UNIT III

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Strategy Formulation

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1.Setting Organizations' objectives - The key component of any strategy statement is to set the long-term objectives of the organization. It is known that strategy is generally a medium for realization of organizational objectives. Objectives stress the state of being there whereas Strategy stresses upon the process of reaching there. Strategy includes both the fixation of objectives as well the medium to be used to realize those objectives. Thus, strategy is a wider term which believes in the manner of deployment of resources so as to achieve the objectives.

While fixing the organizational objectives, it is essential that the factors which influence the selection of objectives must be analyzed before the selection of objectives. Once the objectives and the factors influencing strategic decisions have been determined, it is easy to take strategic decisions.

2.Evaluating the Organizational Environment - The next step is to evaluate the general economic and industrial environment in which the organization operates. This includes a review of the organizations competitive position. It is essential to conduct a qualitative and quantitative review of an organizations existing product line. The purpose of such a review is to make sure that the factors important for competitive success in the market can be discovered so that the management can identify their own strengths and weaknesses as well as their competitors' strengths and weaknesses.

After identifying its strengths and weaknesses, an organization must keep a track of competitors' moves and actions so as to discover probable opportunities of threats to its market or supply sources.

3.Setting Quantitative Targets - In this step, an organization must practically fix the quantitative target values for some of the organizational objectives. The idea behind this is to compare with long term customers, so as to evaluate the contribution that might be made by various product zones or operating departments.

4.Aiming in context with the divisional plans - In this step, the contributions made by each department or division or product category within the organization is identified and accordingly strategic planning is done for each sub-unit. This requires a careful analysis of macroeconomic trends.

5.Performance Analysis - Performance analysis includes discovering and analyzing the gap between the planned or desired performance. A critical evaluation of the organizations past performance, present condition and the desired future conditions must be done by the organization. This critical evaluation identifies the degree of gap that persists between the actual reality and the long-term aspirations of the organization. An attempt is made by the organization to estimate its probable future condition if the current trends persist.

6.Choice of Strategy - This is the ultimate step in Strategy Formulation. The best course of action is actually chosen after considering organizational goals, organizational strengths, potential and limitations as well as the external opportunities.

Strategy in Global Environment

Globalization was the buzzword of the 1990s, and in the twenty first century, there is no evidence that globalization will diminish. Essentially, globalization refers to growth of trade and investment, accompanied by the growth in international businesses, and the integration of economies around the world.

Technological developments have increased the ease and speed of international communication and travel. Increased communication and travel have made the world smaller. A smaller world means that people are more aware of events outside of their home country, and are more likely to travel to other countries.

Managers must be conscious that markets, supplies, investors, locations, partners, and competitors can be anywhere in the world. Successful businesses will take advantage of opportunities wherever they are and will be prepared for downfalls. Successful managers, in this environment, need to understand the similarities and differences across national boundaries, in order to utilize the opportunities and deal with the potential downfalls.

The globalization of business is easy to recognize in the spread of many brands and services throughout the world. For example, Japanese electronics and automobiles are common in Asia, Europe, and North America, while U.S. automobiles, entertainment, and financial services are also common in Asia, Europe, and North America. Moreover, companies have become transnational or multinational-that is, they are based in one country but have operations in others. For example, Japan-based automaker Honda operates the largest single factory in the United States, while U.S. based Coca-Cola operates plants in other countries including France and Belgium—with about 80 percent of that company's profits come from overseas sales.

In developing appropriate global strategies, managers need to take the benefits and drawbacks of globalization into account. A global strategy must be in the context of events around the globe, as well as those at home.

International strategy is the continuous and comprehensive management technique designed to help companies operate and compete effectively across national boundaries. While companies' top managers typically develop global strategies, they rely on all levels of management in order to implement these strategies successfully. The methods companies use to accomplish the goals of these strategies take a host of forms.

Types of Global Business Activities

Businesses may choose to globalize or operate in different countries in four distinct ways: through trade, investment, strategic alliances, and licensing or franchising. Companies may decide to trade tangible goods such as automobiles and electronics (merchandise exports and imports). Alternatively, companies may decide to trade intangible products such as financial or legal services (service exports and imports).

Companies may enter the global market through various kinds of international investments. Companies may choose to make foreign direct investments, which allow them to control companies and assets in other countries. In addition, companies may elect to make portfolio investments, by acquiring the stock of companies in other countries in order to gain control of these companies.

Another way companies tap into the global market is by forming strategic alliances with companies in other countries. While strategic alliances come in many forms, some enable each company to access the home market of the other and thereby market their products as being affiliated with the well-known host company. This method of international business also enables a company to bypass some of the difficulties associated with internationalization such as different political, regulatory, and social conditions. The home company can help the multinational company address and overcome these difficulties because it is accustomed to them.

Finally, companies may participate in the international market by either licensing or franchising. Licensing involves granting another company the right to use its brand names, trademarks, copyrights, or patents in exchange for royalty payments. Franchising, on the other hand, is when one company agrees to allow a company in another country to use its name and methods of operations in exchange for royalty payments.

Building and Restructuring the Corporation

In general, the idea of corporate restructuring is to allow the company to continue functioning in some manner. Even when corporate raiders break up the company and leave behind a shell of the original structure, there is still usually a hope, what remains can function well enough for a new buyer to purchase the diminished corporation and return it to profitability.

Purpose of Corporate Restructuring –

To enhance the shareholder value, The company should continuously evaluate its:

1.Portfolio of businesses,

2.Capital mix,

3.Ownership &Asset arrangements to find opportunities to increase the share holder's value.

4.To focus on asset utilization and profitable investment opportunities.

5.To reorganize or divest less profitable or loss making businesses/products.

The company can also enhance value through capital Restructuring, it can innovate securities that help to reduce cost of capital.

Corporate Restructuring entails a range of activities including financial restructuring and organization restructuring.

1. Financial Restructuring

Financial restructuring is the reorganization of the financial assets and liabilities of a corporation in order to create the most beneficial financial environment for the company. The process of financial restructuring is often associated with corporate restructuring, in that restructuring the general function and composition of the company is likely to impact the financial health of the corporation. When completed, this reordering of corporate assets and liabilities can help the company to remain competitive, even in a depressed economy.

Need For Financial Restructuring

The process of financial restructuring may be undertaken as a means of eliminating waste from the operations of the company.

For example, the restructuring effort may find that two divisions or departments of the company perform related functions and in some cases duplicate efforts. Rather than continue to use financial resources to fund the operation of both departments, their efforts are combined. This helps to reduce costs without impairing the ability of the company to still achieve the same ends in a timely manner

2. Organizational Restructuring

In organizational restructuring, the focus is on management and internal corporate governance structures. Organizational restructuring has become a very common practice amongst the firms in order to match the growing competition of the market. This makes the firms to change the organizational structure of the company for the betterment of the business.

Some of the most common features of organizational restructures are:

Regrouping of business

Downsizing

Decentralization

Outsourcing

Enterprise Resource Planning

Business Process Engineering

Total Quality Management

Various Strategies for Business Restructuring

Smart sizing: It is the process of reducing the size of a company by laying off employees on the basis of incompetence and inefficiency.

Some Examples

Acquisitions: HLL took over TOMCO.

Diversification: Videocon group is diversified into power projects, oil exploration and basic telecom services.

Merger: Asea and Brown Boveri came together to form ABB.

Strategic alliances: Siemens India has got a Strategic alliance with Bharati Telecom for marketing of its EPABX.

Expansion: Siemens is expanding its medical electronics division- a new factory for medical electronics is already come up in Goa.

The important methods of Corporate Restructuring are:

Joint ventures

Sell off and spin off

Divestitures

Leveraged buy outs (LBO)

Management buy outs

Turnaround Strategy

The Turnaround Strategy is a retrenchment strategy followed by an organization when it feels that the decision made earlier is wrong and needs to be undone before it damages the profitability of the company.

Simply, turnaround strategy is backing out or retreating from the decision wrongly made earlier and transforming from a loss making company to a profit making company.

Reasons for Turnaround Strategy

1.Continuous losses

2.Poor management

3.Wrong corporate strategies

4.Persistent negative cash flows

5.High employee attrition rate

6.Poor quality of functional management

7.Declining market share

8.Uncompetitive products and services

Also, the need for a turnaround strategy arises because of the changes in the external environment Viz, change in the government policies, saturated demand for the product, a threat from the substitute products, changes in the tastes and preferences of the customers, etc.

Example: Dell is the best example of a turnaround strategy. In 2006. Dell announced the cost-cutting measures and to do so; it started selling its products directly, but unfortunately, it suffered huge losses. Then in 2007, Dell withdrew its direct selling strategy and started selling its computers through the retail outlets and today it is the second largest computer retailer in the world.

BCG Matrix

The Boston Consulting group's product portfolio matrix (BCG matrix) is designed to help with long-term strategic planning, to help a business consider growth opportunities by reviewing its portfolio of products to decide where to invest, to discontinue or develop products. It's also known as the Growth/Share Matrix.

Boston Consulting Group (BCG) Matrix is a four celled matrix (a 2 * 2 matrix) developed by BCG, USA. It is the most renowned corporate portfolio analysis tool. It provides a graphic representation for an organization to examine different businesses in it’s portfolio on the basis of their related market share and industry growth rates. It is a two dimensional analysis on management of SBU’s (Strategic Business Units). In other words, it is a comparative analysis of business potential and the evaluation of environment.

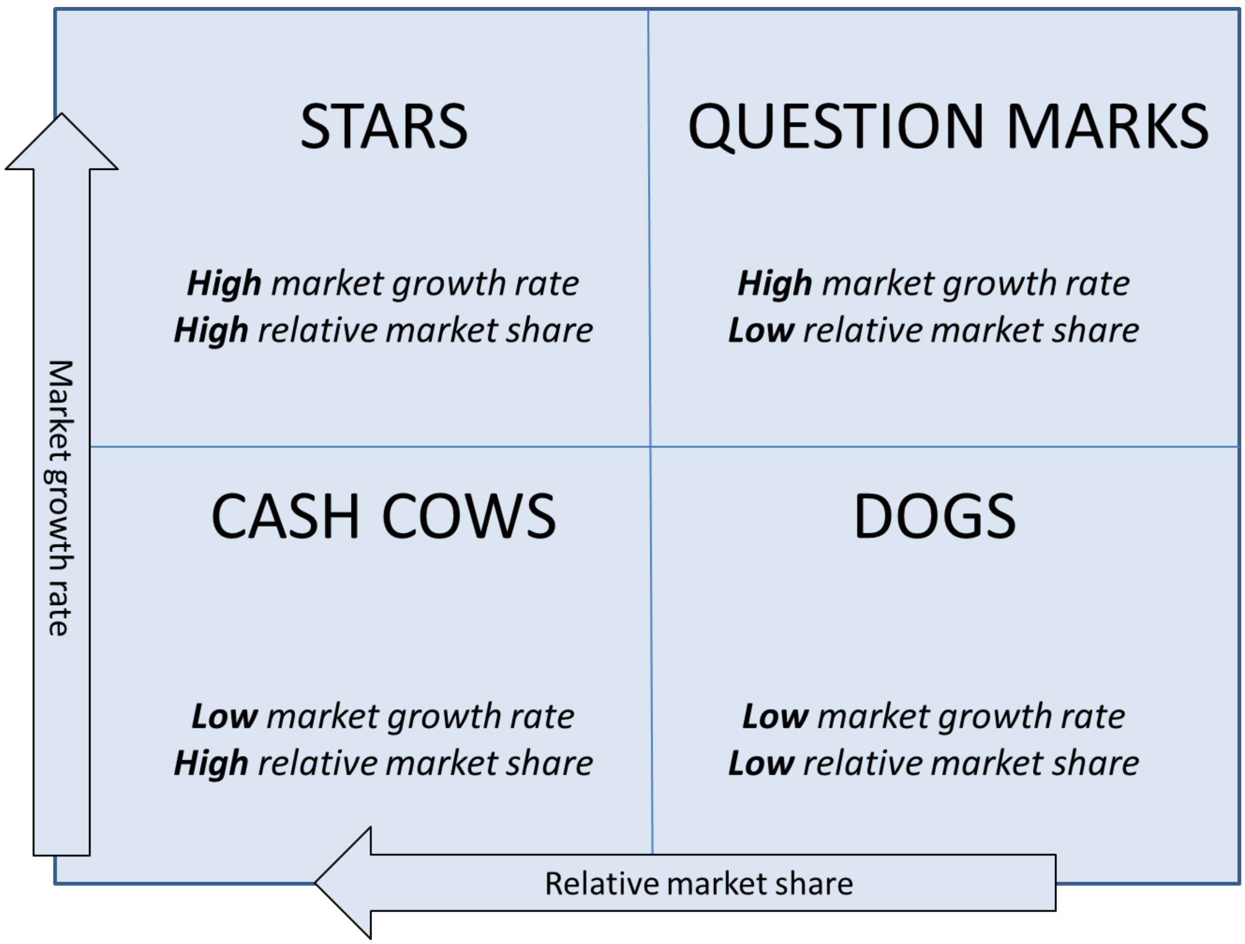
According to this matrix, business could be classified as high or low according to their industry growth rate and relative market share.

Relative Market Share = SBU Sales this year leading competitors sales this year.

Market Growth Rate = Industry sales this year - Industry Sales last year.

The analysis requires that both measures be calculated for each SBU. The dimension of business strength, relative market share, will measure comparative advantage indicated by market dominance. The key theory underlying this is existence of an experience curve and that market share is achieved due to overall cost leadership. BCG matrix has four cells, with the horizontal axis representing relative market share and the vertical axis denoting market growth rate. The mid-point of relative market share is set at 1.0. if all the SBU’s are in same industry, the average growth rate of the industry is used. While, if all the SBU's are located in different industries, then the mid-point is set at the growth rate for the economy.

Resources are allocated to the business units according to their situation on the grid. The four cells of this matrix have been called as stars, cash cows, question marks and dogs. Each of these cells represents a particular type of business.



Stars- Stars represent business units having large market share in a fast growing industry. They may generate cash but because of fast growing market, stars require huge investments to maintain their lead. Net cash flow is usually modest. SBU's located in this cell are attractive as they are located in a robust industry and these business units are highly competitive in the industry. If successful, a star will become a cash cow when the industry matures.

Cash Cows- Cash Cows represents business units having a large market share in a mature, slow growing industry. Cash cows require little investment and generate cash that can be utilized for investment in other business units. These SBU's are the corporation's key source of cash, and are specifically the core business. They are the base of an organization. These businesses usually follow stability strategies. When cash cows loose their appeal and move towards deterioration, then a retrenchment policy may be pursued.

Question Marks- Question marks represent business units having low relative market share and located in a high growth industry. They require huge amount of cash to maintain or gain market share. They require attention to determine if the venture can be viable. Question marks are generally new goods and services which have a good commercial prospective. There is no specific strategy which can be adopted. If the firm thinks it has dominant market share, then it can adopt expansion strategy, else retrenchment strategy can be adopted. Most businesses start as question marks as the company tries to enter a high growth market in which there is already a market-share. If ignored, then question marks may become dogs, while if huge investment is made, then they have potential of becoming stars.

Dogs- Dogs represent businesses having weak market shares in low-growth markets. They neither generate cash nor require huge amount of cash. Due to low market share, these business units face cost disadvantages. Generally retrenchment strategies are adopted because these firms can gain market share only at the expense of competitor's/rival firms. These business firms have weak market share because of high costs, poor quality, ineffective marketing, etc. Unless a dog has some other strategic aim, it should be liquidated if there is fewer prospects for it to gain market share. Number of dogs should be avoided and minimized in an organization.

Uses of BCG Matrix

1.The BCG-Matrix is helpful for managers to evaluate balance in the companies's current portfolio of Stars, Cash Cows, Question Marks and Dogs.

2.BCG-Matrix is applicable to large companies that seek volume and experience effects.

3.The model is simple and easy to understand.

4.It provides a base for management to decide and prepare for future actions.

5.If a company is able to use the experience curve to its advantage, it should be able to manufacture and sell new products at a price that is low enough to get early market share leadership. Once it becomes a star, it is destined to be profitable.

Limitations of BCG Matrix

The BCG Matrix produces a framework for allocating resources among different business units and makes it possible to compare many business units at a glance. But BCG Matrix is not free from limitations, such as-

1.BCG matrix classifies businesses as low and high, but generally businesses can be medium also. Thus, the true nature of business may not be reflected.

2.Market is not clearly defined in this model.

3.High market share does not always leads to high profits. There are high costs also involved with high market share.

4.Growth rate and relative market share are not the only indicators of profitability. This model ignores and overlooks other indicators of profitability.

5.At times, dogs may help other businesses in gaining competitive advantage. They can earn even more than cash cows sometimes.

6.This four-celled approach is considered as to be too simplistic.

Strategic Choice

Strategic choice refers to the decision which determines the future strategy of a firm. It addresses the question “Where shall we go”. A SWOT analysis is conducted to examine the strengths and weaknesses of the firm and opportunities that can be exploited are also determined.

Factors affecting Strategic Choice

1. Environmental constraints
2. Internal organizations and management power relationships
3. Values and preferences
4. Management’s attitude towards risk
5. Impact of past strategy
6. Time constraints
7. Information constraints
8. Competitors reaction

Balanced Score Card

A balanced scorecard is a strategic management performance metric used to identify and improve various internal business functions and their resulting external outcomes. Balanced scorecards are used to measure and provide feedback to organizations.

Benefits of Balanced Score Card

1.Better Strategic Planning

The Balanced Scorecard provides a powerful framework for building and communicating strategy. The business model is visualised in a Strategy Map which helps managers to think about cause-and-effect relationships between the different strategic objectives. The process of creating a Strategy Map ensures that consensus is reached over a set of interrelated strategic objectives. It means that performance outcomes as well as key enablers or drivers of future performance are identified to create a complete picture of the strategy.

2. Improved Strategy Communication & Execution

Having a one-page picture of the strategy allows companies to easily communicate strategy internally and externally. We have known for a long time that a picture is worth a thousand words. This 'plan on a page' facilitates the understanding of the strategy and helps to engage staff and external stakeholders in the delivery and review of the strategy. The thing to remember is that it is difficult for people to help execute a strategy which they don't fully understand.

3. Better Alignment of Projects and Initiatives

The Balanced Scorecard help organisations map their projects and initiatives to the different strategic objectives, which in turn ensures that the projects and initiatives are tightly focused on delivering the most strategic objectives.

4. Better Management Information

The Balanced Scorecard approach helps organisations design key performance indicators for their various strategic objectives. This ensures that companies are measuring what actually matters. Research shows that companies with a BSC approach tend to report higher quality management information and better decision-making.

5. Improved Performance Reporting

The Balanced Scorecard can be used to guide the design of performance reports and dashboards. This ensures that the management reporting focuses on the most important strategic issues and helps companies monitor the execution of their plan.

6. Better Organisational Alignment

The Balanced Scorecard enables companies to better align their organisational structure with the strategic objectives. In order to execute a plan well, organisations need to ensure that all business units and support functions are working towards the same goals. Cascading the Balanced Scorecard into those units will help to achieve that and link strategy to operations.

7. Better Process Alignment

Well implemented Balanced Scorecards also help to align organisational processes such as budgeting, risk management and analytics with the strategic priorities. This will help to create a truly strategy focused organisation.

The Contents in this E-Material is taken from the text and reference book as given in the syllabus.