Subject: Business Economics

Course: B.A., 6th Semester, Undergraduate.

Paper No: 602

Paper Title: Business Strategy & Ethics

Unit No.: 3 (Three)

Title: Strategy Formulation, Analysis & Choice

Lecture No: 2 (Two)

Title: Strategic Analysis & Choice

Academic Scripts

Introduction:

In this session students will learn that Strategic analysis and choice largely involves making subjective decisions based on objective information. According to Kazmi, the process of strategic choice is essentially a decision-making process. Decision-making consists of setting objectives, generating alternatives, choosing one or more alternatives that will help the organization achieve its objectives in the best possible manner, and finally, implementing the chosen alternative. To make a choice from among given alternatives, a decision maker has to set certain criteria in which to accept or reject alternatives. These criteria are the selection factors. They act as guidelinesto decision-making and considerably simplify the process of selection which would otherwise be a very difficult task.

Before any strategic choice is adopted, managers needs to carryout strategic analysis.Strategic analysis according to Kazmi is a dynamic area of strategic management where new tools and techniques are continually being developed, often replacing some of the older techniques. There are myriad tools and techniques available to perform strategic analysis. For instance SWOT analysis can be used with the help of software that provides templates for listing the strengths, weaknesses, opportunities and threats and evaluating them.

<u>1.Strategic analysis at corporate level</u>

There are two Strategy Levels:

- **Business-level Strategy (Competitive)**

- Each business unit in a diversified firm chooses a business-level strategy as its means of competing in individual product markets.

- **Corporate-level Strategy (Companywide)**
  - Specifies actions taken by the firm to gain a competitive advantage by selecting and managing a group of different businesses competing in several industries and product markets.

- Kazmi maintains that strategic analysis can be done at two levels: the corporate and business level. The corporate-level strategic analysis focuses on techniques for analyzing businesses under the same corporate umbrella.
- Corporate-level strategic analysis treats a corporate entity as constituting of portfolio of businesses under a corporate umbrella. The analysis focuses on the questions of what a corporate entity should do regarding the several businesses in its portfolio. The strategic alternatives here are basically the corporate strategies of stability, expansion, retrenchment and combination strategies.

- Our concern here in this session is the corporate level strategic analysis of companies through BCG matrix
- The strategic alternatives here are basically the grand strategies of stability, expansion, retrenchment, and combination strategies. Thompson and Strickland noted that, corporate level strategic analysis is relevant to the case of a diversified corporation which has several businesses. The corporate portfolio analysis constitutes the major chunk of the analysis done at the corporate level. The most outstanding technique considered in corporate level strategic analysis for this research is the Boston Consulting Group (BCG) matrix or product portfolio matrix.

BOSTON CONSULTING GROUP MATRIX (BCG)

This technique is particularly useful for multi-divisional or multiproductcompanies. The divisions or products compromise the organization's "business portfolio". The composition of the portfolio can be critical to the growth and success of the company.

The BCG matrix considers two variables, namely,

1)Market growth rate:

The market growth rate is shown on the vertical (y) axis and is expressed as percentage (%). The range is set somewhat randomly. The overhead shows a range of 0 to 20% with division between low and high growth at 10%

2)Relative market share

The horizontal (x) axis shows relative market share. The share is calculated by reference to the largest competitor in the market. Again the range and division between high and low shares is arbitrary. The original work used a scale of 0.1, i.e. market leadership occurs when the relative market share exceeds 1.0.

The BCG growth/share matrix is divided into four cells or quadrants, each of which represents a particular type of business. Divisions or products are represented by circles. The size of the circle reflects the relative significance of the division/product to group sales. A development of the matrix is to reflect the relative profit contribution of each division and this is shown as a pie segment within the circle.

Question Marks

Question marks are products that grow rapidly and as a result consume large amounts of cash, but because they have lowmarket shares they don't generate much cash. The result is large net cash consumption. A question mark has the potential to gain market share and become a star, andeventually a cash cow when the market growth slows. If it doesn't become a market leader it will become a dog when market growth declines. Question marks need to be analyzed carefully to determine if they are worth the investment required to grow market share.

Stars

Stars generate large sums of cash because of their strongrelative market share, but also consume large amounts ofcash because of their high growth rate. So the cash beingspent and brought in approximately nets out. If a star canmaintain its large market share it will become a cash cowwhen the market growth rate declines.

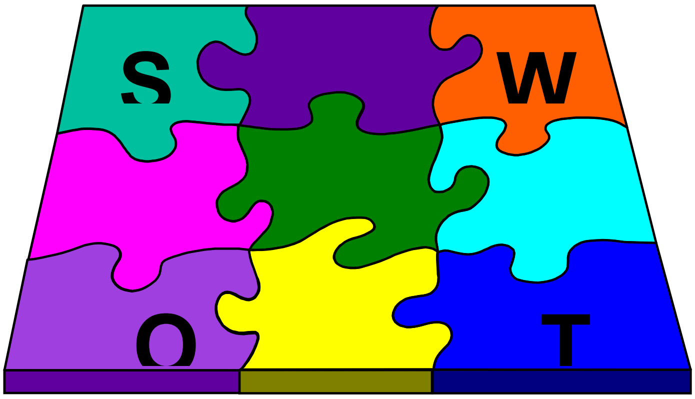
Cash Cows

As leaders in a mature market, cash cows exhibit a returnon assets that is greater than the market growth rate – sothey generate more cash than they consume. These unitsshould be 'milked' extracting the profits and investing as littleas possible. They provide the cash required to turn questionmarks into market leaders.

Dogs

Dogs have a low market share and a low growth rate andneither generates nor consumes a large amount of cash.However, dogs are cash traps because of the money tied upin a business that has little potential. Such businesses arecandidates for divestiture.

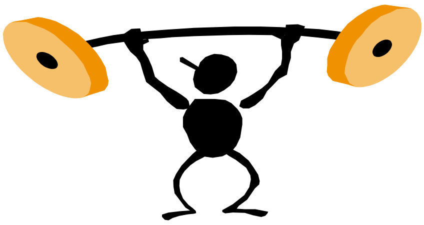
<u>2.SWOT analysis</u>



- **S W O T represents the first letter in**
  - *S* trengths
  - *W*eaknesses
  - *O* pportunities
  - *T* hreats
- **For a company's *strategy* to be *well-conceived,* it must be**
  - Matched to its resource strengths and weaknesses
  - Aimed at capturing its best market opportunities and erecting defenses against external threats to its well-being

Identifying Resource Strengths and Competitive Capabilities

Resource strengths and competitive capabilities are competitive assets!



- **A *strength* is something a firm does well or an attribute that enhances its competitiveness**
- **Examples include**
  - Valuable skills, competencies, or capabilities
  - Valuable physical assets
  - Valuable human assets
  - Valuable organizational assets

- Valuable intangible assets
- Important competitive capabilities
- An attribute placing a company in a position of market advantage
- Alliances or cooperative ventures with partners

Weaknesses

Resource weaknesses and deficiencies are competitive liabilities!

- A ***weakness*** is something a firm lacks, does poorly, or a condition placing it at a disadvantage
- ***Resource weaknesses*** relate to
  - Inferior or unproven skills, expertise, or intellectual capital
  - Lack of important physical, organizational, or intangible assets
  - Missing capabilities in key areas

Identifying a Company'sMarket Opportunities

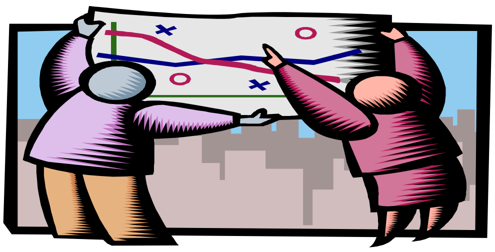
- Opportunities ***most relevant*** to a company are those offering
  - ***Good match*** with its financial and organizational resource capabilities
  - ***Best prospects*** for ***profitable long-term growth***
  - ***Potential*** for ***competitive advantage***

Identifying External Threats – An illustrative list of threats includes

- Emergence of cheaper/better technologies

- Introduction of better products by rivals
- Entry of lower-cost foreign competitors
- Onerous regulations
- Rise in interest rates
- Potential of a hostile takeover
- Unfavorable demographic shifts
- Adverse shifts in foreign exchange rates
- Political upheaval in a country

Role of SWOT Analysis inCrafting a Better Strategy



- **S W O T** analysis ***involves more than just developing the 4 lists*** of strengths, weaknesses, opportunities, and threats
- The most important part of **S W O T** analysis is
  - ➔ ***Using the 4 lists to draw conclusions about a company's overall situation***
  - ➔ ***Acting on the conclusions*** to
    - Better match a company's strategy to its resource strengths and market opportunities
    - Correct the important weaknesses
    - Defend against external threats

<u>Grand strategic matrix</u>

- **Grand Strategy Matrix**

Strategy analysis and choice is a process that reconciles strategic actions, market opportunities, corporate strengths and resources, values of managers, and legal requirements and social responsibilities to select a "best" mission, strategic thrust, and set of strategic actions.

Grand strategies, often called master of business strategies provide basic direction for strategic actions. They are the basis of coordinated and sustained efforts directed toward achieving long term business objectives.

Grand strategies indicate the time period over which long range objectives are to be achieved. Thus, a grand strategy can be defined as a comprehensive general approach that guides a firm's major actions.

Managers can use tools and techniques such as grand selection matrix to achieve long term objectives.

Overcome weakness

Turnaround or

Retrenchment Vertical integration

Divestiture

LiquidationConglomerate diversification

Internal (redirected resources within the firm)

II I

III IV

Concentrated growth

Market development

Product development

Innovation

Horizontal integration

concentric diversification

joint venture

External (acquisition or merger for resource capability)

Maximize strengths

A four cells guide to strategist based upon whether the business is-

1. operating from a position of strength or weakness
2. the choice of an internal or external emphasis for growth or profitability

Vertical integration:

It is an acquisition of firms that supply inputs such as raw materials or customers for its outputs, such as warehouses for finished products.

The main reason for vertical integration is the desire to increase the dependability of the supply or quality of the raw materials used as production inputs

Conglomerate diversification:

It is an acquiring or entering business unrelated to a firm's current technologies, markets or products.

Unlike concentric diversification, conglomerate diversification gives little concern to creating product-market synergy with existing businesses.

Retrenchment:

It is cutting back on products, markets, operations because the firm's overall competitive and financial situation cannot support commitments needed to sustain or build its operations.

Divestiture:

- A **divestiture strategy** involves the sale of a firm or a major component of a firm
- When retrenchment fails to accomplish the desired turnaround, or when a nonintegrated business activity achieves an unusually high market value, strategic managers often decide to sell the firm
- Reasons for divestiture vary

Liquidation:

It is closing down the operations of a business and selling its assets and operations to pay its debts and distribute any gains to stock holders.

- When liquidation is the grand strategy, the firm typically is sold in parts, only occasionally as a whole—but for its tangible asset value and not as a going concern
- Planned liquidation can be worthwhile

Concentrated growth:

It is an aggressive market penetration where a firm's strong position and favorable market growth allows it to "control" resources and effort for focused growth.

Market development:

Selling present products, often with only cosmetic modification, to customers in related marketing areas by adding channels of distribution or buy changing the content of advertising or promotion

Product development:

The substantial modification of existing products or the creation of new but related products that can be marketed to current customers through established channels.

Horizontal integration:

Growth through the acquisition of one or more similar firms operating at the same stage of the production-marketing chain

Concentric diversification:

It is an acquisition of businesses that are related to the acquiring firm in terms of technology, markets or products.

The ideal concentric diversification occurs when the combined company profits increase the strengths and opportunities and decrease the weaknesses and exposure to risk

Joint ventures:

Commercial companies created and operated for the benefit of the co-owners, usually two or more separate companies that from the venture.

- Occasionally two or more capable firms lack a necessary component for success in a particular competitive environment
- The solution is a set of **joint ventures**, which are commercial companies (children) created and operated for the benefit of the co-owners (parents)
- The joint venture extends the supplier-consumer relationship and has strategic advantages for both partners

Contingency approach to strategic choice

Contingency plan or strategy:

Such alternatives are based on certain assumptions and conditions. If the assumptions or conditions change, many of the strategies may lose their relevance. Even if the strategies are carefully chosen, formulated and implemented, unforeseen or sudden changes in the environment like a new technology, emergency of very strong or foreign competitor or government actions and regulations can make a strategy obsolete. To minimize the impact of such development or threats, companies should develop contingency plan or strategy as one of the viable alternatives.

A contingency plan or strategy may be defined as an alternative plan or strategy which could be adopted if certain key conditions do not prevail or events do not occur as anticipated. Instead of a single contingency plan or strategy, a set of contingency strategies may be prepared based on probable alternative scenarios.This provides a broader base for handling eventualities.

Some situations in which contingency strategies are more commonly adopted by organizations are:

- If a major competitor suddenly withdraws from a market, what should be the company's strategy?
- If quarterly sales target are not met, what actions should be taken to prevent loss of profit?
- If actual demand for a new product exceeds plan demand or demand projection, what steps should be taken to meet the higher demand?

- If a new technological innovation makes a product obsolete sooner than expected, what should be the corrective strategy?

Sometimes alternative strategies, considered, but not selected for implementation, can serve as contingency strategies, if the strategy or strategies selected do not work because the environment has suddenly become different.

Also, it may so happen that changes in external conditions, sometimes internal conditions also, provide an unexpected opportunity.When such opportunities develop, contingency strategies, particularly if they are based on alternative scenarios, can greatly help organizations capitalize on them.

Summary

In this session students must have understood that corporate level strategic analysis and choice is an integral part of organization's management especially used for competitive analysis and corporate strategic planning in multi-product and multi-business firms. It assists strategist in exercising a strategic choice. Through this analysis factors responsible for organizational growth will be derived, and established

Moreover students must now be clear about BCG Matrix analysisthat are classed as question marks, Dogs, cash cows needs proper diagnosis and evaluation in the context of the environmental challenges faced by them in order to know the right strategies needed for application to facilitate revitalization. For example question marks that aspires to obtain dominant market share, may select expansion strategies, otherwise retrenchment strategy may be more realistic.

Organizations that are classed as Dogs because of their weak internal and external positions may seek for strategy such as liquidation, divestment or can be trimmed down through retrenchment. For organizations classed as cash cows, they need to adopt product development; concentric diversification may be attractive strategies for strong cash cows. However, as a cash-cow becomes weak, retrenchment or divestiture can become more appropriate.

Students must have understood that organizations that desire to be stars need to invest aggressively in Research and Development (R&D) to stay in the leading edge of technological know-how.
Students must now clear about SWOT for better match of a company's strategy to its resource strengths and market opportunities and correct the important weaknesses*a*nd defend against external threats.

At the end of this session students are understood about grand selection matrix and different contingency approaches to strategic choice and to minimize the impact of different threats, companies should develop contingency plan or strategy as one of the viable alternatives.