in shaping its own future; it allows an organization to initiate and influence (rather than just respond to) activities—and thus to exert control over its own destiny.

Small business owners, chief executive officers, presidents, and managers of many for-profit and nonprofit organizations have recognized and realized the benefits of strategic management.

Historically, the principal benefit of strategic management has been to help organizations formulate better strategies through the use of a more systematic, logical, and rational approach to strategic choice. This certainly continues to be a major benefit of strategic management, but research studies now indicate that the process, rather than the decision or document, is the more important contribution of strategic management. *Communication is a key to successful strategic management.* Through involvement in the process, in other words, through dialogue and participation, managers and employees become committed to supporting the organization. Figure 1.7 illustrates this intrinsic benefit of a firm engaging in strategic planning. Note that all firms need all employees on a mission to help the firm succeed.

The manner in which strategic management is carried out is thus exceptionally important. A major aim of the process is to achieve the understanding of and commitment from all managers and employees. Understanding may be the most important benefit of strategic management, followed by commitment.

When managers and employees understand what the organization is doing and why, they often feel they are a part of the firm and become committed to assisting it. This is especially true when employees also understand linkages between their own compensation and organizational performance. Managers and employees become surprisingly creative and innovative when they understand and support the firm's mission, objectives, and strategies. A great benefit of strategic management, then, is the opportunity that the process provides to empower individuals. Empowerment is the act of strengthening employees' sense of effectiveness by encouraging them to participate in decision making and to exercise initiative and imagination, and rewarding them for doing so.

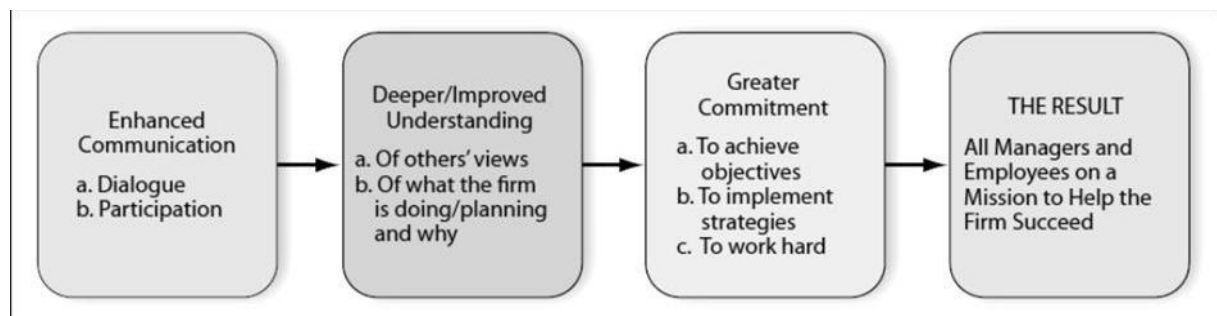


Figure 1.7: Benefits to a Firm That Does Strategic Planning

### 1.8.1 Financial Benefits

Research indicates that organizations using strategic-management concepts are more profitable and successful than those that do not. Businesses using strategic-management concepts show significant improvement in sales, profitability, and productivity compared to firms without systematic planning activities. High-performing firms tend to do systematic planning to prepare for future fluctuations in their external and internal environments.

Firms with planning systems more closely resembling strategic-management theory generally exhibit superior long-term financial performance relative to their industry.

High-performing firms seem to make more informed decisions with good anticipation of both short- and long-term consequences. In contrast, firms that perform poorly often engage in activities that are shortsighted and do not reflect good forecasting of future conditions.

Strategists of low-performing organizations are often preoccupied with solving internal problems and meeting paperwork deadlines. They typically underestimate their competitors' strengths and overestimate their own firm's strengths. They often attribute weak performance to uncontrollable factors such as a poor economy, technological change, or foreign competition.

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### 1.8.2 Nonfinancial Benefits

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Besides helping firms avoid financial demise, strategic management offers other tangible benefits, such as an enhanced awareness of external threats, an improved understanding of competitors' strategies, increased employee productivity, reduced resistance to change, and a clearer understanding of performance–reward relationships. Strategic management enhances the problem-prevention capabilities of organizations because it promotes interaction among managers at all divisional and functional levels. Firms that have nurtured their managers and employees, shared organizational objectives with them, empowered them to help improve the product or service, and recognized their contributions can turn to them for help in a pinch because of this interaction.

In addition to empowering managers and employees, strategic management often brings order and discipline to an otherwise floundering firm. It can be the beginning of an efficient and effective managerial system. Strategic management may renew confidence in the current business strategy or point to the need for corrective actions. The strategic-management process provides a basis for identifying and rationalizing the need for change to all managers and employees of a firm; it helps them view change as an opportunity rather than as a threat. Greenley stated that strategic management offers the following benefits:

- 👍 It allows for identification, prioritization, and exploitation of opportunities.
- 👍 It provides an objective view of management problems.
- 👍 It represents a framework for improved coordination and control of activities.
- 👍 It minimizes the effects of adverse conditions and changes.
- 👍 It allows major decisions to better support established objectives.
- 👍 It allows more effective allocation of time and resources to identified opportunities.

- 👍 It allows fewer resources and less time to be devoted to correcting erroneous or ad hoc decisions.
- 👍 It creates a framework for internal communication among personnel.
- 👍 It helps integrate the behavior of individuals into a total effort.
- 👍 It provides a basis for clarifying individual responsibilities.
- 👍 It encourages forward thinking.
- 👍 It provides a cooperative, integrated, and enthusiastic approach to tackling problems and opportunities.
- 👍 It encourages a favorable attitude toward change.
- 👍 It gives a degree of discipline and formality to the management of a business.

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## 1.9 PITFALLS IN STRATEGIC PLANNING

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Strategic planning is an involved, intricate, and complex process that takes an organization into uncharted territory. It does not provide a ready-to-use prescription for success; instead, it takes the organization through a journey and offers a framework for addressing questions and solving problems. Being aware of potential pitfalls and being prepared to address them is essential to success.

Some pitfalls to watch for and avoid in strategic planning are these:

- 👎 Using strategic planning to gain control over decisions and resources
- 👎 Doing strategic planning only to satisfy accreditation or regulatory requirements
- 👎 Too hastily moving from mission development to strategy formulation
- 👎 Failing to communicate the plan to employees, who continue working in the dark
- 👎 Top managers making many intuitive decisions that conflict with the formal plan
- 👎 Top managers not actively supporting the strategic-planning process
- 👎 Failing to use plans as a standard for measuring performance
- 👎 Delegating planning to a “planner” rather than involving all managers
- 👎 Failing to involve key employees in all phases of planning
- 👎 Failing to create a collaborative climate supportive of change

- ☞ Viewing planning as unnecessary or unimportant
- ☞ Becoming so engrossed in current problems that insufficient or no planning is done
- ☞ Being so formal in planning that flexibility and creativity are stifled

## 1.10 Guidelines for Effective Strategic Management

Failing to follow certain guidelines in conducting strategic management can foster criticisms of the process and create problems for the organization. Issues such as “Is strategic management in our firm a people process or a paper process?” should be addressed.

Strategic management must not become a self-perpetuating bureaucratic mechanism. Rather, it must be a self-reflective learning process that familiarizes managers and employees in the organization with key strategic issues and feasible alternatives for resolving those issues. Strategic management must not become ritualistic, stilted, orchestrated, or too formal, predictable, and rigid. Words supported by numbers, rather than numbers supported by words, should represent the medium for explaining strategic issues and organizational responses. A key role of strategists is to facilitate continuous organizational learning and change.

Table 1.2: Seventeen Guidelines for the Strategic-Planning Process to Be Effective

1. It should be a people process more than a paper process.
2. It should be a learning process for all managers and employees.
3. It should be words supported by numbers rather than numbers supported by words.
4. It should be simple and non routine.
5. It should vary assignments, team memberships, meeting formats, and even the planning calendar.
6. It should challenge the assumptions underlying the current corporate strategy.
7. It should welcome bad news.
8. It should welcome open-mindedness and a spirit of inquiry and learning.
9. It should not be a bureaucratic mechanism.
10. It should not become ritualistic, stilted, or orchestrated.
11. It should not be too formal, predictable, or rigid.

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12. It should not contain jargon or arcane planning language.
  13. It should not be a formal system for control.
  14. It should not disregard qualitative information.
  15. It should not be controlled by “technicians.”
  16. Do not pursue too many strategies at once.
  17. Continually strengthen the “good ethics is good business” policy.
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### 1.11 THE STRATEGIC MANAGEMENT PROCESS

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The strategic-management process can best be studied and applied using a model. Every model represents some kind of process. The framework illustrated in Figure 1.8 is a widely accepted, comprehensive model of the strategic-management process. This model does not guarantee success, but it does represent a clear and practical approach for formulating, implementing, and evaluating strategies. Relationships among major components of the strategic-management process are shown in the model, which appears in all subsequent chapters.

The four elements in the model are:

1. Environmental Scanning
2. Strategy Formulation
3. Strategy Implementation
4. Strategy Evaluation and Control

#### 1. ENVIRONMENTAL ANALYSIS

Environmental analysis is the process of gathering, monitoring, evaluating, and disseminating information from both the external and internal environments. The purpose of environmental analysis is to identify strengths; weaknesses, opportunities, and threats (SWOT) for the organisation which is used as inputs to develop strategies. The environmental analysis is covered in chapters three and four.

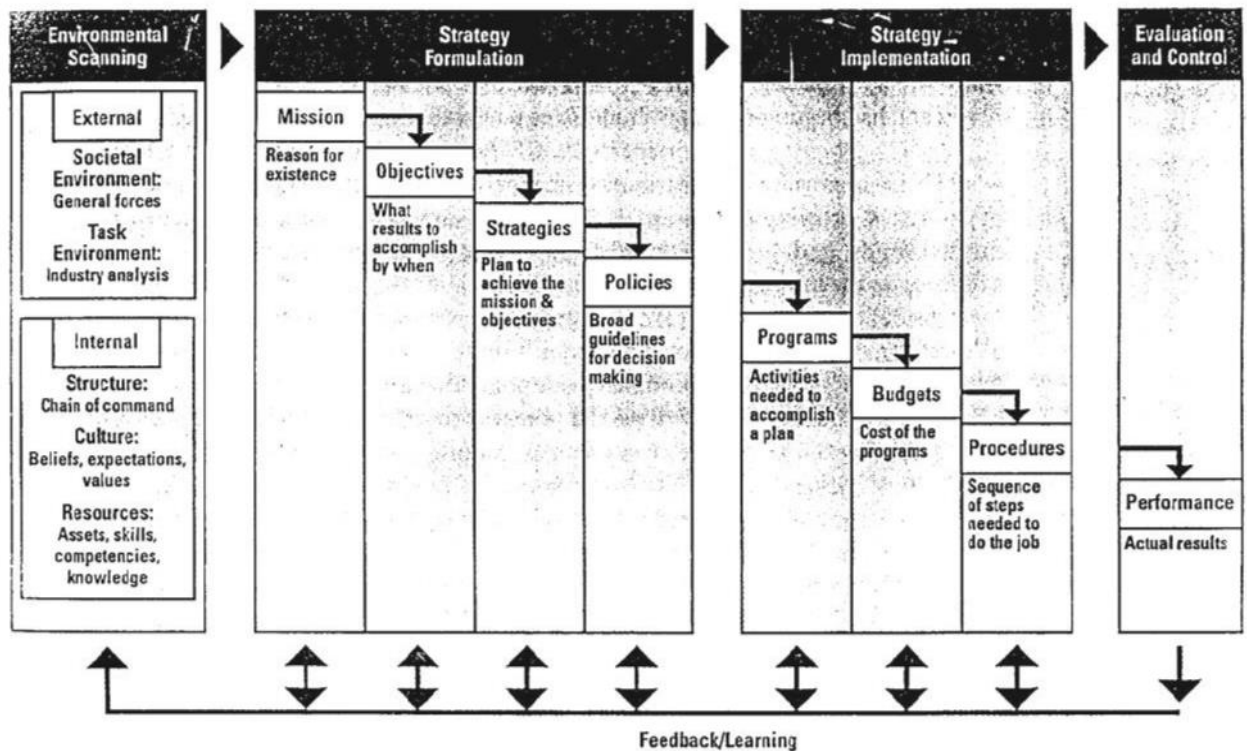


Figure 1.8: Basic elements of the strategic management process

## 2. STRATEGY FORMULATION

The strategy formulation component deals with the development of long – term strategic plans to effectively manage environmental opportunities and threats in view of company strengths and weaknesses. The strategy formulation component consists of vision, mission, objectives and development of strategies and selection of strategies.

## 3. STRATEGY IMPLEMENTATION

Strategy implementation involves the process of translating strategies into action through the development implementation activities (program, budget, procedures) and organizational capabilities (organizational structure, leadership, organizational culture, innovation and entrepreneurship). The strategy implementation element is covered in chapters seven, eight and nine.

#### 4. STRATEGY EVALUATION AND CONTROL

The activities undertaken by an organization and the performance results are reviewed during the strategy evaluation and control process. The actual performance results are compared with the planned objectives and corrective actions will be taken should there exist performance gap. Strategy evaluation and control is covered in chapter ten.



A colleague in your organization said that implementing strategic management process is a waste of time. After learning what the strategic management can offer to an organization, do you agree with his/ her opinion? Why?



## SUMMARY OF THE CHAPTER

-  In this module you have been given an overview of strategic management. The strategic management concept was first used during the warring period around 500 B.C. in ancient Greece and China.
-  Today there is no one standard definition of strategic management as it is defined in various ways based on the perspective of a particular author.
-  Nevertheless most authors agreed that the strategic management process consists of three major components; strategy formulation, strategy implementation and strategy evaluation and control.
-  The strategic management process takes place within four contextual components which are organization, management, environment and strategy.
-  The scope of strategic management is rather wide covering aspects such as competition, future orientation, and firm's resources. There are obvious benefits for firms, both small and big, that implant strategic management in their organizations.
-  key terms used in strategic management are; competitive advantage, strategists, vision and mission statements, external opportunities and threats, internal strengths and weaknesses, long-term objectives, strategies, annual objectives, and policies.
-  The benefits of strategic management practice are many. A few examples include enabling the organization to identify, prioritize, and exploit opportunities, representing a framework for improved co-ordination, control activities and minimizing the effects of adverse conditions and changes.
-  The four elements of strategy management process are strategy formulation consisting of vision, mission, objectives and development of strategies and selection of strategies, strategy implementation which involves the process of translating strategies into action, the activities undertaken by an organization; the performance results are reviewed during the strategy evaluation and control process and the environmental analysis is the process of gathering, monitoring, evaluating, and disseminating information from both the external and internal environments.



## CHAPTER REVIEW EXERCISES

1. One of the following answers is not a benefit of the strategic management process.
  - A. Allows major decisions to better support established objectives.
  - B. Allows more effective allocation of time and resources to identified opportunities.
  - C. Allows fewer resources and less time to be devoted to correcting erroneous or ad hoc decisions.
  - D. Establish annual objectives and short-term strategies that are in accord with the long-term objectives and strategies.
2. The role of the board of directors is to \_\_\_\_\_.
  - A. Act as role model.
  - B. Set goals that provide challenges for the employees.
  - C. Read strategic management journals.
  - D. Set corporate strategy, overall direction mission and vision
3. Identify an external component from the following items.
  - A. An employee
  - B. Managers
  - C. Competitor
  - D. Directors
4. Which of the following is not related to strategic management concept?
  - A. Internal capabilities
  - B. Organizational structure
  - C. Corporate strategy
  - D. Law of gravity
5. The highest level of strategy is \_\_\_\_\_.
  - A. operational strategy
  - B. business strategy
  - C. competitive strategy
  - D. corporate strategy
6. In implementing strategy, resources \_\_\_\_\_.
  - A. Will be transformed into intangible form.

- B. Will be committed over a short period of time.
  - C. Will be shared with competitors to reduce cost.
  - D. Will be committed in large amount.
7. Which of the following is not a responsibility of the board of directors?
- A. Setting corporate strategy, overall direction mission or vision.
  - B. Hiring and firing of Chief Executive Officer and top management.
  - C. Reviewing and approving the use of resources.
  - D. Reviewing and approving operational systems.
8. A local supermarket decides to reduce price on most of its grocery items in order to entice customers from going to nearby hypermarket. This statement refers to \_\_\_\_\_.
- A. corporate strategy
  - B. business strategy
  - C. functional strategy
  - D. operational strategy
9. A holding company sold one of its hotel subsidiaries. This action falls under which of the following strategy?
- A. Corporate strategy
  - B. Business strategy
  - C. Functional strategy
  - D. Operational strategy

## CHAPTER

## 2

## STRATEGIS IN ACTION

## LEARNING OUTCOMES

By the end of this topic, you should be able to:

- ⊕ Discuss the value of establishing long term objectives.
- ⊕ Identify 16 types of business strategies.
- ⊕ Discuss guidelines when particular strategies are most appropriate to pursue.
- ⊕ Discuss Porter's five generic strategies.
- ⊕ Discuss the Balanced Scorecard.
- ⊕ Compare and contrast financial with strategic objectives.
- ⊕ Discuss the levels of strategies in large versus small firms.
- ⊕ Explain the First Mover Advantages concept.
- ⊕ Discuss recent trends in outsourcing.
- ⊕ Discuss strategies for competing in turbulent, high-velocity markets.

*"Tomorrow always arrives. It is always different. And even the mightiest company is in trouble if it has not worked on the future. Being surprised by what happens is a risk that even the largest and richest company cannot afford, and even the smallest business need not run."*

*Peter Drucker*

## INTRODUCTION

Dear learners, Hundreds of companies today have embraced strategic planning fully in their quest for higher revenues and profits. Kent Nelson, former chair of UPS, explains why his company has created a new strategic planning department:

“Because we’re making bigger bets on investments in technology, we can’t afford to spend a whole lot of money in one direction and then find out five years later it was the wrong direction.”

This chapter brings strategic management to life with many contemporary examples. Sixteen types of strategies are defined and exemplified, including Michael Porter’s generic strategies: cost leadership, differentiation, and focus. Guidelines are presented for determining when it is most appropriate to pursue different types of strategies. An overview of strategic management in nonprofit organizations, governmental agencies, and small firms is provided.



Dear learners, from what you have learnt in chapter one, what are objectives and what does the term long-term in long-term objectives imply?

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### 2.1 LONG - TERM OBJECTIVES

Long-term objectives represent the results expected from pursuing certain strategies. Strategies represent the actions to be taken to accomplish long-term objectives. The time frame for objectives and strategies should be consistent, usually from two to five years.

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### 2.1.1 THE NATURE OF LONG-TERM OBJECTIVES

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Objectives should be quantitative, measurable, realistic, understandable, challenging, hierarchical, obtainable, and congruent among organizational units. Each objective should also be associated with a timeline. Objectives are commonly stated in terms such as growth in assets, growth in sales, profitability, market share, degree and nature of diversification, degree and nature of vertical integration, earnings per share, and social responsibility. Clearly established objectives offer many benefits. They provide direction, allow synergy, aid in evaluation, establish priorities, reduce uncertainty, minimize conflicts, stimulate exertion, and aid in both the allocation of resources and the design of jobs. Objectives provide a basis for consistent decision making by managers whose values and attitudes differ. Objectives serve as standards by which individuals, groups, departments, divisions, and entire organizations can be evaluated.

Long-term objectives are needed at the corporate, divisional, and functional levels of an organization. They are an important measure of managerial performance. Many practitioners and academicians attribute a significant part of U.S. industry's competitive decline to the short-term, rather than long-term, strategy orientation of managers in the United States. Arthur D. Little argues that bonuses or merit pay for managers today must be based to a greater extent on long-term objectives and strategies. A general framework for relating objectives to performance evaluation is provided in Table 2.1. A particular organization could tailor these guidelines to meet its own needs, but incentives should be attached to both long-term and annual objectives.

Without long-term objectives, an organization would drift aimlessly toward some unknown end. It is hard to imagine an organization or individual being successful without clear objectives. Success only rarely occurs by accident; rather, it is the result of hard work directed toward achieving certain objectives.

Table 2.1: Varying Performance Measures by Organizational Level

| Organization level | Basis for Annual Bonus or Merit Pay                                 |
|--------------------|---------------------------------------------------------------------|
| <b>Corporate</b>   | 75% based on long-term objectives<br>25% based on annual objectives |
| <b>Division</b>    | 50% based on long-term objectives<br>50% based on annual objectives |
| <b>Function</b>    | 25% based on long-term objectives<br>75% based on annual objectives |

### 2.1.2 THE DESIRED CHARACTERISTICS OF OBJECTIVES

- |                   |                                 |
|-------------------|---------------------------------|
| 1. Quantitative   | 5. Challenging                  |
| 2. Measurable     | 6. Hierarchical                 |
| 3. Realistic      | 7. Obtainable                   |
| 4. Understandable | 8. Congruent across departments |

### 2.1.3 THE BENEFITS OF HAVING CLEAR OBJECTIVES

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

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#### 2.1.4 FINANCIAL VERSUS STRATEGIC OBJECTIVES

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Two types of objectives are especially common in organizations: financial and strategic objectives. Financial objectives include those associated with growth in revenues, growth in earnings, higher dividends, larger profit margins, greater return on investment, higher earnings per share, a rising stock price, improved cash flow, and so on; while strategic objectives include things such as a larger market share, quicker on-time delivery than rivals, shorter design-to-market times than rivals, lower costs than rivals, achieving technological leadership, consistently getting new or improved products to market ahead of rivals, and so on.

Although financial objectives are especially important in firms, oftentimes there is a trade-off between financial and strategic objectives such as that crucial decisions have to be made. For example, a firm can do certain things to maximize short-term financial objectives that would harm long-term strategic objectives.

To improve financial position in the short run through higher prices may, for example, jeopardize long-term market share. The dangers associated with trading off long-term strategic objectives with near-term bottom-line performance are especially severe if competitors relentlessly pursue increased market share at the expense of short-term profitability. And there are other trade-offs between financial and strategic objectives, related to riskiness of actions, concern for business ethics need to preserve the natural environment, and social responsibility issues. Both financial and strategic objectives should include both annual and long-term performance targets. Ultimately, the best way to sustain competitive advantage over the long run is to relentlessly pursue strategic objectives that strengthen a firm's business position over rivals. Financial objectives can best be met by focusing first and foremost on achievement of strategic objectives that improve a firm's competitiveness and market strength.

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## 2.2 THE BALANCED SCORECARD

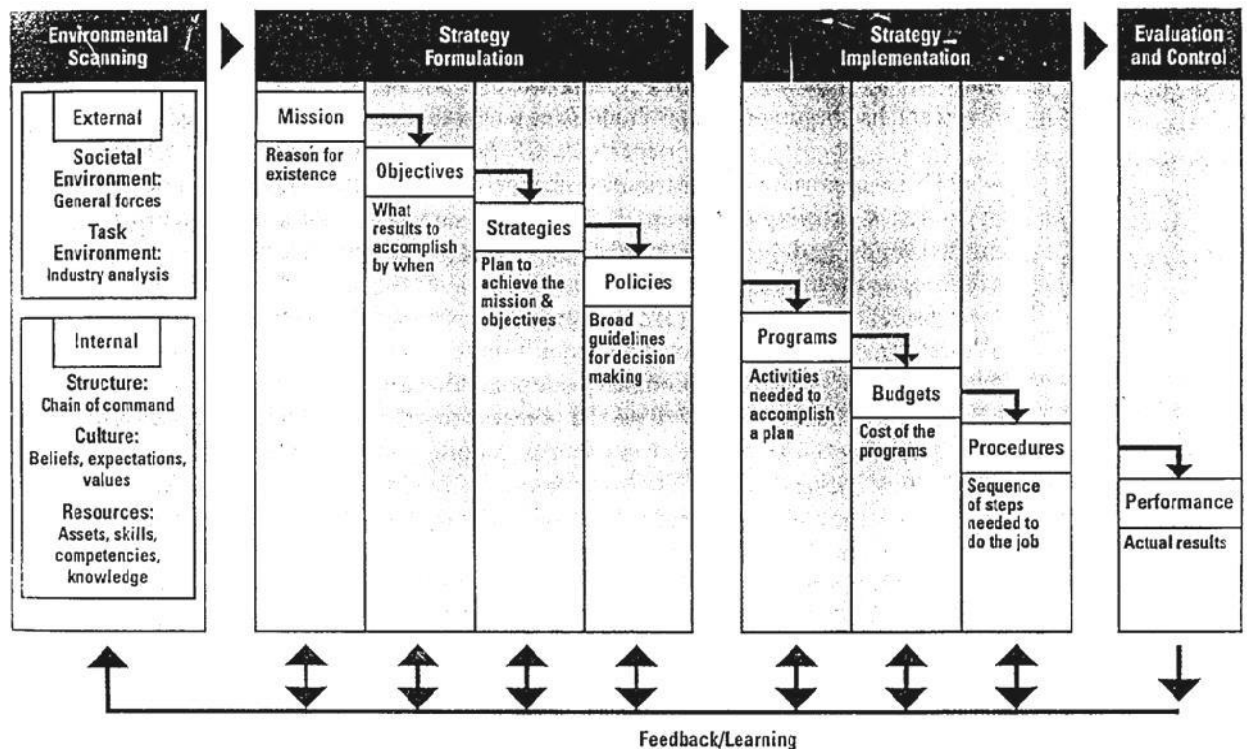
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Developed in 1993 by Harvard Business School professors Robert Kaplan and David Norton, and refined continually through today, the Balanced Scorecard is a strategy evaluation and control technique. *Balanced Scorecard* derives its name from the perceived need of firms to “balance” financial measures that are oftentimes used exclusively in strategy evaluation and control with nonfinancial measures such as product quality and customer service.

An effective Balanced Scorecard contains a carefully chosen combination of strategic and financial objectives tailored to the company’s business. For example, 3M Corporation has a financial objective to achieve annual growth in earnings per share of 10 percent or better, as well as a strategic objective to have at least 30 percent of sales come from products introduced in the past four years. The overall aim of the Balanced Scorecard is to “balance” shareholder objectives with customer and operational objectives. Obviously, these sets of objectives interrelate and many even conflict. For example, customers want low price and high service, which may conflict with shareholders’ desire for a high return on their investment. The Balanced Scorecard concept is consistent with the notions of continuous improvement in management (CIM) and total quality management (TQM).

Note here that firms should establish objectives and evaluate strategies on items other than financial measures. This is the basic tenet of the Balanced Scorecard. Financial measures and ratios are vitally important. However, of equal importance are factors such as customer service, employee morale, product quality, pollution abatement, business ethics, social responsibility, community involvement, and other such items. In conjunction with financial measures, these “softer” factors comprise an integral part of both the objective-setting process and the strategy-evaluation process. These factors can vary by organization, but such items, along with financial measures, comprise the essence of a Balanced Scorecard. A Balanced Scorecard for a firm is simply a listing of all key objectives to work toward, along with an associated time dimension of when each objective is to be accomplished, as well as a primary responsibility or contact person, department, or division for each objective.

Figure 2.1: A Comprehensive Strategic-Management Model



## 2.3 TYPES OF STRATEGIES

The model illustrated in Figure 2.1 provides a conceptual basis for applying strategic management. Defined and exemplified in Table 2.2, alternative strategies that an enterprise could pursue can be categorized into 11 actions:

1. Forward integration
2. Backward integration
3. Horizontal integration
4. Market penetration
5. Market development
6. Product development
7. Related diversification
8. Unrelated diversification
9. Retrenchment
10. Divestiture, and
11. Liquidation

Each alternative strategy has countless variations. For example, market penetration can include adding salespersons, increasing advertising expenditures, couponing, and using similar actions to increase market share in a given geographic area.

Many, if not most, organizations simultaneously pursue a combination of two or more strategies, but a combination strategy can be exceptionally risky if carried too far. No organization can afford to pursue all the strategies that might benefit the firm. Difficult decisions must be made. Priority must be established. Organizations, like individuals, have limited resources. Both organizations and individuals must choose among alternative strategies and avoid excessive indebtedness.

Hansen and Smith explain that strategic planning involves “choices that risk resources” and “trade-offs that sacrifice opportunity.” In other words, if you have a strategy to go north, then you must buy snowshoes and warm jackets (spend resources) and forgo the opportunity of “faster population growth in southern states.” You cannot have a strategy to go north and then take a step east, south, or west “just to be on the safe side.” Firms spend resources and focus on a finite number of opportunities in pursuing strategies to achieve an uncertain outcome in the future. Strategic planning is much more than a roll of the dice; it is a wager based on predictions and hypotheses that are continually tested and refined by knowledge, research, experience, and learning. Survival of the firm itself may hinge on your strategic plan.

Organizations cannot do too many things well because resources and talents get spread thin and competitors gain advantage. In large diversified companies, a combination strategy is commonly employed when different divisions pursue different strategies. Also, organizations struggling to survive may simultaneously employ a combination of several defensive strategies, such as divestiture, liquidation, and retrenchment.

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### 2.3.1 LEVELS OF STRATEGIES

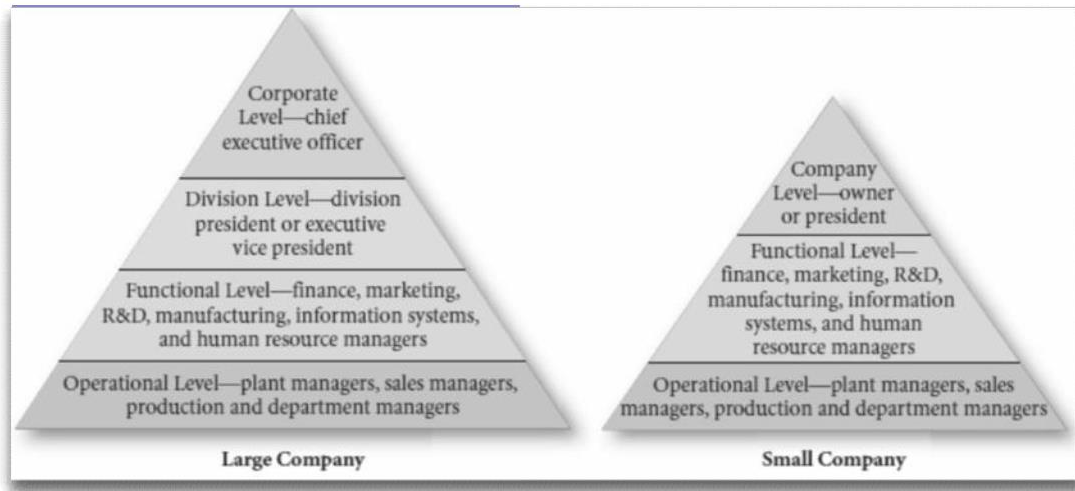
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Strategy making is not just a task for top executives. Middle and lower-level managers too must be involved in the strategic-planning process to the extent possible. In large firms, there are actually four levels of strategies: corporate, divisional, functional, and operational—as illustrated in Figure 2.2. However, in small firms, there are actually three levels of strategies: company, functional, and operational.

In large firms, the persons primarily responsible for having effective strategies at the various levels include the CEO at the corporate level; the president or executive vice president at the divisional level; the respective chief finance officer (CFO), chief information officer (CIO), human resource manager (HRM), chief marketing officer (CMO), and so on, at the functional level; and the plant manager, regional sales manager, and so on, at the operational level. In small firms, the persons primarily responsible for having effective strategies at the various levels include the business owner or president at the company level and then the same range of persons at the lower two levels, as with a large firm.

It is important to note that all persons responsible for strategic planning at the various levels ideally participate and understand the strategies at the other organizational levels to help ensure coordination, facilitation, and commitment while avoiding inconsistency, inefficiency, and miscommunication. Plant managers, for example, need to understand and be supportive of the overall corporate strategic plan (game plan) while the president and the CEO need to be knowledgeable of strategies being employed in various sales territories and manufacturing plants.

Figure 2.2: Levels of Strategies with Persons Most Responsible



## 2.4 INTEGRATION STRATEGIES

Forward integration, backward integration, and horizontal integration are sometimes collectively referred to as vertical integration strategies. Vertical integration strategies allow a firm to gain control over distributors, suppliers, and/or competitors.

### 2.4.1 FORWARD INTEGRATION

*Forward integration* involves gaining ownership or increased control over distributors or retailers. Increasing numbers of manufacturers (suppliers) today are pursuing a forward integration strategy by establishing Web sites to directly sell products to consumers. This strategy is causing turmoil in some industries. For example, Microsoft is opening its own retail stores, a forward integration strategy similar to rival Apple Inc., which currently has more than 200 stores around the world. Microsoft wants to learn firsthand about what consumers want and how they buy.

An effective means of implementing forward integration is franchising. Approximately 2,000 companies in about 50 different industries in the United States use franchising to distribute their products or services. Businesses can expand rapidly by franchising because costs and opportunities are spread among many individuals.

**The following six guidelines indicate when forward integration may be an especially effective Strategy:**

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

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#### 2.4.2 BACKWARD INTEGRATION

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

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

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

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### 2.4.3 HORIZONTAL INTEGRATION

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*Horizontal integration* refers to a strategy of seeking ownership of or increased control over a firm's competitors. One of the most significant trends in strategic management today is the increased use of horizontal integration as a growth strategy. Mergers, acquisitions, and takeovers among competitors allow for increased economies of scale and enhanced transfer of resources and competencies. Kenneth Davidson makes the following observation about horizontal integration:

The trend towards horizontal integration seems to reflect strategists' misgivings about their ability to operate many unrelated businesses. Mergers between direct competitors are more likely to create efficiencies than mergers between unrelated businesses, both because there is a greater potential for eliminating duplicate facilities and because the management of the acquiring firm is more likely to understand the business of the target.

**These five guidelines indicate when horizontal integration may be an especially effective strategy:**

- ❏ When an organization can gain monopolistic characteristics in a particular area or region without being challenged by the federal government for “tending substantially” to reduce competition.
- ❏ When an organization competes in a growing industry.
- ❏ When increased economies of scale provide major competitive advantages.
- ❏ When an organization has both the capital and human talent needed to successfully manage an expanded organization.
- ❏ When competitors are faltering due to a lack of managerial expertise or a need for particular resources that an organization possesses; note that horizontal integration would not be appropriate if competitors are doing poorly, because in that case overall industry sales are declining.

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## 2.5 INTENSIVE STRATEGIES

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

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### 2.5.1 MARKET PENETRATION

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A market penetration strategy seeks to increase market share for present products or services in present markets through greater marketing efforts. This strategy is widely used alone and in combination with other strategies. Market penetration includes increasing the number of salespersons, increasing advertising expenditures, offering extensive sales promotion items, or increasing publicity efforts. As indicated in Table 5-4, Coke in 2009/2010 spent millions on its new advertising slogan, “Open Happiness,” which replaced “The Coke Side of Life.”

**These five guidelines indicate when market penetration may be an especially effective strategy:**

- ❏ When current markets are not saturated with a particular product or service.
- ❏ When the usage rate of present customers could be increased significantly.
- ❏ When the market shares of major competitors have been declining while total industry sales have been increasing.
- ❏ When the correlation between dollar sales and dollar marketing expenditures historically has been high.
- ❏ When increased economies of scale provide major competitive advantages.

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### 2.5.2 MARKET DEVELOPMENT

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*Market development* involves introducing present products or services into new geographic areas. For example, Retailers such as Wal-Mart Stores, Carrefour SA, and Tesco PLC are expanding further into China in 2009/2010 even in a world of slumping sales. Tesco is opening fewer stores in Britain to divert capital expenditures to China.

**These six guidelines indicate when market development may be an especially effective strategy:**

- ❑ When new channels of distribution are available that are reliable, inexpensive, and of good quality.
- ❑ When an organization is very successful at what it does.
- ❑ When new untapped or unsaturated markets exist.
- ❑ When an organization has the needed capital and human resources to manage expanded operations.
- ❑ When an organization has excess production capacity.
- ❑ When an organization's basic industry is rapidly becoming global in scope.

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### 2.5.3 PRODUCT DEVELOPMENT

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

**These five guidelines indicate when product development may be an especially effective strategy to pursue:**

- ❑ When an organization has successful products that are in the maturity stage of the product life cycle; the idea here is to attract satisfied customers to try new (improved) products as a result of their positive experience with the organization's present products or services.
- ❑ When an organization competes in an industry that is characterized by rapid technological developments.
- ❑ When major competitors offer better-quality products at comparable prices.
- ❑ When an organization competes in a high-growth industry.
- ❑ When an organization has especially strong research and development capabilities.

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## 2.6 DIVERSIFICATION STRATEGIES

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There are two general types of *diversification strategies*: related and unrelated. Businesses are said to be *related* when their value chains possess competitively valuable cross-business strategic fits; businesses are said to be *unrelated* when their value chains are so dissimilar that no competitively valuable cross-business relationships exist. Most companies favor related diversification strategies in order to capitalize on synergies as follows:

- ❏ Transferring competitively valuable expertise, technological know-how, or other capabilities from one business to another.
- ❏ Combining the related activities of separate businesses into a single operation to achieve lower costs.
- ❏ Exploiting common use of a well-known brand name.
- ❏ Cross-business collaboration to create competitively valuable resource strengths and capabilities.

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### 2.6.1 RELATED DIVERSIFICATION

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Businesses are said to be related when their value chains possess competitively valuable cross-business strategic fits. Related diversification strategies enable businesses to capitalize on synergies such as:

- \* Transferring competitively valuable expertise,
- \* Combining the related activities of separate businesses into a single operation to achieve lower costs,
- \* Exploiting common use of a well-known brand name, and
- \* Collaborating across businesses to create valuable resource strengths and capacities.

**Six guidelines for when related diversification may be effective are identified below:**

- ❏ When an organization competes in a no-growth or slow growth industry.
- ❏ When adding new, but related products would enhance sales of current products.
- ❏ When new, but related products could be offered at competitive prices.
- ❏ When new, but related products have seasonal sales levels that counterbalance existing peaks and valleys.
- ❏ When an organization's products are in the decline stage of the life cycle.
- ❏ When an organization has a strong management team.

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### 2.6.2 UNRELATED DIVERSIFICATION

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Businesses are said to be unrelated when their value chains are so dissimilar that no competitively valuable cross-business relationships exist. An unrelated diversification strategy favors capitalizing upon a portfolio of businesses that are capable of delivering excellent financial performance in their respective industries.

**Ten guidelines for when unrelated diversification may be effective are identified below:**

- ❏ When revenues derived from an organization's current products or services would increase significantly by adding the new, unrelated products.
- ❏ When an organization competes in a highly competitive and/or no-growth industry.
- ❏ When an organization's present channels of distribution can be used to market the new products to current customers.
- ❏ When the new products have countercyclical sales patterns compared to an organization's present products.
- ❏ When an organization's basic industry is experiencing declining annual sales and profits.
- ❏ When an organization has the capital and managerial talent needed to compete.
- ❏ When an organization has the opportunity to purchase an unrelated business that is an attractive investment.

- ❏ When financial synergy exists between the acquired and acquiring firms.
- ❏ When existing markets for an organization's present products are saturated.
- ❏ When antitrust action could be charged against an organization that historically has concentrated on a single industry.

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## 2.7 DEFENSIVE STRATEGIES

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In addition to integrative, intensive, and diversification strategies, organizations also could pursue retrenchment, divestiture, or liquidation.

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### 2.7.1 RETRENCHMENT

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*Retrenchment* occurs when an organization regroups through cost and asset reduction to reverse declining sales and profits. Sometimes called a *turnaround* or *reorganizational strategy*, retrenchment is designed to fortify an organization's basic distinctive competence. During retrenchment, strategists work with limited resources and face pressure from shareholders, employees, and the media. Retrenchment can entail selling off land and buildings to raise needed cash, pruning product lines, closing marginal businesses, closing obsolete factories, automating processes, reducing the number of employees, and instituting expense control systems.

**Five guidelines identify when retrenchment may be an especially effective strategy to pursue:**

- ❏ When an organization has a clearly distinctive competence but has failed to meet objectives consistently.
- ❏ When an organization is one of the weaker competitors in a given industry.
- ❏ When an organization is plagued by inefficiency, low profitability, poor employee morale, and pressure from stockholders to improve performance.

- ❏ When an organization has failed to capitalize on external opportunities, minimize external threats, take advantage of internal strengths, and overcome internal weaknesses over time.
- ❏ When an organization has grown so large so quickly that major internal reorganization is needed.

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### 2.7.2 DIVESTITURE

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Selling a division or part of an organization is called *divestiture*. Divestiture often is used to raise capital for further strategic acquisitions or investments. Divestiture can be part of an overall retrenchment strategy to rid an organization of businesses that are unprofitable, that require too much capital, or that do not fit well with the firm's other activities. Divestiture has also become a popular strategy for firms to focus on their core businesses and become less diversified.

**Six guidelines for when to use divestiture:**

- ❏ When an organization has pursued a retrenchment strategy and it failed to accomplish needed improvement.
- ❏ When a division needs more resources to be competitive than the company can provide.
- ❏ When a division is responsible for an organization's overall poor performance.
- ❏ When a division is a misfit with the rest of an organization.
- ❏ When a large amount of cash is needed quickly and cannot be obtained.
- ❏ When government antitrust action threatens an organization.

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### 2.7.3 LIQUIDATION

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Selling all of a company's assets, in parts, for their tangible worth is called *liquidation*. Liquidation is a recognition of defeat and consequently can be an emotionally difficult strategy. However, it may be better to cease operating than to continue losing large sums of money.

**Three guidelines of when to use liquidation:**

- ❌ When an organization has pursued both a retrenchment and a divestiture strategy and neither has been successful.
- ❌ When an organization's only alternative is bankruptcy.
- ❌ When the stockholders of a firm can minimize their losses by selling assets.

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## 2.8 PORTER'S COMPETITIVE STRATEGIES

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According to Porter, strategies allow organizations to gain competitive advantage from three different bases: cost leadership, differentiation, and focus. Porter calls these *generic strategies*.

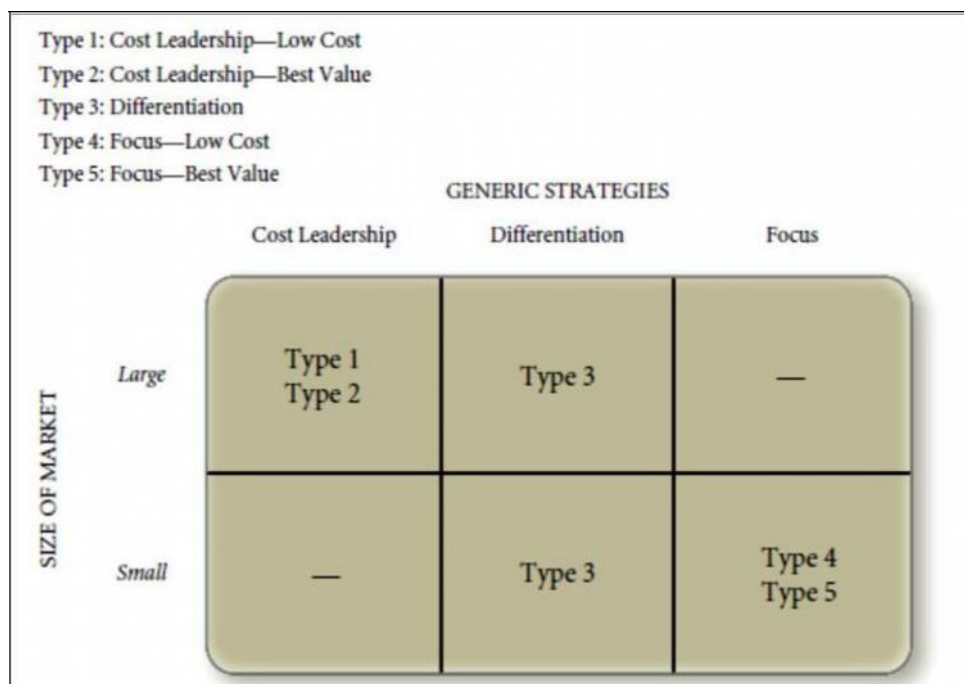


Figure 2.3: Michael Porter's Five Generic Strategies

Cost leadership emphasizes producing standardized products at a very low per-unit cost for consumers who are price-sensitive. Two alternative types of cost leadership strategies can be defined. Type 1 is a low-cost strategy that offers products or services to a wide range of customers at the lowest price available on the market. Type 2 is a best-value strategy that offers products or services to a wide range of customers at the best price-value available on the market; the best-value strategy aims to offer customers a range of products or services at the lowest price available compared to a rival's products with similar attributes. Both Type 1 and Type 2 strategies target a large market.

Porter's Type 3 generic strategy is differentiation, a strategy aimed at producing products and services considered unique industry wide and directed at consumers who are relatively price-insensitive.

**Focus** means producing products and services that fulfill the needs of small groups of consumers. Two alternative types of focus strategies are Type 4 and Type 5. Type 4 is a **low-cost focus** strategy that offers products or services to a small range (niche group) of customers at the lowest price available on the market. Examples of firms that use the Type 4 strategy include Jiffy Lube International and Pizza Hut, as well as local used car dealers and hot dog restaurants. Type 5 is a **best-value focus** strategy that offers products or services to a small range of customers at the best price-value available on the market. Sometimes called "focused differentiation," the best-value focus strategy aims to offer a niche group of customers products or services that meet their tastes and requirements better than rivals' products do. Both Type 4 and Type 5 focus strategies target a small market. However, the difference is that Type 4 strategies offer products services to a niche group at the lowest price, whereas Type 5 offers products/services to a niche group at higher prices but loaded with features so the offerings are perceived as the best value.

Porter's five strategies imply different organizational arrangements, control procedures, and incentive systems. Larger firms with greater access to resources typically compete on a cost leadership and/or differentiation basis, whereas smaller firms often compete on a focus basis. Note that a differentiation strategy (Type 3) can be pursued with either a small target market or a large target market. However, it is not effective to pursue a cost leadership strategy in a small market because profit margins are generally too small. Likewise, it is not effective to pursue a focus strategy in a large market because economies of scale would generally favor a low-cost or best-value cost leadership strategy to gain and/or sustain competitive advantage.

Porter stresses the need for strategists to perform cost-benefit analyses to evaluate "sharing opportunities" among a firm's existing and potential business units. Sharing activities and resources enhances competitive advantage by lowering costs or increasing differentiation. In addition to prompting sharing, Porter stresses the need for firms to effectively "transfer" skills and expertise among autonomous business units to gain competitive advantage. Depending on factors such as type of industry, size of firm, and nature of competition, various strategies could yield advantages in cost leadership, differentiation, and focus.

### ☞ Cost Leadership Strategies (Type 1 and Type 2)

A primary reason for pursuing forward, backward and horizontal integration strategies is to gain low-cost or best-value cost leadership benefits. But cost leadership generally must be pursued in conjunction with differentiation. A number of cost elements affect the relative attractiveness of generic strategies, including economies or diseconomies of scale achieved, learning and experience curve effects, the percentage of capacity utilization achieved, and linkages with suppliers and distributors. Other cost elements to consider in choosing among alternative strategies include the potential for sharing costs and knowledge within the organization, R&D costs associated with new product development or modification of existing products, labor costs, tax rates, energy costs, and shipping costs.

Striving to be the low-cost producer in an industry can be especially effective when the market is composed of many price-sensitive buyers, when there are few ways to achieve product differentiation, when buyers do not care much about differences from brand to brand, or when there are a large number of buyers with significant bargaining power. The basic idea is to under price competitors and thereby gain market share and sales, entirely driving some competitors out of the market. Companies employing a low-cost (Type 1) or best-value (Type 2) cost leadership strategy must achieve their competitive advantage in ways that are difficult for competitors to copy or match. If rivals find it relatively easy or inexpensive to imitate the leader's cost leadership methods, the leaders' advantage will not last long enough to yield a valuable edge in the marketplace. Recall that for a resource to be valuable, it must be either rare, hard to imitate, or not easily substitutable. To employ a cost leadership strategy successfully, a firm must ensure that its total costs across its overall value chain are lower than competitors' total costs. There are two ways to accomplish this:

1. Perform value chain activities more efficiently than rivals and control the factors that drive the costs of value chain activities. Such activities could include altering the plant layout, mastering newly introduced technologies, using common parts or components in different products, simplifying product design, finding ways to operate close to full capacity year-round, and so on.
2. Revamp the firm's overall value chain to eliminate or bypass some cost-producing activities. Such activities could include securing new suppliers or distributors, selling products online, relocating manufacturing facilities, avoiding the use of union labor, and so on.

When employing a cost leadership strategy, a firm must be careful not to use such aggressive price cuts that their own profits are low or nonexistent. Constantly be mindful of cost-saving technological breakthroughs or any other value chain advancements that could erode or destroy the firm's competitive advantage. A Type 1 or Type 2 cost leadership strategy can be especially effective under the following conditions:

1. When price competition among rival sellers is especially vigorous.
2. When the products of rival sellers are essentially identical and supplies are readily available from any of several eager sellers.
3. When there are few ways to achieve product differentiation that have value to buyers.
4. When most buyers use the product in the same ways.
5. When buyers incur low costs in switching their purchases from one seller to another.
6. When buyers are large and have significant power to bargain down prices.
7. When industry newcomers use introductory low prices to attract buyers and build a customer base.

A successful cost leadership strategy usually permeates the entire firm, as evidenced by high efficiency, low overhead, limited perks, intolerance of waste, intensive screening of budget requests, wide spans of control, rewards linked to cost containment, and broad employee participation in cost control efforts. Some risks of pursuing cost leadership are that competitors may imitate the strategy, thus driving overall industry profits down; that technological breakthroughs in the industry may make the strategy ineffective; or that buyer interest may swing to other differentiating features besides price.

### ☞ Differentiation Strategies (Type 3)

Different strategies offer different degrees of differentiation. Differentiation does not guarantee competitive advantage, especially if standard products sufficiently meet customer needs or if rapid imitation by competitors is possible. Durable products protected by barriers to quick copying by competitors are best. Successful differentiation can mean greater product flexibility, greater compatibility, lower costs, improved service, less maintenance, greater convenience, or more features. Product development is an example of a strategy that offers the advantages of differentiation.

A differentiation strategy should be pursued only after a careful study of buyers' needs and preferences to determine the feasibility of incorporating one or more differentiating features into a unique product that features the desired attributes.

A successful differentiation strategy allows a firm to charge a higher price for its product and to gain customer loyalty because consumers may become strongly attached to the differentiation features. Special features that differentiate one's product can include superior service, spare parts availability, engineering design, product performance, useful life, gas mileage, or ease of use.

A risk of pursuing a differentiation strategy is that the unique product may not be valued highly enough by customers to justify the higher price. When this happens, a cost leadership strategy easily will defeat a differentiation strategy. Another risk of pursuing a differentiation strategy is that competitors may quickly develop ways to copy the differentiating features. Firms thus must find durable sources of uniqueness that cannot be imitated quickly or cheaply by rival firms.

Common organizational requirements for a successful differentiation strategy include strong coordination among the R&D and marketing functions and substantial amenities to attract scientists and creative people. Firms can pursue a differentiation (Type 3) strategy based on many different competitive aspects.

Differentiation opportunities exist or can potentially be developed anywhere along the firm's value chain, including supply chain activities, product R&D activities, production and technological activities, manufacturing activities, human resource management activities, distribution activities, or marketing activities.

The most effective differentiation bases are those that are hard or expensive for rivals to duplicate. Competitors are continually trying to imitate, duplicate, and outperform rivals along any differentiation variable that has yielded competitive advantage.

To the extent that differentiating attributes are tough for rivals to copy, a differentiation strategy will be especially effective, but the sources of uniqueness must be time-consuming, cost prohibitive, and simply too burdensome for rivals to match. A firm, therefore, must be careful when employing a differentiation (Type 3) strategy. Buyers will not pay the higher

differentiation price unless their perceived value exceeds the price they are paying.<sup>23</sup> Based on such matters as attractive packaging, extensive advertising, quality of sales presentations, quality of Web site, list of customers, professionalism, size of the firm, and/or profitability of the company, perceived value may be more important to customers than actual value. A Type 3 differentiation strategy can be especially effective under the following conditions:

1. When there are many ways to differentiate the product or service and many buyers perceive these differences as having value.
2. When buyer needs and uses are diverse.
3. When few rival firms are following a similar differentiation approach.
4. When technological change is fast paced and competition revolves around rapidly evolving product features.

#### ☞ Focus Strategies (Type 4 and Type 5)

A successful focus strategy depends on an industry segment that is of sufficient size, has good growth potential, and is not crucial to the success of other major competitors. Strategies such as market penetration and market development offer substantial focusing advantages. Midsize and large firms can effectively pursue focus-based strategies only in conjunction with differentiation or cost leadership-based strategies. All firms in essence follow a differentiated strategy. Because only one firm can differentiate itself with the lowest cost, the remaining firms in the industry must find other ways to differentiate their products.

Focus strategies are most effective when consumers have distinctive preferences or requirements and when rival firms are not attempting to specialize in the same target segment.

Risks of pursuing a focus strategy include the possibility that numerous competitors will recognize the successful focus strategy and copy it or that consumer preferences will drift toward the product attributes desired by the market as a whole. An organization using a focus strategy may concentrate on a particular group of customers, geographic markets, or on particular product-line segments to serve a well-defined but narrow market better than competitors who serve a broader market.

A low-cost (Type 4) or best-value (Type 5) focus strategy can be especially attractive under the following conditions:

1. When the target market niche is large, profitable, and growing.
2. When industry leaders do not consider the niche to be crucial to their own success.
3. When industry leaders consider it too costly or difficult to meet the specialized needs of the target market niche while taking care of their mainstream customers.
4. When the industry has many different niches and segments, thereby allowing a focuser to pick a competitively attractive niche suited to its own resources.
5. When few, if any, other rivals are attempting to specialize in the same target segment.

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## 2.9 MEANS FOR ACHIEVING STRATEGIES

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### 2.9.1 COOPERATION AMONG COMPETITORS

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Strategies that stress cooperation among competitors are being used more. For collaboration between competitors to succeed, both firms must contribute something distinctive, such as technology, distribution, basic research, or manufacturing capacity. But a major risk is that unintended transfers of important skills or technology may occur at organizational levels below where the deal was signed. Information not covered in the formal agreement often gets traded in the day-to-day interactions and dealings of engineers, marketers, and product developers. Firms often give away too much information to rival firms when operating under cooperative agreements! Tighter formal agreements are needed.

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### 2.9.2 JOINT VENTURE/PARTNERING

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Joint venture is a popular strategy that occurs when two or more companies form a temporary partnership or consortium for the purpose of capitalizing on some opportunity. Often, the two or more sponsoring firms form a separate organization and have shared equity ownership in the new entity. Other types of cooperative arrangements include research and development

partnerships, cross-distribution agreements, cross-licensing agreements, cross-manufacturing agreements, and joint-bidding consortia.

Joint ventures and cooperative arrangements are being used increasingly because they allow companies to improve communications and networking, to globalize operations, and to minimize risk. Joint ventures and partnerships are often used to pursue an opportunity that is too complex, uneconomical, or risky for a single firm to pursue alone. Such business creations also are used when achieving and sustaining competitive advantage when an industry requires a broader range of competencies and know-how than any one firm can marshal.

**A few common problems that cause joint ventures to fail are as follows:**

1. Managers who must collaborate daily in operating the venture are not involved in forming or shaping the venture.
2. The venture may benefit the partnering companies but may not benefit customers, who then complain about poorer service or criticize the companies in other ways.
3. The venture may not be supported equally by both partners. If supported unequally, problems arise.
4. The venture may begin to compete more with one of the partners than the other.

**Six guidelines for when a joint venture may be an especially effective means for pursuing strategies are:**

- ❏ When a privately owned organization is forming a joint venture with a publicly owned organization; there are some advantages to being privately held, such as closed ownership; there are some advantages of being publicly held, such as access to stock issuances as a source of capital. Sometimes, the unique advantages of being privately and publicly held can be synergistically combined in a joint venture.

- ✎ When a domestic organization is forming a joint venture with a foreign company; a joint venture can provide a domestic company with the opportunity for obtaining local management in a foreign country, thereby reducing risks such as expropriation and harassment by host country officials.
- ✎ When the distinct competencies of two or more firms complement each other especially well.
- ✎ When some project is potentially very profitable but requires overwhelming resources and risks.
- ✎ When two or more smaller firms have trouble competing with a large firm.
- ✎ When there exists a need to quickly introduce a new technology.

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### 2.9.3 MERGER/ACQUISITION

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Merger and acquisition are two commonly used ways to pursue strategies. A *merger* occurs when two organizations of about equal size unite to form one enterprise. An *acquisition* occurs when a large organization purchases (acquires) a smaller firm, or vice versa. When a merger or acquisition is not desired by both parties, it can be called a *takeover* or *hostile takeover*. In contrast, if the acquisition is desired by both firms, it is termed a *friendly merger*. Most mergers are friendly.

Table 2.3: Key Reasons Why Many Mergers and Acquisitions Fail

- 
- 
- ✎ Integration difficulties
  - ✎ Inadequate evaluation of target
  - ✎ Large or extraordinary debt
  - ✎ Inability to achieve synergy
  - ✎ Too much diversification
  - ✎ Managers overly focused on acquisitions
  - ✎ Too large an acquisition
  - ✎ Difficult to integrate different organizational cultures
  - ✎ Reduced employee morale due to layoffs and relocations
- 
-

Table 2.4: Potential Benefits of Merging with or Acquiring another Firm

- 
- 
- 👍 To provide improved capacity utilization
  - 👍 To make better use of the existing sales force
  - 👍 To reduce managerial staff
  - 👍 To gain economies of scale
  - 👍 To smooth out seasonal trends in sales
  - 👍 To gain access to new suppliers, distributors, customers, products, and creditors
  - 👍 To gain new technology
  - 👍 To reduce tax obligations
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#### 2.9.4 FIRST MOVER ADVANTAGES

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First mover advantages refer to the benefits a firm may achieve by entering a new market or developing a new product or service prior to rival firms. As indicated in Table 2.5, some advantages of being a first mover include securing access to rare resources, gaining new knowledge of key factors and issues, and carving out market share and a position that is easy to defend and costly for rival firms to overtake. First mover advantages are analogous to taking the high ground first, which puts one in an excellent strategic position to launch aggressive campaigns and to defend territory. Being the first mover can be especially wise when such actions;

1. Build a firm's image and reputation with buyers,
2. Produce cost advantages over rivals in terms of new technologies, new components, new distribution channels, and so on,
3. Create strongly loyal customers, and
4. Make imitation or duplication by a rival hard or unlikely.

To sustain the competitive advantage gained by being the first mover, such a firm also needs to be a fast learner. There would, however, be risks associated with being the first mover,

such as unexpected and unanticipated problems and costs that occur from being the first firm doing business in the new market. Therefore, being a slow mover (also called *fast follower* or *late mover*) can be effective when a firm can easily copy or imitate the lead firm's products or services. If technology is advancing rapidly, slow movers can often leapfrog a first mover's products with improved second-generation products. However, slow movers often are relegated to relying on the first mover being a slow mover and making strategic and tactical mistakes. This situation does not occur often, so first mover advantages clearly offset the first mover disadvantages most of the time. Apple Inc. has always been a good example of a first mover firm.

Strategic-management research indicates that first mover advantages tend to be greatest when competitors are roughly the same size and possess similar resources. If competitors are not similar in size, then larger competitors can wait while others make initial investments and mistakes, and then respond with greater effectiveness and resources.

Table 2.5: Benefits of a Firm Being the First Mover

- |   |                                                                                                     |
|---|-----------------------------------------------------------------------------------------------------|
| 👍 | Secure access and commitments to rare resources                                                     |
| 👍 | Gain new knowledge of critical success factors and issues                                           |
| 👍 | Gain market share and position in the best locations                                                |
| 👍 | Establish and secure long-term relationships with customers, suppliers, distributors, and investors |
| 👍 | Gain customer loyalty and commitments                                                               |

### 2.9.5 OUTSOURCING

*Business-process outsourcing (BPO)* is a rapidly growing new business that involves companies taking over the functional operations, such as human resources, information systems, payroll, accounting, customer service, and even marketing of other firms.

Companies are choosing to outsource their functional operations more and more for several reasons:

1. It is less expensive,
2. It allows the firm to focus on its core businesses, and
3. It enables the firm to provide better services.

Other advantages of outsourcing are that the strategy

- ↳ Allows the firm to align itself with “best-in-world” suppliers who focus on performing the special task,
- ↳ Provides the firm flexibility should customer needs shift unexpectedly, and
- ↳ Allows the firm to concentrate on other internal value chain activities critical to sustaining competitive advantage. BPO is a means for achieving strategies that are similar to partnering and joint venturing.



## SUMMARY OF THE CHAPTER

-  Objectives should be quantitative, measurable, realistic, understandable, challenging, hierarchical, obtainable, and congruent among organizational units. Each objective also should be associated with a time line.
-  Objectives are commonly stated in terms such as growth in assets, growth in sales, profitability, market share, degree and nature of diversification, and so on.
-  Long-term objectives are needed at the corporate, divisional, and functional levels in an organization. They are an important measure of managerial performance.
-  Financial objectives include ones associated with growth in revenues, growth in earnings, higher dividends, larger profit margins, greater return on investment, higher earnings per share, a rising stock price, improved cash flow, etc.
-  Strategic objectives include ones such as larger market share, quicker on-time delivery than rivals, quicker design-to-market times than rivals, lower costs than rivals, higher product quality than rivals, wider geographic coverage than rivals, etc.
-  The balanced scorecard is a strategy evaluation and control technique that derives its name from the perceived need of firms to “balance” financial measures, which are oftentimes used exclusively in strategy evaluation and control with non-financial measures such as product quality and customer service.
-  In large firms, there are four levels of strategies: corporate, divisional, functional, and operational. In small firms, there are three levels: company, functional, and operational.
-  Alternative strategies that an enterprise could pursue can be categorized into several actions—forward integration, backward integration, horizontal integration, market penetration, market development, product development, related diversification, unrelated diversification, retrenchment, divestiture, and liquidation.

-  Forward integration involves gaining ownership or increased control over distributors or retailers. Franchising is an effective means of implementing forward integration.
-  Backward integration is a strategy of seeking ownership or increased control of a firm's suppliers. This strategy can be especially appropriate when a firm's current suppliers are unreliable, too costly, or cannot meet the firm's needs.
-  Horizontal integration refers to a strategy of seeking ownership of or increased control over a firm's competitors.
-  A market-penetration strategy seeks to increase market share for present products or services in present markets through greater marketing efforts.
-  Market development involves introducing present products or services into new geographic areas.
-  Product development is a strategy that seeks increased sales by improving or modifying present products or services. Product development usually entails large research and development expenditures.
-  Businesses are said to be related when their value chains possess competitively valuable cross-business strategic fits.
-  Businesses are said to be unrelated when their value chains are so dissimilar that no competitively valuable cross-business relationships exist.
-  Retrenchment occurs when an organization regroups through cost and asset reduction to reverse declining sales and profits.
-  Selling a division or part of an organization is called divestiture. Divestiture often is used to raise capital for further strategic acquisitions or investments.
-  Selling all of a company's assets, in parts, for their tangible worth is called liquidation. Liquidation is recognition of defeat and consequently can be an emotionally difficult strategy.

-  According to Porter, strategies allow organizations to gain competitive advantage from three different bases: cost leadership, differentiation, and focus. Cost leadership and focus strategies can be further segmented by whether the approach is low-cost or best-value. Thus, there are five generic strategies: cost leadership-low cost, cost leadership-best value, differentiation, focus-low cost, and focus-best value.
-  Cost leadership emphasizes producing standardized products at a very low per-unit cost for consumers who are price-sensitive.
-  There are two types of cost leadership strategies. A low-cost strategy offers products to a wide range of customers at the lowest price available on the market. A best-value strategy offers products to a wide range of customers at the best price-value available on the market.
-  The basic idea behind a cost leadership strategy is to under price competitors or offer a better value and thereby gain market share and sales, driving some competitors out of the market entirely.
-  A successful differentiation strategy allows a firm to charge higher prices for its products to gain customer loyalty because consumers may become strongly attached to the differentiation features.
-  Focus means producing products and services that fulfill the needs of small groups of consumers.
-  A low-cost focus strategy offers products or services to a small range (niche) of customers at the lowest price available on the market.
-  A best-value focus strategy offers products to a small range of customers at the best price-value available on the market. This is sometimes called focused differentiation.
-  Joint venture is a popular strategy that occurs when two or more companies form a temporary partnership or consortium for the purpose of capitalizing on some opportunity.
-  Mergers and acquisitions are two commonly used ways to pursue strategies.

-  A merger occurs when two organizations of about equal size unite to form one enterprise. An acquisition occurs when a large organization purchases (acquires) a smaller firm or vice versa.
-  An LBO occurs when a corporation's shareholders are bought out (hence *buyout*) by the company's management and other private investors using borrowed funds (hence *leveraged*).
-  First mover advantages refers to the benefits a firm may achieve by entering a new market or developing a new product or service prior to rival firms.
-  Business-Process Outsourcing (BPO): Companies take over functional operations such as human resources, information systems, and marketing for other firms. Outsourcing can be less expensive, can allow firms to focus on core businesses, and enables firms to provide better services.



## CHAPTER REVIEW EXERCISES

Part I: Choose the correct answer from the given alternatives

1. \_\_\_\_\_ involves gaining ownership or increased control over distributors or retailers.
  - A. Back ward integration
  - B. Forward integration
  - C. Vertical integration
  - D. Horizontal integration
2. One of the following is NOT an intensive strategy
  - A. Market development
  - B. Product development
  - C. Market penetration
  - D. None of the above
3. \_\_\_\_\_ strategy is designed to fortify an organization's basic distinctive competence.
  - A. Related diversification
  - B. Divesture
  - C. Retrenchment
  - D. Liquidation
4. When a merger/acquisition is not desired by both parties, it can be called \_ \_\_\_\_\_. and if the acquisition is desired by both firms, it is said to be \_\_\_\_\_.
  - A. friendly merger and takeover
  - B. takeover and friendly merger
  - C. hostile takeover and friendly merger
  - D. B and C
  - E. None of the above
5. One of the following is NOT the Reason why many mergers and acquisitions fail.
  - A. Too much diversification
  - B. Integration difficulties
  - C. Managers overly focused on acquisitions
  - D. Large or extraordinary debt
  - E. None of the above

## CHAPTER

## 3

## THE

BUSINESS VISION AND MISSION

## CHAPTER OBJECTIVES

After studying this chapter, you should be able to do the following:

- ⊕ Describe the nature and role of vision and mission statements in strategic management.
- ⊕ Discuss why the process of developing a mission statement is as important as the resulting document.
- ⊕ Identify the components of mission statements.
- ⊕ Discuss how clear vision and mission statements can benefit other strategic-management activities.
- ⊕ Evaluate mission statement of different organizations.
- ⊕ Write good vision and mission statements.

*"A business is not defined by its name, statutes, or articles of incorporation. It is defined by the business mission. Only a clear definition of the mission and purpose of the organization makes possible clear and realistic business objectives."*

*Peter Drucker*

## INTRODUCTION

Dear trainees, this chapter focuses on the concepts and tools needed to evaluate and write business vision and mission statements. A practical framework for developing mission statements is provided. Actual mission statements from large and small organizations are presented and critically examined. The process of creating a vision and mission statement is discussed.

Organizations strive to achieve the end results which are ‘vision’, ‘mission’, ‘purpose’, ‘objective’, ‘goals’, ‘targets’ and so on. The hierarchy of strategic intent lays the foundation for the strategic management of any organization. The strategic intent makes clear what an organization stands for. It is reflected through vision, mission, business definition and objectives.

Vision serves the purpose of stating what an organization wishes to achieve in long run. The process of assigning a part of a mission to a particular department and then further subdividing the assignment among sections and individuals creates a hierarchy of objectives. The objectives of the sub unit contribute to the objectives of the larger unit of which it is a part. From strategy formulation point of view, an organization must define ‘why’ it exists, ‘how’ it justifies that existence, and ‘when’ it justifies the reasons for that existence. The answers to these questions lie in the organization’s mission, business definition, objectives and goals. These terms become the base for strategic decisions and actions.

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### 3.1 VISSION

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The vision of the organization refers to the broad category of long-term intentions that the organization wishes to pursue. It is broad, all inclusive, and futuristic. As the word ‘vision’ suggests, it is an image of how the organization sees itself. It is in most cases, a dream; the aspirations the organization holds for its future; a mental image of the future state. It might therefore be difficult for the organization to actually achieve its vision even in long-term, but it provides the direction and energy to work towards it.

Dear Learners, A vision is often expressed in a unique way to combine competitive influences in a way that directs a firm to pursue a revolutionary strategy. A vision statement presents the firm's strategic intent that focuses the energies and resources of the company on achieving a desirable future.



Dear learner, from your own point of view, can you define vision and mission?

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### 3.1.1 DEFINITIONS OF VISION

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The starting point for articulating strategic management process is defining the vision. Vision has been defined as in several ways by different authors and scholars.

**Kotter (1990)** defines it as “description of something (an organization, corporate culture, a business, a technology, an activity) in the future”.

**El-Namaki (1992)** considers it as a “mental perception of the kind of environment an individual, or an organization, aspires to create within a broad time horizon and the underlying conditions for the actualization of this perception”.

**Miller and Dess (1996)** view it simply as the “category of intentions that are broad, all-inclusive, and forward thinking”.

It is also defined as what the firm or person would ultimately like to become. It is what keeps up the organization moving forward even against discouraging odds.

The common strand of thought evident in these definitions and several others available in strategic management literature relates to “Vision” being future aspirations that lead to an inspiration to be the best in one's field of activity. A vision is more dreamt of than it is articulated. By its very nature, it could be as hazy and vague as a dream that one experienced

the previous night and is not able to recall exactly in broad daylight. Yet, it is found to be a powerful motivator to action.

**Some examples of a vision statement are given below:**

***“Our vision is to be the world’s best quick service restaurant.” (McDonalds)***

***Arba Minch University aspires to be one of the leading higher educational institutions in the country and a center of excellence in the area of water resources in eastern Africa.***

***“We want to satisfy all our customer’s financial needs and help them succeed financially.” (Wells Fargo)***

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### 3.1.2 BENEFITS OF VISION

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The benefits accruing to an organization having a vision are:

- 👍 Good visions are inspiring and exhilarating.
- 👍 Visions represent a discontinuity, a step function and a jump ahead so that the company knows what it is to be.
- 👍 Good visions help in the creation of a common identity, and a shared sense of purpose. They are competitive, original and unique. They make sense in the market place as they are practical.
- 👍 Good visions foster risk-taking and experimentation. They represent integrity; they are truly genuine and can be used for the benefit of people.

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### 3.1.3 PROCESS OF ENVISIONING

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The process of envisioning is a difficult one. A well-conceived vision consists of two major components which are given below.

- i) **Core ideology:** It defines the enduring character of an organization that remains unchangeable as it passes through the vicissitudes of vector, such as, technology, competition, or management fads. The core ideology rests on the core values and core purposes.
- ii) **Envisioned future:** It also consists of two components: a 10-30 years audacious goal, and a vivid description of what it will be like to achieve that goal. The process of envisioning is indeed fascinating.

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#### 3.1.4 CHARACTERISTICS OF VISION

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The characteristics of vision are:

- ✎ **Shared view:** A vision statement is developed through sharing views across an organization. However, the founder will have a powerful impact on others.
- ✎ **Convincing nature:** A vision statement should be able to convince others in the organization.
- ✎ **Reflect new realities:** A vision statement should recognize the complexity of changing business trends, and it should be able to reflect new realities.

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### 3.2 MISSION

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Dear Learners, an organization's mission is the purpose for the organization's existence. A well conceived mission statement defines the fundamental and unique purpose that sets a company apart from other firms of its type and identifies the scope of the company's operations in terms of products offered and markets served.

A mission statement promotes a sense of shared expectations in employees and communicates a public image to important stakeholder groups in the company's task environment.

A mission was earlier considered as the scope of the business activities a firm pursues. The definition of mission has gradually expanded to represent a concept that embodies the

purpose behind the existence of an organization. Some of the definitions of a mission statement are extracted from different sources given below:

Mission is defined as an “essential purpose of the organization, concerning particularly why it is in existence, the nature of the businesses it is in, and the customers it seeks to serve and satisfy”.

**Thompson (1997)** defines mission as the “essential purpose of the organization, concerning particularly why it is in existence, the nature of the business/es it is in, and the customers it seeks to serve and satisfy”.

**Hunger and Wheelen (1999)** say that mission is the “purpose or reason for the organization’s existence”.

Mission is a statement that defines the role an organization plays in a society. Hence, it sets out why the organization exists and what it should be doing.

**Some examples of a mission statement are given below:**

*Satisfying the needs of individual and business travelers for high speed transportation at a reasonable cost to all clients in south Ethiopia. (Ethiopian airlines.)*

*Promoting democratic thinking, offering high quality education and training, conducting need based research and consultancy, and rendering community service in order to contribute to the development endeavor of the country. ( Arba Minch University)*

*To develop and exploit our network at home and overseas so that we can meet the requirements of customers. (BBC)*

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### 3.2.1 CHARACTERISTICS OF A MISSION STATEMENT

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Organizations legitimize themselves by performing some function that is valued by the society. A mission statement defines the basic reason for the existence of that organization. Such a statement reflects the corporate philosophy, identity, character and image of an organization. It may be defined explicitly or could be deduced from the management's actions, decisions, or the chief executive's press statements. When explicitly defined it provides enlightenment to the insiders and outsiders on what the organization stands for. In order to be effective, a mission statement should possess the following seven characteristics.

#### Need for Mission Statement

Following are the reasons for evolving a mission statement.

1. The mission statement gives a unified direction to the company's growth.
2. The utilization of the company's resources is also unified, and people get motivated to exploit these resources in a specific direction for the company's growth.
3. Allocation of resources is based on the mission statement. Company executives get an idea for allocation of resources as directed by the mission statement.
4. The mission statement while giving a direction for growth also tends to build up a professional climate for maintenance and improvement of the company's status in any desired area. Thus it streamlines the functioning of the organization.
5. The mission statement vividly brings forth the purpose of the organization and growth direction in the prevalent cultural climate of an organization, thus bringing into focus the style of management and functioning of the organization. This approach draws support from people who wish to grow with the organization.
6. The mission statement outlines a framework for organizational planning assigning definite tasks and responsibilities to each business unit.

7. The mission statement helps set-up and develop a control mechanism for achievement of objectives.
8. Defining the mission of an organization brings forth the hidden talent amongst the work force who take up challenges to meet the company's strategic objectives.

### Characteristics of a Mission Statement

1. **It should be feasible:** A mission should always aim high but it should not be an impossible statement. It should be realistic and achievable- its followers must find it to be credible. But feasibility depends on the resources available to work towards a mission. In the sixties, the US National Aeronautics and Space Administration (NASA) had a mission- to land on the moon. It was feasible mission that was ultimately realized.
2. **It Should be Precise:** Using too many or too few words in a mission statement may lead to ambiguity. If too many words embody a mission statement, it may not be clearly understood by people at the functional and operating level. On the contrary, if less than the necessary numbers of words are used in a mission statement, the employees at operating level may derive different meanings out of it.

Similarly the mission statement should not have a narrow focus or a very broad view. For preparing a mission statement strategy managers have to create an abstraction ladder and choose appropriate words to define the mission. Defining mission as 'manufacturing refrigerators' may be too narrow a focus. Likewise, defining the mission as just taking health care may appear very non-specific.

3. **It should be clear:** The mission statement should culminate into an action program and hence brevity is the essential requirement of a mission statement. It should not contain high-sounding words which eventually do not clearly convey any action. The mission statement should be clear to employees of the company because all of them would be guided by this statement. It should be made clear to those who do not understand it through training workshops, or other forms of communication.

4. **It should be motivating:** The mission statement should be a source of inspiration for members of an organization. Members of the organizations should take pride in associating themselves with their organization through mission statement and they should get motivated to accept the challenge and accomplish the mission. Customers and societies associated with an organization should also feel good about the mission of the organization.
5. **It should be distinctive:** The mission statement of an organization should be distinct. There may be many organization manufacturing washing machines, refrigerators, scooters, cars etc., but each one of them define their mission differently because they are basically pursuing a specific mission that exclusively belongs to them. The mission statement should be unique for an organization as it makes it different from the crowd, and makes an impact on minds of people associated with the organizations. It is very rare that the mission statements of any two companies are similar. Each company depending on its resources environment, purpose and various other conditions evolve its own mission statement.
6. **It should indicate major components of strategy:** An organization may have different strategies but the mission statement should speak of the major strategy being followed by the company. The company should highlight potential strengths or requirements, that is, stability, growth, leadership, business volume and so on, such that the requirement is well driven home in the minds of the employees for giving them a unified direction of growth. The major strategy along with the purpose of an organization gives an insight to a reader about the organization. The major strategy should also be reflected with a view to bind the organization in unidirectional effort to meet objectives. Stating the major strategy in mission statement gives an insight to the employees regarding the course of action that they have to jointly take.
7. **It should indicate how objectives are accomplished:** The mission statement should indicate the manner in which the organizations objectives would be achieved. Since the

mission statement is related to a specific time-period, the reflection of methods of accomplishing the objectives gives a better understanding of the mission of a company and the way defined objectives are to be pursued. Different companies have different kinds of culture and working environments typical to that specific company, due to which text book methodologies for evolving mission statements do not work and each company has to evolve its own methodologies suited to its own specific working conditions. However, some generalizations with regard to this are possible.



Dear learner, what is your college or university's self-concept? How would you state that in a mission statement?

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### 3.2.2 MISSION STATEMENT COMPONENTS

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Mission statements can and do vary in length, content, format, and specificity. Most practitioners and academicians of strategic management feel that an effective statement should include nine components. Because a mission statement is often the most visible and public part of the strategic-management process, it is important that it includes the nine characteristics, as well as the following nine components:

1. **Customers:** Who are the firm's customers?
2. **Products or services:** What are the firm's major products or services?
3. **Markets:** Geographically, where does the firm compete?
4. **Technology:** Is the firm technologically current?
5. **Concern for survival, growth, and profitability:** Is the firm committed to growth and financial soundness?
6. **Philosophy:** What are the basic beliefs, values, aspirations, and ethical priorities of the firm?
7. **Self-concept:** What is the firm's distinctive competence or major competitive advantage?

8. **Concern for public image:** Is the firm responsive to social, community, and environmental concerns?
9. **Concern for employees:** Are employees a valuable asset of the firm?



Figure 3.1: Contents of ideal mission statements

### Examples of the nine essential components of a mission statement

#### 1. CUSTOMERS

- ❏ We believe our first responsibility is to the doctors, nurses, patients, mothers, and all others who use our products and services.

**(Johnson & Johnson)**

- ❏ To earn our customers' loyalty, we listen to them, anticipate their needs, and act to create value in their eyes.

**(Lexmark International)**

#### 2. PRODUCTS OR SERVICES

- ❏ AMAX's principal products are molybdenum, coal, iron ore, copper, lead, zinc, petroleum and natural gas, potash, phosphates, nickel, tungsten, silver, gold, and magnesium.

**(AMAX Engineering Company)**

- ❏ Standard Oil Company (Indiana) is in business to find and produce crude oil, natural gas, and natural gas liquids; to manufacture high-quality products useful to society

from these raw materials; and to distribute and market those products and to provide dependable related services to the consuming public at reasonable prices.

**(Standard Oil Company)**

### 3. MARKETS

- ❧ We are dedicated to the total success of Corning Glass Works as a worldwide competitor.

**(Corning Glass Works)**

- ❧ Our emphasis is on North American markets, although global opportunities will be explored.

**(Blockway)**

### 4. TECHNOLOGY

- ❧ Control Data is in the business of applying micro-electronics and computer technology in two general areas: computer-related hardware; and computing-enhancing services, which include computation, information, education, and finance.

**(Control Data)**

- ❧ We will continually strive to meet the preferences of adult smokers by developing technologies that have the potential to reduce the health risks associated with smoking.

**(RJ Reynolds)**

### 5. CONCERN FOR SURVIVAL, GROWTH, AND PROFITABILITY

- ❧ In this respect, the company will conduct its operations prudently and will provide the profits and growth which will assure Hoover's ultimate success.

**(Hoover Universal)**

- ❧ To serve the worldwide need for knowledge at a fair profit by adhering, evaluating, producing, and distributing valuable information in a way that benefits our customers, employees, other investors, and our society.

**(McGraw-Hill)**

## 6. PHILOSOPHY

- ❧ Our world-class leadership is dedicated to a management philosophy that holds people above profits.

**(Kellogg)**

- ❧ It's all part of the Mary Kay philosophy—a philosophy based on the golden rule. A spirit of sharing and caring where people give cheerfully of their time, knowledge, and experience.

**(Mary Kay Cosmetics)**

## 7. SELF-CONCEPT

- ❧ Crown Zellerbach is committed to leapfrogging ongoing competition within 1,000 days by unleashing the constructive and creative abilities and energies of each of its employees.

**(Crown Zellerbach)**

## 8. CONCERN FOR PUBLIC IMAGE

- ❧ To share the world's obligation for the protection of the environment.

**(Dow Chemical)**

- ❧ To contribute to the economic strength of society and function as a good corporate citizen on a local, state, and national basis in all countries in which we do business.

**(Pfizer)**

## 9. CONCERN FOR EMPLOYEES

- ↻ To recruit, develop, motivate, reward, and retain personnel of exceptional ability, character, and dedication by providing good working conditions, superior leadership, compensation on the basis of performance, an attractive benefit program, opportunity for growth, and a high degree of employment security.

**(The Wachovia Corporation)**

- ↻ To compensate its employees with remuneration and fringe benefits competitive with other employment opportunities in its geographical area and commensurate with their contributions toward efficient corporate operations.

**(Public Service Electric & Gas Company)**

### 3.2.3 DIFFERENCE BETWEEN VISION AND MISSION

Following table tabulates the differences between vision and mission of an organization.

Table 3.1: Difference between Vision & Mission

| VISSION                                                                      | MISSION                                                                                                                                                                      |
|------------------------------------------------------------------------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| ↻ Category of intentions that are broad, all inclusive and forward thinking, | ↻ Mission is the fundamental, unique purpose that sets a business apart from other firms of its type and identifies the scope of its operations in product and market terms. |
| ↻ States aspirations for the firm without stating the means to achieve them  | ↻ It states how it would achieve the vision of the firm.                                                                                                                     |
| ↻ Dream, little hazy or intangible                                           | ↻ Clear, tangibalises vision.                                                                                                                                                |

|                                     |                                                                       |
|-------------------------------------|-----------------------------------------------------------------------|
| ↳ Guides in formulation of mission. | ↳ Guides in formulation of business definition, goals and objectives. |
| ↳ Futuristic in nature.             | ↳ Current in nature.                                                  |



Dear trainees evaluate the following mission statement using the nine components of a mission statement and try to answer the questions that follow.

***For Motor Company** is a worldwide leader in automotive and automotive-related products and services as well as in new industries such as aerospace, communications, and financial services. Our mission is to improve continually our products and services to meet our customers' needs, allowing us to prosper as a business and to provide a reasonable return for our stockholders, the owners of our business.*

1. Do you find it a satisfying statement of the company's mission?
2. Is there anything in the statement that you would wish to criticize?
3. Would you alter the statement in any way, either taking something out or adding more information to it?
4. Is it likely to fulfill this purpose?
5. What would be an appropriate mission statement for your own firm or organization?

### 3.3 AN EVALUATION MATRIX OF MISSION STATEMENTS

There is no one best mission statement for a particular organization, so good judgment is required in evaluating mission statements. Realize that some individuals are more demanding than others in assessing mission statements in this manner. For example, if a statement merely includes the word “customers” without specifying who the customers are, is that satisfactory? Ideally a statement would provide more than simply inclusion of a single word such as “products” or “employees” regarding a respective component. Why? Because, the

statement should be informative, inspiring, enduring, and serve to motivate stakeholders to action.

Evaluation of a mission statement regarding inclusion of the nine components is just the beginning of the process to assess a statement's overall effectiveness. Perhaps the best way to develop a skill for writing and evaluating mission statements is to study actual company missions. These statements are evaluated in Table 3.2 based on the nine criteria presented above.

**Examples:**

**PEPSI COLA MISSION STATEMENT:**

“ . . . . is to increase the value of our shareholders' investment. We do this through sales growth, cost controls, and wise investment resources. We believe our commercial success depends upon offering quality and value to our consumers and customers; providing products that are safe, wholesome, economically efficient and environmentally sound; and providing a fair return to our investors while adhering to the highest standards of integrity.”

**BEN & JERRY'S MISSION STATEMENT**

“ . . . . is to make, distribute and sell the finest quality all-natural ice cream and related products in a wide variety of innovative flavors made from Vermont dairy products. To operate the Company on a sound financial basis of profitable growth, increasing value for our shareholders, and creating career opportunities and financial rewards for our employees. To operate the Company in a way that actively recognizes the central role that business plays in the structure of society by initiating innovative ways to improve the quality of life of a broad community—local, national and international.”

Table 3.3: An Evaluation Matrix of Mission Statements

| COMPONENTS    |           |                     |         |                                                  |            |
|---------------|-----------|---------------------|---------|--------------------------------------------------|------------|
| Organization  | Customers | Product/<br>Service | Markets | Concern for Survival, Growth,<br>& Profitability | Technology |
| PepsiCo       | YES       | NO                  | NO      | YES                                              | NO         |
| Ben & Jerry's | NO        | YES                 | YES     | YES                                              | NO         |

As indicated in Table 3.3, the Ben & Jerry's mission statement was relatively best among the two statements evaluated. Note, however, that the Ben & Jerry's statement lacks inclusion of the "customers" and "Technology" components. The PepsiCo mission statements are evaluated worst with inclusion of only two of the nine components. Note that none of these two statements included the "Technology" component in their document.

### 3.4 GOAL AND OBJECTIVES



Dear learner, do you think goals are the same with objectives? Or are they different?

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Basically, Goals denote what an organization hopes to accomplish in future. They represent the future state or outcome of effort put in now. A broad category of financial and non-financial issues are addressed by the goals that a firm sets.

Objectives are the ends that specifically state how the goals shall be achieved. They are concrete and specific in contrast to goals that are generalized. In this manner, objectives make the goals operational. While goals may be qualitative, objectives tend to be mainly quantitative in specification. This way they are measurable and comparable.

In strategic management literature, there is confusion with regard to the usage of these terms: goals and objectives. There is overwhelming evidence available now, as inferred from recent strategic management literature, that goals connote the broader sense of the term objectives. After all, it must be remembered that objectives are the manifestations of goals, whether quantified and specifically stated or not.

Any organization shall always have a potential set of goals. It has to exercise a choice from among these goals. This choice must be further elaborated and expressed in terms of operational and measurable objectives.

For example, goals and objectives of Arba Minch University are as follows:

#### Goals

- a. Develop a conducive environment for learning and teaching*
- b. Ensure the quality and expansion of education and training*
- c. Advance research and consultancy works in various fields.*
- d. Improve services to the community*
- e. Increase the revenue, minimize the costs*

### Objectives

- a. *Provides skilled manpower in quantity and quality that will serve the country in different professions.*
- b. *Expands higher education services that are free from any discrimination on grounds of race, religion, sex, politics and other similar grounds.*
- c. *Lays down problem solving education and institutional system that enables to utilize potential resources of the country and undertake study and research.*
- d. *Provides higher education and community services that are compatible with the needs and development of the country.*
- e. *Lays down an institutional system that ensures the accountability of the institution.*
- f. *Ensures the participation of all those concerned bodies in administration decision making, create and promote participation culture.*
- g. *Make efforts to develop and disseminate the culture of respect, tolerance and living together among people;*
- h. *Establish a system which increases the revenue and minimize unnecessary costs.*

---

#### 3.4.1 IMPORTANCE OF OBJECTIVES

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The managers should use objectives to guide their organizations and it can also be used for the following:

- ↳ Decision making
- ↳ Increasing organizational efficiency
- ↳ Performance appraisal

---

### 3.4.2 ROLES OF OBJECTIVES

---

Objectives play an important role in strategic management. The various facets of such a role are described below:

- **Objectives define the organization's relationship with its environment:** By stating its objectives, an organization commits itself to what it has to achieve for its employees, customers and the society at large.
- **Objectives help an organization pursue its vision and mission:** By defining the long-term position that an organization wishes to attain and the short-term targets to be achieved, objectives help an organization in pursuing its vision and mission.
- **Objectives provide the basis for strategic decision-making:** By directing the attention of strategists to those areas where strategic decisions need to be taken, objectives lead to desirable standards of behavior and, in this manner, help to coordinate strategic decision-making.
- **Objectives provide the standards for performance appraisal:** By stating targets to be achieved in a given time period and the measures to be adopted to achieve them, objectives lay down the standards against which organizational as well as individual performance could be judged. In the absence of objectives, an organization would have no clear and definite basis for evaluating its performance.

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### 3.4.3 CHARACTERISTICS OF OBJECTIVES

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Objectives, as measures of organizational behavior and performance, should possess certain desirable characteristics in order to be effective. The seven characteristics of objectives are as such:

- Objectives should be understandable.
- They should be concrete and specific.
- They should be related to a time frame.

- ⇒ They should be measurable and controllable.
- ⇒ They should be challenging.
- ⇒ Different objectives should correlate with each other.
- ⇒ They should be set within constraints

---

#### 3.4.4 ISSUES IN OBJECTIVE-SETTING

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There are many issues which have a bearing on different levels of objective-setting. Few of such issues are discussed below:

- ⇒ **Specificity:** Objectives may be stated at different levels of specificity. At one extreme, they might be very broadly stated as goals, while at the other, they might be specifically stated as targets. The issue of specificity is resolved through stating objectives at different levels and prefixing terms such as corporate, general and particular so they serve the needs of performance and its evaluation.
- ⇒ **Multiplicity:** Since objectives deal with a number of performance areas, a variety of them have to be formulated to cover all aspects of the functioning of an organization. No organization operates on the basis of a single or a few objectives.

The issue of multiplicity deals with different types of objectives with respect to organizational levels, importance, ends functions and nature.

- ⇒ **Periodicity:** Objectives are formulated for different time periods. It is possible to set long-term, medium-term and short-term objectives. Long-term objectives are, by nature, less certain and are, therefore stated in general terms. Short-term objectives, on the other hand, are relatively more certain, specific and comprehensive. One long-term objective may result in several short-term objectives; many short-term objectives converge to form a long-term objective.
- ⇒ **Verifiability:** Each objective has to be tested on the basis of its verifiability. Only verifiable objectives can be meaningfully used in strategic management.

The issue of verifiability could be resolved through the judicious use of a combination of quantitative and qualitative objectives.

- **Reality:** It is a common observation that organizations tend to have two sets of objectives: official and operative. Official objectives are those which the organizations profess to attain, while operative objectives are those which the organization seek to attain in reality.
- **Quality:** Objectives may be both good as well as bad. The quality of an objective can be judged on the basis of its capability to provide a specific direction and tangible basis for evaluating performance.

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### 3.4.5 TYPES OF OBJECTIVES

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Objectives may be classified on the basis of time frame and nature as shown in the figure below.

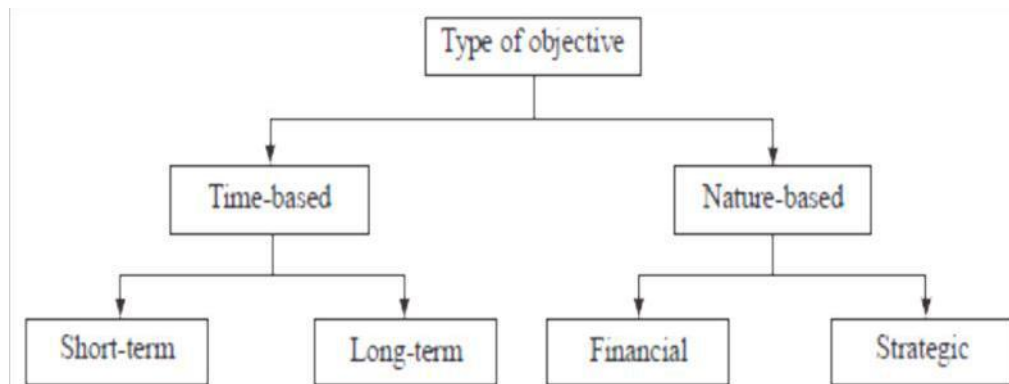


Figure 3.2: Types of Objectives

- **Short-term and long-term objectives:** Short-term objectives have a time frame of 3 months to one year; long-term objectives have a time frame of 3 to 5 years. Short-term objectives should be logically consistent. There must be congruence between the two types of objectives, and short-term objectives should serve as stair steps toward the achievement of long-term and define the pace at which top management wants to progress.

For instance, a firm wants to become a market leader from its existing position of market follower within a time frame of 3 years. The market share of the leader is 38% while that of this firm is 25%. It is clear that this increase of 13% has to be achieved in steps as it would be impossible to bridge this gap during the third year. The marketing department would suggest the plan as 7% in the first year, 4% in the second year and 2% in the last year.

- ✚ Financial and strategic objectives: Strategic objectives of a firm are objectives that are competition focused and aimed to dislodge the best player in its industry. While it is highly advisable that a firm should have both financial and strategic objectives, situations do arise wherein a firm has to strike a trade-off between financial and strategic objectives.

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#### 3.4.6 AREAS IN OBJECTIVES

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The objectives may be set in the following areas:

- ✚ Market position: It looks into how a firm should stand relative to its competitors.
- ✚ Innovation: A firm should identify the areas of innovation and decide metrics say for process improvement, alternative materials, new product launching, improved technology, innovation in selling.
- ✚ Productivity: Improve the output level to resource used ratio.
- ✚ Resource allocation: A firm should specify what resources are to be acquired in what quantities. It must strive to acquire these resources at optimum costs.
- ✚ Profitability: Profit in terms of return on investment (ROI).
- ✚ Managerial performance and development: The quality of performance and the rate of improvement; this is critical for success especially in service business.
- ✚ Worker performance and attitude: It focuses on performance at job, a positive feeling about work and an inclination to commit to the organizational vision.
- ✚ Social responsibility: It contributes to the welfare of community society and so on.

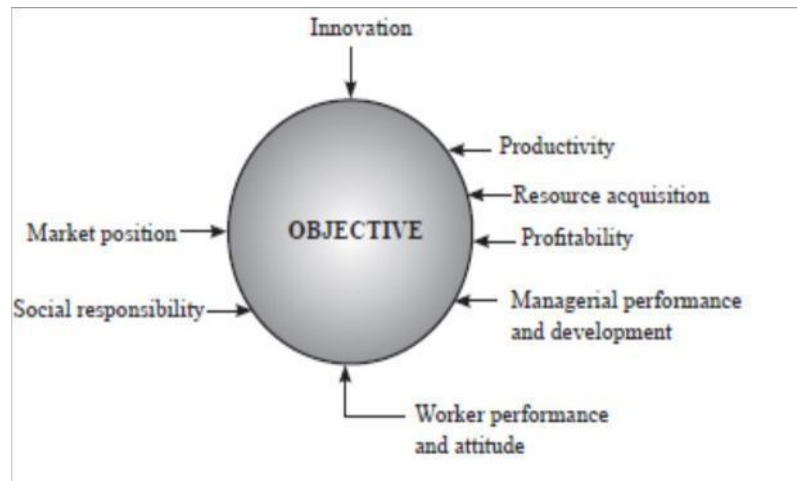


Figure 3.3: Areas of Setting Objectives

#### 3.4.7 HOW ARE OBJECTIVES FORMULATED?

The factors that should be considered for objective setting are mentioned below.

- **The forces in the environment:** These take into account all the interests, sometimes coinciding but often conflicting, of different stakeholders in an organization. Each group of stakeholders has claims, which have to be considered while setting objectives. It is important to note that the interests of the various stakeholders may change from time to time, necessitating a corresponding shift in the importance attached to different objectives.
- **Realities of the enterprise's resources and internal power relationships:** This means that objectives are dependent on the resources capability of a company as well as the relative decisional power that different groups of strategists wield with respect to each other in sharing those resources. A dominant group of strategists such as the board of directors may wield considerable power so as to set objectives in consonance with their respective views.

- Value system of top executives: This has an impact on the corporate philosophy that organizations adopt with regard to strategic management in general and objectives in particular. Values, as an enduring set of beliefs, shape perceptions about what is good or bad, desirable or undesirable.
- Awareness in management of the past objectives of the firm:  
Awareness of the past objectives may lead the organization to a choice of objectives that has been in the past due to different reasons. Keeping in view the four factors described above, it is observed that objective-setting is a complex task, which is based on consensus-building and has no beginning or end. Vision and mission provide a 'common thread' to bind together the different as



## SUMMARY OF THE CHAPTER

- ✎ A vision statement should answer the basic question, “What do we want to become?” A clear vision provides the foundation for developing a comprehensive mission statement.
- ✎ Many organizations have both a vision and a mission statement, but the vision statement should be established first and foremost.
- ✎ Vision consists of two components: core ideology and envisioned future.
- ✎ The characteristics of vision are: shared view, convincing nature, and reflect new.
- ✎ A clear mission statement is needed before alternative strategies can be formulated and implemented.
- ✎ It is important to involve as many managers as possible in the process of developing a mission statement, because through involvement, people become committed to an organization.
- ✎ An organization that fails to develop a vision statement as well as a comprehensive and inspiring mission statement loses the opportunity to present itself favorably to existing and potential stakeholders.
- ✎ Components and Questions That a Mission Statement Should Answer includes; customers, products, markets, technology, concern for survival, growth, & profitability, philosophy, self-concept, concern for public image, and concern for employees.
- ✎ Goals denote what an organization hopes to accomplish in a future period of time.
- ✎ Objectives are the ends that specifically state how the goals shall be achieved.
- ✎ The seven basic characteristics that every objective should possess are; understandability, being specific, clear time frame, measurable and controllable, challenging, correlate with each other, and ability to be set within constraints.
- ✎ There are many issues which have a bearing on different levels of objective-setting. Few of such issues are; specificity, multiplicity, periodicity, verifiability, reality, and quality.
- ✎ The two main types of objectives are time based and nature based.
- ✎ Time based objectives are of two types; short-term and long-term
- ✎ Nature based objectives are classified in to two financial and strategic objectives.



## CHAPTER REVIEW EXERCISES

Part I: Choose the correct answer from the given alternatives

1. A vision statement should answer which of these basic questions?
  - A. What is our business?
  - B. Who are our employees?
  - C. Why do we exist?
  - D. What do we want to become?
2. Which of these should be established first and foremost?
  - A. Strategies
  - B. Vision
  - C. Objectives
  - D. D. Mission
3. The hierarchy of organizational goals is in this order (least specific to most specific):
  - A. Vision statements, strategic objectives, mission statements.
  - B. Mission statements, strategic objectives, vision statements.
  - C. Vision statements, mission statements, strategic objectives.
  - D. Mission statements, vision statements, strategic objectives.
4. One of the following is NOT true about vision statement
  - A. It is current in nature.
  - B. Guides in formulation of mission.
  - C. Futuristic in nature.
  - D. None of the above
5. \_\_\_\_\_ is also called a creed statement, a statement of purpose, a statement of philosophy, a statement of beliefs, a statement of business principles, or a statement “defining our business,”
  - A. Mission statement
  - B. Vision statement
  - C. Strategic objectives
  - D. Strategic goals

## CHAPTER

## 4

THEEXTERNAL ASSESSMENT

## CHAPTER OUTLINE

- ◆ The Nature of an External Audit
- ◆ The Industrial Organization (I/O) View
- ◆ Economic Forces
- ◆ Social, Cultural, Demographic, and Environmental Forces
- ◆ Political, Governmental, and Legal Forces
- ◆ Technological Forces
- ◆ Competitive Forces
- ◆ Competitive Analysis: Porter's Five-Forces Model
- ◆ Sources of External Information
- ◆ Forecasting Tools and Techniques
- ◆ The Global Challenge
- ◆ Industry Analysis: The External Factor Evaluation (EFE) Matrix
- ◆ The Competitive Profile Matrix (CPM)

## CHAPTER OBJECTIVES

By the end of this topic, you should be able to:

- ⊕ Describe how to conduct an external strategic-management audit.
- ⊕ Discuss 10 major external forces that affect organizations: economic, social, cultural, demographic, environmental, political, governmental, legal, technological, and competitive.
- ⊕ Describe key sources of external information, including the Internet.
- ⊕ Discuss important forecasting tools used in strategic management.
- ⊕ Discuss the importance of monitoring external trends and events.
- ⊕ Explain how to develop an EFE Matrix.
- ⊕ Explain how to develop a Competitive Profile Matrix.
- ⊕ Discuss the importance of gathering competitive intelligence.
- ⊕ Discuss market commonality and resource similarity in relation to competitive analysis.

*"The opportunities and threats existing in any situation always exceed the resources needed to exploit the opportunities or avoid the threats. Thus, strategy is essentially a problem of allocating resources. If strategy is to be successful, it must allocate superior resources against a decisive opportunity."*

*William Cohen*

**H**ello Learner, welcome to the fourth chapter of the module which examines the tools and concepts needed to conduct an external strategic management audit (sometimes called ***environmental scanning*** or ***industry analysis***). An *external audit* focuses on identifying and evaluating trends and events beyond the control of a single firm, such as increased foreign competition, population shifts to the Sunbelt, an aging society, consumer fear of traveling, and stock market volatility. An external audit reveals key opportunities and threats confronting an organization so that managers can formulate strategies to take advantage of the opportunities and avoid or reduce the impact of threats. This chapter presents a practical framework for gathering, assimilating, and analyzing external information. The Industrial Organization (I/O) view of strategic management is introduced.

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## 4.1 The Nature of an External Audit

---

The purpose of an *external audit* is to develop a finite list of opportunities that could benefit a firm and threats that should be avoided. As the term *finite* suggests, the external audit is not aimed at developing an exhaustive list of every possible factor that could influence the business; rather, it is aimed at identifying key variables that offer actionable responses. Firms should be able to respond either offensively or defensively to the factors by formulating strategies that take advantage of external opportunities or that minimize the impact of potential threats.



Dear learner, what do you think are the external forces that influence the day to day operation of an organization and how does it influence?

---

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## 4.2 Key External Forces

External forces can be divided into five broad categories:

1. Economic forces;
2. Social, cultural, demographic, and natural environment forces;
3. Political, governmental, and legal forces;
4. Technological forces; and
5. Competitive forces.

Relationships among these forces and an organization are depicted in Figure 4.1 External trends and events, such as the global economic recession, significantly affect products, services, markets, and organizations worldwide.

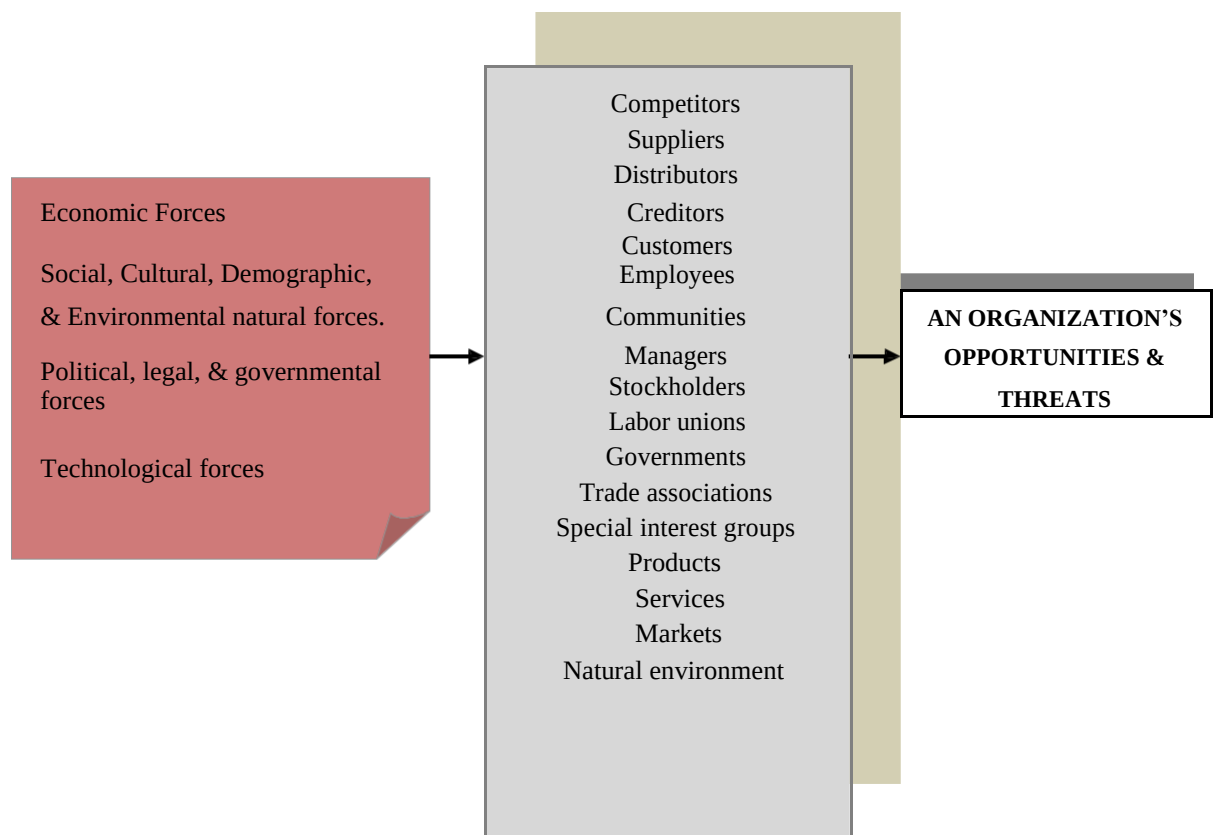


Figure 4.1: Relationships between Key External Forces and an Organization

Changes in external forces translate into changes in consumer demand for both industrial and consumer products and services. External forces affect the types of products developed, the nature of positioning and market segmentation strategies, the type of services offered, and the choice of businesses to acquire or sell. External forces directly affect both suppliers and distributors. Identifying and evaluating external opportunities and threats enables organizations to develop a clear mission, to design strategies to achieve long-term objectives, and to develop policies to achieve annual objectives.

The increasing complexity of business today is evidenced by more countries developing the capacity and will to compete aggressively in world markets. Foreign businesses and countries are willing to learn, adapt, innovate, and invent to compete successfully in the marketplace. There are more competitive new technologies in Europe and Asia today than ever before.

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### 4.3 The Process of Performing an External Audit

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

To perform an external audit, a company first must gather competitive intelligence and information about economic, social, cultural, demographic, environmental, political, governmental, legal, and technological trends. Individuals can be asked to monitor various sources of information, such as key magazines, trade journals, and newspapers. These persons can submit periodic scanning reports to a committee of managers charged with performing the external audit. This approach provides a continuous stream of timely strategic information and involves many individuals in the external-audit process. The Internet provides another source for gathering strategic information, as do corporate, university, and

public libraries. Suppliers, distributors, salespersons, customers, and competitors represent other sources of vital information.

Once information is gathered, it should be assimilated and evaluated. A meeting or series of meetings of managers is needed to collectively identify the most important opportunities and threats facing the firm. These key external factors should be listed on flip charts or a chalkboard. A prioritized list of these factors could be obtained by requesting that all managers rank the factors identified, from 1 for the most important opportunity/threat to 20 for the least important opportunity/threat. These key external factors can vary over time and by industry. Relationships with suppliers or distributors are often a critical success factor. Other variables commonly used include market share, breadth of competing products, world economies, foreign affiliates, proprietary and key account advantages, price competitiveness, technological advancements, population shifts, interest rates, and pollution abatement.

Freund emphasized that these key external factors should be (1) important to achieving long-term and annual objectives, (2) measurable, (3) applicable to all competing firms, and (4) hierarchical in the sense that some will pertain to the overall company and others will be more narrowly focused on functional or divisional areas. A final list of the most important key external factors should be communicated and distributed widely in the organization. Both opportunities and threats can be key external factors.

---

#### 4.3.1 The Industrial Organization (I/O) View

---

The *Industrial Organization (I/O)* approach to competitive advantage advocates that external (industry) factors are more important than internal factors in a firm achieving competitive advantage. Proponents of the I/O view, such as Michael Porter, contend that organizational performance will be primarily determined by industry forces. Porter's Five-Forces Model, presented later in this chapter, is an example of the I/O perspective, which focuses on analyzing external forces and industry variables as a basis for getting and keeping competitive advantage. Competitive advantage is determined largely by competitive positioning within an industry, according to I/O advocates.

Managing strategically from the I/O perspective entails firms striving to compete in attractive industries, avoiding weak or faltering industries, and gaining a full understanding of key external factor relationships within that attractive industry. I/O research provides important contributions to our understanding of how to gain competitive advantage.

I/O theorists contend that external factors in general and the industry in which a firm chooses to compete has a stronger influence on the firm's performance than do the internal functional decisions managers make in marketing, finance, and the like. Firm performance, they contend, is primarily based more on industry properties, such as economies of scale, barriers to market entry, product differentiation, the economy, and level of competitiveness than on internal resources, capabilities, structure, and operations. The global economic recession's impact on both strong and weak firms has added credence of late to the notion that external forces are more important than internal.

The I/O view has enhanced our understanding of strategic management. However, it is not a question of whether external or internal factors are more important in gaining and maintaining competitive advantage. Effective integration and understanding of both external and internal factors is the key to securing and keeping a competitive advantage. In fact, matching key external opportunities/threats with key internal strengths/weaknesses provides the basis for successful strategy formulation.

#### A) Economic Forces

Increasing numbers of two-income households is an economic trend in the United States. Individuals place a premium on time. Improved customer service, immediate availability, trouble-free operation of products, and dependable maintenance and repair services are becoming more important. People today are more willing than ever to pay for good service if it limits inconvenience.

Economic factors have a direct impact on the potential attractiveness of various strategies. For example, when interest rates rise, funds needed for capital expansion become and the demand for discretionary goods falls. When stock prices increase, the desirability of equity as a source of capital for market development increases. Also, when the market rises, consumer and business wealth expands. A summary of economic variables that often represent opportunities and threats for organizations is provided in Table 4.1.

Table 4.1: Key Economic Variables to Be Monitored

|                                        |                                                               |
|----------------------------------------|---------------------------------------------------------------|
| Shift to a service economy in the US   | Import/export factors                                         |
| Availability of credit                 | Demand shifts for different categories of goods and services  |
| Level of disposable income             | Income differences by region and consumer groups              |
| Propensity of people to spend          | Price fluctuations                                            |
| Interest rates                         | Export of labor and capital from the United States            |
| Inflation rates                        | Monetary policies                                             |
| Money market rates                     | Fiscal policies                                               |
| Federal government budget deficits     | Tax rates                                                     |
| Gross domestic product trend           | European Economic Community (EEC) policies                    |
| Consumption patterns                   | Organization of Petroleum Exporting Countries (OPEC) policies |
| Unemployment trends                    |                                                               |
| Worker productivity levels             |                                                               |
| Value of the dollar in world markets   |                                                               |
| Stock market trends                    |                                                               |
| Foreign countries' economic conditions |                                                               |

## B) Social, Cultural, Demographic, and Natural Environment Forces

Social, cultural, demographic, and environmental changes have a major impact on virtually all products, services, markets, and customers. Small, large, for-profit, and nonprofit organizations in all industries are being staggered and challenged by the opportunities and threats arising from changes in social, cultural, demographic, and environmental variables.

A summary of important social, cultural, demographic, and environmental variables that represent opportunities or threats for virtually all organizations is given in Table 4.2.

Table 4.2: Key Social, Cultural, Demographic, and Natural Environment Variables

|                                       |                               |
|---------------------------------------|-------------------------------|
| Attitudes toward product quality      | Attitudes toward leisure time |
| Childbearing rates                    | Attitudes toward retirement   |
| Number of special-interest groups     | Average disposable income     |
| Number of marriages                   | Trust in government           |
| Number of divorces                    | Attitudes toward government   |
| Number of births                      | Attitudes toward work         |
| Number of deaths                      | Buying habits                 |
| Immigration and emigration rates      | Ethical concerns              |
| Social Security programs              | Attitudes toward saving       |
| Life expectancy rates                 | Sex roles                     |
| Per capita income                     | Attitudes toward investing    |
| Location of retailing, manufacturing, | Racial equality               |
| Attitudes toward customer service     | Use of birth control          |
| Pollution control                     | Average level of education    |
| Attitudes toward foreign peoples      | Government regulation         |
| Energy conservation                   | Social programs               |

### C) Political, Governmental, and Legal Forces

Federal, state, local, and foreign governments are major regulators, deregulators, subsidizers, employers, and customers of organizations. Political, governmental, and legal factors, therefore, can represent key opportunities or threats for both small and large organizations.

For industries and firms that depend heavily on government contracts or subsidies, political forecasts can be the most important part of an external audit. Changes in patent laws, antitrust legislation, tax rates, and lobbying activities can affect firms significantly. The increasing global interdependence among economies, markets, governments, and organizations makes it imperative that firms consider the possible impact of political variables on the formulation and implementation of competitive strategies.

A summary of political, governmental, and legal variables that can represent key opportunities or threats to organizations is provided in

Table 4.3: Some Political, Governmental, and Legal Variables

|                                                       |                                               |
|-------------------------------------------------------|-----------------------------------------------|
| Government regulations or deregulations               | Government fiscal and monetary policy changes |
| Changes in tax laws                                   | Political conditions in foreign countries     |
| Special tariffs                                       | Special local, state, and federal laws        |
| Political action committees                           | Lobbying activities                           |
| Voter participation rates                             | Size of government budgets                    |
| Number, severity, and location of government protests | World oil, currency, and labor markets        |
| Number of patents                                     | Location and severity of terrorist activities |
| Changes in patent laws                                | Local, state, and national elections          |
| Environmental protection laws                         |                                               |
| Level of defense expenditures                         |                                               |
| Legislation on equal employment                       |                                               |
| Level of government subsidies                         |                                               |
| Antitrust legislation                                 |                                               |

## D) Technological Forces

Revolutionary technological changes and discoveries are having a dramatic impact on organizations. The Internet has changed the very nature of opportunities and threats by altering the life cycles of products, increasing the speed of distribution, creating new products and services, erasing limitations of traditional geographic markets, and changing the historical trade-off between production standardization and flexibility. The Internet is altering economies of scale, changing entry barriers, and redefining the relationship between industries and various suppliers, creditors, customers, and competitors.

Technological forces represent major opportunities and threats that must be considered in formulating strategies. Technological advancements can dramatically affect organizations' products, services, markets, suppliers, distributors, competitors, customers, manufacturing processes, marketing practices, and competitive position. Technological advancements can create new markets, result in a proliferation of new and improved products, change the relative competitive cost positions in an industry, and render existing products and services obsolete. Technological changes can reduce or eliminate cost barriers between businesses, create shorter production runs, create shortages in technical skills, and result in changing values and expectations of employees, managers, and customers.

Technological advancements can create new competitive advantages that are more powerful than existing advantages. No company or industry today is insulated against emerging technological developments. In high-tech industries, identification and evaluation of key technological opportunities and threats can be the most important part of the external strategic-management audit.

## E) Competitive Forces

Collecting and evaluating information on competitors is essential for successful strategy formulation. Identifying major competitors is not always easy because many firms have divisions that compete in different industries. Many multidivisional firms do not provide sales and profit information on a divisional basis for competitive reasons.

Also, privately held firms do not publish any financial or marketing information. Addressing questions about competitors such as those presented as follows is important in performing an external audit.

1. What are the major competitors' strengths?
2. What are the major competitors' weaknesses?
3. What are the major competitors' objectives and strategies?
4. How will the major competitors most likely respond to current economic, social, cultural, demographic, environmental, political, governmental, legal, technological, and competitive trends affecting our industry?
5. How vulnerable are the major competitors to our alternative company strategies?
6. How vulnerable are our alternative strategies to successful counterattack by our major competitors?
7. How are our products or services positioned relative to major competitors?
8. To what extent are new firms entering and old firms leaving this industry?
9. What key factors have resulted in our present competitive position in this industry?
10. How have the sales and profit rankings of major competitors in the industry changed over recent years?
11. Why have these rankings changed that way?
12. What is the nature of supplier and distributor relationships in this industry?
13. To what extent could substitute products or services be a threat to competitors in this industry?

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#### 4.4 Competitive Intelligence Programs

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What is competitive intelligence? *Competitive intelligence (CI)*, as formally defined by the Society of Competitive Intelligence Professionals (SCIP) is a systematic and ethical process for gathering and analyzing information about the competition's activities and general business trends to further a business's own goals.

Good competitive intelligence in business, as in the military, is one of the keys to success. The more information and knowledge a firm can obtain about its competitors, the more likely

it is that it can formulate and implement effective strategies. Major competitors' weaknesses can represent external opportunities; major competitors' strengths may represent key threats.

Firms need an effective competitive intelligence (CI) program. The three basic objectives of a CI program are;

- 1) To provide a general understanding of an industry and its competitors
- 2) To identify areas in which competitors are vulnerable and to assess the impact strategic actions would have on competitors, and
- 3) To identify potential moves that a competitor might make that would endanger a firm's position in the market.

Competitive information is equally applicable for strategy formulation, implementation, and evaluation decisions. An effective CI program allows all areas of a firm to access consistent and verifiable information in making decisions. All members of an organization—from the chief executive officer to custodians—are valuable intelligence agents and should feel themselves to be a part of the CI process. Special characteristics of a successful CI program include flexibility, usefulness, timeliness, and cross-functional cooperation.

The increasing emphasis on *competitive analysis* in the United States is evidenced by corporations putting this function on their organizational charts under job titles such as Director of Competitive Analysis, Competitive Strategy Manager, Director of Information Services, or Associate Director of Competitive Assessment. The responsibilities of a *director of competitive analysis* include planning, collecting data, analyzing data, facilitating the process of gathering and analyzing data, disseminating intelligence on a timely basis, researching special issues, and recognizing what information is important and who needs to know. Sources of competitive information include trade journals, want ads, newspaper articles, and government filings, as well as customers, suppliers, distributors, competitors themselves, and the Internet.

Unethical tactics such as bribery, wiretapping, and computer break-ins should never be used to obtain information.

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#### 4.4.1 Competitive Analysis: Michael Porter's Five Forces Model

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Michael Porter (1980), from Harvard School of Business Administration, developed a framework for analyzing the nature and extent of competition within an industry. He argued that there are five competitive forces which determine the nature of competition within an industry. Understanding the nature and strength of each of the five forces within an industry assists managers in developing the competitive strategy of their organization. The five forces are:

1. The threats of new entrants to the industry.
2. The threat of substitute products.
3. The bargaining power of buyers or customers.
4. The bargaining power of suppliers.
5. Rivalry among businesses in the industry.

By determining the relative “power” of each of these forces, an organization can identify how to position itself to take advantage of opportunities and overcome threats. The strategy of an organization may then be designed to explain the competitive forces at work within an industry.



Dear learner, what do you think are the external forces that influence the day to day operation of an organization and how does it influence?

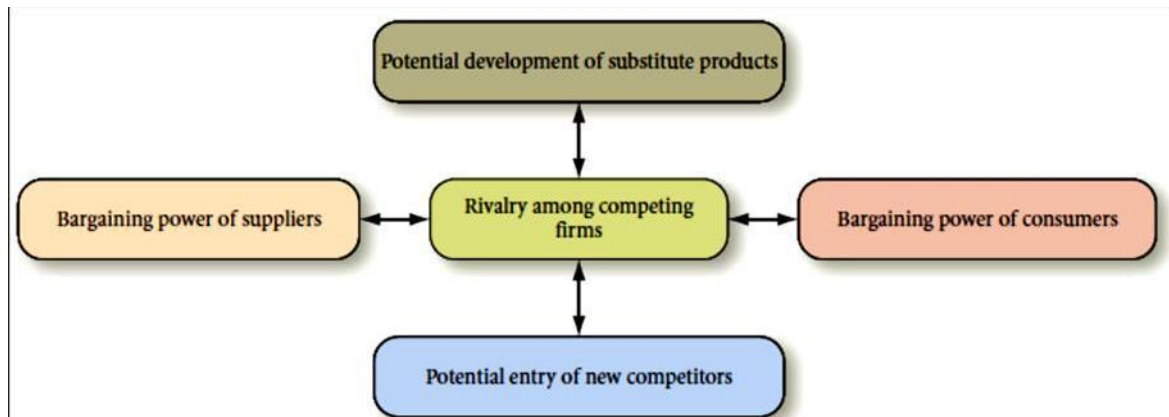
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Figure 4.2: The Five-Force Model of Competition



Dear learner's, when using the Porter's framework, it is important to identify which of the five forces are the key forces at work in an industry at any given point in time. In many cases, it transpires that one or more of the five forces prove to be "Key forces" and the strategic analysis must focus on these if it is to use the framework fruitfully. The dynamic nature of the competitive environment means that the relative strength of the forces in a particular industry will change over time. It is, therefore, important that the five forces analysis is repeated on a regular basis so as to detect such changes before competitors and allow an early adjustment of strategy. Before any conclusions can be drawn about the nature of competition within an industry each of the five forces must be analyzed in detail. We will now discuss each of the five forces in turn.

### 1) Threat of New Entrants

A new entrant in an industry represents a competitive pressure to established firms. The threat of new entrants is the possibility that new firms will enter the industry. New entrants bring a desire to gain market share and often have significant resources. Their presence may force prices down and put pressure on profits of incumbents. Analyzing the threat of new entrants involves examining the barriers to entry and the expected reactions of existing firms to a new competitor.

Barriers to entry are the costs and/or legal requirements needed to enter a market. These barriers protect the companies already in business by being a hurdle to those trying to enter the market. In addition to up-front barriers, a new competitor may inspire established companies to react with tactics to deter entry, such as lowering prices or forming partnerships. The chance of reaction is high in markets where firms have a history of retaliation, excess cash, are committed to the industry, or the industry has slow growth.

The strength of competitive force of potential rivalries is largely a function of the height of barriers to entry. Barriers to entry are factors that make it costly for competitors to enter an industry. The greater the costs potential competitors must bear to enter an industry, the greater are the barriers to entry. High barriers to entry keep potential competitors out of an industry even when industry returns are high. To reduce the threat of new entrants, managers of established firms use barriers to entry. Barriers to entry are usually higher for companies involved in manufacturing than for companies that provide a service because there is often a significant expense in setting up a production facility. Entry barriers are unique for each industry and situation, and can change over time.

Major barriers to entry include:

- ↳ **Economies of scale:** is the cost advantages associated with large capacity size. Sources of economies of scale include cost reductions gained through mass production of a standardized output, discounts on bulk purchase of material inputs and component parts, the advantages gained by spreading fixed costs over large production volume, and economies of scale in advertising. This discourages new firms, which have less volume and higher production costs, from entering the market.
- ↳ **Cost Disadvantages Independent of Size:** incumbent firms may have cost advantages even when new entrants have comparable economies of scale, i.e., in case where volume and size have little impact on production cost. These advantages include among others learning curve, proprietary product knowledge- like patents-, favorable access to raw materials, favorable location, government subsidies and so forth.

- ✎ **Product Differentiation:** brand loyalty is buyers' preference for the products of incumbent firms. A company can create brand loyalty through continuous advertising of brand and company names, patent protection of products, product innovation achieved through its research and development programs, an emphasis on high product quality and good after sales services. Significant brand loyalty makes it difficult for new entrants to take market share away from established firms. Thus, brand loyalty reduces threats of entry by potential competitors since they may see the task of breaking down well established consumer preference as too costly. If differences in physical or perceived characteristics make an incumbent's product unique on the eyes of the consumer, new entrants must overcome the resulting brand loyalty.
- ✎ **Capital Requirements:** if the amount of investment required to enter an industry (plant and equipment costs, working capital, etc) is high, the entrants who can afford to start up will be limited.
- ✎ **Switching cost:** the costs, either psychological or financial, that would be incurred by a customer switching from one supplier to another make it difficult for new entrants to gain sales.
- ✎ **Access to Distribution Channels:** costs or other restrictions associated with development to move its products to or through such channels as whole sellers, retailers, brokers, and agents.
- ✎ **Government policy:** government can limit or even foreclose entry to industry with such controls as license requirements and limits on access to raw materials. The government also can play a major indirect role by affecting entry barriers through controls like air and water pollution standards and safety regulations.

Most barriers stem from irreversible resource commitments you must make in order to enter a market. For example, if the existing businesses have well established brand names and fully differentiated products, as a potential market entrant you will need to undertake an expensive marketing campaign to introduce your products.

The threat of new entrants is greatest when:

1. Processes are not protected by regulations or patents.
2. Customers have little brand loyalty.
3. Start-up costs are low for new businesses entering the industry: the less commitment needed in advertising, research and development, and capital assets, the greater the chance of new entrants to the industry.
4. The products provided are not unique: when the products are commodities and the assets used to produce them are common, firms are more willing to enter an industry because they know they can easily liquidate their inventory and assets if the venture fails.
5. Switching costs are low: in situations where customers do not face significant one- time costs from switching suppliers, it is more attractive for new firms to enter the industry and lure the customers away from their previous suppliers.
6. The production process is easily learned: just as competitors may be scared away when the learning curve is steep, competitors will be attracted to an industry where the production process is easily learned.
7. Access to inputs is easy: entry by new firms is easier when established firms do not have favorable access to raw materials, locations, or government subsidies.
8. Access to customers is easy: for instance, it may be easy to rent space to sell produce at a farmer's market, but nearly impossible to get shelf space in a grocery store.
9. Economies of scale are minimal. If there is little improvement in efficiency as scale (or size) increases, a firm entering a market will not be at a disadvantage if it does not produce the large volume that an existing firm produces.

## 2) The Threat of Substitute Products

A substitute can be regarded as something that meets the same needs as the product of the industry. Products from one business can be replaced by products from another. If you produce a commodity product that is undifferentiated, customers can easily switch away from your product to a competitor's product with few consequences. In contrast, there may be a distinct penalty for switching if your product is unique or essential for your customer's

business. Substitute products are those that can fulfill a similar need to the one your product fills.

For example, companies in coffee industry compete indirectly with those in the tea and soft drink industries. The price that companies in the coffee industry can charge is limited by the presence of substitutes such as tea and soft drinks. Hence, the existence of close substitutes presents a strong threat which limits the price to be charged and thereby profitability. Consequently managers must closely monitor substitute products that show improvements in performance and/or decline in prices. Deregulation and technological advances have given rise to a large number of substitutes that have successfully taken market share away from others. For example, deregulation of banking has allowed a wide range of financial businesses to provide many services that were not available and it has led to the emergence of many private banks in Ethiopia.

When developing a business plan, it is critical to assess the other options your customers have to satisfy their needs. To do this, look for products that serve the same function as yours. A threat exists if there are alternative products with lower prices or better performance or both.

Substitutes are greater threat when:

- ◆ Your product doesn't offer any real benefit compared to other products. What will hold your customers if they can get an identical product from your competitor?
- ◆ It is easy for customers to switch. A grocer can easily switch from paper to plastic bags for its customers, but a bottler may have to reconfigure its equipment and retrain its workers if it switches from aluminum cans to plastic bottles.
- ◆ Customers have little loyalty. When price is the customer's primary motivator, the threat of substitutes is greater.
- ◆ The extent to which the price and performance of the substitute can match the industry's product.
- ◆ The willingness of buyers to switch to the substitute.

You can reduce the threat of substitutes by using tactics such as staying closely in tune with customer preferences and differentiating your product by branding. In some cases, the advertising required to differentiate is more than one firm can bear. In that case, collective advertising for an industry may be more effective.

### 3) Bargaining Power of Buyers/customers

The power of buyers describes the effect that your customers have on the profitability of your business. The transaction between the seller and the buyer creates value for both parties. But if buyers (who may be distributors, consumers, or other manufacturers) have more economic power, your ability to capture a high proportion of the value created will decrease, and you will earn lower profits. Buyers can exert bargaining power over a suppliers' 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. When buyers are weak, a company can raise its prices and earn greater profits.

According to porter, buyers are most powerful when the following circumstances prevail:

- ◆ When the supply industry is composed of many small companies and the buyers are few in number and large. These circumstances allow the buyers to dominate suppliers. If a business sells to a few large buyers, they will have significant leverage to negotiate lower prices and other favorable terms because the threat of losing an important buyer puts the business in a weak position.
- ◆ When the buyers purchase in large quantities. in such cases buyers can use their purchasing power as leverage to bargain for price reduction. Buyers have the most power when they are large and purchase much of a firm's output.
- ◆ When the supply industry depends on the buyers for larger percentage of its total sales.
- ◆ When the buyers can switch orders between supply companies at low cost, thereby playing off companies against each other to force down prices.
- ◆ When it is economically feasible for the buyers to purchase the inputs from several companies at once

- ◆ When there is a threat of backward integration by buyers, i.e. when buyers can use the threat to supply their own needs through vertical integration as a tool for forcing down prices. Backward integration would involve buyers moving into an earlier stage of manufacturing or distribution that is moving into the suppliers' business.
- ◆ When the suppliers offer undifferentiated or standard outputs: if the product being supplied is commodity type, the customer can more easily shop around for the most favorable terms.
- ◆ When customers have accurate information about the cost structure of the supplier which allows buyers to exercise more precision in negotiating the prices.
- ◆ When the buyers are highly price sensitive who are more likely to fight for lower prices and/or better terms.

The bargaining power of customers can be reduced by increasing their loyalty to your business through partnerships or loyalty programs, selling directly to consumers, or increasing the inherent or perceived value of a product by adding features or branding. In addition, if you can select the customers who have little knowledge of the market and have less power, you can enhance your profitability.

#### 4) Bargaining Power of Suppliers

Any business requires inputs like labor, component parts, raw materials, and services. The cost of the inputs can have a significant effect on a company's profitability. Whether the strength of suppliers represents a weak or a strong force hinges on the amount of bargaining power they can exert and, ultimately, on how they can influence the terms and conditions of transactions in their favor. Suppliers would prefer to sell at the highest price possible or provide no more services than necessary. If the force is weak, then you may be able to negotiate a favorable business deal for yourself. Conversely, if the force is strong, then the buyers are in a weak position and may have to pay a higher price or accept a lower level of quality or service. Suppliers can be viewed as a threat when they are able to force up price

that a firm must pay for its inputs or reduce the quality of the inputs they supply, thereby reducing the firm's profitability.

Suppliers become powerful when:

- ◆ The product they sell has few substitutes and is important to the company. This limits customers' options.
- ◆ The company's industry is not an important customer. In this case the supplier's health does not depend on the buyers and they will have little incentive to reduce prices or improve quality.
- ◆ The products offered are differentiated to such an extent that it is costly for a firm to switch from one supplier to another. High differentiation by the supplier and high switching cost for the buyer discourages customers from shopping around and playing one supplier against another.
- ◆ They use the threat of forward integration and directly compete with the buyers. Credible threat of forward integration by suppliers involves suppliers moving into a later stage of the manufacturing process or distribution.
- ◆ Buying companies do not use the threat of vertically integrating backward and supplying their own needs as a means to reduce input prices.
- ◆ The buyers do not have a full understanding of their supplier's market. You are less able to negotiate if you have little information about market demand, prices, and supplier's costs.

To reduce the bargaining power of buyers, as most businesses do not have the resources to produce their own inputs then they might consider forming a partnership with their suppliers. This can result in a more even distribution of power.

For instance, Dell Computer uses partnering with its components suppliers as a key strategy to be the low- cost/high-quality leader in the market. This can be mutually beneficial for both supplier and buyer if they can:

- ✍ Reduce inventory costs by providing just-in-time deliveries,
- ✍ Enhance the value of goods and services supplied by making effective use of information about customer needs and preferences, and
- ✍ Speed the adoption of new technologies.

- ✎ Another option may be to increase your power by forming a buying group of small producers to buy as one large-volume customer.

### 5) Intensity of Rivalry among Competitors

Rivalry among competitors is often the strongest of the five competitive forces, but can vary widely among industries. If the competitive force is weak, companies may be able to raise prices, provide fewer products for the price, and earn more profits. If competition is intense, it may be necessary to enhance product offerings to keep customers, and prices may fall below break-even levels. Rivalries can occur on various “playing fields.” In some industries, rivalries are centered on *price* competition-especially companies that sell commodities such as paper, gasoline, or soaps. In other industries, competition may be about offering customers the most attractive combination of *performance features like better quality*, introducing new products, offering more after-sale services or warranties, or creating a stronger brand image than competitors. In some cases the presence of more rivals can actually be a positive-for instance in a shopping area where attracting customers may hinge on having enough stores and attractions to make it a worthwhile shop.

Many industries in free market economies have a high level of competition that usually is characterized by intense price competition, product differentiation, and/or product innovation. In recent years the soft drink industry is being caught up in the “cola wars” which are characterized by frequent price discounts, massive advertising budgets, and constant proliferation of new products. The extent of rivalry among established firms within a given industry largely depends on three factors: the industry’s competitive structure, demand conditions and the height of exit barriers.

1. **Competitive Structure:** refers to the number and size distribution of companies in an industry. Structure can vary from *fragmented* to *consolidated* and have different implications for rivalry. A fragmented industry contains a large number of small or medium sized companies; none of which is in a position to dominate the industry. A consolidated industry may be dominated by a small number of large companies.

Many fragmented industries are characterized by low barriers, and commodity type products that are hard to be differentiated. Low barriers to entry imply that whenever demand is strong and profits are high, there will be a flood of new entrants hoping to cash in the boom. Often the flood of new entrants into a booming fragmented industry creates excess capacity. Once excess capacity develops, companies start to cut prices in order to utilize their spare capacity. The difficulty companies face when trying to differentiate their products from those of competitors can worsen this tendency. The result is price war which depresses industry profits, forces some companies out of business, and deters potential new entrants. In general, a fragmented industry structure then constitutes a threat rather than an opportunity. Most booms will be short lived because of the ease of new entry and will be followed by price wars and bankruptcies. The most intense competition results from well matched rivals in a situation that does not allow any particular firm to dominate.

The nature and intensity of rivalry in consolidated industries is much more difficult to predict. In consolidated industries companies are interdependent such that the competitive action of one company directly affects the profitability of others in the industry. Thus, in a consolidated industry the competitive action of one company directly affects the market share of its rivals, forcing a response from them.

**2. Demand Conditions:** demand conditions are also other determinants of the intensity of rivalry among established companies. Growing demand from either new customers or additional purchases by existing customers tends to moderate competition by providing greater room for expansion. Growing demand tends to reduce rivalry because all companies can sell more without taking market share away from other companies and high profits often the result. Conversely, declining demand results in more rivalry as companies fight to maintain revenues and market share. Demand declines when consumers leave the market place or when each consumer buys less. Under these conditions a company can grow only by taking market share away from other firms. Thus, declining demand constitutes a major threat for it increases the extent of rivalry between established companies.

**3. Exit Barriers:** are economic, strategic, or emotional factors that keep companies in an industry even when returns are low. If exit barriers are high, companies can become locked into an unprofitable industry in which overall demand is static or declining. Excess productive capacity can be created which tends to lead to intensified price competition with companies cutting prices in an attempt to obtain the orders needed to utilize idle capacity. Common exit barriers include the following:

- ◆ Investments in plant and equipment that have no alternative uses and cannot be sold off. If the company wishes to leave the industry, it has to write off the values of these assets.
- ◆ High fixed cost of exit such as severance pay to workers who are being made redundant
- ◆ Emotional attachments to an industry as when a firm is unwilling to exit from its original industry for sentimental reasons.
- ◆ Economic dependence on the industry as when a company is not diversified and so relies on the industry for its income.

Threats of rivals can be reduced by employing a variety of tactics. To minimize price competition, distinguish your product from your competitors' by innovating or improving features. Other tactics include focusing on a unique segment of the market, distributing your product in a novel channel, or trying to form stronger relationships and build customer loyalty.



Dear learner, what do you think are the external forces that influence the day to day operation of an organization and how does it influence?

- 1) What is an industry?
- 2) Discuss the five forces industry analysis models of Michael Porter
- 3) List down the major barriers to entry one by one
- 4) The extent of rivalry among established firms within a given industry largely hinges on three factors. Name these factors.
- 5) What are the conditions that enable suppliers to be powerful over their buyers?

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## 4.5 Industry Analysis: The External Factor Evaluation (EFE) Matrix

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An *External Factor Evaluation (EFE)* Matrix allows strategists to summarize and evaluate economic, social, cultural, demographic, environmental, political, governmental, legal, technological, and competitive information. Illustrated in Table 4.4, the EFE Matrix can be developed in five steps:

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

Table 4.4: EFE Matrix for a Local Ten-Theatre Cinema Complex

| Key External Factors                                            | Weight      | Rating | Weighted Score |
|-----------------------------------------------------------------|-------------|--------|----------------|
| <b>Opportunities</b>                                            |             |        |                |
| Rowan County is growing 8% annually in population               | 0.05        | 3      | 0.15           |
| TDB University is expanding 6% annually                         | 0.08        | 4      | 0.32           |
| Major competitor across town recently ceased operations         | 0.08        | 3      | 0.24           |
| Demand for going to cinema growing 10% annually                 | 0.07        | 2      | 0.14           |
| Two new neighborhoods being developed within 3 miles            | 0.09        | 1      | 0.09           |
| Disposable income among citizens grew 5% in prior year          | 0.06        | 3      | 0.18           |
| 7. Unemployment rate in county declined to 3.1%                 | 0.03        | 2      | 0.06           |
| <b>Threats</b>                                                  |             |        |                |
| 8. Trend toward healthy eating eroding concession sales         | 0.12        | 4      | 0.48           |
| 9. Demand for online movies and DVDs growing 10% annually       | 0.06        | 2      | 0.12           |
| 10. Commercial property adjacent to cinemas for sale            | 0.06        | 3      | 0.18           |
| 11. TDB University installing an on-campus movie theatre        | 0.04        | 3      | 0.12           |
| 12. County and city property taxes increasing 25% this year     | 0.08        | 2      | 0.16           |
| 13. Local religious groups object to R-rated movies being shown | 0.04        | 3      | 0.12           |
| 14. Movies rented from local Blockbuster store up 12%           | 0.08        | 2      | 0.16           |
| 15. Movies rented last quarter from Time Warner up 15%          | 0.06        | 1      | 0.06           |
| <b>Total</b>                                                    | <b>1.00</b> |        | <b>2.58</b>    |

Regardless of the number of key opportunities and threats included in an EFE Matrix, the highest possible total weighted score for an organization is 4.0 and the lowest possible total weighted score is 1.0. The average total weighted score is 2.5.

A total weighted score of 4.0 indicates that an organization is responding in an outstanding way to existing opportunities and threats in its industry. In other words, the firm's strategies effectively take advantage of existing opportunities and minimize the potential adverse effects of external threats. A total score of 1.0 indicates that the firm's strategies are not capitalizing on opportunities or avoiding external threats.

An example of an EFE Matrix is provided in Table 4.4 for a local ten-theatre cinema complex. Note that the most important factor to being successful in this business is "Trend toward healthy eating eroding concession sales" as indicated by the 0.12 weight. Also note

that the local cinema is doing excellent in regard to handling two factors, “TDB University is expanding 6 percent annually” and “Trend toward healthy eating eroding concession sales.” Perhaps the cinema is placing flyers on campus and also adding yogurt and healthy drinks to its concession menu. Note that you may have a 1, 2, 3, or 4 anywhere down the Rating column. Note also that the factors are stated in quantitative terms to the extent possible, rather than being stated in vague terms. Quantify the factors as much as possible in constructing an EFE Matrix. Finally, note that the total weighted score of 2.58 is above the average (midpoint) of 2.5, so this cinema business is doing pretty well, taking advantage of the external opportunities and avoiding the threats facing the firm. There is definitely room for improvement, though, because the highest total weighted score would be 4.0. As indicated by ratings of 1, this business needs to capitalize more on the “two new neighborhoods nearby” opportunity and the “movies rented from Time Warner” threat. Note also that there are many percentage-based factors among the group. Be quantitative to the extent possible! Note also that the ratings range from 1 to 4 on both the opportunities and threats.

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#### 4.6 The Competitive Profile Matrix (CPM)

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The *Competitive Profile Matrix (CPM)* identifies a firm’s major competitors and its particular strengths and weaknesses in relation to a sample firm’s strategic position. The weights and total weighted scores in both a CPM and an EFE have the same meaning.

However, *critical success* factors in a CPM include both internal and external issues; therefore, the ratings refer to strengths and weaknesses, where 4 = major strength, 3 = minor strength, 2 = minor weakness, and 1 = major weakness. The critical success factors in a CPM are not grouped into opportunities and threats as they are in an EFE. In a CPM, the ratings and total weighted scores for rival firms can be compared to the sample firm. This comparative analysis provides important internal strategic information. A sample Competitive Profile Matrix is provided in Table 4.5.

In this example, the two most important factors to being successful in the industry are “advertising” and “global expansion,” as indicated by weights of 0.20. If there were no weight column in this analysis, note that each factor then would be equally important. Thus,

having a weight column makes for a more robust analysis, because it enables the analyst to assign higher and lower numbers to capture perceived or actual levels of importance.

Note in Table 4.5 that Company 1 is strongest on “product quality,” as indicated by a rating of 4, whereas Company 2 is strongest on “advertising.” Overall, Company 1 is strongest, as indicated by the total weighted score of 3.15. Other than the critical success factors listed in the example CPM, factors often included in this analysis include breadth of product line, effectiveness of sales distribution, proprietary or patent advantages, location of facilities, production capacity and efficiency, experience, union relations, technological advantages, and e-commerce expertise.

A word on interpretation: Just because one firm receives a 3.2 rating and another receives a 2.80 rating in a Competitive Profile Matrix, it does not follow that the first firm is 20 percent better than the second. Numbers reveal the relative strengths of firms, but their implied precision is an illusion. Numbers are not magic. The aim is not to arrive at a single number, but rather to assimilate and evaluate information in a meaningful way that aids in decision making.

Table 4.5: An Example Competitive Profile Matrix

| Critical success factors | Weight      | Company 1 |             | Company 1 |             | Company 1 |             |
|--------------------------|-------------|-----------|-------------|-----------|-------------|-----------|-------------|
|                          |             | Rating    | Score       | Rating    | Score       | Rating    | Score       |
| Advertising              | 0.20        | 1         | 0.20        | 4         | 0.80        | 3         | 0.60        |
| Product Quality          | 0.10        | 4         | 0.40        | 3         | 0.30        | 2         | 0.20        |
| Price Competitiveness    | 0.10        | 3         | 0.30        | 2         | 0.20        | 4         | 0.40        |
| Management               | 0.10        | 4         | 0.40        | 3         | 0.20        | 3         | 0.30        |
| Financial Position       | 0.15        | 4         | 0.60        | 2         | 0.30        | 3         | 0.45        |
| Customer Loyalty         | 0.10        | 4         | 0.40        | 3         | 0.30        | 2         | 0.20        |
| Global Expansion         | 0.20        | 4         | 0.80        | 1         | 0.20        | 2         | 0.40        |
| Market Share             | 0.05        | 1         | 0.05        | 4         | 0.20        | 3         | 0.15        |
| <b>Total</b>             | <b>1.00</b> |           | <b>3.15</b> |           | <b>2.50</b> |           | <b>2.70</b> |

**Note:** (1) The ratings values are as follows: 1 = major weakness, 2 = minor weakness, 3 = minor strength, 4 = major strength. (2) As indicated by the total weighted score of 2.50, Competitor 2 is weakest. (3) Only eight critical success factors are included for simplicity; this is too few in actuality.

Dear learner! In conclusion, increasing turbulence in markets and industries around the world means the external audit has become an explicit and vital part of the strategic-management process. This chapter provides a framework for collecting and evaluating economic, social, cultural, demographic, environmental, political, governmental, legal, technological, and competitive information. Firms that do not mobilize and empower their managers and employees to identify, monitor, forecast, and evaluate key external forces may fail to anticipate emerging opportunities and threats and, consequently, may pursue ineffective strategies, miss opportunities, and invite organizational demise. Firms not taking advantage of the Internet are technologically falling behind.

A major responsibility of strategists is to ensure development of an effective external audit system. This includes using information technology to devise a competitive intelligence system that works.

The external-audit approach described in this chapter can be used effectively by any size or type of organization. Typically, the external-audit process is more informal in small firms, but the need to understand key trends and events is no less important for these firms. The EFE Matrix and Porter's Five-Forces Model can help strategists evaluate the market and industry, but these tools must be accompanied by good intuitive judgment. Multinational firms especially need a systematic and effective external audit system because external forces among foreign countries vary so greatly.



## SUMMARY OF THE CHAPTER

-  The purpose of an external audit is to develop a finite list of opportunities that could benefit a firm and avoid threats.
-  External forces can be divided into five broad categories: (1) economic forces; (2) social, cultural, demographic, and environmental forces; (3) political, governmental, and legal forces; (4) technological forces; and (5) competitive forces.
-  To perform an external audit, a company first must gather competitive intelligence and information about social, cultural, demographic, environmental, economic, political, legal, governmental, and technological trends.
-  Porter's Five-Forces Model depicts that the intensity of competition among firms varies widely from industry to industry.
-  According to Porter, the nature of competitiveness in a given industry can be viewed as a composite of five forces.
  -  Rivalry among competitive firms.
  -  Potential entry of new competitors.
  -  Potential development of substitute products.
  -  Bargaining power of suppliers.
  -  Bargaining power of consumers.
-  An EFE Matrix allows strategists to summarize and evaluate economic, social, cultural, demographic, environmental, political, governmental, legal, technological, and competitive information.
-  CPM identifies a firm's major competitors and their particular strengths and weaknesses in relation to a sample firm's strategic position.
-  There are some important differences between the EFE and CPM. First, the critical success factors in a CPM are broader. These factors are also not grouped into opportunities and threats as in the EFE. In a CPM, the ratings and weighted scores can be compared to rival firms.



## CHAPTER REVIEW EXERCISES

1. Which of the following is not a key force affecting the structure of an industry, according to Michael Porter's five force model?
  - A. Threats of new entrants.
  - B. Threats of substitute products
  - C. Rivalry among existing competitors
  - D. Political environment.
2. Which one of the following is major barrier to entry.
  - A. Economies of scale
  - B. Product differentiation
  - C. Government policy
  - D. Cost switching
  - E. All of the above
3. External factors are more important than internal factors in a firm achieving competitive advantage.
  - A. True
  - B. false
4. identifies a firm's major competitors and their particular strengths and weaknesses in relation to a sample firm's strategic position.
  - A. EFE
  - B. CPM
  - C. Porter's five forces model
  - D. All of the above
5. allows strategists to summarize and evaluate economic, social, cultural, demographic, environmental, political, governmental, legal, technological, and competitive information.
  - A. CPM
  - B. EFE
  - C. Competitive intelligence

## CHAPTER

## 5

## THE

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**INTERNAL ASSESSMENT**

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**CHAPTER OUTLINE**

- ◆ The Nature of an Internal Audit
- ◆ The Resource-Based View
- ◆ Integrating Strategy and Culture
- ◆ Management
- ◆ Marketing
- ◆ Finance/Accounting
- ◆ Production/Operations
- ◆ Research and Development
- ◆ Management Information Systems
- ◆ Value Chain Analysis
- ◆ The Internal Factor Evaluation (IFE) Matrix

## CHAPTER OBJECTIVES

After studying this chapter, you should be able to do the following:

- ⊕ Describe how to perform an internal strategic-management audit.
- ⊕ Discuss the Resource-Based View (RBV) in strategic management.
- ⊕ Discuss key interrelationships among the functional areas of business.
- ⊕ Identify the basic functions or activities that make up management, marketing, finance/ accounting, production/operations, research and development, and management information systems.
- ⊕ Explain how to determine and prioritize a firm's internal strengths and weaknesses.
- ⊕ Discuss the nature and role of management information systems in strategic management.
- ⊕ Develop an IFE Matrix.
- ⊕ Explain benchmarking as a strategic management tool.

*"The idea is to concentrate our strength against our competitor's relative weakness."*

*Bruce Henderson*

**D**ear learner! This chapter focuses on identifying and evaluating a firm's strengths and weaknesses in the functional areas of business, including management, marketing, finance/accounting, production/operations, research and development, and management information systems. Relationships among these areas of business are examined. Strategic implications of important functional area concepts are examined. The process of performing an internal audit is described. The Resource-Based View (RBV) of strategic management is introduced as is the Value Chain Analysis (VCA) concept.

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## 5.1 The Nature of an Internal Audit

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All organizations have strengths and weaknesses in the functional areas of business. No enterprise is equally strong or weak in all areas. Maytag, for example, is known for excellent production and product design, whereas Procter & Gamble is known for superb marketing. Internal strengths/weaknesses, coupled with external opportunities/threats and a clear statement of mission, provide the basis for establishing objectives and strategies. Objectives and strategies are established with the intention of capitalizing upon internal strengths and overcoming weaknesses.



Dear student, in this section you will be studying about the internal environment of an organization. What factors, do you think, should be assessed while conducting internal environment analysis? You may use the space given below to write your answer.

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## 5.2 Key Internal Forces

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

For different types of organizations, such as hospitals, universities, and government agencies, the functional business areas, of course, differ. In a hospital, for example, functional areas may include cardiology, hematology, nursing, maintenance, physician support, and receivables. Functional areas of a university can include athletic programs, placement services, housing, fund-raising, academic research, counseling, and intramural programs. Within large organizations, each division has certain strengths and weaknesses.

A firm's strengths that cannot be easily matched or imitated by competitors are called *distinctive competencies*. Building competitive advantages involves taking advantage of distinctive competencies. For example, 3M exploits its distinctive competence in research and development by producing a wide range of innovative products. Strategies are designed in part to improve on a firm's weaknesses, turning them into strengths—and maybe even into distinctive competencies. Figure 5.1 illustrates that all firms should continually strive to improve on their weaknesses, turning them into strengths, and ultimately developing distinctive competencies that can provide the firm with competitive advantages over rival firms.

Figure 5.1: The Process of Gaining Competitive Advantage in a Firm



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### 5.3 The Process of Performing an Internal Audit

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The process of performing an *internal audit* closely parallels the process of performing an external audit. Representative managers and employees from throughout the firm need to be involved in determining a firm's strengths and weaknesses. The internal audit requires gathering and assimilating information about the firm's management, marketing, finance/accounting, production/operations, research and development (R&D), and management information systems operations. Key factors should be prioritized so that the firm's most important strengths and weaknesses can be determined collectively.

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

Performing an internal audit requires gathering, assimilating, and evaluating information about the firm's operations. According to William King, a task force of managers from different units of the organization, supported by staff, should be charged with determining the 10 to 20 most important strengths and weaknesses that should influence the future of the organization. He says:

The development of conclusions on the 10 to 20 most important organizational strengths and weaknesses can be, as any experienced manager knows, a difficult task, when it involves managers representing various organizational interests and points of view.

Developing a 20-page list of strengths and weaknesses could be accomplished relatively easily, but a list of the 10 to 15 most important ones involves significant analysis and negotiation. This is true because of the judgments that are required and the impact which such a list will inevitably have as it is used in the formulation, implementation, and evaluation of strategies.

Strategic management is a highly interactive process that requires effective coordination among management, marketing, finance/accounting, production/operations, R&D, and management information systems managers. Although the strategic-management process is overseen by strategists, success requires that managers and employees from all functional areas work together to provide ideas and information. Financial managers, for example, may need to restrict the number of feasible options available to operations managers, or R&D managers may develop products for which marketing managers need to set higher objectives. A key to organizational success is effective coordination and understanding among managers from all functional business areas. Through involvement in performing an internal strategic-management audit, managers from different departments and divisions of the firm come to understand the nature and effect of decisions in other functional business areas in their firm. Knowledge of these relationships is critical for effectively establishing objectives and strategies.

A failure to recognize and understand relationships among the functional areas of business can be detrimental to strategic management, and the number of those relationships that must be managed increases dramatically with a firm's size, diversity, geographic dispersion, and the number of products or services offered. Governmental and nonprofit enterprises traditionally have not placed sufficient emphasis on relationships among the business functions. Some firms place too great an emphasis on one function at the expense of others. Ansoff explained:

*During the first fifty years, successful firms focused their energies on optimizing the performance of one of the principal functions: production/operations, R&D, or marketing. Today, due to the growing complexity and dynamism of the environment, success increasingly depends on a judicious combination of several functional influences.*

*This transition from a single function focus to a multifunction focus is essential for successful strategic management.*

*Financial ratio analysis* exemplifies the complexity of relationships among the functional areas of business. A declining return on investment or profit margin ratio could be the result of ineffective marketing, poor management policies, research and development errors, or a weak management information system. The effectiveness of strategy formulation, implementation, and evaluation activities hinges upon a clear understanding of how major business functions affect one another. For strategies to succeed, a coordinated effort among all the functional areas of business is needed. In the case of planning, George wrote:

*We may conceptually separate planning for the purpose of theoretical discussion and analysis, but in practice, neither is it a distinct entity nor is it capable of being separated. The planning function is mixed with all other business functions and, like ink once mixed with water, it cannot be set apart. It is spread throughout and is a part of the whole of managing an organization.*

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## 5.4 The Resource-Based View (RBV)

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Do you agree or disagree with the RBV theorists that internal resources are more important than external factors for a firm in achieving and sustaining competitive advantage? Explain your and their position.

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Some researchers emphasize the importance of the internal audit part of the strategic management process by comparing it to the external audit. Robert Grant concluded that the internal audit is more important, saying:

In a world where customer preferences are volatile, the identity of customers is changing, and the technologies for serving customer requirements are continually evolving, an externally focused orientation does not provide a secure foundation for formulating long-term strategy. When the external environment is in a state of flux, the firm's own resources and capabilities may be a much more stable basis on which to define its identity. Hence, a definition of a business in terms of what it is capable of doing may offer a more durable basis for strategy than a definition based upon the needs which the business seeks to satisfy.

The *Resource-Based View (RBV)* approach to competitive advantage contends that internal resources are more important for a firm than external factors in achieving and sustaining competitive advantage. In contrast to the I/O theory presented in the previous chapter, proponents of the RBV view contend that organizational performance will primarily be determined by internal resources that can be grouped into three all-encompassing categories: physical resources, human resources, and organizational resources.<sup>5</sup> Physical resources include all plant and equipment, location, technology, raw materials, machines; human resources include all employees, training, experience, intelligence, knowledge, skills, abilities; and organizational resources include firm structure, planning processes, information systems, patents, trademarks, copyrights, databases, and so on. RBV theory asserts that resources are actually what helps a firm exploit opportunities and neutralize threats.

The basic premise of the RBV is that the mix, type, amount, and nature of a firm's internal resources should be considered first and foremost in devising strategies that can lead to sustainable competitive advantage. Managing strategically according to the RBV involves developing and exploiting a firm's unique resources and capabilities, and continually maintaining and strengthening those resources. The theory asserts that it is advantageous for a firm to pursue a strategy that is not currently being implemented by any competing firm. When other firms are unable to duplicate a particular strategy, then the focal firm has a sustainable competitive advantage, according to RBV theorists.

For a resource to be valuable, it must be either (1) rare, (2) hard to imitate, or (3) not easily substitutable.

Often called *empirical indicators*, these three characteristics of resources enable a firm to implement strategies that improve its efficiency and effectiveness and lead to a sustainable competitive advantage. The more a resource(s) is rare, non imitable, and non substitutable, the stronger a firm's competitive advantage will be and the longer it will last.

Rare resources are resources that other competing firms do not possess. If many firms have the same resource, then those firms will likely implement similar strategies, thus giving no one firm a sustainable competitive advantage. This is not to say that resources that are common are not valuable; they do indeed aid the firm in its chance for economic prosperity. However, to sustain a competitive advantage, it is more advantageous if the resource(s) is also rare.

It is also important that these same resources be difficult to imitate. If firms cannot easily gain the resources, say RBV theorists, then those resources will lead to a competitive advantage more so than resources easily imitable. Even if a firm employs resources that are rare, a sustainable competitive advantage may be achieved only if other firms cannot easily obtain these resources.

The third empirical indicator that can make resources a source of competitive advantage is substitutability. Borrowing from Porter's Five-Forces Model, to the degree that there are no viable substitutes, a firm will be able to sustain its competitive advantage. However, even if a competing firm cannot perfectly imitate a firm's resource, it can still obtain a sustainable competitive advantage of its own by obtaining resource substitutes.

The RBV has continued to grow in popularity and continues to seek a better understanding of the relationship between resources and sustained competitive advantage in strategic management. However, one cannot say with any degree of certainty that either external or internal factors will always or even consistently be more important in seeking competitive advantage. Understanding both external and internal factors, and more importantly, understanding the relationships among them, will be the key to effective strategy formulation. Because both external and internal factors continually change, strategists seek to identify and

take advantage of positive changes and buffer against negative changes in a continuing effort to gain and sustain a firm's competitive advantage. This is the essence and challenge of strategic management, and oftentimes survival of the firm hinges on this work.

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## 5.5 Integrating Strategy and Culture

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Relationships among a firm's functional business activities perhaps can be exemplified best by focusing on organizational culture, an internal phenomenon that permeates all departments and divisions of an organization.



Identify cultural products at your college or university. Do these products, viewed collectively or separately, represent a strength or weakness for the organization?

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*Organizational culture* can be defined as “a pattern of behavior that has been developed by an organization as it learns to cope with its problem of external adaptation and internal integration, and that has worked well enough to be considered valid and to be taught to new members as the correct way to perceive, think, and feel.” This definition emphasizes the importance of matching external with internal factors in making strategic decisions.

Organizational culture captures the subtle, elusive, and largely unconscious forces that shape a workplace. Remarkably resistant to change, culture can represent a major strength or weakness for the firm. It can be an underlying reason for strengths or weaknesses in any of the major business functions. *Cultural products* include values, beliefs, rites, rituals, ceremonies, myths, stories, legends, sagas, language, metaphors, symbols, heroes, and heroines. These products or dimensions are levers that strategists can use to influence and direct strategy formulation, implementation, and evaluation activities.

An organization's culture compares to an individual's personality in the sense that no two organizations have the same culture and no two individuals have the same personality. Both culture and personality are enduring and can be warm, aggressive, friendly, open, innovative, conservative, liberal, harsh, or likable.

Dimensions of organizational culture permeate all the functional areas of business. It is something of an art to uncover the basic values and beliefs that are deeply buried in an organization's rich collection of stories, language, heroes, and rituals, but cultural products can represent both important strengths and weaknesses. Culture is an aspect of an organization that can no longer be taken for granted in performing an internal strategic-management audit because culture and strategy must work together.

Table 5.1 provides some example (possible) aspects of an organization's culture. Note you could ask employees/managers to rate the degree that the dimension characterizes the firm. When one firm acquires another firm, integrating the two cultures can be important. For example, in Table 5.1, one firm may score mostly 1's and the other firm may score mostly 5's, which would present a challenging strategic problem.

The strategic-management process takes place largely within a particular organization's culture. Lorsch found that executives in successful companies are emotionally committed to the firm's culture, but he concluded that culture can inhibit strategic management in two basic ways. First, managers frequently miss the significance of changing external conditions because they are blinded by strongly held beliefs. Second, when a particular culture has been effective in the past, the natural response is to stick with it in the future, even during times of major strategic change. An organization's culture must support the collective commitment of its people to a common purpose. It must foster competence and enthusiasm among managers and employees.

Organizational culture significantly affects business decisions and thus must be evaluated during an internal strategic-management audit. If strategies can capitalize on cultural strengths, such as a strong work ethic or highly ethical beliefs, then management often can

swiftly and easily implement changes. However, if the firm's culture is not supportive, strategic changes may be ineffective or even counterproductive. A firm's culture can become antagonistic to new strategies, with the result being confusion and disorientation.

Table 5.1: Fifteen Example (Possible) Aspects of an Organization's Culture

| Dimension                                                           | Degree |   |   |   |   |
|---------------------------------------------------------------------|--------|---|---|---|---|
| 1. Strong work ethic; arrive early and leave late                   | 1      | 2 | 3 | 4 | 5 |
| 2. High ethical beliefs; clear code of business ethics followed     | 1      | 2 | 3 | 4 | 5 |
| 3. Formal dress; shirt and tie expected                             | 1      | 2 | 3 | 4 | 5 |
| 4. Informal dress; many casual dress days                           | 1      | 2 | 3 | 4 | 5 |
| 5. Socialize together outside of work                               | 1      | 2 | 3 | 4 | 5 |
| 6. Do not question supervisor's decision                            | 1      | 2 | 3 | 4 | 5 |
| 7. Encourage whistle-blowing                                        | 1      | 2 | 3 | 4 | 5 |
| 8. Be health conscious; have a wellness program                     | 1      | 2 | 3 | 4 | 5 |
| 9. Allow substantial "working from home"                            | 1      | 2 | 3 | 4 | 5 |
| 10. Encourage creativity/innovation/open-mindedness                 | 1      | 2 | 3 | 4 | 5 |
| 11. Support women and minorities; no glass ceiling                  | 1      | 2 | 3 | 4 | 5 |
| 12. Be highly socially responsible; be philanthropic                | 1      | 2 | 3 | 4 | 5 |
| 13. Have numerous meetings                                          | 1      | 2 | 3 | 4 | 5 |
| 14. Have a participative management style                           | 1      | 2 | 3 | 4 | 5 |
| 15. Preserve the natural environment; have a sustainability program | 1      | 2 | 3 | 4 | 5 |

An organization's culture should infuse individuals with enthusiasm for implementing strategies. Allarie and Firsirotu emphasized the need to understand culture:

*Culture provides an explanation for the insuperable difficulties a firm encounters when it attempts to shift its strategic direction. Not only has the "right" culture become the essence and foundation of corporate excellence, it is also claimed that success or failure of reforms hinges on management's sagacity and ability to change the firm's driving culture in time and in time with required changes in strategies.*

The potential value of organizational culture has not been realized fully in the study of strategic management. Ignoring the effect that culture can have on relationships among the functional areas of business can result in barriers to communication, lack of coordination, and an inability to adapt to changing conditions.

Some tension between culture and a firm's strategy is inevitable, but the tension should be monitored so that it does not reach a point at which relationships are severed and the culture becomes antagonistic. The resulting disarray among members of the organization would disrupt strategy formulation, implementation, and evaluation. In contrast, a supportive organizational culture can make managing much easier.

Internal strengths and weaknesses associated with a firm's culture sometimes are overlooked because of the inter-functional nature of this phenomenon. It is important, therefore, for strategists to understand their firm as a socio cultural system. Success is often determined by linkages between a firm's culture and strategies. The challenge of strategic management today is to bring about the changes in organizational culture and individual mind-sets that are needed to support the formulation, implementation, and evaluation of strategies.

## 5.6 Management

The *functions of management* consist of five basic activities: planning, organizing, motivating, staffing, and controlling. An overview of these activities is provided in Table 5.2.

Table 5.2: The Basic Functions of Management

| Function    | Description                                                                                                                                                                                                                                                                                                                                                                                              | Stage of Strategic-Management Process When Most Important |
|-------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------------------------------------------------------|
| Planning    | Planning consists of all those managerial activities related to preparing for the future. Specific tasks include forecasting, establishing objectives, devising strategies, developing policies, and setting goals.                                                                                                                                                                                      | Strategy Formulation                                      |
| Organizing  | Organizing includes all those managerial activities that result in a structure of task and authority relationships. Specific areas include organizational design, job specialization, job descriptions, job specifications, span of control, unity of command, coordination, job design, and job analysis.                                                                                               | Strategy Implementation                                   |
| Motivating  | Motivating involves efforts directed toward shaping human behavior. Specific topics include leadership, communication, work groups, behavior modification, delegation of authority, job enrichment, job satisfaction, needs fulfillment, organizational change, employee morale, and managerial morale.                                                                                                  | Strategy Implementation                                   |
| Staffing    | Staffing activities are centered on personnel or human resource management. Included are wage and salary administration, employee benefits, interviewing, hiring, firing, training, management development, employee safety, affirmative action, equal employment opportunity, union relations, career development, personnel research, discipline policies, grievance procedures, and public relations. | Strategy Implementation                                   |
| Controlling | Controlling refers to all those managerial activities directed toward ensuring that actual results are consistent with planned results. Key areas of concern include quality control, financial control, sales control, inventory control, expense control, analysis of variances, rewards, and sanctions.                                                                                               | Strategy Evaluation                                       |

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## 5.7 Marketing

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

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### 5.7.1 Customer Analysis

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*Customer analysis*—the examination and evaluation of consumer needs, desires, and wants— involves administering customer surveys, analyzing consumer information, evaluating market positioning strategies, developing customer profiles, and determining optimal market segmentation strategies. The information generated by customer analysis can be essential in developing an effective mission statement. Customer profiles can reveal the demographic characteristics of an organization's customers. Buyers, sellers, distributors, salespeople, managers, wholesalers, retailers, suppliers, and creditors can all participate in gathering information to successfully identify customers' needs and wants. Successful organizations continually monitor present and potential customers' buying patterns.

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### 5.7.2 Selling Products/Services

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Successful strategy implementation generally rests upon the ability of an organization to sell some product or service. *Selling* includes many marketing activities, such as advertising, sales promotion, publicity, personal selling, sales force management, customer relations, and dealer relations. These activities are especially critical when a firm pursues a market penetration strategy. The effectiveness of various selling tools for consumer and industrial products varies. Personal selling is most important for industrial goods companies, and advertising is most important for consumer goods companies.

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### 5.7.3 Product and Service Planning

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*Product and service planning* includes activities such as test marketing; product and brand positioning; devising warranties; packaging; determining product options, features, style, and quality; deleting old products; and providing for customer service. Product and service planning is particularly important when a company is pursuing product development or diversification.

One of the most effective product and service planning techniques is *test marketing*. Test markets allow an organization to test alternative marketing plans and to forecast future sales of new products. In conducting a test market project, an organization must decide how many cities to include, which cities to include, how long to run the test, what information to collect during the test, and what action to take after the test has been completed. Test marketing is used more frequently by consumer goods companies than by industrial goods companies. Test marketing can allow an organization to avoid substantial losses by revealing weak products and ineffective marketing approaches before large-scale production begins.

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### 5.7.4 Pricing

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Five major stakeholders affect *pricing* decisions: consumers, governments, suppliers, distributors, and competitors. Sometimes an organization will pursue a forward integration strategy primarily to gain better control over prices charged to consumers. Governments can impose constraints on price fixing, price discrimination, minimum prices, unit pricing, price advertising, and price controls. For example, the Robinson-Patman Act prohibits manufacturers and wholesalers from discriminating in price among channel member purchasers (suppliers and distributors) if competition is injured.

Competing organizations must be careful not to coordinate discounts, credit terms, or condition of sale; not to discuss prices, markups, and costs at trade association meetings; and not to arrange to issue new price lists on the same date, to rotate low bids on contracts, or to uniformly restrict production to maintain high prices. Strategists should view price from both

a short-run and a long-run perspective, because competitors can copy price changes with relative ease. Often a dominant firm will aggressively match all price cuts by competitors.

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### 5.7.5 Distribution

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*Distribution* includes warehousing, distribution channels, distribution coverage, retail site locations, sales territories, inventory levels and location, transportation carriers, wholesaling, and retailing. Most producers today do not sell their goods directly to consumers. Various marketing entities act as intermediaries; they bear a variety of names such as wholesalers, retailers, brokers, facilitators, agents, vendors—or simply distributors.

Distribution becomes especially important when a firm is striving to implement a market development or forward integration strategy. Some of the most complex and challenging decisions facing a firm concern product distribution. Intermediaries flourish in our economy because many producers lack the financial resources and expertise to carry out direct marketing. Manufacturers who could afford to sell directly to the public often can gain greater returns by expanding and improving their manufacturing operations.

Successful organizations identify and evaluate alternative ways to reach their ultimate market. Possible approaches vary from direct selling to using just one or many wholesalers and retailers. Strengths and weaknesses of each channel alternative should be determined according to economic, control, and adaptive criteria. Organizations should consider the costs and benefits of various wholesaling and retailing options. They must consider the need to motivate and control channel members and the need to adapt to changes in the future. Once a marketing channel is chosen, an organization usually must adhere to it for an extended period of time.

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### 5.7.6 Marketing Research

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*Marketing research* is the systematic gathering, recording, and analyzing of data about problems relating to the marketing of goods and services. Marketing research can uncover critical strengths and weaknesses, and marketing researchers employ numerous scales,

instruments, procedures, concepts, and techniques to gather information. Marketing research activities support all of the major business functions of an organization. Organizations that possess excellent marketing research skills have a definite strength in pursuing generic strategies.

*The President of PepsiCo said, “Looking at the competition is the company’s best form of market research. The majority of our strategic successes are ideas that we borrow from the marketplace, usually from a small regional or local competitor. In each case, we spot a promising new idea, improve on it, and then out-execute our competitor.”*

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#### 5.7.7 Cost/Benefit Analysis

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The seventh function of marketing is *cost/benefit analysis*, which involves assessing the costs, benefits, and risks associated with marketing decisions. Three steps are required to perform a cost/benefit analysis: (1) compute the total costs associated with a decision, (2) estimate the total benefits from the decision, and (3) compare the total costs with the total benefits. When expected benefits exceed total costs, an opportunity becomes more attractive. Sometimes the variables included in a cost/benefit analysis cannot be quantified or even measured, but usually reasonable estimates can be made to allow the analysis to be performed. One key factor to be considered is risk. Cost/benefit analysis should also be performed when a company is evaluating alternative ways to be socially responsible.

#### Marketing Audit Checklist of Questions

The following questions about marketing must be examined in strategic planning:

1. Are markets segmented effectively?
2. Is the organization positioned well among competitors?
3. Has the firm’s market share been increasing?
4. Are present channels of distribution reliable and cost effective?
5. Does the firm have an effective sales organization?
6. Does the firm conduct market research?
7. Are product quality and customer service good?

8. Are the firm's products and services priced appropriately?
9. Does the firm have an effective promotion, advertising, and publicity strategy?
10. Are marketing, planning, and budgeting effective?
11. Do the firm's marketing managers have adequate experience and training?
12. Is the firm's Internet presence excellent as compared to rivals?

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#### 5.7.8 Finance/Accounting

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Financial condition is often considered the single best measure of a firm's competitive position and overall attractiveness to investors. Determining an organization's financial strengths and weaknesses is essential to effectively formulating strategies. A firm's liquidity, leverage, working capital, profitability, asset utilization, cash flow, and equity can eliminate some strategies as being feasible alternatives. Financial factors often alter existing strategies and change implementation plans.

#### **Finance/Accounting Audit Checklist**

The following finance/accounting questions, like the similar questions about marketing and management earlier, should be examined:

1. Where is the firm financially strong and weak as indicated by financial ratio analyses?
2. Can the firm raise needed short-term capital?
3. Can the firm raise needed long-term capital through debt and/or equity?
4. Does the firm have sufficient working capital?
5. Are capital budgeting procedures effective?
6. Are dividend payout policies reasonable?
7. Does the firm have good relations with its investors and stockholders?
8. Are the firm's financial managers experienced and well trained?
9. Is the firm's debt situation excellent?

### 5.7.9 Production/Operations

The *production/operations function* of a business consists of all those activities that transform inputs into goods and services. Production/operations management deals with inputs, transformations, and outputs that vary across industries and markets. A manufacturing operation transforms or converts inputs such as raw materials, labor, capital, machines, and facilities into finished goods and services. As indicated in Table 5.3, Roger Schroeder suggested that production/operations management comprises five functions or decision areas: process, capacity, inventory, workforce, and quality.

Table 5.3: The Basic Functions (Decisions) Within Production/Operations

| Decision Areas | Example Decisions                                                                                                                                                                                                                                               |
|----------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 1. Process     | These decisions include choice of technology, facility layout, process flow analysis, facility location, line balancing, process control, and transportation analysis. Distances from raw materials to production sites to customers are a major consideration. |
| 2. Capacity    | These decisions include forecasting, facilities planning, aggregate planning, scheduling, capacity planning, and queuing analysis. Capacity utilization is a major consideration.                                                                               |
| 3. Inventory   | These decisions involve managing the level of raw materials, work-in-process, and finished goods, especially considering what to order, when to order, how much to order, and materials handling.                                                               |
| 4. Workforce   | These decisions involve managing the skilled, unskilled, clerical, and managerial employees by caring for job design, work measurement, job enrichment, work standards, and motivation techniques.                                                              |
| 5. Quality     | These decisions are aimed at ensuring that high-quality goods and services are produced by caring for quality control, sampling, testing, quality assurance, and cost control.                                                                                  |

#### Production/Operations Audit Checklist

Questions such as the following should be examined:

1. Are supplies of raw materials, parts, and subassemblies reliable and reasonable?
2. Are facilities, equipment, machinery, and offices in good condition?
3. Are inventory-control policies and procedures effective?
4. Are quality-control policies and procedures effective?
5. Are facilities, resources, and markets strategically located?
6. Does the firm have technological competencies?

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### 5.7.10 Research and Development

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The fifth major area of internal operations that should be examined for specific strengths and weaknesses is *research and development (R&D)*. Many firms today conduct no R&D, and yet many other companies depend on successful R&D activities for survival. Firms pursuing a product development strategy especially need to have a strong R&D orientation.

Organizations invest in R&D because they believe that such an investment will lead to a superior product or service and will give them competitive advantages. Research and development expenditures are directed at developing new products before competitors do, at improving product quality, or at improving manufacturing processes to reduce costs.

Effective management of the R&D function requires a strategic and operational partnership between R&D and the other vital business functions. A spirit of partnership and mutual trust between general and R&D managers is evident in the best-managed firms today. Managers in these firms jointly explore; assess; and decide the what, when, where, why, and how much of R&D. Priorities, costs, benefits, risks, and rewards associated with R&D activities are discussed openly and shared. The overall mission of R&D thus has become broad-based, including supporting existing businesses, helping launch new businesses, developing new products, improving product quality, improving manufacturing efficiency, and deepening or broadening the company's technological capabilities.

#### Research and Development Audit

Questions such as the following should be asked in performing an R&D audit:

1. Does the firm have R&D facilities? Are they adequate?
2. If outside R&D firms are used, are they cost-effective?
3. Are the organization's R&D personnel well qualified?
4. Are R&D resources allocated effectively?
5. Are management information and computer systems adequate?
6. Is communication between R&D and other organizational units effective?
7. Are present products technologically competitive?

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### 5.7.11 Management Information Systems

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Can you explain the difference between data and information in terms of each being useful to strategists?

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Information ties all business functions together and provides the basis for all managerial decisions. It is the cornerstone of all organizations. Information represents a major source of competitive management advantage or disadvantage. Assessing a firm's internal strengths and weaknesses in information systems is a critical dimension of performing an internal audit. The company motto of Mitsui, a large Japanese trading company, is "Information is the lifeblood of the company."

A management information system's purpose is to improve the performance of an enterprise by improving the quality of managerial decisions. An effective information system thus collects, codes, stores, synthesizes, and presents information in such a manner that it answers important operating and strategic questions. The heart of an information system is a database containing the kinds of records and data important to managers.

*A management information system* receives raw material from both the external and internal evaluation of an organization. It gathers data about marketing, finance, production, and personnel matters internally, and social, cultural, demographic, environmental, economic, political, governmental, legal, technological, and competitive factors externally. Data are integrated in ways needed to support managerial decision making.

There is a logical flow of material in a computer information system, whereby data are input to the system and transformed into output. Outputs include computer printouts, written reports, tables, charts, graphs, checks, purchase orders, invoices, inventory records, payroll accounts, and a variety of other documents.

Payoffs from alternative strategies can be calculated and estimated. *Data* become *information* only when they are evaluated, filtered, condensed, analyzed, and organized for a specific purpose, problem, individual, or time.

Because organizations are becoming more complex, decentralized, and globally dispersed, the function of information systems is growing in importance. Spurring this advance is the falling cost and increasing power of computers. There are costs and benefits associated with obtaining and evaluating information, just as with equipment and land. Like equipment, information can become obsolete and may need to be purged from the system. An effective information system is like a library, collecting, categorizing, and filing data for use by managers throughout the organization. Information systems are a major strategic resource, monitoring internal and external issues and trends, identifying competitive threats, and assisting in the implementation, evaluation, and control of strategy.

We are truly in an information age. Firms whose information-system skills are weak are at a competitive disadvantage. In contrast, strengths in information systems allow firms to establish distinctive competencies in other areas. Low-cost manufacturing and good customer service, for example, can depend on a good information system.

#### Management Information Systems Audit

Questions such as the following should be asked when conducting this audit:

1. Do all managers in the firm use the information system to make decisions?
2. Is there a chief information officer or director of information systems position in the firm?
3. Are data in the information system updated regularly?
4. Do managers from all functional areas of the firm contribute input to the information system?
5. Are there effective passwords for entry into the firm's information system?
6. Are strategists of the firm familiar with the information systems of rival firms?
7. Is the information system user-friendly?

8. Do all users of the information system understand the competitive advantages that information can provide firms?
9. Are computer training workshops provided for users of the information system?
10. Is the firm's information system continually being improved in content and user-friendliness?

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## 5.8 Value Chain Analysis (VCA)

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Define and explain value chain analysis (VCA).

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According to Porter, the business of a firm can best be described as a *value chain*, in which total revenues minus total costs of all activities undertaken to develop and market a product or service yields value. All firms in a given industry have a similar value chain, which includes activities such as obtaining raw materials, designing products, building manufacturing facilities, developing cooperative agreements, and providing customer service. A firm will be profitable as long as total revenues exceed the total costs incurred in creating and delivering the product or service. Firms should strive to understand not only their own value chain operations but also their competitors', suppliers', and distributors' value chains.

*Value chain analysis (VCA)* refers to the process whereby a firm determines the costs associated with organizational activities from purchasing raw materials to manufacturing product(s) to marketing those products. VCA aims to identify where low-cost advantages or disadvantages exist anywhere along the value chain from raw material to customer service activities. VCA can enable a firm to better identify its own strengths and weaknesses, especially as compared to competitors' value chain analyses and their own data examined over time.

Substantial judgment may be required in performing a VCA because different items along the value chain may impact other items positively or negatively, so there exist complex interrelationships. For example, exceptional customer service may be especially expensive yet may reduce the costs of returns and increase revenues. Cost and price differences among rival firms can have their origins in activities performed by suppliers, distributors, creditors, or even shareholders. Despite the complexity of VCA, the initial step in implementing this procedure is to divide a firm's operations into specific activities or business processes. Then the analyst attempts to attach a cost to each discrete activity, and the costs could be in terms of both time and money. Finally, the analyst converts the cost data into information by looking for competitive cost strengths and weaknesses that may yield competitive advantage or disadvantage. Conducting a VCA is supportive of the RBV's examination of a firm's assets and capabilities as sources of distinctive competence.

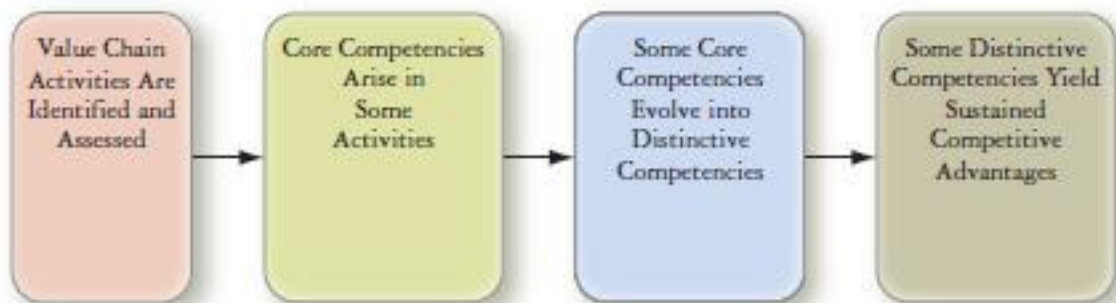
When a major competitor or new market entrant offers products or services at very low prices, this may be because that firm has substantially lower value chain costs or perhaps the rival firm is just waging a desperate attempt to gain sales or market share. Thus value chain analysis can be critically important for a firm in monitoring whether its prices and costs are competitive. There can be more than a hundred particular value-creating activities associated with the business of producing and marketing a product or service, and each one of the activities can represent a competitive advantage or disadvantage for the firm. The combined costs of all the various activities in a company's value chain define the firm's cost of doing business. Firms should determine where cost advantages and disadvantages in their value chain occur *relative to the value chain of rival firms*.

Value chains differ immensely across industries and firms. Whereas a paper products company, such as Stone Container, would include on its value chain timber farming, logging, pulp mills, and papermaking, a computer company such as Hewlett-Packard would include programming, peripherals, software, hardware, and laptops. A motel would include food, housekeeping, check-in and check-out operations, Web site, reservations system, and so on.

However all firms should use value chain analysis to develop and nurture a core competence and convert this competence into a distinctive competence. A *core competence* is a value chain activity that a firm performs especially well. When a core competence evolves into a major competitive advantage, then it is called a *distinctive competence*. Figure 5.4 illustrates this process.

More and more companies are using VCA to gain and sustain competitive advantage by being especially efficient and effective along various parts of the value chain. For example, Wal-Mart has built powerful value advantages by focusing on exceptionally tight inventory control, volume purchasing of products, and offering exemplary customer service. Computer companies in contrast compete aggressively along the distribution end of the value chain. Of course, price competitiveness is a key component of effectiveness among both mass retailers and computer firms.

Table 5.4: Transforming Value Chain Activities into Sustained Competitive Advantage  
**Transforming Value Chain Activities into Sustained Competitive Advantage**



## 5.9 Benchmarking

*Benchmarking* is an analytical tool used to determine whether a firm's value chain activities are competitive compared to rivals and thus conducive to winning in the marketplace. Benchmarking entails measuring costs of value chain activities across an industry to determine "best practices" among competing firms for the purpose of duplicating or improving upon those best practices. Benchmarking enables a firm to take action to improve its competitiveness by identifying (and improving upon) value chain activities where rival firms have comparative advantages in cost, service, reputation, or operation.

The hardest part of benchmarking can be gaining access to other firms' value chain activities with associated costs. Typical sources of benchmarking information, however, include published reports, trade publications, suppliers, distributors, customers, partners, creditors, shareholders, lobbyists, and willing rival firms.

Some rival firms share benchmarking data. However, the International Benchmarking Clearinghouse provides guidelines to help ensure that restraint of trade, price fixing, bid rigging, bribery, and other improper business conduct do not arise between participating firms.

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### 5.10 The Internal Factor Evaluation (IFE) Matrix

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A summary step in conducting an internal strategic-management audit is to construct an *Internal Factor Evaluation (IFE) Matrix*. This strategy-formulation tool summarizes and evaluates the major strengths and weaknesses in the functional areas of a business, and it also provides a basis for identifying and evaluating relationships among those areas. Intuitive judgments are required in developing an IFE Matrix, so the appearance of a scientific approach should not be interpreted to mean this is an all-powerful technique. A thorough understanding of the factors included is more important than the actual numbers. Similar to the EFE Matrix and Competitive Profile Matrix described in Chapter 3, an IFE Matrix can be developed in five steps:

1. List key internal factors as identified in the internal-audit process. Use a total of from 10 to 20 internal factors, including both strengths and weaknesses. List strengths first and then weaknesses. Be as specific as possible, using percentages, ratios, and comparative numbers. Recall that Edward Deming said, "In God we trust. Everyone else bring data."
2. Assign a weight that ranges from 0.0 (not important) to 1.0 (all-important) to each factor. The weight assigned to a given factor indicates the relative importance of the factor to being successful in the firm's industry. Regardless of whether a key factor is an internal strength or weakness, factors considered to have the greatest effect on

organizational performance should be assigned the highest weights. The sum of all weights must equal 1.0.

3. Assign a 1-to-4 rating to each factor to indicate whether that factor represents a major weakness (rating = 1), a minor weakness (rating = 2), a minor strength (rating = 3), or a major strength (rating = 4). Note that strengths must receive a 3 or 4 rating and weaknesses must receive a 1 or 2 rating. Ratings are thus company-based, whereas the weights in step 2 are industry-based.
4. Multiply each factor's weight by its rating to determine a weighted score for each variable.
5. Sum the weighted scores for each variable to determine the total weighted score for the organization.

Regardless of how many factors are included in an IFE Matrix, the total weighted score can range from a low of 1.0 to a high of 4.0, with the average score being 2.5. Total weighted scores well below 2.5 characterize organizations that are weak internally, whereas scores significantly above 2.5 indicate a strong internal position. Like the EFE Matrix, an IFE Matrix should include from 10 to 20 key factors. The number of factors has no effect upon the range of total weighted scores because the weights always sum to 1.0. When a key internal factor is both a strength and a weakness, the factor should be included twice in the IFE Matrix, and a weight and rating should be assigned to each statement.

An example of an IFE Matrix is provided in Table 5.5 for a retail computer store. Note that the two most important factors to be successful in the retail computer store business are "revenues from repair/service in the store" and "location of the store." Also note that the store is doing best on "average customer purchase amount" and "in-store technical support." The store is having major problems with its carpet, bathroom, paint, and checkout procedures. Note also that the matrix contains substantial quantitative data rather than vague statements; this is excellent. Overall, this store receives a 2.5 total weighted score, which on a 1-to-4 scale is exactly average/halfway, indicating there is definitely room for improvement in store operations, strategies, policies, and procedures.

The IFE Matrix provides important information for strategy formulation. For example, this retail computer store might want to hire another checkout person and repair its carpet, paint, and bathroom problems. Also, the store may want to increase advertising for its repair/services, because that is a really important (weight 0.15) factor to being successful in this business. In multidivisional firms, each autonomous division or strategic business unit should construct an IFE Matrix. Divisional matrices then can be integrated to develop an overall corporate IFE Matrix.

Table 5.5: A Sample Internal Factor Evaluation Matrix for a Retail Computer Store

| Key Internal Factors                                             | Weight      | Rating | Weighted Score |
|------------------------------------------------------------------|-------------|--------|----------------|
| <b>Strengths</b>                                                 |             |        |                |
| 1. Inventory turnover increased from 5.8 to 6.7                  | 0.05        | 3      | 0.15           |
| 2. Average customer purchase increased from \$97 to \$128        | 0.07        | 4      | 0.28           |
| 3. Employee morale is excellent                                  | 0.10        | 3      | 0.30           |
| 4. In-store promotions resulted in 20 percent increase in sales  | 0.05        | 3      | 0.15           |
| 5. Newspaper advertising expenditures increased 10 percent       | 0.02        | 3      | 0.06           |
| 6. Revenues from repair/service segment of store up 16 percent   | 0.15        | 3      | 0.45           |
| 7. In-store technical support personnel have MIS college degrees | 0.05        | 4      | 0.20           |
| 8. Store's debt-to-total assets ratio declined to 34 percent     | 0.03        | 3      | 0.09           |
| 9. Revenues per employee up 19 percent                           | 0.02        | 3      | 0.06           |
| <b>Weaknesses</b>                                                |             |        |                |
| 1. Revenues from software segment of store down 12 percent       | 0.10        | 2      | 0.20           |
| 2. Location of store negatively impacted by new Highway 34       | 0.15        | 2      | 0.30           |
| 3. Carpet and paint in store somewhat in disrepair               | 0.02        | 1      | 0.02           |
| 4. Bathroom in store needs refurbishing                          | 0.02        | 1      | 0.02           |
| 5. Revenues from businesses down 8 percent                       | 0.04        | 1      | 0.04           |
| 6. Store has no Web site                                         | 0.05        | 2      | 0.10           |
| 7. Supplier on-time delivery increased to 2.4 days               | 0.03        | 1      | 0.03           |
| 8. Often customers have to wait to check out                     | 0.05        | 1      | 0.05           |
| <b>Total</b>                                                     | <b>1.00</b> |        | <b>2.50</b>    |



## SUMMARY OF THE CHAPTER

- ✎ All organizations have strengths and weaknesses in the functional areas of business. No enterprise is equally strong or weak in all areas. Internal strengths/weaknesses, coupled with external opportunities/threats and a clear statement of mission, provide the basis for establishing objectives and strategies.
- ✎ A firm's strengths that cannot be easily matched or imitated by competitors are called distinctive competencies. Building competitive advantages involves taking advantage of distinctive competencies.
- ✎ Strategies are designed in part to improve on a firm's weaknesses, turning them into strengths, and maybe even into distinctive competencies.
- ✎ The process of performing an internal audit closely parallels the process of performing an external audit. Representative managers and employees from throughout the firm need to be involved in determining a firm's strengths and weaknesses.
- ✎ Compared to the external audit, the process of performing an internal audit provides more opportunity for participants to understand how their jobs, departments, and divisions fit into the whole organization.
- ✎ The RBV takes the opposing view to that of the I/O theorists discussed in Chapter 3. The RBV approach to competitive advantage contends that internal resources are more important than external factors for a firm in achieving and sustaining competitive advantage.
- ✎ Internal resources come from three categories.
  - A. Physical resources: plant, equipment, location, technology, raw materials, machines, etc.
  - B. Human resources: employees, training, experience, intelligence, knowledge, skills, abilities, etc.
  - C. Organizational resources: firm structure, planning processes, information systems, patents, trademarks, copyrights, databases, etc.

- 📁 Resources are only valuable if they have one or more of the following characteristics:
  - A. rare
  - B. hard to imitate
  - C. not easily substitutable
- 📁 Relationships among a firm's functional business activities perhaps can be exemplified by focusing on organizational culture, an internal phenomenon that permeates through all departments and divisions of an organization.
- 📁 Organizational culture significantly affects business decisions and thus, must be evaluated during an internal strategic-management audit.
- 📁 Marketing research can uncover critical strengths and weaknesses, and marketing researchers can employ numerous scales, instruments, procedures, concepts, and techniques to gather information.
- 📁 Financial condition is often considered the single best measure of a firm's competitive position and overall attractiveness to investors. Determining an organization's financial strengths and weaknesses is essential to formulating strategies effectively.
- 📁 Firms use benchmarking to determine whether its value chain activities are competitive compared to rivals. This entails measuring the costs of value chain activities across an industry to determine "best practices" among competing firms for the purpose of duplicating or improving upon those best practices.



## CHAPTER REVIEW EXERCISES

Part I: Choose the correct answer from the given alternatives

1. Which of the following is not a key functional area in a typical business organization?
  - A. Management
  - B. Marketing
  - C. Research and development
  - D. Purchasing
2. An internal audit is performed at which stage in the strategic management process?
  - A. Strategy formulation
  - B. Strategy implementation
  - C. Strategy evaluation
  - D. Strategy analysis
3. Which of the following activities identifies and evaluates a firm's management, marketing, finance, production, and research & development strengths and weaknesses?
  - A. Environmental scanning.
  - B. Internal analysis.
  - C. External analysis.
  - D. Development of a mission statement.
4. Span of control and job analysis are two area of concern under the function of management.
  - A. Planning
  - B. Organizing
  - C. Controlling
  - D. Directing
5. What should strategies do if it is determined that a key internal factor is both a strength and a weakness?
  - A. Include that factor in the Internal Organization Factor Matrix twice.
  - B. Decide whether the factor is more a strength or a weakness and include it only once in the Internal Organization Factor Matrix.
  - C. Do not include it in the Internal Organization Factor Matrix.
  - D. Revise the way that key factor is stated, and then include it in the Internal Organization Factor Evaluation Matrix.

## CHAPTER

## 6

## STRATEGY ANALYSIS &amp; CHOICE

## /Strategy Formulation/

## CHAPTER OUTLINE

- ◆ The Nature of Strategy Analysis and Choice
- ◆ A Comprehensive Strategy-Formulation Framework
- ◆ The Input Stage
- ◆ The Matching Stage
- ◆ The Decision Stage
- ◆ Cultural Aspects of Strategy Choice

## CHAPTER OBJECTIVES

After studying this chapter, you should be able to do the following:

1. Describe a three-stage framework for choosing among alternative strategies.
2. Explain how to develop a SWOT Matrix, SPACE Matrix, BCG Matrix, IE Matrix, and QSPM.
3. Identify important behavioral, political, ethical, and social responsibility considerations in strategy analysis and choice.
4. Discuss the role of intuition in strategic analysis and choice.
5. Discuss the role of organizational culture in strategic analysis and choice.

*"Strategic management is not a box of tricks or a bundle of techniques. It is analytical thinking and commitment of resources to action. But quantification alone is not planning. Some of the most important issues in strategic management cannot be quantified at all."*

*Peter Drucker*

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## 6.1 The Nature of Strategy Analysis and Choice

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This chapter focuses on generating and evaluating alternative strategies, as well as selecting strategies to pursue. Strategy analysis and choice seek to determine alternative courses of action that could best enable the firm to achieve its mission and objectives. The firm's present strategies, objectives, and mission, coupled with the external and internal audit information, provide a basis for generating and evaluating feasible alternative strategies. Unless a desperate situation confronts the firm, alternative strategies will likely represent incremental steps that move the firm from its present position to a desired future position. Alternative strategies do not come out of the wild blue yonder; they are derived from the firm's vision, mission, objectives, external audit, and internal audit; they are consistent with, or build on, past strategies that have worked well.

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## 6.2 The Process of Generating and Selecting Strategies

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Strategists never consider all feasible alternatives that could benefit the firm because there are an infinite number of possible actions and an infinite number of ways to implement those actions. Therefore, a manageable set of the most attractive alternative strategies must be developed. The advantages, disadvantages, trade-offs, costs, and benefits of these strategies should be determined. This section discusses the process that many firms use to determine an appropriate set of alternative strategies.

Identifying and evaluating alternative strategies should involve many of the managers and employees who earlier assembled the organizational vision and mission statements,

performed the external audit, and conducted the internal audit. Representatives from each department and division of the firm should be included in this process, as was the case in previous strategy-formulation activities. Recall that involvement provides the best opportunity for managers and employees to gain an understanding of what the firm is doing and why and to become committed to helping the firm accomplish its objectives.

All participants in the strategy analysis and choice activity should have the firm's external and internal audit information by their sides. This information, coupled with the firm's mission statement, will help participants crystallize in their own minds particular strategies that they believe could benefit the firm most. Creativity should be encouraged in this thought process.

Alternative strategies proposed by participants should be considered and discussed in a meeting or series of meetings. Proposed strategies should be listed in writing. When all feasible strategies identified by participants are given and understood, the strategies should be ranked in order of attractiveness by all participants, with 1 = should not be implemented, 2 = possibly should be implemented, 3 = probably should be implemented, and 4 = definitely should be implemented. This process will result in a prioritized list of best strategies that reflects the collective wisdom of the group.

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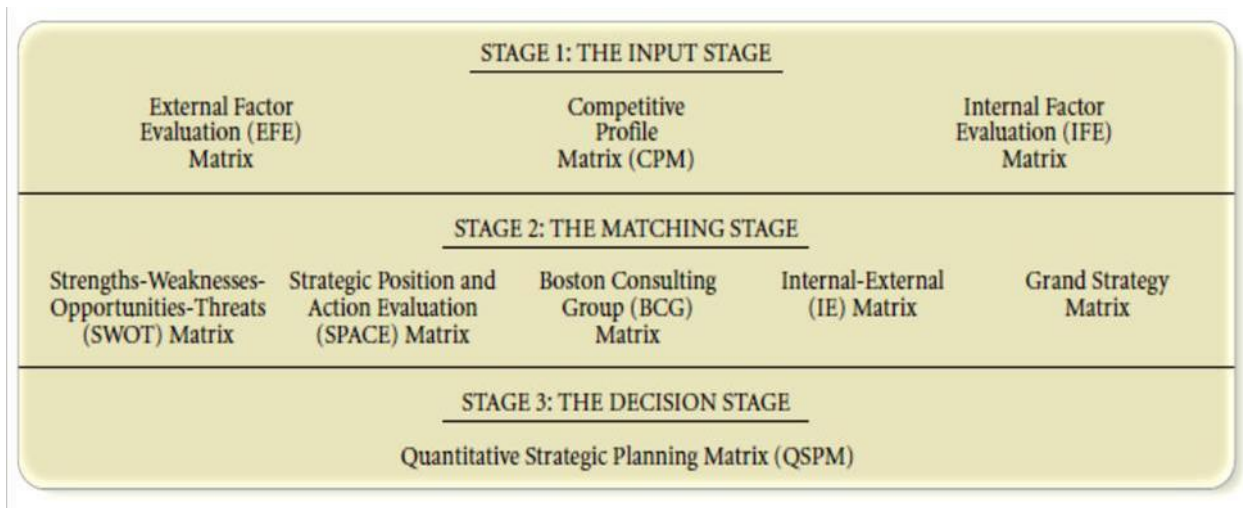
### 6.3 A Comprehensive Strategy-Formulation Framework

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Important strategy-formulation techniques can be integrated into a three-stage decision making framework, as shown in Figure 6.1. The tools presented in this framework are applicable to all sizes and types of organizations and can help strategists identify, evaluate, and select strategies.

Stage 1 of the formulation framework consists of the EFE Matrix, the IFE Matrix, and the Competitive Profile Matrix (CPM). Called the *Input Stage*, Stage 1 summarizes the basic input information needed to formulate strategies. Stage 2, called the *Matching Stage*, focuses upon generating feasible alternative strategies by aligning key external and internal factors. Stage 2 techniques include the Strengths-Weaknesses-Opportunities-Threats (SWOT) Matrix, the Strategic Position and Action Evaluation (SPACE) Matrix, the Boston Consulting Group (BCG) Matrix, the Internal-External (IE) Matrix, and the Grand Strategy Matrix. Stage 3, called the *Decision Stage*, involves a single technique, the Quantitative Strategic Planning Matrix (QSPM). A QSPM uses input information from Stage 1 to objectively evaluate feasible alternative strategies identified in Stage 2. A QSPM reveals the relative attractiveness of alternative strategies and thus provides objective basis for selecting specific strategies.

Figure 6.1: The Strategy-Formulation Analytical Framework



All nine techniques included in the *strategy-formulation framework* require the integration of intuition and analysis. Autonomous divisions in an organization commonly use strategy-formulation techniques to develop strategies and objectives. Divisional analyses provide a basis for identifying, evaluating, and selecting among alternative corporate-level strategies.

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### 6.3.1 The Input Stage

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Procedures for developing an EFE Matrix, an IFE Matrix, and a CPM were presented in Chapters 4 and 5. The information derived from these three matrices provides basic input information for the matching and decision stage matrices described later in this chapter. The input tools require strategists to quantify subjectivity during early stages of the strategy-formulation process. Making small decisions in the input matrices regarding the relative importance of external and internal factors allows strategists to more effectively generate and evaluate alternative strategies. Good intuitive judgment is always needed in determining appropriate weights and ratings.

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### 6.3.2 The Matching Stage

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Strategy is sometimes defined as the match an organization makes between its internal resources and skills and the opportunities and risks created by its external factors. The matching stage of the strategy-formulation framework consists of five techniques that can be used in any sequence: 1) the SWOT Matrix, 2) the SPACE Matrix, 3) the BCG Matrix, 4) the IE Matrix, and 5) the Grand Strategy Matrix. These tools rely upon information derived from the input stage to match external opportunities and threats with internal strengths and weaknesses. *Matching* external and internal critical success factors is the key to effectively generating feasible alternative strategies.

For example, a firm with excess working capital (an internal strength) could take advantage of the cell phone industry's 20 percent annual growth rate (an external opportunity) by acquiring Cellfone, Inc., a firm in the cell phone industry. This example portrays simple one-to-one matching. In most situations, external and internal relationships are more complex, and the matching requires multiple alignments for each strategy generated. The basic concept of matching is illustrated in Table 6.1 below.

**Table 6.1: Matching Key External and Internal Factors to Formulate Alternative Strategies**

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

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

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

The *Strengths-Weaknesses-Opportunities-Threats (SWOT) Matrix* is an important matching tool that helps managers develop four types of strategies: SO (strengths-opportunities) Strategies, WO (weaknesses-opportunities) Strategies, ST (strengths-threats) Strategies, and WT (weaknesses-threats) Strategies.<sup>3</sup> Matching key external and internal factors is the most difficult part of developing a SWOT Matrix and requires good judgment—and there is no one best set of matches. Note in Table 6.1 that the first, second, third, and fourth strategies are SO, WO, ST, and WT strategies, respectively.

*SO Strategies* use a firm's internal strengths to take advantage of external opportunities. All managers would like their organizations to be in a position in which internal strengths can be used to take advantage of external trends and events. Organizations generally will pursue WO, ST, or WT strategies to get into a situation in which they can apply SO Strategies. When a firm has major weaknesses, it will strive to overcome them and make them strengths. When an organization faces major threats, it will seek to avoid them to concentrate on opportunities.

*WO Strategies* aim at improving internal weaknesses by taking advantage of external opportunities. Sometimes key external opportunities exist, but a firm has internal weaknesses that prevent it from exploiting those opportunities. For example, there may be a high demand for electronic devices to control the amount and timing of fuel injection in automobile engines (opportunity), but a certain auto parts manufacturer may lack the technology required for producing these devices (weakness). One possible WO Strategy would be to acquire this technology by forming a joint venture with a firm having competency in this area. An alternative WO Strategy would be to hire and train people with the required technical capabilities.

*ST Strategies* use a firm's strengths to avoid or reduce the impact of external threats. This does not mean that a strong organization should always meet threats in the external environment head-on. An example of ST Strategy occurred when Texas Instruments used an excellent legal department (a strength) to collect nearly \$700 million in damages and royalties from nine Japanese and Korean firms that infringed on patents for semiconductor memory chips (threat).

Rival firms that copy ideas, innovations, and patented products are a major threat in many industries. This is still a major problem for U.S. firms selling products in China.

*WT Strategies* are defensive tactics directed at reducing internal weakness and avoiding external threats. An organization faced with numerous external threats and internal weaknesses may indeed be in a precarious position.

**Table 6.2: A SWOT Matrix for a Retail Computer Store**

| Strengths                                              |                                                                            | Weaknesses                                         |
|--------------------------------------------------------|----------------------------------------------------------------------------|----------------------------------------------------|
| 1. Inventory turnover up 5.8 to 6.7                    |                                                                            | 1. Software revenues in store down 12%             |
| 2. Average customer purchase up \$97 to \$128          |                                                                            | 2. Location of store hurt by new Hwy 34            |
| 3. Employee morale is excellent                        |                                                                            | 3. Carpet and paint in store in disrepair          |
| 4. In-store promotions = 20% increase in sales         |                                                                            | 4. Bathroom in store needs refurbishing            |
| 5. Newspaper advertising expenditures down 10%         |                                                                            | 5. Total store revenues down 8%                    |
| 6. Revenues from repair/service in-store up 16%        |                                                                            | 6. Store has no Web site                           |
| 7. In-store technical support persons have MIS degrees |                                                                            | 7. Supplier on-time-delivery up to 2.4 days        |
| 8. Store's debt-to-total assets ratio down 34%         |                                                                            | 8. Customer checkout process too slow              |
|                                                        |                                                                            | 9. Revenues per employee up 19%                    |
| Opportunities                                          | SO Strategies                                                              | WO Strategies                                      |
| 1. Population of city growing 10%                      | 1. Add 4 new in-store promotions monthly (S4, O3)                          | 1. Purchase land to build new store (W2, O2)       |
| 2. Rival computer store opening 1 mile away            | 2. Add 2 new repair/service persons (S6, O5)                               | 2. Install new carpet/paint/bath (W3, W4, O1)      |
| 3. Vehicle traffic passing store up 12%                | 3. Send flyer to all seniors over age 55 (S5, O5)                          | 3. Up Web site services by 50% (W6, O7, O8)        |
| 4. Vendors average six new products/yr                 |                                                                            | 4. Launch mailout to all Realtors in city (W5, O7) |
| 5. Senior citizen use of computers up 8%               |                                                                            |                                                    |
| 6. Small business growth in area up 10%                |                                                                            |                                                    |
| 7. Desire for Web sites up 18% by Realtors             |                                                                            |                                                    |
| 8. Desire for Web sites up 12% by small firms          |                                                                            |                                                    |
| Threats                                                | ST Strategies                                                              | WT Strategies                                      |
| 1. Best Buy opening new store in 1yr nearby            | 1. Hire two more repair persons and market these new services (S6, S7, T1) | 1. Hire 2 new cashiers (W8, T1, T4)                |
| 2. Local university offers computer repair             | 2. Purchase land to build new store (S8, T3)                               | 2. Install new carpet/paint/bath (W3, W4, T1)      |
| 3. New bypass Hwy 34 in 1 yr will divert traffic       | 3. Raise out-of-store service calls from \$60 to \$80 (S6, T5)             |                                                    |
| 4. New mall being built nearby                         |                                                                            |                                                    |
| 5. Gas prices up 14%                                   |                                                                            |                                                    |
| 6. Vendors raising prices 8%                           |                                                                            |                                                    |

In fact, such a firm may have to fight for its survival, merge, retrench, declare bankruptcy, or choose liquidation. A schematic representation of the SWOT Matrix is provided in Table 6.2. Note that a SWOT Matrix is composed of nine cells. As shown, there are four key factor cells, four strategy cells, and one cell that is always left blank (the upper-left cell). The four strategy cells, labeled *SO*, *WO*, *ST*, and *WT*, are developed after completing four key factor cells, labeled *S*, *W*, *O*, and *T*. There are eight steps involved in constructing a SWOT Matrix:

1. List the firm's key external opportunities.
2. List the firm's key external threats.
3. List the firm's key internal strengths.
4. List the firm's key internal weaknesses.
5. Match internal strengths with external opportunities, and record the resultant *SO* Strategies in the appropriate cell.
6. Match internal weaknesses with external opportunities, and record the resultant *WO* Strategies.
7. Match internal strengths with external threats, and record the resultant *ST* Strategies.
8. Match internal weaknesses with external threats, and record the resultant *WT* Strategies.

Some important aspects of a SWOT Matrix are evidenced in Figure 6-3. For example, note that both the internal/external factors and the *SO/ST/WO/WT* Strategies are stated in quantitative terms to the extent possible. This is important. For example, regarding the second *SO* #2 and *ST* #1 strategies, if the analyst just said, "Add new repair/service persons," the reader might think that 20 new repair/service persons are needed. Actually only two are needed. Always *be specific* to the extent possible in stating factors and strategies.

It is also important to include the "S1, O2" type notation after each strategy in a SWOT Matrix. This notation reveals the rationale for each alternative strategy. Strategies do not rise out of the blue. Note in Figure 6-3 how this notation reveals the internal/external factors that were matched to formulate desirable strategies. For example, note that this retail computer store business may need to "purchase land to build new store" because a new Highway 34

will make its location less desirable. The notation (W2, O2) and (S8, T3) in Table 6.3 exemplifies this matching process.

The purpose of each Stage 2 matching tool is to generate feasible alternative strategies, not to select or determine which strategies are best. Not all of the strategies developed in the SWOT Matrix, therefore, will be selected for implementation.

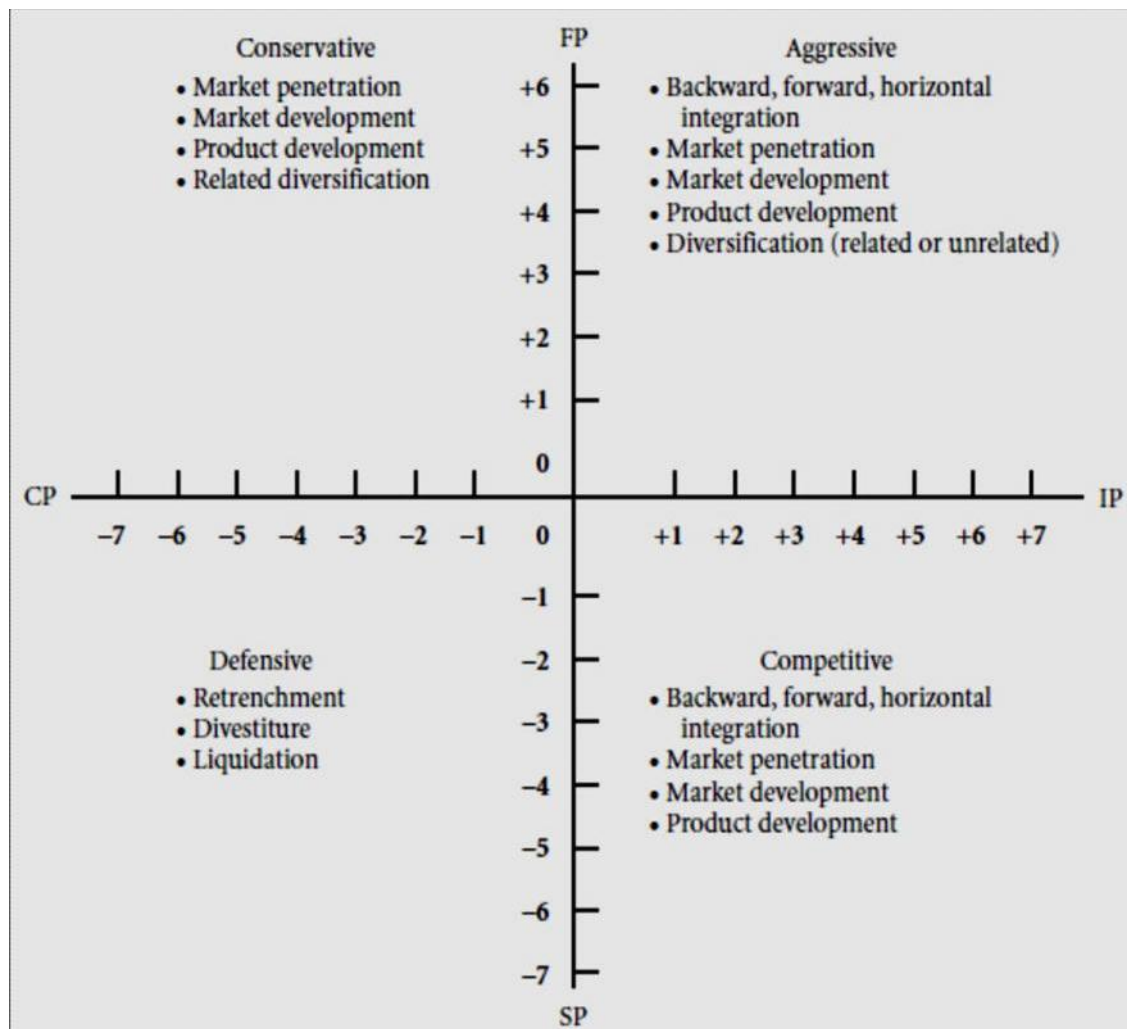
For example, when an organization has both the capital and human resources needed to distribute its own products (internal strength) and distributors are unreliable, costly, or incapable of meeting the firm's needs (external threat), forward integration can be an attractive ST Strategy. When a firm has excess production capacity (internal weakness) and its basic industry is experiencing declining annual sales and profits (external threat), related diversification can be an effective WT Strategy.

Although the SWOT matrix is widely used in strategic planning, the analysis does have some limitations. First, SWOT does not show how to achieve a competitive advantage, so it must not be an end in itself. The matrix should be the starting point for a discussion on how proposed strategies could be implemented as well as cost-benefit considerations that ultimately could lead to competitive advantage. Second, SWOT is a static assessment (or snapshot) in time. A SWOT matrix can be like studying a single frame of a motion picture where you see the lead characters and the setting but have no clue as to the plot. As circumstances, capabilities, threats, and strategies change, the dynamics of a competitive environment may not be revealed in a single matrix. Third, SWOT analysis may lead the firm to overemphasize a single internal or external factor in formulating strategies. There are interrelationships among the key internal and external factors that SWOT does not reveal that may be important in devising strategies.

### 6.3.2.2 The Strategic Position and Action Evaluation (SPACE) Matrix

The *Strategic Position and Action Evaluation (SPACE) Matrix*, another important Stage 2 matching tool, is illustrated in Figure 6.2. Its four-quadrant framework indicates whether aggressive, conservative, defensive, or competitive strategies are most appropriate for a given organization. The axes of the SPACE Matrix represent two internal dimensions (*financial position [FP]* and *competitive position [CP]*) and two external dimensions (*stability position [SP]* and *industry position [IP]*). These four factors are;

Figure 6.2: The SPACE Matrix



Depending on the type of organization, numerous variables could make up each of the dimensions represented on the axes of the SPACE Matrix. Factors that were included earlier in the firm's EFE and IFE Matrices should be considered in developing a SPACE Matrix. Other variables commonly included are given in Table 6.2. For example, return on investment, leverage, liquidity, working capital, and cash flow are commonly considered to be determining factors of an organization's financial strength. Like the SWOT Matrix, the SPACE Matrix should be both tailored to the particular organization being studied and based on factual information as much as possible.

Table 6.3: Example Factors That Make Up the SPACE Matrix Axes

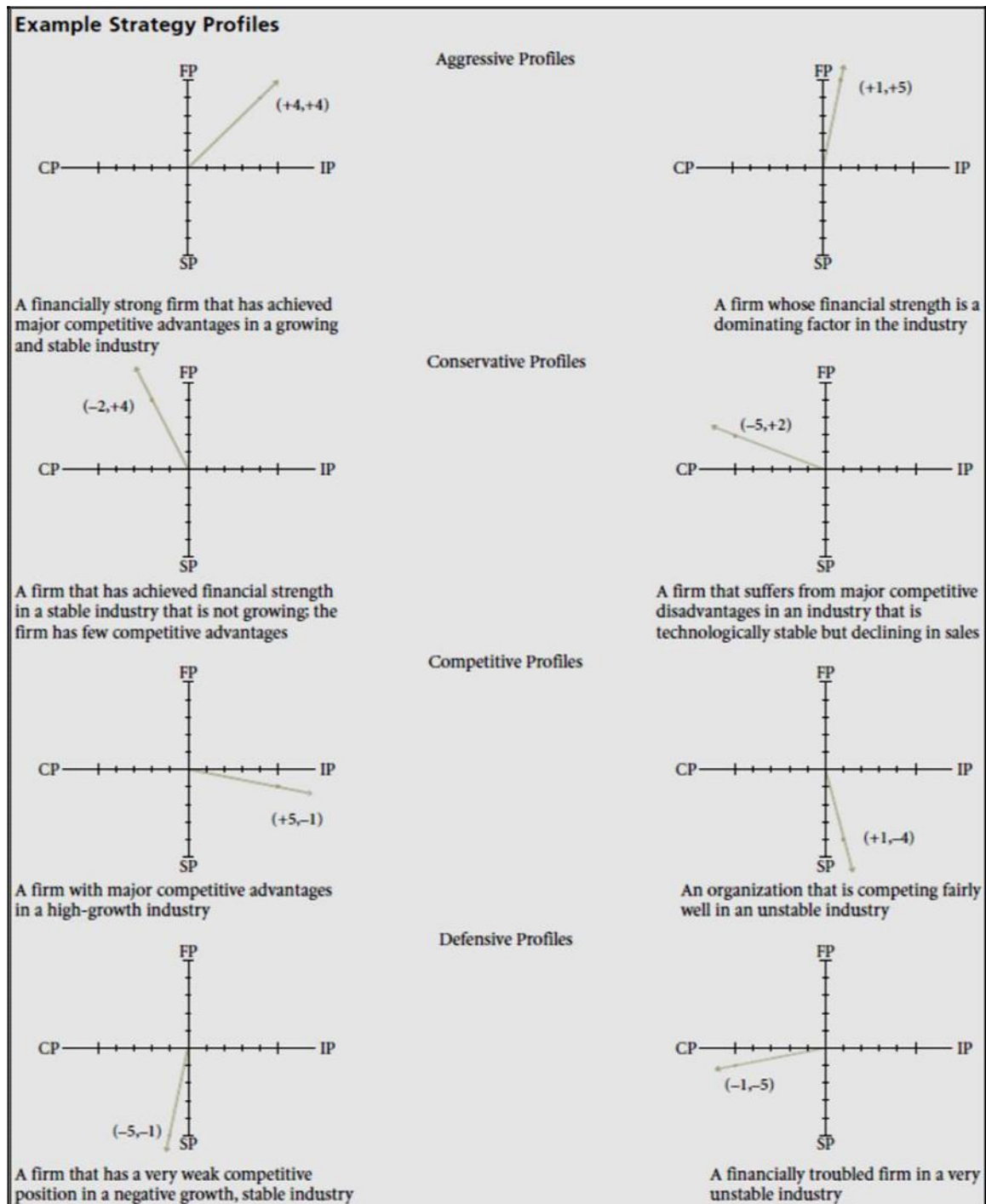
| <b>Internal Strategic Position</b>      | <b>External Strategic Position</b>    |
|-----------------------------------------|---------------------------------------|
| <b><i>Financial Position (FP)</i></b>   | <b><i>Stability Position (SP)</i></b> |
| Return on investment                    | Technological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

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

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

Some examples of strategy profiles that can emerge from a SPACE analysis are shown in Figure 6.3. The directional vector associated with each profile suggests the type of strategies to pursue: aggressive, conservative, defensive, or competitive. When a firm's directional vector is located in the *aggressive quadrant* (upper-right quadrant) of the SPACE Matrix, an organization is in an excellent position to use its internal strengths to (1) take advantage of external opportunities, (2) overcome internal weaknesses, and (3) avoid external threats. Therefore, market penetration, market development, product development, backward integration, forward integration, horizontal integration, or diversification, can be feasible, depending on the specific circumstances that face the firm.

Figure 6.3: Example Strategy Profile



The directional vector may appear in the *conservative quadrant* (upper-left quadrant) of the SPACE Matrix, which implies staying close to the firm's basic competencies and not taking excessive risks.

Conservative strategies most often include market penetration, market development, product development, and related diversification. The directional vector may be located in the lower-left or *defensive quadrant* of the SPACE Matrix, which suggests that the firm should focus on rectifying internal weaknesses and avoiding external threats. Defensive strategies include retrenchment, divestiture, liquidation, and related diversification. Finally, the directional vector may be located in the lower-right or *competitive quadrant* of the SPACE Matrix, indicating competitive strategies. Competitive strategies include backward, forward, and horizontal integration; market penetration; market development and product development. A SPACE Matrix analysis for a bank is provided in Table 6.4. Note that competitive type strategies are recommended.

| Financial Position (FP)                                                                                                                                  | Ratings                             |
|----------------------------------------------------------------------------------------------------------------------------------------------------------|-------------------------------------|
| The bank's primary capital ratio is 7.23 percent, which is 1.23 percentage points over the generally required ratio of 6 percent.                        | 1.0                                 |
| The bank's return on assets is negative 0.77, compared to a bank industry average ratio of positive 0.70.                                                | 1.0                                 |
| The bank's net income was \$183 million, down 9 percent from a year earlier.                                                                             | 3.0                                 |
| The bank's revenues increased 7 percent to \$3.46 billion.                                                                                               | 4.0                                 |
|                                                                                                                                                          | 9.0                                 |
| <b>Industry Position (IP)</b>                                                                                                                            |                                     |
| Deregulation provides geographic and product freedom.                                                                                                    | 4.0                                 |
| Deregulation increases competition in the banking industry.                                                                                              | 2.0                                 |
| Pennsylvania's interstate banking law allows the bank to acquire other banks in New Jersey, Ohio, Kentucky, the District of Columbia, and West Virginia. | 4.0                                 |
|                                                                                                                                                          | 10.0                                |
| <b>Stability Position (SP)</b>                                                                                                                           |                                     |
| Less-developed countries are experiencing high inflation and political instability.                                                                      | -4.0                                |
| Headquartered in Pittsburgh, the bank historically has been heavily dependent on the steel, oil, and gas industries.                                     | -5.0                                |
| These industries are depressed.                                                                                                                          |                                     |
| Banking deregulation has created instability throughout the industry.                                                                                    | -4.0                                |
|                                                                                                                                                          | -13.0                               |
| <b>Competitive Position (CP)</b>                                                                                                                         |                                     |
| The bank provides data processing services for more than 450 institutions in 38 states.                                                                  | -2.0                                |
| Superregional banks, international banks, and nonbanks are becoming increasingly competitive.                                                            | -5.0                                |
| The bank has a large customer base.                                                                                                                      | -2.0                                |
|                                                                                                                                                          | -9.0                                |
| <b>Conclusion</b>                                                                                                                                        |                                     |
| SP Average is $-13.0 \div 3 = -4.33$                                                                                                                     | IP Average is $+10.0 \div 3 = 3.33$ |
| CP Average is $-9.0 \div 3 = -3.00$                                                                                                                      | FP Average is $+9.0 \div 4 = 2.25$  |
| Directional Vector Coordinates: x-axis: $-3.00 + (+3.33) = +0.33$                                                                                        |                                     |
| y-axis: $-4.33 + (+2.25) = -2.08$                                                                                                                        |                                     |
| The bank should pursue Competitive Strategies.                                                                                                           |                                     |

Autonomous divisions (or profit centers) of an organization make up what is called a *business portfolio*. When a firm's divisions compete in different industries, a separate strategy often must be developed for each business.

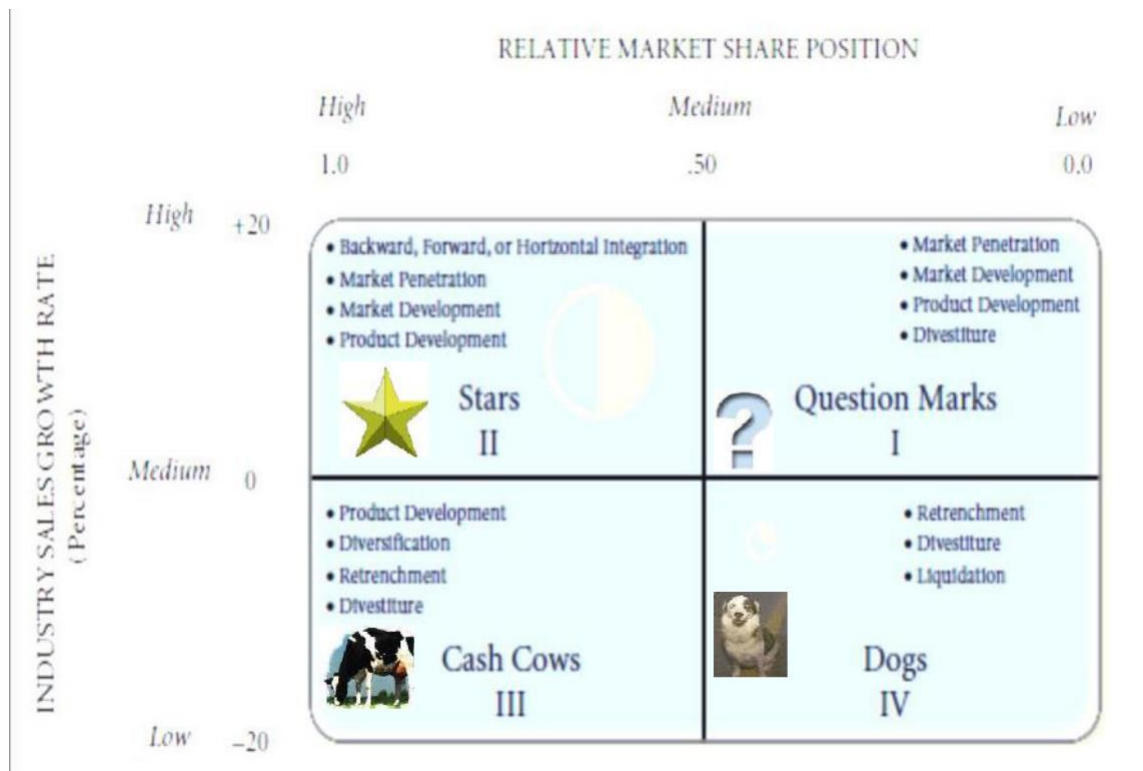
The *Boston Consulting Group (BCG) Matrix* and the *Internal-External (IE) Matrix* are designed specifically to enhance a multidivisional firm's efforts to formulate strategies. (BCG is a private management consulting firm based in Boston. BCG employs about 4,300 consultants worldwide.)

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

Relative market share position is given on the *x*-axis of the BCG Matrix. The midpoint on the *x*-axis usually is set at .50, corresponding to a division that has half the market share of the leading firm in the industry. The *y*-axis represents the industry growth rate in sales, measured in percentage terms. The growth rate percentages on the *y*-axis could range from -20 to +20 percent, with 0.0 being the midpoint. The average annual increase in revenues for several leading firms in the industry would be a good estimate of the value. These numerical ranges on the *x*- and *y*-axes are often used, but other numerical values could be established as deemed appropriate for particular organizations, such as -10 to +10 percent.

The basic BCG Matrix appears in Figure 6-6. Each circle represents a separate division. The size of the circle corresponds to the proportion of corporate revenue generated by that business unit, and the pie slice indicates the proportion of corporate profits generated by that division. Divisions located in Quadrant I of the BCG Matrix are called "Question Marks," those located in Quadrant II are called "Stars," those located in Quadrant III are called "Cash Cows," and those divisions located in Quadrant IV are called "Dogs."

Figure 6.4: The BCG Matrix



**Question Marks:** Divisions in Quadrant I have a low relative market share position, yet they compete in a high-growth industry. Generally these firms' cash needs are high and their cash generation is low. These businesses are called *Question Marks* because the organization must decide whether to strengthen them by pursuing an intensive strategy (market penetration, market development, or product development) or to sell them.

**Stars:** Quadrant II businesses (*Stars*) represent the organization's best long-run opportunities for growth and profitability. Divisions with a high relative market share and a high industry growth rate should receive substantial investment to maintain or strengthen their dominant positions. Forward, backward, and horizontal integration; market penetration; market development; and product development are appropriate strategies for these divisions to consider, as indicated in Figure 6.4.

**Cash Cows:** Divisions positioned in Quadrant III have a high relative market share position but compete in a low-growth industry. Called *Cash Cows* because they generate cash in excess of their needs, they are often milked. Many of today's Cash Cows were yesterday's Stars. Cash Cow divisions should be managed to maintain their strong position for as long as possible. Product development or diversification may be attractive strategies for strong Cash Cows. However, as a Cash Cow division becomes weak, retrenchment or divestiture can become more appropriate.

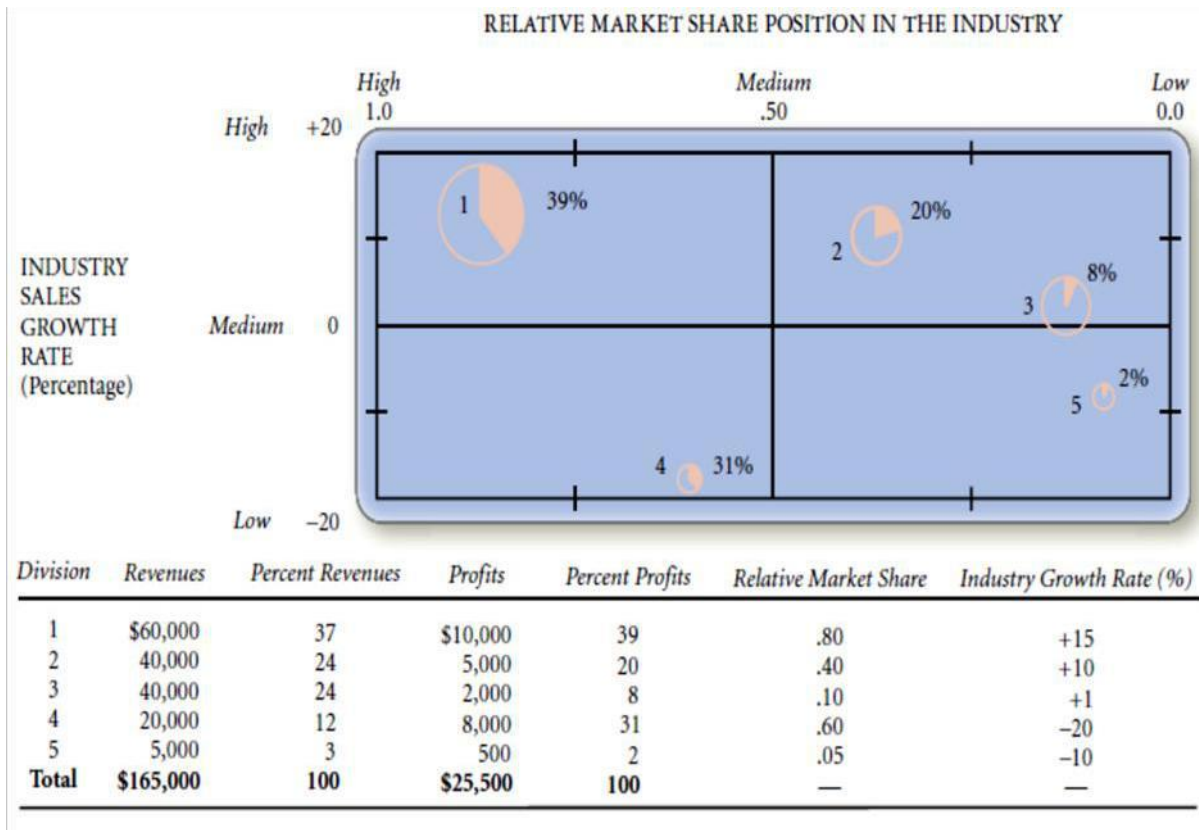
**Dogs:** Quadrant IV divisions of the organization have a low relative market share position and compete in a slow- or no-market-growth industry; they are *Dogs* in the firm's portfolio. Because of their weak internal and external position, these businesses are often liquidated, divested, or trimmed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

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

An example BCG Matrix is provided in Figure 6-7, which illustrates an organization composed of five divisions with annual sales ranging from \$5,000 to \$60,000. Division 1 has the greatest sales volume, so the circle representing that division is the largest one in the matrix. The circle corresponding to Division 5 is the smallest because its sales volume (\$5,000) is least among all the divisions. The pie slices within the circles reveal the percent of corporate profits contributed by each division.

As shown, Division 1 contributes the highest profit percentage, 39 percent. Notice in the diagram that Division 1 is considered a Star, Division 2 is a Question Mark, Division 3 is also a Question Mark, Division 4 is a Cash Cow, and Division 5 is a Dog.

Figure 6.5: An Example BCG Matrix



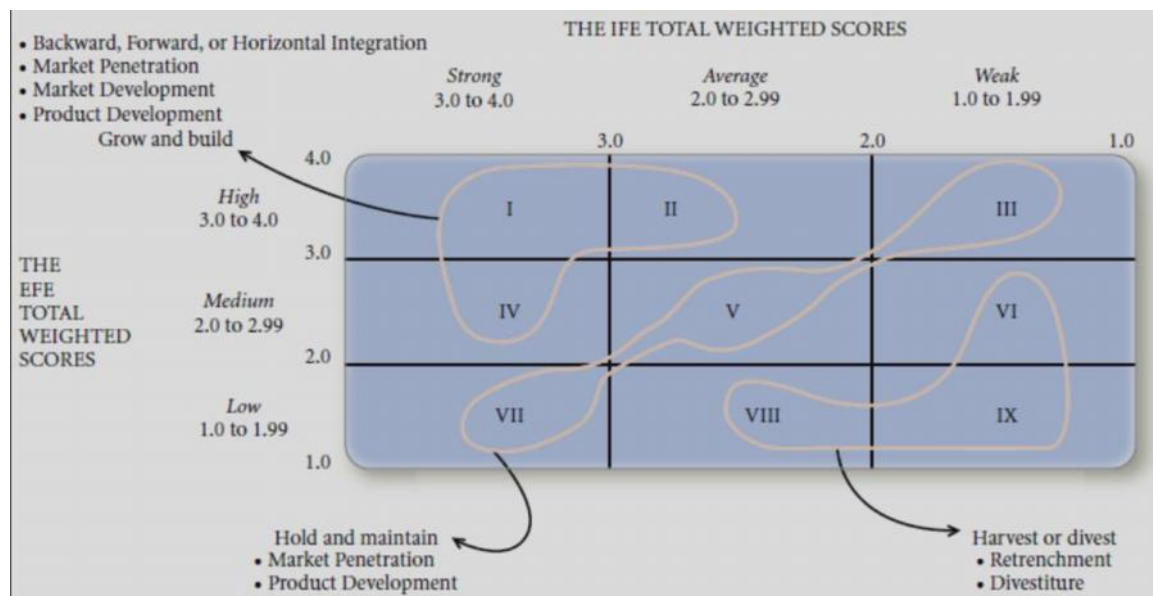
The BCG Matrix, like all analytical techniques, has some limitations. For example, viewing every business as either a Star, Cash Cow, Dog, or Question Mark is an oversimplification; many businesses fall right in the middle of the BCG Matrix and thus are not easily classified. Furthermore, the BCG Matrix does not reflect whether or not various divisions or their industries are growing over time; that is, the matrix has no temporal qualities, but rather it is a snapshot of an organization at a given point in time. Finally, other variables besides relative market share position and industry growth rate in sales, such as size of the market and competitive advantages, are important in making strategic decisions about various divisions.

### 6.3.2.4 The Internal-External (IE) Matrix

The *Internal-External (IE) Matrix* positions an organization's various divisions in a nine cell display, illustrated in Figure 6.6. The IE Matrix is similar to the BCG Matrix in that both tools involve plotting organization divisions in a schematic diagram; this is why they are both called "portfolio matrices." Also, the size of each circle represents the percentage sales contribution of each division, and pie slices reveal the percentage profit contribution of each division in both the BCG and IE Matrix.

But there are some important differences between the BCG Matrix and the IE Matrix. First, the axes are different. Also, the IE Matrix requires more information about the divisions than the BCG Matrix. Furthermore, the strategic implications of each matrix are different. For these reasons, strategists in multidivisional firms often develop both the BCG Matrix and the IE Matrix in formulating alternative strategies. A common practice is to develop a BCG Matrix and an IE Matrix for the present and then develop projected matrices to reflect expectations of the future. This before-and-after analysis forecasts the expected effect of strategic decisions on an organization's portfolio of divisions.

Figure 6.6: The Internal – External (IE) Matrix

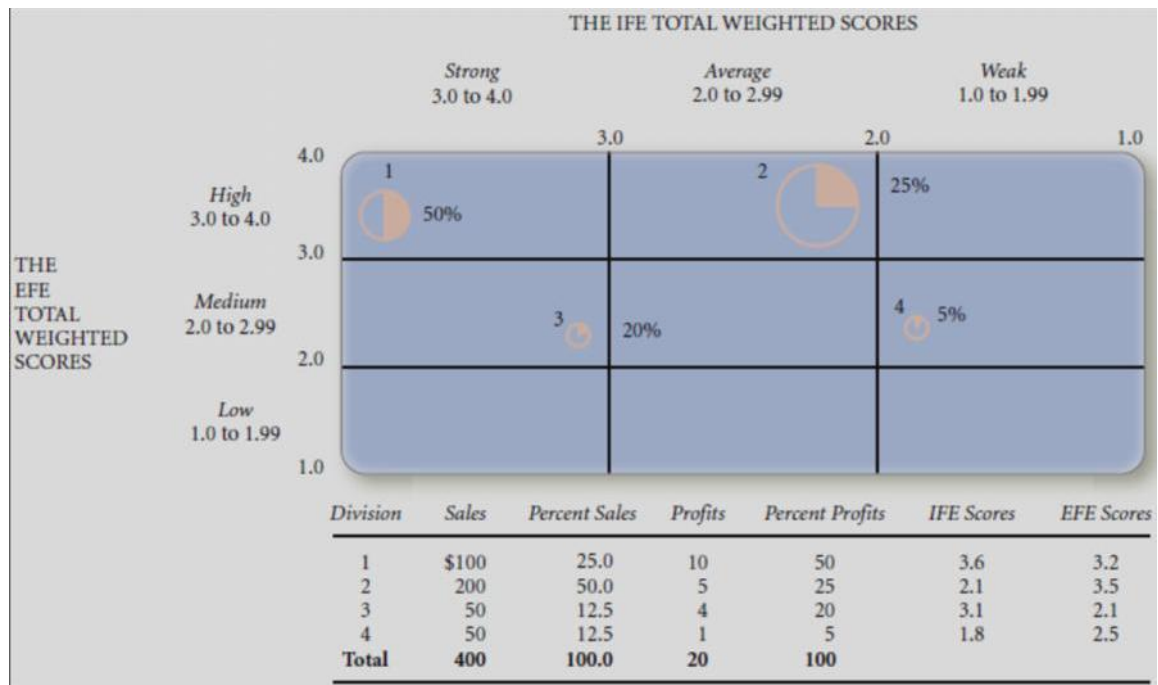


The IE Matrix is based on two key dimensions: the IFE total weighted scores on the x-axis and the EFE total weighted scores on the y-axis. Recall that each division of an organization should construct an IFE Matrix and an EFE Matrix for its part of the organization. The total weighted scores derived from the divisions allow construction of the corporate-level IE Matrix. On the x-axis of the IE Matrix, an IFE total weighted score of 1.0 to 1.99 represents a weak internal position; a score of 2.0 to 2.99 is considered average; and a score of 3.0 to 4.0 is strong. Similarly, on the y-axis, an EFE total weighted score of 1.0 to 1.99 is considered low; a score of 2.0 to 2.99 is medium; and a score of 3.0 to 4.0 is high.

The IE Matrix can be divided into three major regions that have different strategy implications. First, the prescription for divisions that fall into cells I, II, or IV can be described as *grow and build*. Intensive (market penetration, market development, and product development) or integrative (backward integration, forward integration, and horizontal integration) strategies can be most appropriate for these divisions. Second, divisions that fall into cells III, V, or VII can be managed best with *hold and maintain* strategies; market penetration and product development are two commonly employed strategies for these types of divisions. Third, a common prescription for divisions that fall into cells VI, VIII, or IX is *harvest or divest*. Successful organizations are able to achieve a portfolio of businesses positioned in or around cell I in the IE Matrix.

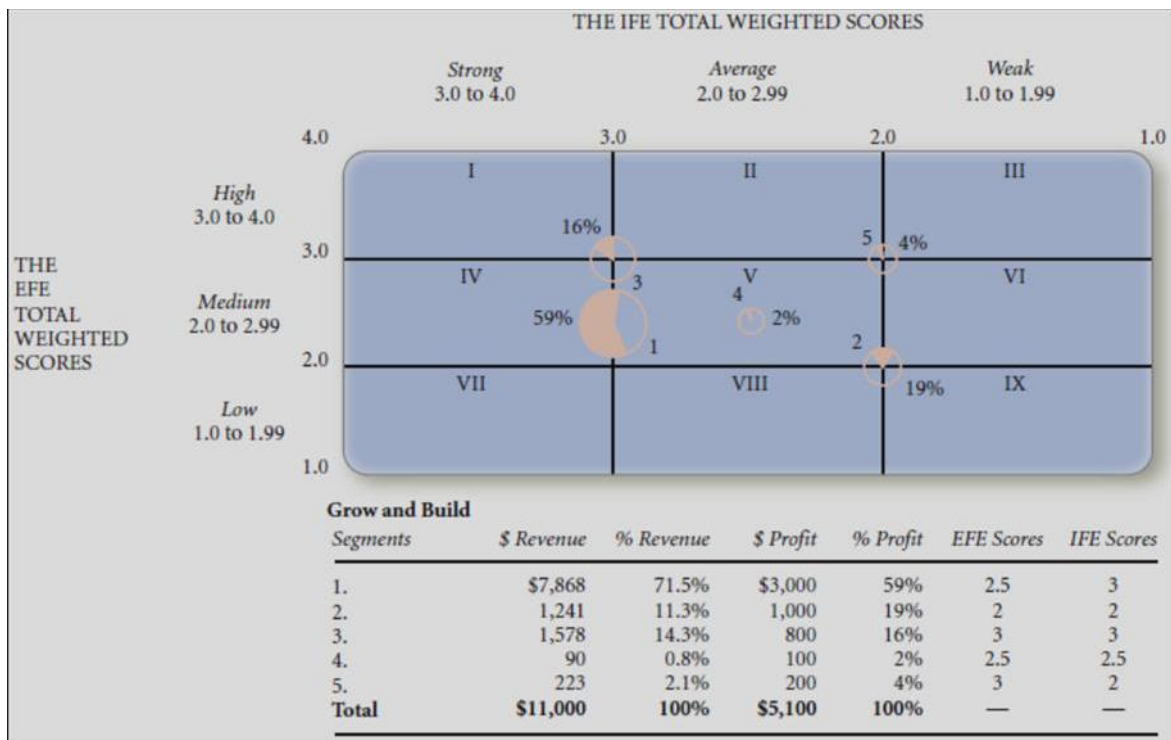
An example of a completed IE Matrix is given in Figure 6.7, which depicts an organization composed of four divisions. As indicated by the positioning of the circles, *grow and build* strategies are appropriate for Division 1, Division 2, and Division 3. Division 4 is a candidate for *harvest or divest*. Division 2 contributes the greatest percentage of company sales and thus is represented by the largest circle. Division 1 contributes the greatest proportion of total profits; it has the largest-percentage pie slice.

Figure 6.7: An Example IE Matrix



As indicated in Figure 6.8, the IE Matrix has five product segments. Note that Division #1 has the largest revenues (as indicated by the largest circle) and the largest profits (as indicated by the largest pie slice) in the matrix. It is common for organizations to develop both geographic and product-based IE Matrices to more effectively formulate strategies and allocate resources among divisions. In addition, firms often prepare an IE (or BCG) Matrix for competitors. Furthermore, firms will often prepare “before and after” IE (or BCG) Matrices to reveal the situation at present versus the expected situation after one year. This latter idea minimizes the limitation of these matrices being a “snapshot in time.” In performing case analysis, feel free to estimate the IFE and EFE scores for the various divisions based upon your research into the company and industry—rather than preparing a separate IE Matrix for each division.

Figure 6.8: The IE Matrix



### 6.3.2.5 The Grand Strategy Matrix

In addition to the SWOT Matrix, SPACE Matrix, BCG Matrix, and IE Matrix, the *Grand Strategy Matrix* has become a popular tool for formulating alternative strategies. All organizations can be positioned in one of the Grand Strategy Matrix's four strategy quadrants. A firm's divisions likewise could be positioned. As illustrated in Figure 6.9, the Grand Strategy Matrix is based on two evaluative dimensions: competitive position and market (industry) growth. Any industry whose annual growth in sales exceeds 5 percent could be considered to have rapid growth. Appropriate strategies for an organization to consider are listed in sequential order of attractiveness in each quadrant of the matrix.

Firms located in Quadrant I of the Grand Strategy Matrix are in an excellent strategic position. For these firms, continued concentration on current markets (market penetration and market development) and products (product development) is an appropriate strategy.

It is unwise for a Quadrant I firm to shift notably from its established competitive advantages. When a Quadrant I organization has excessive resources, then backward, forward, or horizontal integration may be effective strategies. When a Quadrant I firm is too heavily committed to a single product, then related diversification may reduce the risks associated with a narrow product line. Quadrant I firms can afford to take advantage of external opportunities in several areas. They can take risks aggressively when necessary.

Figure 6.9: The Grand Strategy Matrix



Firms positioned in Quadrant II need to evaluate their present approach to the marketplace seriously. Although their industry is growing, they are unable to compete effectively, and they need to determine why the firm's current approach is ineffective and how the company can best change to improve its competitiveness. Because Quadrant II firms are in a rapid-market-growth industry, an intensive strategy (as opposed to integrative or diversification) is usually the first option that should be considered. However, if the firm is lacking a distinctive competence or competitive advantage, then horizontal integration is often a desirable alternative. As a last resort, divestiture or liquidation should be considered. Divestiture can provide funds needed to acquire other businesses or buy back shares of stock.

Quadrant III organizations compete in slow-growth industries and have weak competitive positions. These firms must make some drastic changes quickly to avoid further decline and possible liquidation. Extensive cost and asset reduction (retrenchment) should be pursued first. An alternative strategy is to shift resources away from the current business into different areas (diversify). If all else fails, the final options for Quadrant III businesses are divestiture or liquidation.

Finally, Quadrant IV businesses have a strong competitive position but are in a slow growth industry. These firms have the strength to launch diversified programs into more promising growth areas: Quadrant IV firms have characteristically high cash-flow levels and limited internal growth needs and often can pursue related or unrelated diversification successfully. Quadrant IV firms also may pursue joint ventures.

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## 6.4 The Decision Stage

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Analysis and intuition provide a basis for making strategy-formulation decisions. The matching techniques just discussed reveal feasible alternative strategies. Many of these strategies will likely have been proposed by managers and employees participating in the strategy analysis and choice activity. Any additional strategies resulting from the matching analyses could be discussed and added to the list of feasible alternative options. As indicated earlier in this chapter, participants could rate these strategies on a 1 to 4 scale so that a prioritized list of the best strategies could be achieved.

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

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Other than ranking strategies to achieve the prioritized list, there is only one analytical technique in the literature designed to determine the relative attractiveness of feasible alternative actions. This technique is the *Quantitative Strategic Planning Matrix (QSPM)*, which comprises Stage 3 of the strategy-formulation analytical framework. This technique objectively indicates which alternative strategies are best.

The QSPM uses input from Stage 1 analyses and matching results from Stage 2 analyses to decide objectively among alternative strategies. That is, the EFE Matrix, IFE Matrix, and Competitive Profile Matrix that make up Stage 1, coupled with the SWOT Matrix, SPACE Matrix, BCG Matrix, IE Matrix, and Grand Strategy Matrix that make up Stage 2, provide the needed information for setting up the QSPM (Stage 3). The QSPM is a tool that allows strategists to evaluate alternative strategies objectively, based on previously identified external and internal critical success factors. Like other strategy-formulation analytical tools, the QSPM requires good intuitive judgment.

The basic format of the QSPM is illustrated in Table 6.5. Note that the left column of a QSPM consists of key external and internal factors (from Stage 1), and the top row consists of feasible alternative strategies (from Stage 2). Specifically, the left column of a QSPM consists of information obtained directly from the EFE Matrix and IFE Matrix. In a column adjacent to the critical success factors, the respective weights received by each factor in the EFE Matrix and the IFE Matrix are recorded.

Table 6.5: The Quantitative Strategic Planning Matrix—QSPM

| Key Factors                               | Strategic Alternatives |            |            |            |
|-------------------------------------------|------------------------|------------|------------|------------|
|                                           | Weight                 | Strategy 1 | Strategy 2 | Strategy 3 |
| <i>Key External Factors</i>               |                        |            |            |            |
| Economy                                   |                        |            |            |            |
| Political/Legal/Governmental              |                        |            |            |            |
| Social/Cultural/Demographic/Environmental |                        |            |            |            |
| Technological                             |                        |            |            |            |
| Competitive                               |                        |            |            |            |
| <i>Key Internal Factors</i>               |                        |            |            |            |
| Management                                |                        |            |            |            |
| Marketing                                 |                        |            |            |            |
| Finance/Accounting                        |                        |            |            |            |
| Production/Operations                     |                        |            |            |            |
| Research and Development                  |                        |            |            |            |
| Management Information Systems            |                        |            |            |            |

The top row of a QSPM consists of alternative strategies derived from the SWOT Matrix, SPACE Matrix, BCG Matrix, IE Matrix, and Grand Strategy Matrix. These matching tools usually generate similar feasible alternatives. However, not every strategy suggested by the matching techniques has to be evaluated in a QSPM. Strategists should use good intuitive judgment in selecting strategies to include in a QSPM.

Conceptually, the QSPM determines the relative attractiveness of various strategies based on the extent to which key external and internal critical success factors are capitalized upon or improved. The relative attractiveness of each strategy within a set of alternatives is computed by determining the cumulative impact of each external and internal critical success factor. Any number of sets of alternative strategies can be included in the QSPM, and any number of strategies can make up a given set, but only strategies within a given set are evaluated relative to each other. For example, one set of strategies may include diversification, whereas another set may include issuing stock and selling a division to raise needed capital. These two sets of strategies are totally different, and the QSPM evaluates strategies only within sets. Note in Table 6.5 that three strategies are included, and they make up just one set.

A QSPM for a retail computer store is provided in Table 6.6. This example illustrates all the components of the QSPM: Strategic Alternatives, Key Factors, Weights, Attractiveness Scores (AS), Total Attractiveness Scores (TAS), and the Sum Total Attractiveness Score. The three new terms just introduced—(1) Attractiveness Scores, (2) Total Attractiveness Scores, and (3) the Sum Total Attractiveness Score—are defined and explained as the six steps required to develop a QSPM are discussed:

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

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

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

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

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

Table 6.6: A QSPM for a Retail Computer Store

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

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

In Table 6.6, two alternative strategies—(1) buy new land and build new larger store and (2) fully renovate existing store—are being considered by a computer retail store. Note by sum total attractiveness scores of 4.63 versus 3.27 that the analysis indicates the business should buy new land and build a new larger store. Note the use of dashes to indicate which factors do not affect the strategy choice being considered. If a particular factor affects one strategy but not the other, it affects the choice being made, so attractiveness scores should be recorded for both strategies. Never rate one strategy and not the other. Note also in Table 6.6 that there are no double 1's, 2's, 3's, or 4's in a row. Never duplicate scores in a row. Never work column by column; always prepare a QSPM working row by row. If you have more than one strategy in the QSPM, then let the AS scores range from 1 to “the number of strategies being evaluated.” This will enable you to have a different AS score for each strategy. These are all important guidelines to follow in developing a QSPM. In actual practice, the store did purchase the new land and build a new store; the business also did some minor refurbishing until the new store was operational.

There should be a rationale for each AS score assigned. Note in Table 6.6 in the first row that the “city population growing 10 percent annually” opportunity could be capitalized on best by strategy 1, “building the new, larger store,” so an AS score of 4 was assigned to Strategy 1. AS scores, therefore, are not mere guesses; they should be rational, defensible, and reasonable.

Avoid giving each strategy the same AS score. Note in Table 6.6 that dashes are inserted all the way across the row when used. Also note that double 4's, or double 3's, or double 2's, or

double 1's are never in a given row. Again work row by row, not column by column. These are important guidelines to follow in constructing a QSPM.

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#### 6.4.2 Positive Features and Limitations of the QSPM

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A positive feature of the QSPM is that sets of strategies can be examined sequentially or simultaneously. For example, corporate-level strategies could be evaluated first, followed by division-level strategies, and then function-level strategies. There is no limit to the number of strategies that can be evaluated or the number of sets of strategies that can be examined at once using the QSPM.

Another positive feature of the QSPM is that it requires strategists to integrate pertinent external and internal factors into the decision process. Developing a QSPM makes it less likely that key factors will be overlooked or weighted inappropriately. A QSPM draws attention to important relationships that affect strategy decisions.

Although developing a QSPM requires a number of subjective decisions, making small decisions along the way enhances the probability that the final strategic decisions will be best for the organization. A QSPM can be adapted for use by small and large for-profit and nonprofit organizations so can be applied to virtually any type of organization. A QSPM can especially enhance strategic choice in multinational firms because many key factors and strategies can be considered at once. It also has been applied successfully by a number of small businesses.

The QSPM is not without some limitations. First, it always requires intuitive judgments and educated assumptions. The ratings and attractiveness scores require judgmental decisions, even though they should be based on objective information. Discussion among strategists, managers, and employees throughout the strategy-formulation process, including development of a QSPM, is constructive and improves strategic decisions. Constructive discussion during strategy analysis and choice may arise because of genuine differences of interpretation of information and varying opinions.

Another limitation of the QSPM is that it can be only as good as the prerequisite information and matching analyses upon which it is based.

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## 6.5 Cultural Aspects of Strategy Choice

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Dear learners, can you explain why cultural factors should be an important consideration in analyzing and choosing among alternative strategies.

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All organizations have a culture. *Culture* includes the set of shared values, beliefs, attitudes, customs, norms, personalities, heroes, and heroines that describe a firm. Culture is the unique way an organization does business. It is the human dimension that creates solidarity and meaning, and it inspires commitment and productivity in an organization when strategy changes are made. All human beings have a basic need to make sense of the world, to feel in control, and to make meaning. When events threaten meaning, individuals react defensively. Managers and employees may even sabotage new strategies in an effort to recapture the status quo.

It is beneficial to view strategic management from a cultural perspective because success often rests upon the degree of support that strategies receive from a firm's culture. If a firm's strategies are supported by cultural products such as values, beliefs, rites, rituals, ceremonies, stories, symbols, language, heroes, and heroines, then managers often can implement changes swiftly and easily. However, if a supportive culture does not exist and is not cultivated, then strategy changes may be ineffective or even counterproductive. A firm's culture can become antagonistic to new strategies, and the result of that antagonism may be confusion and disarray.

Strategies that require fewer cultural changes may be more attractive because extensive changes can take considerable time and effort. Whenever two firms merge, it becomes especially important to evaluate and consider culture-strategy linkages. Culture provides an explanation for the difficulties a firm encounters when it attempts to shift its strategic direction, as the following statement explains: Not only has the “right” corporate culture become the essence and foundation of corporate excellence, but success or failure of needed corporate reforms hinges on management’s sagacity and ability to change the firm’s driving culture in time and in tune with required changes in strategies.



## SUMMARY OF THE CHAPTER

-  Strategists never consider all feasible alternatives that could benefit the firm, because there are an infinite number of possible actions and an infinite number of ways to implement those actions. Therefore, a manageable set of the most attractive alternative strategies must be developed.
-  Identifying and evaluating alternative strategies should involve many of the managers and employees who earlier assembled the organizational mission statement, performed the external audit, and conducted the internal audit
-  Important strategy-formulation techniques can be integrated into a three-stage decision-making framework, as shown which are applicable to all sizes and types of organizations and can help strategists identify, evaluate, and select strategies.
  - ✓ Stage 1: The Input Stage
  - ✓ Stage 2: The Matching Stage
  - ✓ Stage 3: The Decision Stage
-  The Input Stage includes the External Factor Evaluation (EFE) Matrix, the Competitive Profile Matrix (CPM), and the Internal Factor Evaluation (IFE) Matrix.
-  The Matching Stage includes the Strengths-Weaknesses-Opportunities-Threats (SWOT) Matrix, the Strategic Position and Action Evaluation (SPACE) Matrix, the Boston Consulting Group (BCG) Matrix, the Internal-External (IE) Matrix, and the Grand Strategy Matrix.
-  The SWOT Matrix is an important matching tool that helps managers develop four types of strategies:
  - i. SO strategies: use a firm's internal strengths to take advantage of external opportunities.
  - ii. WO strategies: are aimed at improving internal weaknesses by taking advantage of external opportunities.
  - iii. ST strategies: use a firm's strengths to avoid or reduce the impact of external threats.

- iv. WT strategies—are defensive tactics directed at reducing internal weaknesses and avoiding external threats.
-  The BCG Matrix graphically portrays differences among divisions (of a firm) in terms of relative market share position and industry growth rate.
-  In addition to the SWOT Matrix, SPACE Matrix, BCG Matrix, and IE Matrix, the Grand Strategy Matrix has become a popular tool for formulating alternative strategies. All organizations can be positioned in one of the Grand Strategy Matrix's four strategy quadrants.
-  Other than ranking strategies to achieve the prioritized list, there is only one analytical technique in the literature designed to determine the relative attractiveness of feasible alternative actions. This technique is the QSPM, which comprises Stage 3 of the strategy-formulation analytical framework. This technique objectively indicates which alternative strategies are best.
-  It is beneficial to view strategic management from a cultural perspective because success often rests on the degree of support that strategies receive from a firm's culture.
-  If a firm's strategies are supported by cultural products such as values, beliefs, rites, rituals, ceremonies, stories, symbols, language, heroes, and heroines, then managers often can implement changes swiftly and easily.



## CHAPTER REVIEW EXERCISES

Part I: True/False

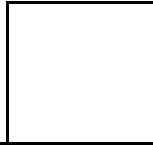
1. Analysis and intuition provide a basis for making strategy-formulation decisions
2. Since The IE Matrix is similar to the BCG Matrix in plotting organization divisions in a schematic diagram, they are called portfolio matrices.
3. The IE Matrix is based on two evaluative dimensions: competitive position and market growth.
4. The first in developing QSPM is assigning weights to each key external and internal factor.
5. The SPACE Matrix is a four-quadrant framework which indicates whether aggressive, conservative, defensive, or competitive strategies are more appropriate for a given organization.

Part II: Choose the correct answer from the given alternatives

1. Which one of the following is incorrect about the difference between the IE Matrix and the BCG Matrix.
  - A. The axes are the same
  - B. IE Matrix requires more information about divisions than BCG.
  - C. Strategic implications of each matrix are different.
  - D. Both plot organization divisions in a schematic diagram
  - E. None of the above
2. Which one of the following is the first task in developing a QSPM:
  - A. Compute the sum Total AS.
  - B. Assign weights to each key external and internal factor.
  - C. Compute the total AS.
  - D. Determine the Attractiveness Scores (AS)
  - E. None of the above

3. In \_\_\_\_\_ strategies, firm's use their internal strengths to take advantage of external opportunities.
  - A. WT
  - B. SO
  - C. ST
  - D. WO
  
4. In which quadrant of the BCG matrix that businesses have a high relative market share and compete in high growth rate industries.
  - A. Question Marks – Quadrant I
  - B. Cash Cows – Quadrant III
  - C. Stars – Quadrant II
  - D. Dogs – Quadrant IV
  
5. One is different from the other
  - A. The Strengths-Weaknesses-Opportunities-Threats (SWOT) Matrix
  - B. The Strategic Position and Action Evaluation (SPACE) Matrix
  - C. The Boston Consulting Group (BCG) Matrix
  - D. The Internal Factor Evaluation (IFE) Matrix.
  - E. The Internal-External (IE) Matrix, and the Grand Strategy Matrix.

## CHAPTER

IMPLEMENTING STRATEGIES:  
(Management & operations issues)

## CHAPTER OUTLINE

- ◆ The Nature of Strategy Implementation
- ◆ Annual Objectives
- ◆ Policies
- ◆ Resource Allocation
- ◆ Managing Conflict
- ◆ Matching Structure with Strategy
- ◆ Managing Resistance to Change

## CHAPTER OBJECTIVES

After studying this chapter, you should be able to do the following:

- ⊕ Explain why strategy implementation is more difficult than strategy formulation.
- ⊕ Discuss the importance of annual objectives and policies in achieving organizational commitment for strategies to be implemented.
- ⊕ Explain why organizational structure is so important in strategy implementation.
- ⊕ Describe several reasons why conflict may occur during objective-setting activities and what are the various approaches for managing and resolving them

*"In actual navigation, a ship may veer off its course for many miles. Without a compass bearing, a ship would neither find its port nor be able to estimate the time required to get there."*

*Peter Drucker*

## Introduction

The strategic-management process does not end when the firm decides what strategy or strategies to pursue. There must be a translation of strategic thought into strategic action. This translation is much easier if managers and employees of the firm understand the business, feel a part of the company, and through involvement in strategy-formulation activities have become committed to helping the organization succeed. Without understanding and commitment, strategy-implementation efforts face major problems. Implementing strategy affects an organization from top to bottom; it affects all the functional and divisional areas of a business. It is beyond the purpose and scope of this text to examine all of the business administration concepts and tools important in strategy implementation. This chapter focuses on management issues most central to implementing strategies

Even the most technically perfect strategic plan will serve little purpose if it is not implemented. Many organizations tend to spend an inordinate amount of time, money, and effort on developing the strategic plan, treating the means and circumstances under which it will be implemented as afterthoughts! Change comes through implementation and evaluation, not through the plan. A technically imperfect plan that is implemented well will achieve more than the perfect plan that never gets off the paper on which it is typed.

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## 7.1 The Nature of Strategy Implementation

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Compare strategy formulation with strategy implementation in terms of each being an art or a science.

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Successful strategy formulation does not guarantee successful strategy implementation. It is always more difficult to do something (strategy implementation) than to say you are going to do it (strategy formulation)! Although inextricably linked, strategy implementation is fundamentally different from strategy formulation. Strategy formulation and implementation can be contrasted in the following ways:

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

Strategy-formulation concepts and tools do not differ greatly for small, large, for-profit, or nonprofit organizations. However, strategy implementation varies substantially among different types and sizes of organizations. Implementing strategies requires such actions as altering sales territories, adding new departments, closing facilities, hiring new employees, changing an organization's pricing strategy, developing financial budgets, developing new

employee benefits, establishing cost-control procedures, changing advertising strategies, building new facilities, training new employees, transferring managers among divisions, and building a better management information system. These types of activities obviously differ greatly between manufacturing, service, and governmental organizations.

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### 7.1.1 Management Perspectives

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In all but the smallest organizations, the transition from strategy formulation to strategy implementation requires a shift in responsibility from strategists to divisional and functional managers.

Implementation problems can arise because of this shift in responsibility, especially if strategy-formulation decisions come as a surprise to middle- and lower-level managers. Managers and employees are motivated more by perceived self-interests than by organizational interests, unless the two coincide. Therefore, it is essential that divisional and functional managers be involved as much as possible in strategy-formulation activities. Of equal importance, strategists should be involved as much as possible in strategy-implementation activities.

As indicated in Table 7.1, management issues central to strategy implementation include establishing annual objectives, devising policies, allocating resources, altering an existing organizational structure, restructuring and reengineering, revising reward and incentive plans, minimizing resistance to change, matching managers with strategy, developing a strategy supportive culture, adapting production/operations processes, developing an effective human resources function, and, if necessary, downsizing. Management changes are necessarily more extensive when strategies to be implemented move a firm in a major new direction.

Managers and employees throughout an organization should participate early and directly in strategy-implementation decisions. Their role in strategy implementation should build upon prior involvement in strategy-formulation activities. Strategists' genuine personal commitment to implementation is a necessary and powerful motivational force for managers and employees.

Too often, strategists are too busy to actively support strategy-implementation efforts, and their lack of interest can be detrimental to organizational success. The rationale for objectives and strategies should be understood and clearly communicated throughout an organization. Major competitors' accomplishments, products, plans, actions, and performance should be apparent to all organizational members. Major external opportunities and threats should be clear, and managers' and employees' questions should be answered. Top down flow of communication is essential for developing bottom-up support.

Table 7.1: Some Management Issues Central to Strategy Implementation

|                                               |
|-----------------------------------------------|
| Establish annual objectives                   |
| Devise policies                               |
| Allocate resources                            |
| Alter an existing organizational structure    |
| Restructure and reengineer                    |
| Revise reward and incentive plans             |
| Minimize resistance to change                 |
| Match managers with strategy                  |
| Develop a strategy-supportive culture         |
| Adapt production/operations processes         |
| Develop an effective human resources function |
| Downsize and furlough as needed               |
| Link performance and pay to strategies        |

## 7.2 Annual Objectives

*Establishing annual objectives* is a decentralized activity that directly involves all managers in an organization. Active participation in establishing annual objectives can lead to acceptance and commitment. *Annual objectives* are essential for strategy implementation because they (1) represent the basis for allocating resources; (2) are a primary mechanism for evaluating managers; (3) are the major instrument for monitoring progress toward achieving long-term objectives; and (4) establish organizational, divisional, and departmental priorities. Considerable time and effort should be devoted to ensuring that annual objectives are well conceived, consistent with long-term objectives, and supportive of strategies to be implemented. Approving, revising, or rejecting annual objectives is much more than a rubber-stamp activity. The purpose of annual objectives can be summarized as follows:

Annual objectives serve as guidelines for action, directing and channeling efforts and activities of organization members. They provide a source of legitimacy in an enterprise by justifying activities to stakeholders. They serve as standards of performance. They serve as an important source of employee motivation and identification. They give incentives for managers and employees to perform. They provide a basis for organizational design.

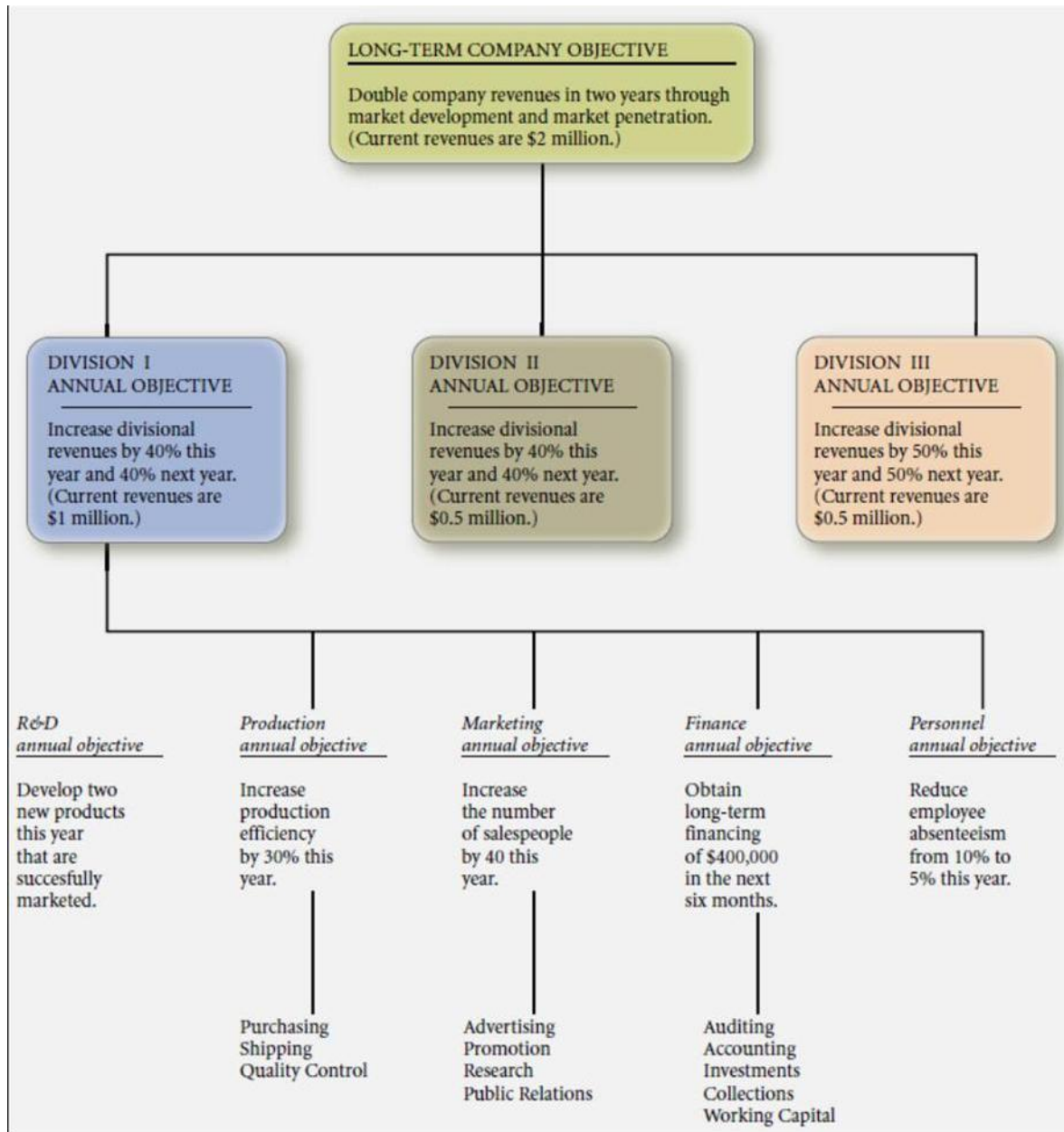
Clearly stated and communicated objectives are critical to success in all types and sizes of firms. Annual objectives, stated in terms of profitability, growth, and market share by business segment, geographic area, customer groups, and product, are common in organizations. Figure 7.2 illustrates how the Stamus Company could establish annual objectives based on long-term objectives. Table 7.2 reveals associated revenue figures that correspond to the objectives outlined in Figure 7.2. Note that, according to plan, the Stamus Company will slightly exceed its long-term objective of doubling company revenues between 2010 and 2012.

Figure 7.1 also reflects how a hierarchy of annual objectives can be established based on an organization's structure. Objectives should be consistent across hierarchical levels and form a network of supportive aims.

*Horizontal consistency of objectives* is as important as *vertical consistency of objectives*. For instance, it would not be effective for manufacturing to achieve more than its annual objective of units produced if marketing could not sell the additional units.

Annual objectives should be measurable, consistent, reasonable, challenging, clear, communicated throughout the organization, characterized by an appropriate time dimension, and accompanied by commensurate rewards and sanctions. Too often, objectives are stated in generalities, with little operational usefulness. Annual objectives, such as “to improve communication” or “to improve performance,” are not clear, specific, or measurable. Objectives should state quantity, quality, cost, and time—and also be verifiable. Terms and phrases such as *maximize*, *minimize*, *as soon as possible*, and *adequate* should be avoided.

Figure 7.1: The Stamus Company's Hierarchy of Aims



Annual objectives should be compatible with employees' and managers' values and should be supported by clearly stated policies. More of something is not always better. Improved quality or reduced cost may, for example, be more important than quantity. It is important to tie rewards and sanctions to annual objectives so that employees and managers understand that achieving objectives is critical to successful strategy implementation.

Clear annual objectives do not guarantee successful strategy implementation, but they do increase the likelihood that personal and organizational aims can be accomplished. Overemphasis on achieving objectives can result in undesirable conduct, such as faking the numbers, distorting the records, and letting objectives become ends in themselves. Managers must be alert to these potential problems.

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### 7.3 Policies

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Changes in a firm's strategic direction do not occur automatically. On a day-to-day basis, policies are needed to make a strategy work. Policies facilitate solving recurring problems and guide the implementation of strategy. Broadly defined, *policy* refers to specific guidelines, methods, procedures, rules, forms, and administrative practices established to support and encourage work toward stated goals. Policies are instruments for strategy implementation. Policies set boundaries, constraints, and limits on the kinds of administrative actions that can be taken to reward and sanction behavior; they clarify what can and cannot be done in pursuit of an organization's objectives. For example, Carnival's *Paradise* ship has a no smoking policy anywhere, anytime aboard ship.

It is the first cruise ship to ban smoking comprehensively. Another example of corporate policy relates to surfing the Web while at work. About 40 percent of companies today do not have a formal policy preventing employees from surfing the Internet, but software is being marketed now that allows firms to monitor how, when, where, and how long various employees use the Internet at work.

Policies let both employees and managers know what is expected of them, thereby increasing the likelihood that strategies will be implemented successfully. They provide a basis for management control, allow coordination across organizational units, and reduce the amount of time managers spend making decisions. Policies also clarify what work is to be done and by whom. They promote delegation of decision making to appropriate managerial levels where various problems usually arise. Many organizations have a policy manual that serves to guide and direct behavior.

Table 7.2: A Hierarchy of Policies

|                                                                                                                                                                                                                                                                                                                                                                              |
|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <b>Company Strategy</b>                                                                                                                                                                                                                                                                                                                                                      |
| Acquire a chain of retail stores to meet our sales growth and profitability objectives.                                                                                                                                                                                                                                                                                      |
| <b>Supporting Policies</b>                                                                                                                                                                                                                                                                                                                                                   |
| 1. “All stores will be open from 8 A.M. to 8 P.M. Monday through Saturday.” (This policy could increase retail sales if stores                                                                                                                                                                                                                                               |
| 2. “All stores must submit a Monthly Control Data Report.” (This policy could reduce expense-to-sales ratios.)                                                                                                                                                                                                                                                               |
| 3. “All stores must support company advertising by contributing 5 percent of their total monthly revenues for this purpose.”                                                                                                                                                                                                                                                 |
| 4. “All stores must adhere to the uniform pricing guidelines set forth in the Company Handbook.” (This policy could help assure customers that the company offers a consistent product in terms of price and quality in all its stores.)                                                                                                                                     |
| <b>Divisional Objective</b>                                                                                                                                                                                                                                                                                                                                                  |
| Increase the division’s revenues from \$10 million in 2009 to \$15 million in 2010.                                                                                                                                                                                                                                                                                          |
| <b>Supporting Policies</b>                                                                                                                                                                                                                                                                                                                                                   |
| 1. “Beginning in January 2010, each one of this division’s salespersons must file a weekly activity report that includes the number of calls made, the number of miles traveled, the number of units sold, the dollar volume sold, and the number of new accounts opened.” (This policy could ensure that salespersons do not place too great an emphasis in certain areas.) |
| 2. “Beginning in January 2010, this division will return to its employees 5 percent of its gross revenues in the form of a Christmas bonus.” (This policy could increase employee productivity.)                                                                                                                                                                             |
| 3. “Beginning in January 2010, inventory levels carried in warehouses will be decreased by 30 percent in accordance with a just-in-time (JIT) manufacturing approach.” (This policy could reduce production expenses and thus free funds for increased marketing efforts.)                                                                                                   |
| <b>Production Department Objective</b>                                                                                                                                                                                                                                                                                                                                       |
| Increase production from 20,000 units in 2009 to 30,000 units in 2010.                                                                                                                                                                                                                                                                                                       |
| <b>Supporting Policies</b>                                                                                                                                                                                                                                                                                                                                                   |
| 1. “Beginning in January 2010, employees will have the option of working up to 20 hours of overtime per week.” (This policy could minimize the need to hire additional employees.)                                                                                                                                                                                           |
| 2. “Beginning in January 2010, perfect attendance awards in the amount of \$100 will be given to all employees who do not miss a workday in a given year.” (This policy could decrease absenteeism and increase productivity.)                                                                                                                                               |
| 3. “Beginning in January 2010, new equipment must be leased rather than purchased.” (This policy could reduce tax liabilities and thus allow more funds to be invested in modernizing production processes.)                                                                                                                                                                 |

Table 7.3: Some Issues That May Require a Management Policy

|                                                                                      |
|--------------------------------------------------------------------------------------|
| ◆ To offer extensive or limited management development workshops and seminars        |
| ◆ To centralize or decentralize employee-training activities                         |
| ◆ To recruit through employment agencies, college campuses, and/or newspapers        |
| ◆ To promote from within or to hire from the outside                                 |
| ◆ To promote on the basis of merit or on the basis of seniority                      |
| ◆ To tie executive compensation to long-term and/or annual objectives                |
| ◆ To offer numerous or few employee benefits                                         |
| ◆ To negotiate directly or indirectly with labor unions                              |
| ◆ To delegate authority for large expenditures or to centrally retain this authority |
| ◆ To allow much, some, or no overtime work                                           |
| ◆ To establish a high- or low-safety stock of inventory                              |
| ◆ To use one or more suppliers                                                       |
| ◆ To buy, lease, or rent new production equipment                                    |
| ◆ To greatly or somewhat stress quality control                                      |
| ◆ To establish many or only a few production standards                               |
| ◆ To operate one, two, or three shifts                                               |
| ◆ To discourage using insider information for personal gain                          |
| ◆ To discourage sexual harassment                                                    |
| ◆ To discourage smoking at work                                                      |
| ◆ To discourage insider trading                                                      |
| ◆ To discourage moonlighting                                                         |

Wal-Mart has a policy that it calls the “10 Foot” Rule, whereby customers can find assistance within 10 feet of anywhere in the store. This is a welcomed policy in Japan, where Wal-Mart is trying to gain a foothold; 58 percent of all retailers in Japan are mom-and-pop stores and consumers historically have had to pay “top yen” rather than “discounted prices” for merchandise.

Policies can apply to all divisions and departments (for example, “We are an equal opportunity employer”). Some policies apply to a single department (“Employees in this department must take at least one training and development course each year”). Whatever their scope and form, policies serve as a mechanism for implementing strategies and obtaining objectives. Policies should be stated in writing whenever possible. They represent the means for carrying out strategic decisions. Examples of policies that support a company strategy, a divisional objective, and a departmental objective are given in Table 7.2. Some example issues that may require a management policy are provided in Table 7.3.

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## 7.4 Resource Allocation

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*Resource allocation* is a central management activity that allows for strategy execution. In organizations that do not use a strategic-management approach to decision making, resource allocation is often based on political or personal factors. Strategic management enables resources to be allocated according to priorities established by annual objectives. Nothing could be more detrimental to strategic management and to organizational success than for resources to be allocated in ways not consistent with priorities indicated by approved annual objectives.

All organizations have at least four types of resources that can be used to achieve desired objectives: financial resources, physical resources, human resources, and technological resources. Allocating resources to particular divisions and departments does not mean that strategies will be successfully implemented. A number of factors commonly prohibit effective resource allocation, including an overprotection of resources, too great an emphasis on short-run financial criteria, organizational politics, vague strategy targets, a reluctance to take risks, and a lack of sufficient knowledge. Below the corporate level, there often exists an absence of systematic thinking about resources allocated and strategies of the firm. Yavitz and Newman explain why:

Managers normally have many more tasks than they can do. Managers must allocate time and resources among these tasks. Pressure builds up. Expenses are too high. The CEO wants a good financial report for the third quarter.

Strategy formulation and implementation activities often get deferred. Today's problems soak up available energies and resources. Scrambled accounts and budgets fail to reveal the shift in allocation away from strategic needs to currently squeaking wheels.

The real value of any resource allocation program lies in the resulting accomplishment of an organization's objectives. Effective resource allocation does not guarantee successful strategy implementation because programs, personnel, controls, and commitment must breathe life into the resources provided. Strategic management itself is sometimes referred to as a "resource allocation process."

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## 7.5 Managing Conflict

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Can you describe several reasons why conflict may occur during objective-setting activities? And what are the various approaches for managing and resolving conflict?

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Interdependency of objectives and competition for limited resources often leads to conflict. *Conflict* can be defined as a disagreement between two or more parties on one or more issues. Establishing annual objectives can lead to conflict because individuals have different expectations and perceptions, schedules create pressure, personalities are incompatible, and misunderstandings between line managers (such as production supervisors) and staff managers (such as human resource specialists) occur. For example, a collection manager's objective of reducing bad debts by 50 percent in a given year may conflict with a divisional objective to increase sales by 20 percent.

Establishing objectives can lead to conflict because managers and strategists must make trade-offs, such as whether to emphasize short-term profits or long-term growth, profit margin or market share, market penetration or market development, growth or stability, high risk or low risk, and social responsiveness or profit maximization. Trade-offs are necessary because no firm has sufficient resources pursue all strategies to would benefit the firm. Table 7.4 reveals some important management trade-off decisions required in strategy implementation.

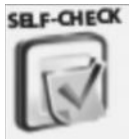
Conflict is unavoidable in organizations, so it is important that conflict be managed and resolved before dysfunctional consequences affect organizational performance. Conflict is not always bad. An absence of conflict can signal indifference and apathy. Conflict can serve to energize opposing groups into action and may help managers identify problems.

Various approaches for managing and resolving conflict can be classified into three categories: avoidance, defusion, and confrontation. *Avoidance* includes such actions as ignoring the problem in hopes that the conflict will resolve itself or physically separating the conflicting individuals (or groups). *Defusion* can include playing down differences between conflicting parties while accentuating similarities and common interests, compromising so that there is neither a clear winner nor loser, resorting to majority rule, appealing to a higher authority, or redesigning present positions. *Confrontation* is exemplified by exchanging members of conflicting parties so that each can gain an appreciation of the other's point of view or holding a meeting at which conflicting parties present their views and work through their differences.

Table 7.4: Some Management Trade-Off Decisions Required in Strategy Implementation

|                                                       |
|-------------------------------------------------------|
| To emphasize short-term profits or long-term growth   |
| To emphasize profit margin or market share            |
| To emphasize market development or market penetration |
| To lay off or furlough                                |
| To seek growth or stability                           |
| To take high risk or low risk                         |
| To be more socially responsible or more profitable    |
| To outsource jobs or pay more to keep jobs at home    |
| To acquire externally or to build internally          |
| To restructure or reengineer                          |
| To use leverage or equity to raise funds              |
| To use part-time or full-time employees               |

## 7.6 Matching Structure with Strategy



Can you explain why organizational structure is so important in strategy implementation?

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Changes in strategy often require changes in the way an organization is structured for two major reasons. First, structure largely dictates how objectives and policies will be established. For example, objectives and policies established under a geographic organizational structure are couched in geographic terms. Objectives and policies are stated largely in terms of products in an organization whose structure is based on product groups.

The structural format for developing objectives and policies can significantly impact all other strategy-implementation activities.

The second major reason why changes in strategy often require changes in structure is that structure dictates how resources will be allocated. If an organization's structure is based on customer groups, then resources will be allocated in that manner. Similarly, if an organization's structure is set up along functional business lines, then resources are allocated by functional areas. Unless new or revised strategies place emphasis in the same areas as old strategies, structural reorientation commonly becomes a part of strategy implementation.

Changes in strategy lead to changes in organizational structure. Structure should be designed to facilitate the strategic pursuit of a firm and, therefore, follow strategy. Without a strategy or reasons for being (mission), companies find it difficult to design an effective structure. Chandler found a particular structure sequence to be repeated often as organizations grow and change strategy over time; this sequence is depicted in Figure 7.2.

There is no one optimal organizational design or structure for a given strategy or type of organization. What is appropriate for one organization may not be appropriate for a similar firm, although successful firms in a given industry do tend to organize themselves in a similar way..

Figure 7.2: Chandler's Strategy-Structure Relationship



For example, consumer goods companies tend to emulate the divisional structure- by-product form of organization. Small firms tend to be functionally structured (centralized). Medium-sized firms tend to be divisionally structured (decentralized). Large firms tend to use a strategic business unit (SBU) or matrix structure. As organizations grow, their structures generally change from simple to complex as a result of concatenation, or the linking together of several basic strategies

Numerous external and internal forces affect an organization; no firm could change its structure in response to every one of these forces, because to do so would lead to chaos. However, when a firm changes its strategy, the existing organizational structure may become ineffective. As indicated in Table 7.5, symptoms of an ineffective organizational structure include too many levels of management, too many meetings attended by too many people, too much attention being directed toward solving interdepartmental conflicts, too large a span of control, and too many unachieved objectives. Changes in structure can facilitate strategy-implementation efforts, but changes in structure should not be expected to make a bad strategy good, to make bad managers good, or to make bad products sell.

Table 7.5: Symptoms of an Ineffective Organizational Structure

|                                                                                            |
|--------------------------------------------------------------------------------------------|
| 1. Too many levels of management                                                           |
| 2. Too many meetings attended by too many people                                           |
| 3. Too much attention being directed toward solving interdepartmental conflicts            |
| 4. Too large a span of control                                                             |
| 5. Too many unachieved objectives                                                          |
| 6. Declining corporate or business performance                                             |
| 7. Losing ground to rival firms                                                            |
| 8. Revenue and/or earnings divided by number of employees and/or number of managers is low |

Structure undeniably can and does influence strategy. Strategies formulated must be workable, so if a certain new strategy required massive structural changes it would not be an attractive choice. In this way, structure can shape the choice of strategies. But a more important concern is determining what types of structural changes are needed to implement new strategies and how these changes can best be accomplished.

We examine this issue by focusing on seven basic types of organizational structure: functional, divisional by geographic area, divisional by product, divisional by customer, divisional process, strategic business unit (SBU), and matrix.

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### 7.6.1 The Functional Structure

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The most widely used structure is the functional or centralized type because this structure is the simplest and least expensive of the seven alternatives. A *functional structure* groups tasks and activities by business function, such as production/operations, marketing, finance/accounting, research and development, and management information systems. A university may structure its activities by major functions that include academic affairs, student services, alumni relations, athletics, maintenance, and accounting. Besides being simple and inexpensive, a functional structure also promotes specialization of labor, encourages efficient use of managerial and technical talent, minimizes the need for an elaborate control system, and allows rapid decision making.

Some disadvantages of a functional structure are that it forces accountability to the top, minimizes career development opportunities, and is sometimes characterized by low employee morale, line/staff conflicts, poor delegation of authority, and inadequate planning for products and markets.

A functional structure often leads to short-term and narrow thinking that may undermine what is best for the firm as a whole. For example, the research and development department may strive to overdesign products and components to achieve technical elegance, while manufacturing may argue for low-frills products that can be mass produced more easily. Thus, communication is often not as good in a functional structure. Schein gives an example of a communication problem in a functional structure: The word “marketing” will mean product development to the engineer, studying customers through market research to the product manager, merchandising to the salesperson, and constant change in design to the manufacturing manager. Then when these managers try to work together, they often attribute disagreements to personalities and fail to notice the deeper, shared assumptions that vary and

dictate how each function thinks. Table 7.6 summarizes the advantages and disadvantages of a functional organizational structure.

Table 7.6: Advantages and Disadvantages of a Functional Organizational Structure

| Advantages                                                                                                                           | Disadvantages                                                                                                 |
|--------------------------------------------------------------------------------------------------------------------------------------|---------------------------------------------------------------------------------------------------------------|
| <ul style="list-style-type: none"> <li>Simple and inexpensive</li> </ul>                                                             | <ul style="list-style-type: none"> <li>Accountability forced to the top</li> </ul>                            |
| <ul style="list-style-type: none"> <li>Capitalizes on specialization of business activities such as marketing and finance</li> </ul> | <ul style="list-style-type: none"> <li>Delegation of authority &amp; responsibility not encouraged</li> </ul> |
| <ul style="list-style-type: none"> <li>Minimizes need for elaborate control system</li> </ul>                                        | <ul style="list-style-type: none"> <li>Minimizes career development</li> </ul>                                |
| <ul style="list-style-type: none"> <li>Allows for rapid decision making</li> </ul>                                                   | <ul style="list-style-type: none"> <li>Low employee/manager morale</li> </ul>                                 |
|                                                                                                                                      | <ul style="list-style-type: none"> <li>Inadequate planning for products &amp; markets</li> </ul>              |
|                                                                                                                                      | <ul style="list-style-type: none"> <li>Leads to short-term, narrow thinking</li> </ul>                        |
|                                                                                                                                      | <ul style="list-style-type: none"> <li>Leads to communication problems</li> </ul>                             |

### 7.6.2 The Divisional Structure



Would you recommend a divisional structure by geographic area, product, customer, or process for a medium-sized bank in your local area? Why?

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The *divisional* or *decentralized structure* is the second most common type used by U.S. businesses. As a small organization grows, it has more difficulty managing different products and services in different markets. Some form of divisional structure generally becomes necessary to motivate employees, control operations, and compete successfully in diverse locations. The divisional structure can be organized in one of four ways: *by geographic area*, *by product or service*, *by customer*, or *by process*. With a divisional structure, functional activities are performed both centrally and in each separate division.

A divisional structure has some clear advantages. First and perhaps foremost, accountability is clear. That is, divisional managers can be held responsible for sales and profit levels. Because a divisional structure is based on extensive delegation of authority, managers and employees can easily see the results of their good or bad performances. As a result, employee morale is generally higher in a divisional structure than it is in a centralized structure. Other advantages of the divisional design are that it creates career development opportunities for managers, allows local control of situations, leads to a competitive climate within an organization, and allows new businesses and products to be added easily.

The divisional design is not without some limitations, however. Perhaps the most important limitation is that a divisional structure is costly, for a number of reasons. First, each division requires functional specialists who must be paid. Second, there exists some duplication of staff services, facilities, and personnel; for instance, functional specialists are also needed centrally (at headquarters) to coordinate divisional activities. Third, managers must be well qualified because the divisional design forces delegation of authority; better-qualified individuals require higher salaries. A divisional structure can also be costly because it requires an elaborate, headquarters-driven control system. Fourth, competition between divisions may become so intense that it is dysfunctional and leads to limited sharing of ideas and resources for the common good of the firm. Table 7.7 summarizes the advantages and disadvantages of divisional organizational structure.

Table 7.7: Advantages and Disadvantages of a Divisional Organizational Structure

| Advantages                                                                 | Disadvantages                                                            |
|----------------------------------------------------------------------------|--------------------------------------------------------------------------|
| Accountability is clear                                                    | Can be costly                                                            |
| Allows local control of local situations                                   | Duplication of functional activities                                     |
| Creates career development chances                                         | Requires a skilled management force                                      |
| Promotes delegation of authority                                           | Requires an elaborate control system                                     |
| Leads to competitive climate internally                                    | Competition among divisions can become so intense as to be dysfunctional |
| Allows easy adding of new products or regions                              | Can lead to limited sharing of ideas and resources                       |
| Allows strict control and attention to products, customers, and/or regions | Some regions/products/customers may receive special treatment            |

### 7.6.3 The Strategic Business Unit (SBU) Structure

As the number, size, and diversity of divisions in an organization increase, controlling and evaluating divisional operations become increasingly difficult for strategists. Increases in sales often are not accompanied by similar increases in profitability. The span of control becomes too large at top levels of the firm.

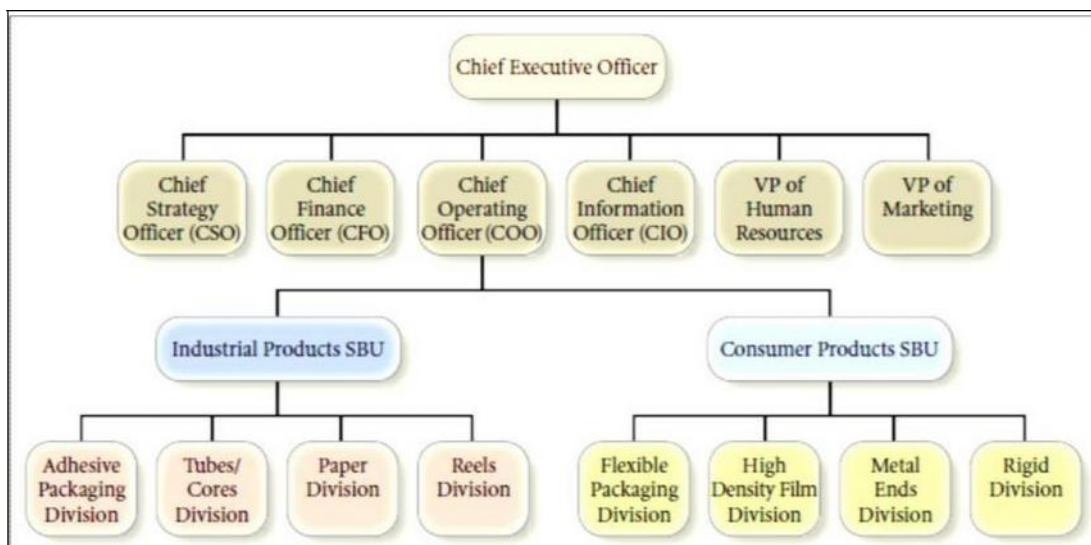
The SBU structure groups similar divisions into strategic business units and delegates authority and responsibility for each unit to a senior executive who reports directly to the chief executive officer. This change in structure can facilitate strategy implementation by improving coordination between similar divisions and channeling accountability to distinct business units. In a 100-division conglomerate, the divisions could perhaps be regrouped into 10 SBUs according to certain common characteristics, such as competing in the same industry, being located in the same area, or having the same customers.

Two disadvantages of an SBU structure are that it requires an additional layer of management, which increases salary expenses. Also, the role of the group vice president is often ambiguous. However, these limitations often do not outweigh the advantages of

improved coordination and accountability. Another advantage of the SBU structure is that it makes the tasks of planning and control by the corporate office more manageable.

As illustrated in Figure 7.3 below, Sonoco Products Corporation, based in Hartsville, South Carolina, utilizes an SBU organizational structure. Note that Sonoco's SBUs Industrial Products and Consumer Products—each have four autonomous divisions that have their own sales, manufacturing, R&D, finance, HRM, and MIS functions.

Figure 7.3: Sonoco Products' SBU Organizational Chart



#### 7.6.4 The Matrix Structure

A *matrix structure* is the most complex of all designs because it depends upon both vertical and horizontal flows of authority and communication (hence the term *matrix*). In contrast, functional and divisional structures depend primarily on vertical flows of authority and communication. A matrix structure can result in higher overhead because it creates more management positions. Other disadvantages of a matrix structure that contribute to overall complexity include dual lines of budget authority (a violation of the unity-of-command principle), dual sources of reward and punishment, shared authority, dual reporting channels, and a need for an extensive and effective communication system.

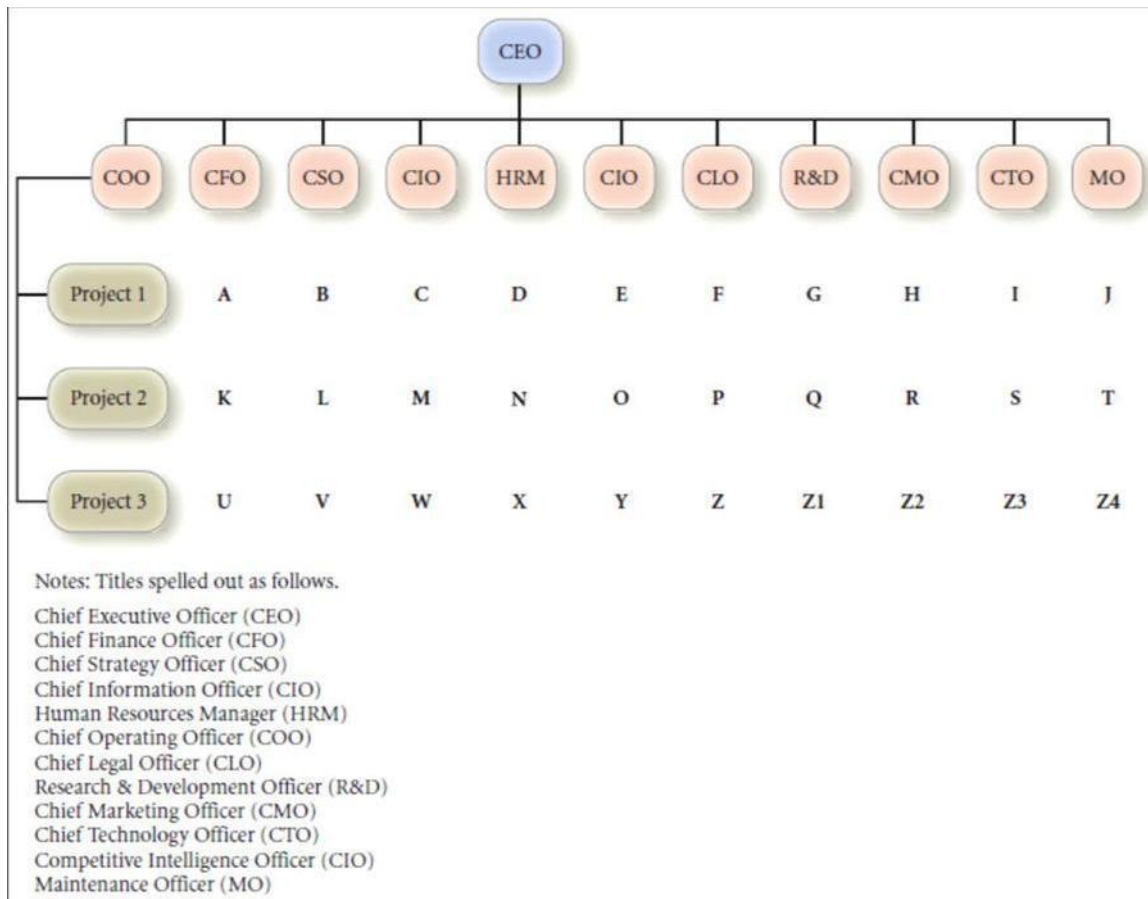
Despite its complexity, the matrix structure is widely used in many industries, including construction, health care, research, and defense. As indicated in Table 7.8, some advantages of a matrix structure are that project objectives are clear, there are many channels of communication, workers can see the visible results of their work, and shutting down a project can be accomplished relatively easily. Another advantage of a matrix structure is that it facilitates the use of specialized personnel, equipment, and facilities. Functional resources are shared in a matrix structure, rather than duplicated as in a divisional structure. Individuals with a high degree of expertise can divide their time as needed among projects, and they in turn develop their own skills and competencies more than in other structures.

Table 7.8: Advantages and Disadvantages of a Matrix Structure

| Advantages                                                                           | Disadvantages                                                       |
|--------------------------------------------------------------------------------------|---------------------------------------------------------------------|
| 👍 Project objectives are clear                                                       | 👎 Requires excellent vertical and horizontal flows of communication |
| 👍 Employees can clearly see results of their work                                    | 👎 Costly because creates more manager positions                     |
| 👍 Shutting down a project is easily accomplished                                     | 👎 Violates unity of command principle                               |
| 👍 Facilitates uses of special equipment/ personnel/facilities                        | 👎 Creates dual lines of budget authority                            |
| 👍 Functional resources are shared instead of duplicated as in a divisional structure | 👎 Creates dual sources of reward/punishment                         |
|                                                                                      | 👎 Creates shared authority and reporting                            |
|                                                                                      | 👎 Requires mutual trust and understanding                           |

A typical matrix structure is illustrated in Figure 7-5. Note that the letters (A through Z4) refer to managers. For example, if you were manager A, you would be responsible for financial aspects of Project 1, and you would have two bosses: the Project 1 Manager on site and the CFO off site.

Figure 7.4: An Example Matrix Structure



For a matrix structure to be effective, organizations need participative planning, training, clear mutual understanding of roles and responsibilities, excellent internal communication, and mutual trust and confidence. The matrix structure is being used more frequently by U.S. businesses because firms are pursuing strategies that add new products, customer groups, and technology to their range of activities. Out of these changes are coming product managers, functional managers, and geographic-area managers, all of whom have important strategic responsibilities. When several variables, such as product, customer, technology, geography, functional area, and line of business, have roughly equal strategic priorities, a matrix organization can be an effective structural form.

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## 7.7 Managing Resistance to Change

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No organization or individual can escape change. But the thought of change raises anxieties because people fear economic loss, inconvenience, uncertainty, and a break in normal social patterns. Almost any change in structure, technology, people, or strategies has the potential to disrupt comfortable interaction patterns. For this reason, people resist change. The strategic-management process itself can impose major changes on individuals and processes. Reorienting an organization to get people to think and act strategically is not an easy task. *Resistance to change* can be considered the single greatest threat to successful strategy implementation. Resistance regularly occurs in organizations in the form of sabotaging production machines, absenteeism, filing unfounded grievances, and an unwillingness to cooperate. People often resist strategy implementation because they do not understand what is happening or why changes are taking place. In that case, employees may simply need accurate information.

Successful strategy implementation hinges upon managers' ability to develop an organizational climate conducive to change. Change must be viewed as an opportunity rather than as a threat by managers and employees. Resistance to change can emerge at any stage or level of the strategy-implementation process. Although there are various approaches for implementing changes, three commonly used strategies are a force change strategy, an educative change strategy, and a rational or self-interest change strategy. A *force change strategy* involves giving orders and enforcing those orders; this strategy has the advantage of being fast, but it is plagued by low commitment and high resistance. The *educative change strategy* is one that presents information to convince people of the need for change; the disadvantage of an educative change strategy is that implementation becomes slow and difficult. However, this type of strategy evokes greater commitment and less resistance than does the force change strategy. Finally, a *rational or self-interest change strategy* is one that attempts to convince individuals that the change is to their personal advantage. When this appeal is successful, strategy implementation can be relatively easy. However, implementation changes are seldom to everyone's advantage.

The rational change strategy is the most desirable, so this approach is examined a bit further. Managers can improve the likelihood of successfully implementing change by carefully designing change efforts. Jack Duncan described a rational or self-interest change strategy as consisting of four steps. First, employees are invited to participate in the process of change and in the details of transition; participation allows everyone to give opinions, to feel a part of the change process, and to identify their own self-interests regarding the recommended change. Second, some motivation or incentive to change is required; self-interest can be the most important motivator. Third, communication is needed so that people can understand the purpose for the changes. Giving and receiving feedback is the fourth step: everyone enjoys knowing how things are going and how much progress is being made.

Because of diverse external and internal forces, change is a fact of life in organizations. The rate, speed, magnitude, and direction of changes vary over time by industry and organization. Strategists should strive to create a work environment in which change is recognized as necessary and beneficial so that individuals can more easily adapt to change. Adopting a strategic-management approach to decision making can itself require major changes in the philosophy and operations of a firm.

Strategists can take a number of positive actions to minimize managers' and employees' resistance to change. For example, individuals who will be affected by a change should be involved in the decision to make the change and in decisions about how to implement the change. Strategists should anticipate changes and develop and offer training and development workshops so that managers and employees can adapt to those changes. They also need to effectively communicate the need for changes. The strategic-management process can be described as a process of managing change.



## SUMMARY OF THE CHAPTER

-  Successful strategy formulation does not guarantee successful strategy implementation. It is always more difficult to do something (strategy implementation) than to say you are going to do it (strategy formulation).
-  In all but the smallest organizations, the transition from strategy formulation to strategy implementation requires a shift in responsibility from strategists to divisional and functional managers.
-  Management issues central to strategy implementation include establishing annual objectives, devising policies, allocating resources, altering an existing organizational structure, restructuring and reengineering, revising reward and incentive plans, minimizing resistance to change, matching managers with strategy, developing a strategy-supportive culture, adapting production/operations processes, developing an effective human resource function, and, if necessary, downsizing.
-  Managers and employees throughout an organization should participate early and directly in strategy-implementation decisions.
-  Establishing annual objectives is a decentralized activity that directly involves all managers in an organization.
-  Annual objectives are essential for strategy implementation because they:
  - ✓ Represent the basis for allocating resources.
  - ✓ Are a primary mechanism for evaluating managers.
  - ✓ Are the major instrument for monitoring progress towards achieving long-term objectives.
  - ✓ Establish organizational, divisional, and departmental priorities.
-  Annual objectives should be measurable, consistent, reasonable, challenging, clear, communicated throughout the organization, characterized by an appropriate time dimension, and accompanied by commensurate rewards and sanctions.

-  Changes in a firm's strategic direction do not occur automatically. On a day-to-day basis, policies are needed to make a strategy work.
-  Policies let both employees and managers know what is expected of them, thereby increasing the likelihood that strategies will be implemented successfully.
-  In organizations that do not use a strategic-management approach to decision making, resource allocation is often based on political or personal factors.
-  Interdependency of objectives and competition for limited resources often leads to conflict. Conflict can be defined as a disagreement between two or more parties on one or more issues.
-  Various approaches for managing and resolving conflict can be classified into three categories: avoidance, defusion, and confrontation.
-  Changes in strategy lead to changes in organizational structure. Structure should be designed to facilitate the strategic pursuit of a firm and, therefore, follow strategy.
-  Resistance to change can be considered the single greatest threat to successful strategy implementation.
-  Resistance to change can emerge at any stage or level of the strategy-implementation process.



## CHAPTER REVIEW EXERCISES

Part I: True/False

1. Policies can represent the means for carrying out strategic decisions.
2. Successful strategy formulation guarantee successful strategy implementation.
3. Changes in strategy lead to changes in organizational structure.
4. Strategic implementation is a science whereas Strategic formulation is an art.
5. While efficiency is the focus of strategy formulation, strategy implementation focuses on effectiveness.

Part II: Choose the correct answer from the given alternatives

1. Divisional structure is preferred the functional structure in that;
  - A. Employees can clearly see results of their work
  - B. Promotes delegation of authority
  - C. Allows for rapid decision making
  - D. Creates career development chances
  - E. B & D
  - F. None of the above
2. One of the following is true about strategy implementation.
  - A. It focuses on effectiveness
  - B. Policies are vital instruments in achieving it
  - C. It requires greater motivational & leadership skills than strategic formulation
  - D. A & B
  - E. B & C
  - F. All of the above
3. \_\_\_\_\_ refers to specific guidelines, methods, procedures, rules, forms, and administrative practices established to support and encourage work toward stated goals.

|                      |                      |
|----------------------|----------------------|
| A. Strategy          | D. Resources         |
| B. Annual Objectives | E. None of the above |
| C. Policies          |                      |

4. A \_\_\_\_\_ structure is most simple and inexpensive.
- A. Departmental
  - B. Strategic business unit
  - C. Functional
  - D. D. Process
5. One of the following is not symptom of ineffective organizational structure
- A. Decrease in business performance
  - B. Unable to stand competition
  - C. Narrow span of control
  - D. Too many unachieved objectives
  - E. All of the above

## CHAPTER

8

## STRATEGY

## REVIEW, EVALUATION, AND CONTROL

## Introduction

**D**ear student, welcome to the final chapter of the module! This chapter deals with the important activities that take place after implementing a strategy-evaluation and control. As you may recall from the previous chapter, strategy implementation is concerned with putting the selected strategy into action whereas evaluation and control are activities that are carried out after a given strategy is implemented. Strategic evaluation and control constitutes the final phase of strategic management. The basic objective of evaluation and control is to ensure whether the strategy is being implemented as per the intention and to rectify deviations, if any.

## CHAPTER OUTLINE

- ◆ The Nature of Strategy Evaluation
- ◆ A Strategy-Evaluation Framework
- ◆ The Balanced Scorecard
- ◆ Characteristics of an Effective Evaluation System
- ◆ Contingency Planning

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## CHAPTER OBJECTIVES

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After studying this chapter, you should be able to do the following:

- ⊕ Describe a practical framework for evaluating strategies.
- ⊕ Explain why strategy evaluation is complex, sensitive, and yet essential for organizational success.
- ⊕ Discuss the importance of contingency planning in strategy evaluation.
- ⊕ Explain how computers can aid in evaluating strategies.
- ⊕ Discuss the Balanced Scorecard.

*"There is no 'perfect' strategic decision. One always has to pay a price. One always has to balance conflicting objectives, conflicting opinions, and conflicting priorities. The best strategic decision is only an approximation and a risk."*

**Peter Drucker**

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### 8.1 The Nature of Strategy Evaluation

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Why has strategy evaluation become so important in business today?

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The strategic-management process results in decisions that can have significant, long lasting consequences. Erroneous strategic decisions can inflict severe penalties and can be exceedingly difficult, if not impossible, to reverse. Most strategists agree, therefore, that strategy evaluation is vital to an organization's well-being; timely evaluations can alert management to problems or potential problems before a situation becomes critical. Strategy evaluation includes three basic activities: (1) examining the underlying bases of a firm's strategy, (2) comparing expected results with actual results, and (3) taking corrective actions to ensure that performance conforms to plans.

Adequate and timely feedback is the cornerstone of effective strategy evaluation. Strategy evaluation can be no better than the information on which it is based. Too much pressure from top managers may result in lower managers contriving numbers they think will be satisfactory. Strategy evaluation can be a complex and sensitive undertaking. Too much emphasis on evaluating strategies may be expensive and counterproductive. No one likes to be evaluated too closely! The more managers attempt to evaluate the behavior of others, the less control they have. Yet too little or no evaluation can create even worse problems. Strategy evaluation is essential to ensure that stated objectives are being achieved. In many organizations, strategy evaluation is simply an appraisal of how well an organization has performed. Have the firm's assets increased? Has there been an increase in profitability?

Have sales increased? Have productivity levels increased? Have profit margin, return on investment, and earnings-per-share ratios increased? Some firms argue that their strategy must have been correct if the answers to these types of questions are affirmative. Well, the strategy or strategies may have been correct, but this type of reasoning can be misleading because strategy evaluation must have both a long-run and short-run focus. Strategies often do not affect short-term operating results until it is too late to make needed changes.

It is impossible to demonstrate conclusively that a particular strategy is optimal or even to guarantee that it will work. One can, however, evaluate it for critical flaws. Richard Rumelt

offered four criteria that could be used to evaluate a strategy: consistency, consonance, feasibility, and advantage. Described in Table 8.1, *consonance* and *advantage* are mostly based on a firm's external assessment, whereas *consistency* and *feasibility* are largely based on an internal assessment. Strategy evaluation is important because organizations face dynamic environments in which key external and internal factors often change quickly and dramatically. Success today is no guarantee of success tomorrow! An organization should never be lulled into complacency with success. Countless firms have thrived one year only to struggle for survival the following year.

Strategy evaluation is becoming increasingly difficult with the passage of time, for many reasons. Domestic and world economies were more stable in years past, product life cycles were longer, product development cycles were longer, technological advancement was slower, change occurred less frequently, there were fewer competitors, foreign companies were weak, and there were more regulated industries. Other reasons why strategy evaluation is more difficult today include the following trends:

1. A dramatic increase in the environment's complexity
2. The increasing difficulty of predicting the future with accuracy
3. The increasing number of variables
4. The rapid rate of obsolescence of even the best plans
5. The increase in the number of both domestic and world events affecting organizations
6. The decreasing time span for which planning can be done with any degree of certainty

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## 8.2 The Process of Evaluating Strategies

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As a managing director of the organization you are currently working, explain how you would evaluate the firm's strategy.

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Strategy evaluation is necessary for all sizes and kinds of organizations. Strategy evaluation should initiate managerial questioning of expectations and assumptions, should trigger a review of objectives and values, and should stimulate creativity in generating alternatives and formulating criteria of evaluation.<sup>3</sup> Regardless of the size of the organization, a certain amount of *management by wandering around* at all levels is essential to effective strategy evaluation. Strategy-evaluation activities should be performed on a continuing basis, rather than at the end of specified periods of time or just after problems occur. Waiting until the end of the year, for example, could result in a firm closing the barn door after the horses have already escaped.

Evaluating strategies on a continuous rather than on a periodic basis allows benchmarks of progress to be established and more effectively monitored. Some strategies take years to implement; consequently, associated results may not become apparent for years. Successful strategies combine patience with a willingness to promptly take corrective actions when necessary. There always comes a time when corrective actions are needed in an organization!

Managers and employees of the firm should be continually aware of progress being made toward achieving the firm's objectives. As critical success factors change, organizational members should be involved in determining appropriate corrective actions. If assumptions and expectations deviate significantly from forecasts, then the firm should renew strategy-formulation activities, perhaps sooner than planned. In strategy evaluation, like strategy formulation and strategy implementation, people make the difference. Through involvement in the process of evaluating strategies, managers and employees become committed to keeping the firm moving steadily toward achieving objectives.

Table 8.1: Rumelt's Criteria for Evaluating Strategies

|                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                     |
|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <b>Consistency</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                  |
| <p>A strategy should not present inconsistent goals and policies. Organizational conflict and interdepartmental bickering are often symptoms of managerial disorder, but these problems may also be a sign of strategic inconsistency. Three guidelines help determine if organizational problems are due to inconsistencies in strategy:</p> <ul style="list-style-type: none"> <li>• If managerial problems continue despite changes in personnel and if they tend to be issue-based rather than people-based, then strategies may be inconsistent.</li> <li>• If success for one organizational department means, or is interpreted to mean, failure for another department, then strategies may be inconsistent.</li> <li>• If policy problems and issues continue to be brought to the top for resolution, then strategies may be inconsistent.</li> </ul>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                     |
| <b>Consonance</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                   |
| <p>Consonance refers to the need for strategists to examine <i>sets of trends</i>, as well as individual trends, in evaluating strategies. A strategy must represent an adaptive response to the external environment and to the critical changes occurring within it. One difficulty in matching a firm's key internal and external factors in the formulation of strategy is that most trends are the result of interactions among other trends. For example, the day-care explosion came about as a combined result of many trends that included a rise in the average level of education, increased inflation, and an increase in women in the workforce. Although single economic or demographic trends might appear steady for many years, there are waves of change going on at the interaction level.</p>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                   |
| <b>Feasibility</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                  |
| <p>A strategy must neither overtax available resources nor create unsolvable subproblems. The final broad test of strategy is its feasibility; that is, can the strategy be attempted within the physical, human, and financial resources of the enterprise? The financial resources of a business are the easiest to quantify and are normally the first limitation against which strategy is evaluated. It is sometimes forgotten, however, that innovative approaches to financing are often possible. Devices, such as captive subsidiaries, sale-leaseback arrangements, and tying plant mortgages to long-term contracts, have all been used effectively to help win key positions in suddenly expanding industries. A less quantifiable, but actually more rigid, limitation on strategic choice is that imposed by individual and organizational capabilities. In evaluating a strategy, it is important to examine whether an organization has demonstrated in the past that it possesses the abilities, competencies, skills, and talents needed to carry out a given strategy.</p>                                                                                                                                                                                                                                                                                                                                                                                                       |
| <b>Advantage</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                    |
| <p>A strategy must provide for the creation and/or maintenance of a competitive advantage in a selected area of activity. Competitive advantages normally are the result of superiority in one of three areas: (1) resources, (2) skills, or (3) position. The idea that the positioning of one's resources can enhance their combined effectiveness is familiar to military theorists, chess players, and diplomats. Position can also play a crucial role in an organization's strategy. Once gained, a good position is defensible—meaning that it is so costly to capture that rivals are deterred from full-scale attacks. Positional advantage tends to be self-sustaining as long as the key internal and environmental factors that underlie it remain stable. This is why entrenched firms can be almost impossible to unseat, even if their raw skill levels are only average. Although not all positional advantages are associated with size, it is true that larger organizations tend to operate in markets and use procedures that turn their size into advantage, while smaller firms seek product/market positions that exploit other types of advantage. The principal characteristic of good position is that it permits the firm to obtain advantage from policies that would not similarly benefit rivals without the same position. Therefore, in evaluating strategy, organizations should examine the nature of positional advantages associated with a given strategy.</p> |

### 8.3 A Strategy-Evaluation Framework

Table 8.2 summarizes strategy-evaluation activities in terms of key questions that should be addressed, alternative answers to those questions, and appropriate actions for an organization to take. Notice that corrective actions are almost always needed except when (1) external and internal factors have not significantly changed and (2) the firm is progressing satisfactorily

toward achieving stated objectives. Relationships among strategy-evaluation activities are illustrated in Figure 8.1.

Table 8.2: A Strategy-Evaluation Assessment Matrix

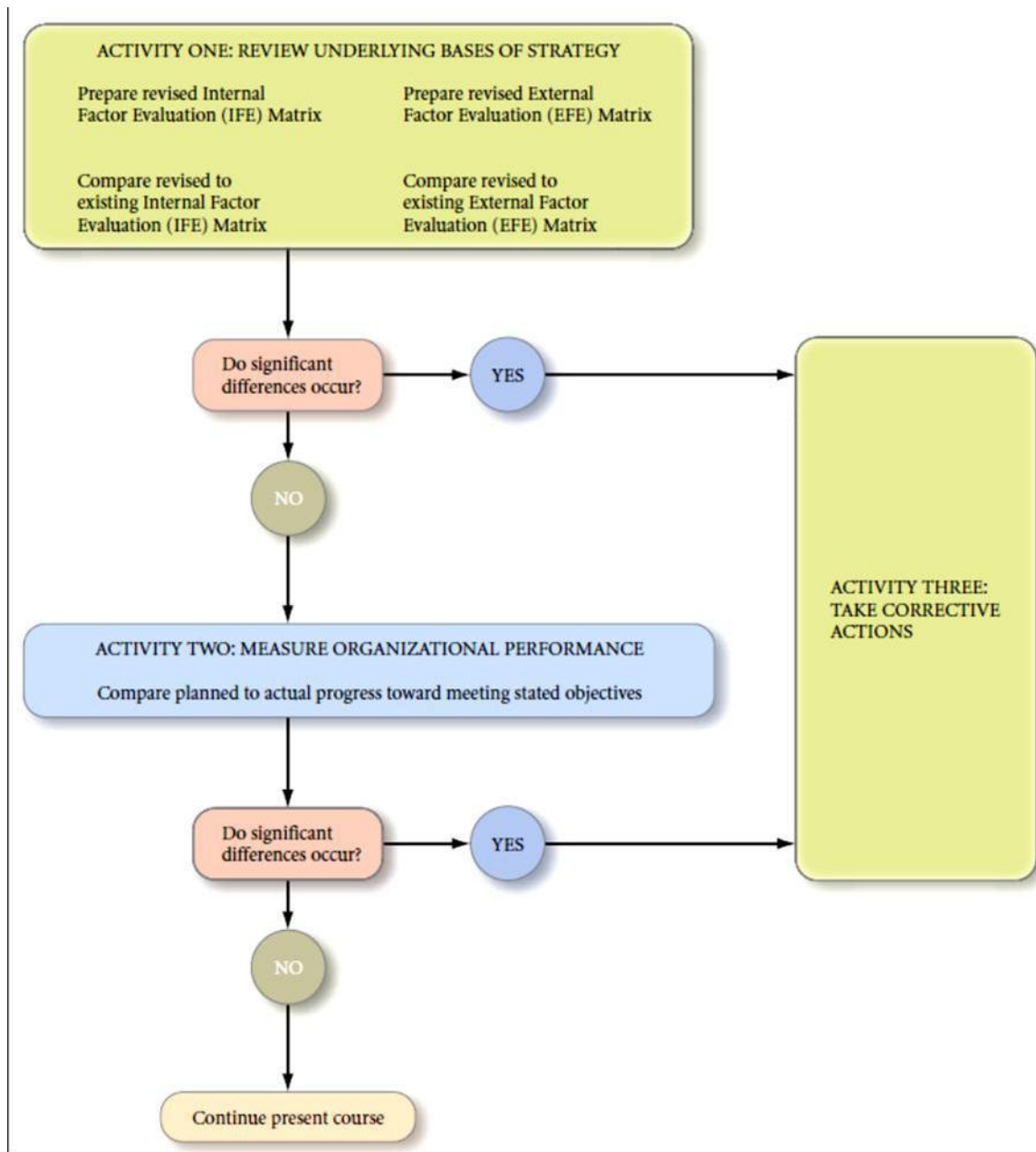
| Have Major Changes Occurred in the Firm Internal Strategic Position? | Have Major Changes Occurred in the Firm External Strategic Position? | Has the Firm Progressed Satisfactorily Toward Achieving Its Stated Objectives? | Result                            |
|----------------------------------------------------------------------|----------------------------------------------------------------------|--------------------------------------------------------------------------------|-----------------------------------|
| No                                                                   | No                                                                   | No                                                                             | Take corrective actions           |
| Yes                                                                  | Yes                                                                  | Yes                                                                            | Take corrective actions           |
| Yes                                                                  | Yes                                                                  | No                                                                             | Take corrective actions           |
| Yes                                                                  | No                                                                   | Yes                                                                            | Take corrective actions           |
| Yes                                                                  | No                                                                   | No                                                                             | Take corrective actions           |
| No                                                                   | Yes                                                                  | Yes                                                                            | Take corrective actions           |
| No                                                                   | Yes                                                                  | No                                                                             | Take corrective actions           |
| No                                                                   | No                                                                   | Yes                                                                            | Continue present strategic course |

### 8.3.1 Reviewing Bases of Strategy

As shown in Figure 9.1, *reviewing the underlying bases of an organization's strategy* could be approached by developing a revised EFE Matrix and IFE Matrix. A *revised IFE Matrix* should focus on changes in the organization's management, marketing, finance/accounting, production/operations, R&D, and management information systems strengths and weaknesses. A *revised EFE Matrix* should indicate how effective a firm's strategies have been in response to key opportunities and threats. This analysis could also address such questions as the following:

1. How have competitors reacted to our strategies?
2. How have competitors' strategies changed?
3. Have major competitors' strengths and weaknesses changed?
4. Why are competitors making certain strategic changes?
5. Why are some competitors' strategies more successful than others?
6. How satisfied are our competitors with their present market positions and profitability?
7. How far can our major competitors be pushed before retaliating?
8. How could we more effectively cooperate with our competitors?

Figure 8.1: A Strategy-Evaluation Framework



Numerous external and internal factors can prevent firms from achieving long-term and annual objectives. Externally, actions by competitors, changes in demand, changes in technology, economic changes, demographic shifts, and governmental actions may prevent objectives from being accomplished. Internally, ineffective strategies may have been chosen or implementation activities may have been poor. Objectives may have been too optimistic.

Thus, failure to achieve objectives may not be the result of unsatisfactory work by managers and employees. All organizational members need to know this to encourage their support for strategy-evaluation activities. Organizations desperately need to know as soon as possible when their strategies are not effective. Sometimes managers and employees on the front lines discover this well before strategists.

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

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

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## 8.4 Participants in Strategic Evaluation and control

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Since strategic evaluation and control is part of strategic management process, all those persons who participate in strategy formulation and implementation should also participate in strategic evaluation except those who act in advisory capacity. Board of directors, chief executives, other managers, corporate planning staff and consultants participate in strategic management process. Out of these corporate planning staff and consultants act either advisors or facilitators. Thus, three groups of personnel are actively involved in strategic evaluation and control though their areas of evaluation and control differ.

In some cases, outside agencies like financial institutions or government, mostly to the case of public sector enterprises also participate in strategic evaluation and control either through their participation in board of directors or having power to interfere with management practices. However, the role of financial institutions in strategic evaluation and control is quite limited except through their nominee's on board of directors. In the case of public sector enterprises, the role of government in strategic evaluation is performed through nomination of board members and through controlling ministries of particular enterprises.

**A) Role of Board of Directors:** Board of directors of a company, being the trustee of shareholders' property, is directly answerable to them. Thus, board should be directly involved in strategic evaluation and control. However, since board does not participate in day-to-day management process, it evaluates the performance of the company concerned after certain intervals in its meetings. Therefore, the role of board of directors is limited to evaluating and controlling those aspects of the organizational functioning, which have long-term implications. Such aspects are overall financial performance, overall social concern and performance, and certain key management practices having significant impact on organization's long-term survival. Generally, the evaluation and control information used by the board is concise but comprehensive as compared to control reports used at lower levels.

**B) Role of Chief Executive:** The chief executive of an organization is responsible for overall performance. Therefore, his role is quite crucial in strategic evaluation and control. Though he is not involved in evaluation of routine performance, which is left to other managers, he concentrates his attention on critical variations between planned and actual. Generally, he applies the principle of management by exception, which is a system of identification and communication of that signal which is critical and needs the attention of a high-level manager. Depending on the size of the organization, the chief executive's role varies in the context of evaluation and control on day-to-day basis. In a smaller organization, the chief executive may, perhaps, be interested in daily production and cost figures, but in a large organization, these become unimportant for him from his control point of view.

Thus, in a large organization, the chief executive is more involved on controlling through return on investment, value added, and other indicators, which measure performance of overall organization.

**C) Role of Other Managers:** Besides board of directors and chief executive, other managers are also involved in strategic evaluation and control. These are finance managers, SBU managers, and middle-level managers. Their role in strategic evaluation and control is as follows:

- ❧ Finance managers are primarily concerned with finding out deviations between planned and actual performance expressed in monetary terms. These are done through financial analysis, budgeting, etc.
- ❧ SBU managers are responsible for overall evaluation and control of their respective strategic business units. In fact, they are the chief executives of their own SBUs except that they report to the chief executive of the organisation from whom they seek directions.
- ❧ Middle-level managers, mostly functional managers and subunit managers are responsible for evaluation and control of their respective functions and sub-units. These managers are more concerned with day-to-day operational control and prepare reports to be used by higher-level managers. For example\_ a production manager is more interested in controlling production volume, production cost, product quality, etc.

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## 8.5 Measuring Organizational Performance

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Another important strategy-evaluation activity is *measuring organizational performance*. This activity includes comparing expected results to actual results, investigating deviations from plans, evaluating individual performance, and examining progress being made toward meeting stated objectives.

Both long-term and annual objectives are commonly used in this process. Criteria for evaluating strategies should be measurable and easily verifiable. Criteria that predict results may be more important than those that reveal what already has happened. For example, rather than simply being informed that sales in the last quarter were 20 percent under what

was expected, strategists need to know that sales in the next quarter may be 20 percent below standard unless some action is taken to counter the trend. Really effective control requires accurate forecasting.

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

Many variables can and should be included in measuring organizational performance. As indicated in Table 8.4, typically a favorable or unfavorable variance is recorded monthly, quarterly, and annually, and resultant actions needed are then determined.

Determining which objectives are most important in the evaluation of strategies can be difficult. Strategy evaluation is based on both quantitative and qualitative criteria. Selecting the exact set of criteria for evaluating strategies depends on a particular organization's size, industry, strategies, and management philosophy. An organization pursuing a retrenchment strategy, for example, could have an entirely different set of evaluative criteria from an organization pursuing a market-development strategy. Quantitative criteria commonly used to evaluate strategies are financial ratios, which strategists use to make three critical comparisons: (1) comparing the firm's performance over different time periods, (2) comparing the firm's performance to competitors', and (3) comparing the firm's performance to industry averages. Some key financial ratios that are particularly useful as criteria for strategy evaluation are as follows:

1. Return on investment (ROI)
2. Return on equity (ROE)
3. Profit margin
4. Market share
5. Debt to equity

6. Earnings per share
7. Sales growth
8. Asset growth

Table 8.4: A Sample Framework for Measuring Organizational Performance

| Factor             | Actual Result | Expected Result | Variance | Action Needed |
|--------------------|---------------|-----------------|----------|---------------|
| Corporate Revenues |               |                 |          |               |
| Corporate Profits  |               |                 |          |               |
| Corporate ROI      |               |                 |          |               |
| Region 1 Revenues  |               |                 |          |               |
| Region 1 Profits   |               |                 |          |               |
| Region 1 ROI       |               |                 |          |               |
| Region 2 Revenues  |               |                 |          |               |
| Region 2 Profits   |               |                 |          |               |
| Region 2 ROI       |               |                 |          |               |
| Product 1 Revenues |               |                 |          |               |
| Product 1 Profits  |               |                 |          |               |
| Product 1 ROI      |               |                 |          |               |
| Product 2 Revenues |               |                 |          |               |
| Product 2 Profits  |               |                 |          |               |
| Product 2 ROI      |               |                 |          |               |

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

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

1. How good is the firm's balance of investments between high-risk and low-risk projects?
2. How good is the firm's balance of investments between long-term and short-term projects?

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

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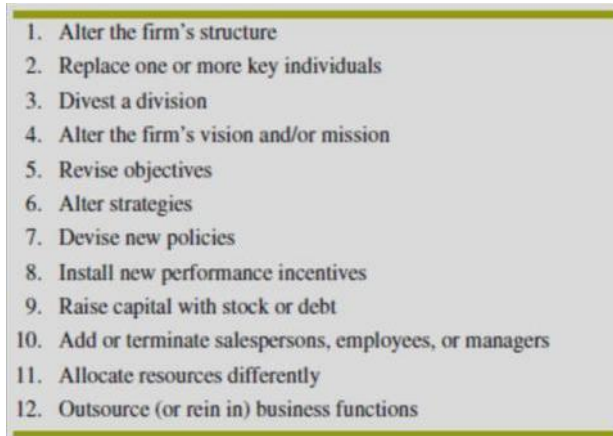
## 8.6 Taking Corrective Actions

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The final strategy-evaluation activity, *taking corrective actions*, requires making changes to competitively reposition a firm for the future. As indicated in Table 8.5, examples of changes that may be needed are altering an organization's structure, replacing one or more key individuals, selling a division, or revising a business mission. Other changes could include establishing or revising objectives, devising new policies, issuing stock to raise capital, adding additional salespersons, differently allocating resources, or developing new performance incentives. Taking corrective actions does not necessarily mean that existing strategies will be abandoned or even that new strategies must be formulated.

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

Table 8.5: Corrective Actions Possibly Needed to Correct Unfavorable Variances



|                                                           |
|-----------------------------------------------------------|
| 1. Alter the firm's structure                             |
| 2. Replace one or more key individuals                    |
| 3. Divest a division                                      |
| 4. Alter the firm's vision and/or mission                 |
| 5. Revise objectives                                      |
| 6. Alter strategies                                       |
| 7. Devise new policies                                    |
| 8. Install new performance incentives                     |
| 9. Raise capital with stock or debt                       |
| 10. Add or terminate salespersons, employees, or managers |
| 11. Allocate resources differently                        |
| 12. Outsource (or rein in) business functions             |

No organization can survive as an island; no organization can escape change. Taking corrective actions is necessary to keep an organization on track toward achieving stated objectives. In his thought-provoking books *Future Shock* and *The Third Wave*, Alvin Toffler argued that business environments are becoming so dynamic and complex that they threaten people and organizations with *future shock*, which occurs when the nature, types, and speed of changes overpower an individual's or organization's ability and capacity to adapt. Strategy evaluation enhances an organization's ability to adapt successfully to changing circumstances.

Taking corrective actions raises employees' and managers' anxieties. Research suggests that participation in strategy-evaluation activities is one of the best ways to overcome individuals' resistance to change. According to Erez and Kanfer, individuals accept change best when they have a cognitive understanding of the changes, a sense of control over the situation, and an awareness that necessary actions are going to be taken to implement the changes. Strategy evaluation can lead to strategy-formulation changes, strategy-implementation changes, both formulation and implementation changes, or no changes at all. Strategists cannot escape having to revise strategies and implementation approaches sooner or later.

Hussey and Langham offered the following insight on taking corrective actions: Resistance to change is often emotionally based and not easily overcome by rational argument.

Resistance may be based on such feelings as loss of status, implied criticism of present competence, fear of failure in the new situation, annoyance at not being consulted, lack of understanding of the need for change, or insecurity in changing from well-known and fixed methods. It is necessary, therefore, to overcome such resistance by creating situations of participation and full explanation when changes are envisaged.

Corrective actions should place an organization in a better position to capitalize upon internal strengths; to take advantage of key external opportunities; to avoid, reduce, or mitigate external threats; and to improve internal weaknesses. Corrective actions should have a proper time horizon and an appropriate amount of risk. They should be internally consistent and socially responsible. Perhaps most important, corrective actions strengthen an organization's competitive position in its basic industry. Continuous strategy evaluation keeps strategists close to the pulse of an organization and provides information needed for an effective strategic-management system. Carter Bayles described the benefits of strategy evaluation as follows:

Evaluation activities may renew confidence in the current business strategy or point to the need for actions to correct some weaknesses, such as erosion of product superiority or technological edge. In many cases, the benefits of strategy evaluation are much more far-reaching, for the outcome of the process may be a fundamentally new strategy that will lead, even in a business that is already turning a respectable profit, to substantially increased earnings. It is this possibility that justifies strategy evaluation, for the payoff can be very large.

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## 8.7 The Balanced Scorecard

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Balanced Scorecard is an important strategy-evaluation tool. It is a process that allows firms to evaluate strategies from four perspectives: financial performance, customer knowledge, internal business processes, and learning and growth. The *Balanced Scorecard* analysis requires that firms seek answers to the following questions and utilize that information, in conjunction with financial measures, to adequately and more effectively evaluate strategies being implemented:

1. How well is the firm continually improving and creating value along measures such as innovation, technological leadership, product quality, operational process efficiencies, and so on?
2. How well is the firm sustaining and even improving upon its core competencies and competitive advantages?
3. How satisfied are the firm's customers?

A sample Balanced Scorecard is provided in Table 8.6. Notice that the firm examines six key issues in evaluating its strategies: (1) Customers, (2) Managers/Employees, (3) Operations/Processes, (4) Community/Social Responsibility, (5) Business Ethics/Natural Environment, and (6) Financial. The basic form of a Balanced Scorecard may differ for different organizations. The Balanced Scorecard approach to strategy evaluation aims to balance long-term with short-term concerns, to balance financial with nonfinancial concerns, and to balance internal with external concerns. It can be an excellent management tool, and it is used successfully today by Chemical Bank, Exxon/Mobil Corporation, CIGNA Property and Casualty Insurance, and numerous other firms. The Balanced Scorecard would be constructed differently, that is, adapted, to particular firms in various industries with the underlying theme or thrust being the same, which is to evaluate the firm's strategies based upon both key quantitative and qualitative measures.



Dear learner! Can you develop a Balanced Scorecard for a private/public academic institution around your locality?

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Table 8.6: An Example Balanced Scorecard

| Area of Objectives                         | Measure/Target | Time Expectation | Primary Responsibility |
|--------------------------------------------|----------------|------------------|------------------------|
| Customers                                  |                |                  |                        |
| 1.                                         |                |                  |                        |
| 2.                                         |                |                  |                        |
| 3.                                         |                |                  |                        |
| 4.                                         |                |                  |                        |
| <b>Managers/Employees</b>                  |                |                  |                        |
| 1.                                         |                |                  |                        |
| 2.                                         |                |                  |                        |
| 3.                                         |                |                  |                        |
| 4.                                         |                |                  |                        |
| <b>Operations/Processes</b>                |                |                  |                        |
| 1.                                         |                |                  |                        |
| 2.                                         |                |                  |                        |
| 3.                                         |                |                  |                        |
| 4.                                         |                |                  |                        |
| <b>Community/Social Responsibility</b>     |                |                  |                        |
| 1.                                         |                |                  |                        |
| 2.                                         |                |                  |                        |
| 3.                                         |                |                  |                        |
| 4.                                         |                |                  |                        |
| <b>Business Ethics/Natural Environment</b> |                |                  |                        |
| 1.                                         |                |                  |                        |
| 2.                                         |                |                  |                        |
| 3.                                         |                |                  |                        |
| 4.                                         |                |                  |                        |
| <b>Financial</b>                           |                |                  |                        |
| 1.                                         |                |                  |                        |
| 2.                                         |                |                  |                        |
| 3.                                         |                |                  |                        |
| 4.                                         |                |                  |                        |

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## 8.8 Characteristics of an Effective Evaluation System

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Strategy evaluation must meet several basic requirements to be effective. First, strategy evaluation activities must be economical; too much information can be just as bad as too little information; and too many controls can do more harm than good. Strategy-evaluation activities also should be meaningful; they should specifically relate to a firm's objectives. They should provide managers with useful information about tasks over which they have control and influence. Strategy-evaluation activities should provide timely information; on occasion and in some areas, managers may daily need information. For example, when a firm has diversified by acquiring another firm, evaluative information may be needed frequently. However, in an R&D department, daily or even weekly evaluative information could be dysfunctional. Approximate information that is timely is generally more desirable as a basis for strategy evaluation than accurate information that does not depict the present. Frequent measurement and rapid reporting may frustrate control rather than give better control. The time dimension of control must coincide with the time span of the event being measured.

Strategy evaluation should be designed to provide a true picture of what is happening. For example, in a severe economic downturn, productivity and profitability ratios may drop alarmingly, although employees and managers are actually working harder. Strategy evaluations should fairly portray this type of situation. Information derived from the strategy-evaluation process should facilitate action and should be directed to those individuals in the organization who need to take action based on it. Managers commonly ignore evaluative reports that are provided only for informational purposes; not all managers need to receive all reports. Controls need to be action-oriented rather than information-oriented.

The strategy-evaluation process should not dominate decisions; it should foster mutual understanding, trust, and common sense. No department should fail to cooperate with another in evaluating strategies. Strategy evaluations should be simple, not too cumbersome, and not too restrictive. Complex strategy-evaluation systems often confuse people and accomplish little. The test of an effective evaluation system is its usefulness, not its complexity.

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

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

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## 8.9 Contingency Planning

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

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

Some contingency plans commonly established by firms include the following:

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

Too many organizations discard alternative strategies not selected for implementation although the work devoted to analyzing these options would render valuable information. Alternative strategies not selected for implementation can serve as contingency plans in case the strategy or strategies selected do not work. U.S. companies and governments are increasingly considering nuclear-generated electricity as the most efficient means of power generation. Many contingency plans certainly call for nuclear power rather than for coal and gas-derived electricity.

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

In some cases, external or internal conditions present unexpected opportunities. When such opportunities occur, contingency plans could allow an organization to quickly capitalize on them.

Linneman and Chandran reported that contingency planning gave users three major benefits: (1) It permitted quick response to change, (2) it prevented panic in crisis situations, and (3) it made managers more adaptable by encouraging them to appreciate just how variable the future can be. They suggested that effective contingency planning involves a seven-step process:

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

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## 8.10 Strategic Control and Evaluation Process

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Although control systems must be tailored to specific situations, such systems generally follow the same basic process. Such a process has four important steps as mentioned below:

- 1) Setting Standards of Performance:** strategists encounter the following three questions while dealing with standard setting: what standards to set? How to set these standards? And in what terms should we express the standards? A three basic approach to standard setting could be used to settle these issues, as given below:

- ✚ The key managerial tasks, derived from the strategic requirements, can be analyzed for finding out the key areas of performance. Standards can then be set in each of these key result areas.
  - ✚ The special requirements for the performance of the key tasks can help to determine the type of standards to set.
  - ✚ Performance indicators that best express the special requirements could then be decided upon to be used for evaluation
- 2) **Measurement of Performance:** the evaluation process operates at the performance level as action takes place. Standards of performance act as the benchmark against which the actual performance is to be compared. It is important, however, to understand how the measurement of performance can take place. Operationally, measurement is done through the accounting, reporting and communication systems. Other important points to be considered while measuring performance include the difficulties, timing and periodicity in measuring.
- 3) **Analyzing Variances:** the measurement of actual performance and its comparison with standard or budgeted performance leads to an analysis of variances. Broadly, the following three situations may arise:
- ✚ The actual performance matches the budgeted performance
  - ✚ The actual performance deviates positively over the budgeted performance
  - ✚ The actual performance deviates negatively from the budgeted performance

The first situation is ideal but not realistic. In practice the actual performance rarely matches the budgeted performance. Here, the strategist has to set range of tolerance limit between which the results may be accepted satisfactorily. The second case is welcome as it is an indication of superior performance. It may be so because of setting easily attainable standards or due to other reasons. The third type of situation is alarming as it indicates a shortfall in achievement. The strategist needs to pinpoint the areas where performance is below standards and go into the causes of deviation.

- 4) **Taking Corrective Actions:** there are three courses for corrective actions: checking of performance, checking of standards, and reformulating strategies, plans and objectives. Initiating corrective action is not an insignificant part of evaluation process for it involves a variety of managerial functions which are performed during strategy implementation.



## SUMMARY OF THE CHAPTER

- ✎ The strategic-management process results in decisions that can have significant, long-lasting consequences. Erroneous strategic decisions can inflict severe penalties and can be exceedingly difficult, if not impossible, to reverse.
- ✎ Strategy evaluation includes three basic activities:
  - ✓ Examining the underlying bases of a firm's strategy.
  - ✓ Comparing expected results with actual results.
  - ✓ Taking corrective actions to ensure that performance conforms to plans.
- ✎ Strategy evaluation can be a complex and sensitive undertaking. Too much emphasis on evaluating strategies may be expensive and counterproductive. Yet, too little or no evaluation can create even worse problems. Strategy evaluation is essential to ensure that stated objectives are being achieved.
- ✎ It is impossible to demonstrate conclusively that a particular strategy is optimal, but it can be evaluated for critical flaws. As described in Table 9-1, here are four criteria to use in evaluating a strategy:
  - a) consistency
  - b) consonance
  - c) feasibility
  - d) advantage
- ✎ Trends that make strategy evaluation difficult are:
  - a) dramatic increase in environmental complexity
  - b) difficult in predicting future
  - c) increasing number of variables
  - d) rapid rate of obsolescence
  - e) increase in the number of world events affecting the organization
  - f) decreasing time spans for planning

- ✎ Strategy evaluation is necessary for all sizes and kinds of organizations. Strategy evaluation should initiate managerial questioning of expectations and assumptions, trigger a review of objectives and values, and stimulate creativity in generating alternatives and formulating criteria of evaluation.
- ✎ Evaluating strategies on a continuous rather than a periodic basis allows benchmarks of progress to be established and more effectively monitored.
- ✎ Managers and employees of the firm should continually be aware of progress being made toward achieving the firm's objectives. As critical success factors change, organizational members should be involved in determining appropriate corrective actions.
- ✎ A revised IFE Matrix should focus on changes in the organization's management, marketing, finance/accounting, production/operations, R&D, and MIS strengths and weaknesses whereas a revised EFE Matrix should indicate how effectively a firm's strategies have been in response to key opportunities and threats.
- ✎ Another important strategy-evaluation activity is measuring organizational performance. This activity includes comparing expected results to actual results, investigating deviations from plans, evaluating individual performance, and examining progress being made toward meeting stated objectives. Both long-term and annual objectives are commonly used in this process.
- ✎ Failure to make satisfactory progress toward accomplishing long-term or annual objectives signals a need for corrective action.
- ✎ Quantitative criteria commonly used to evaluate strategies are financial ratios, which strategists use to make three critical comparisons:
  - a) Comparing the firm's performance over different time periods,
  - b) Comparing the firm's performance to competitors, and
  - c) Comparing the firm's performance to industry averages.
- ✎ The six qualitative questions useful for evaluating strategies are:
  - i. Is the strategy internally consistent?
  - ii. Is it consistent with the environment?

- iii. Is the strategy appropriate in view of available resources?
- iv. Does the strategy involve an acceptable degree of risk?
- v. Does the strategy have an appropriate time framework?
- vi. Is the strategy workable?

-  The final strategy-evaluation activity, taking corrective action, requires making changes to reposition a firm competitively for the future.
-  Examples of changes that may be needed are altering an organization's structure, replacing one or more key individuals, selling a division, or revising a business mission.
-  A basic premise of good strategic management is that firms plan ways to deal with unfavorable and favorable events before they occur.
-  Contingency plans can be defined as alternative plans that can be put into effect if certain key events do not occur as expected.



## CHAPTER REVIEW EXERCISES

Part I: Choose the correct answer from the given alternatives

1. In \_\_\_\_\_ stage, the implemented actions are assessed and reviewed and appropriate action will be taken to improve the situation.
  - A. strategy evaluation and control
  - B. strategy formulation
  - C. strategy implementation
  - D. mission statement formulation
2. Which of the following is **NOT** a criterion to be considered in evaluating a strategy, according to Rumelt?
  - A. Consistency,
  - B. Feasibility
  - C. Acceptable degree of risks
  - D. Efficiency
3. of a selected strategy is important as it can determine whether the strategy can be done without much barriers or obstacles.
  - A. Feasibility
  - B. Advantage
  - C. Consonance
  - D. Consistency
4. The first step of strategy evaluation process is
  - A. Identifying aspects to be measured.
  - B. Assessing the performance.
  - C. Setting the standards to be gauged.
  - D. Determining what to review.
5. As a result of strategy evaluation, corrective actions
  - A. Are almost always needed.
  - B. Are definitely needed.
  - C. Are rarely needed.
  - D. Are none of the above.

# APPENDICES

## REFERENCES

- Fred R. David (2011), Strategic Management concepts and cases, 13<sup>th</sup> ed. Pearson Education, Inc., publishing as Prentice Hall, One Lake Street, Upper Saddle River, New Jersey 07458.
- Azhar Kazmi (2002), Business Policy and Strategic Management, 2nd ed. Tata McGraw- Hill Publishing Company Limited, NewDelhi.





## ANSWER KEY FOR CHAPTER REVIEW QUESTIONS

| CHAPTER ONE | CHAPTER TWO |  | CHAPTER THREE | CHAPTER FOUR |
|-------------|-------------|--|---------------|--------------|
| 1. C        | 1. B        |  | 1. C          | 1. D         |
| 2. D        | 2. D        |  | 2. B          | 2. E         |
| 3. C        | 3. C        |  | 3. C          | 3. A         |
| 4. D        | 4. D        |  | 4. A          | 4. B         |
| 5. D        | 5. E        |  | 5. A          | 5. B         |
| 6. D        |             |  |               |              |
| 7. D        |             |  |               |              |
| 8. B        |             |  |               |              |
| 9. A        |             |  |               |              |

| CHAPTER FIVE |
|--------------|
| 1. D         |
| 2. C         |
| 3. B         |
| 4. B         |
| 5. A         |

| CHAPTER SIX |         |  | CHAPTER SEVEN |         |
|-------------|---------|--|---------------|---------|
| PART I      | PART II |  | PART I        | PART II |
| 1. TRUE     | 1. A    |  | 1. FALSE      | 1. E    |
| 2. TRUE     | 2. E    |  | 2. TRUE       | 2. E    |
| 3. FALSE    | 3. B    |  | 3. TRUE       | 3. C    |
| 4. FALSE    | 4. C    |  | 4. FALSE      | 4. C    |
| 5. TRUE     | 5. D    |  | 5. FALSE      | 5. C    |

| CHAPTER EIGHT |
|---------------|
| 1. A          |
| 2. C          |
| 3. A          |
| 4. C          |
| 5. B          |

**ARBAMINCH UNIVERSITY COLLEGE**  
**OF BUSINESS & ECONOMICS**  
**DEPARTEMENT OF MANAGEMENT**  
**STRATEGIC MANAGEMENT TAKE HOME ASSIGNMENT**

**Part I: Multiple Choice Questions ( 8 x 1 = 8 Points)**

1. What type of strategy in the Grand Strategy Matrix is recommended for a firm that has rapid market growth and a strong competitive position?  
A. Market penetration C. Joint venture B. Conglomerate diversification D. Retrenchment
2. A \_\_\_\_\_ reveals the relative attractiveness of alternative strategies and thus provides an objective basis for selecting specific strategies.  
A. TOWS C. QSPM  
B. SPACE D. CPM
3. A \_\_\_\_\_ statement should answer the basic question, "What do we want to become?"  
A. Mission C. Objective  
B. Vision D. Goal
4. Objectives are the ends that state specifically how the \_\_\_\_\_ shall be achieved.  
A. targets C. profits  
B. goals D. mission
5. Which one of the following is true concerning internal and external factors?  
A. External factors are more important than internal factors in a firm achieving competitive advantage.  
B. Organizational performance is primarily determined by internal forces.  
C. Political, governmental, and legal factors can not represent key opportunities or threats for both small and large organizations  
D. None of the above

6. \_\_\_\_\_ allows strategists to summarize and evaluate economic, social, cultural, demographic, environmental, political, governmental, legal, technological, and competitive information.
- A. The CPM matrix
  - B. An EFE matrix
  - C. An IFE matrix
  - D. All of the above
  - E. None of the above
7. \_\_\_\_\_ involves gaining ownership or increased control over distributors or retailers.
- A. Franchising
  - B. Backward integration
  - C. Forward integration
  - D. Horizontal integration
8. Which one of the following is true regarding intensive strategy?
- A. Market penetration strategy is effective when usage rate of current customers could be increased.
  - B. Product development usually entails large research and development expenditures.
  - C. Product development strategy is appropriate when major competitors offer better-quality products at comparable prices.
  - D. Market penetration strategy is effective when current markets are saturated.
  - E. All except D.

Part II: Essay type questions (2 x 5 = 10 points)

9. Do you believe strategic management should be more a top-down or bottom-up process in a firm? Explain.
10. Why is it important to integrate strategy implementation and strategy formulation
11. Discuss how a cost leadership strategy can allow a firm to earn above-average returns in spite of strong competitive forces.
12. Why is the Balanced Scorecard an important topic both in devising objectives and in evaluating strategies?
13. Describe 3 reasons why firms pursue a diversification strategy. Differentiate between corporate- and business-level strategies and give examples of each.

## Case analysis questions

AO Swift (Pvt.) Ltd. was promoted nineteen years back as company manufacturing automobile parts with an investment of Rupees 5 crores by Abhishek Oberai. He took over as its chief executive and is occupying the same position till date. Abhishek an automobile engineer himself possessed rich experience of working abroad and in Hindustan Motors Ltd in India. He is dynamic and ready to take risk. He always emphasized on maintaining high quality standards. Initially, the products were supplied to automobile service centers all across the country. The market was small and the company suffered some losses. Eight years after its inception the company entered into an agreement with Maruti Udyog Ltd to manufacture and supply specific components for their small car. This agreement was a turning point for the company. Later the company was able to enter agreements with other companies entering India. The company is able to manage a growth rate of over 25% in last five years. Its turnover in the last financial year exceeded 800 crores. The overall market is also witnessing a very high growth rate. Abhishek also possessed strong behavioural skills and allowed some autonomy and discretion to the senior managers of the company. A year back in an internal meeting Abhishek felt that the company can grow still faster if it enters other markets outside India. Various options were analyzed and efforts were made to discuss and negotiate with major manufacturers of the world. Getting some response from two manufacturers in European Union the company opened an office in London.

Abhishek closely monitored the day-to-day working of this office. Having strategic implications all major decisions were taken by himself. He will also visit London every month to have first hand information about its working. However, as the company is growing it is becoming increasing difficult for him to manage this office. He also wants to expand further. He called a meeting with head of various department. In the meeting following alternatives were considered for foreign market:

- ❖ Continue to manufacture products in India and export them to other countries.
- ❖ Initiate manufacturing activities in other countries.
- ❖ Takeover existing manufacturers of the

products. Answer the following questions:

- A. Write a note on reasons for AO Swift Ltd. to open office in London? (5 Marks)
- B. What should be the strategy of the company in a high growth market? Why? (5 Marks)
- C. Make an analysis of various alternatives that are being considered for expanding in foreign markets? (2 Marks)