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Strategic Management

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Content

1 Strategic Management Overview

All firms have a strategy, even if it is informal, unstructured, and sporadic. All organizations are heading somewhere, but unfortunately some organizations do not know where they are going. The old saying “If you do not know where you are going, then any road will lead you there!” accents the need for organizations to use strategic-management concepts and techniques. The strategic-management process is becoming more widely used by small firms, large companies, nonprofit institutions, governmental organizations, and multinational conglomerates alike. The process of empowering managers and employees has almost limitless benefits.

Organizations should take a proactive rather than a reactive approach in their industry, and they should strive to influence, anticipate, and initiate rather than just respond to events. The strategic-management process embodies this approach to decision making. It represents a logical, systematic, and objective approach for determining an enterprises future direction. The stakes are generally too high for strategists to use intuition alone in choosing among alternative courses of action. Successful strategists take the time to think about their businesses, where they are with their businesses, and what they want to be as organizations and then they implement programs and policies to get from where they are to where they want to be in a reasonable period of time.

It is a known and accepted fact that people and organizations that plan ahead are much more likely to become what they want to become than those that do not plan at all. A good strategist plans and controls his or her plans, while a bad strategist never plans and then tries to control people!
Success in business increasingly depends upon offering products and services that are competitive on a world basis, not just on a local basis. If the price and quality of a firm’s products and services are not competitive with those available elsewhere in the world, the firm may soon face extinction. Global markets have become a reality in all but the most remote areas of the world. Certainly throughout the world, even in small towns, firms feel the pressure of world competitors. Nearly half of all the automobiles sold in the United States, for example, are made in Japan and Germany.

1.1 What is a Strategy?

1.1.1 Strategy Proverbs

The game of business used to be like football: size mattered. Then it changed to basketball: speed and agility. Today, business is more like chess. Customer priorities change continually, and the signals given by these changes are vital clues to the next cycle of growth... (Adrian Slywotzky, author of The Profit Zone)

Perception is strong and sight weak. In strategy it is important to see distant things as if they were close and to take a distanced view of close things.

(Miyamoto Musashi 1584-1645, legendary Japanese swordsman)

When I have one week to solve a seemingly impossible problem, I spend six days defining the problem. Then, the solution becomes obvious. (Albert Einstein)

You have to understand what it is that you are better at than anybody else and mercilessly focus your efforts on it. (Andrew Grove, CEO, Intel)

There is nothing so useless as doing efficiently that which should not be done at all. (Peter Drucker)

However beautiful the strategy, you should occasionally look at the results.
(Sir Winston Churchill)

War is ninety percent information. (Napoleon Bonaparte, 1769-1821)

If you want it, measure it. If you can't measure it, forget it. (Peter Drucker)

Strategy is about making choices, trade-offs; it's about deliberately choosing to be different. - Michael Porter [Harvard Professor]

Do not repeat the tactics which have gained you one victory, but let your methods be regulated by the infinite variety of circumstances.
(Sun Tzu c. 490 BC, Chinese military strategist)

1.1.2 Definition of Strategy

"Strategy is the direction and scope of an organization over the long-term: which achieves advantage for the organization through its configuration of resources within a challenging environment, to meet the needs of markets and to fulfill stakeholder expectations".
(Johnson and Scholes, Exploring Corporate Strategy)

In other words, strategy is about:
- **Direction**: where is the business trying to get to in the long-term
- **Markets, scope**: Which markets should a business compete in and what kind of activities' are involved in such markets?
- **Competition**: How can the business perform better than the competition in those markets?
- **Resources**: what resources (skills, assets, finance, relationships, technical competence, facilities') are required in order to be able to compete?
- **Environment**: what external, environmental factors affect the businesses' ability to compete?
- **Stakeholders**: what are the values and expectations of those who have power in and around the business?

No matter how hard employees work, an organization is in real trouble if strategic decisions are not made effectively. Doing the right things (effectiveness) is more important than doing things right (efficiency).

For example, ineffective strategies led to revenue declines of 71 percent and 10 percent in 2006 for Avis Budget Group and American Express, respectively. Boston Scientific and the New York Times had profit declines of 670 percent and 309 percent, respectively that year.

Even well known firms such as Nortel, Circuit City, Eastman Kodak, La-Z-Boy, Citigroup, New Century Financial, Cadbury Schweppes, and Motorola are struggling with ineffective strategies. Many American newspapers are faltering as consumers increasingly switch to interactive media for news.

All firms should think about their businesses, where they are with their businesses, and what they want to be as organizations and then they implement programs and policies to get from where they are to where they want to be in a reasonable period of time.

1.2 What is Strategic Management?

Strategic management is the process of analyzing the current situation, developing appropriate strategies, putting those strategies into action and evaluating, modifying, or changing those strategies as needed.

"Strategic management is an ongoing process that evaluates and controls the business and the industries in which the company is involved; assesses its competitors and sets goals and strategies to meet all existing and potential competitors; and then reassesses each strategy annually or quarterly [i.e. regularly] to determine how it has been implemented and whether it has succeeded or needs replacement by a new strategy to meet changed circumstances, new technology, new competitors, a new economic environment., or a new social, financial, or political environment." (Lamb, 1984:ix)[2]

In its broadest sense, strategic management is about taking "strategic decisions" - decisions that answer the following questions:

1. Where are we now?
2. Where do we want to go?
3. How will we get there?

Strategic Management is an Ongoing Process

Strategic management provides a valuable and clear vision for an organization to follow in order to be more competitive and effective. By effective strategic management, organization can manage to sustain competitive advantages in the global market by managing internal and external linkages between competences and activities in the value chain.
Strategic management acts as an important guideline to lead an organization to the road of success. Without a well-organized and clear selection strategy, the organization will be lost and unable to make progress.

1.3 Stages of Strategic Management

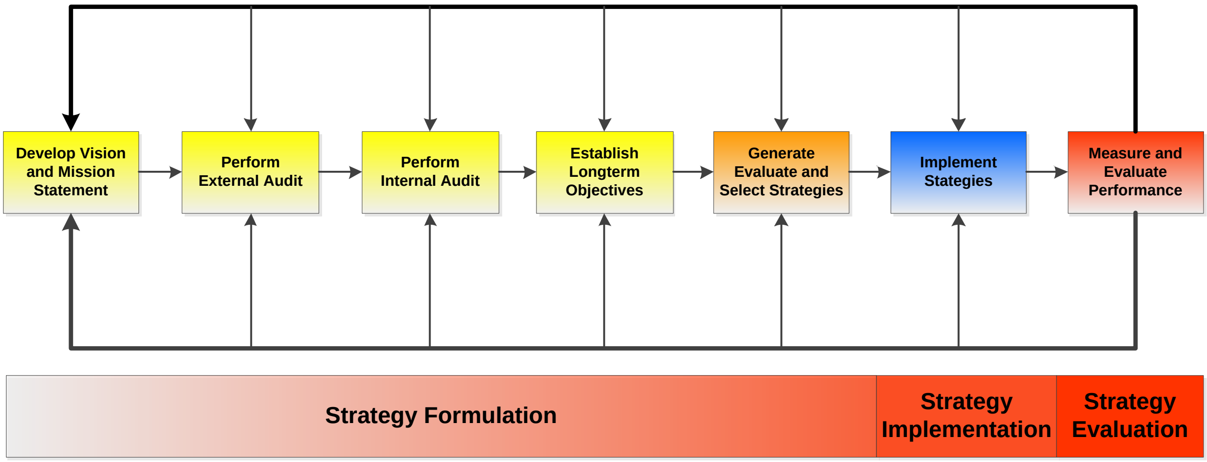
Peter Drucker says the prime task of strategic management is thinking through the overall mission of a business: . . . that is, of asking the question, What is our Business?

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]

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

The strategic-management process is dynamic and continuous. A change in any one of the major components in the model can necessitate a change in any or all of the other components. For instance, a shift in the economy could represent a major opportunity and require a change in long- term objectives and strategies; a failure to accomplish annual objectives could require a change in policy; or a major competitor's change in strategy could require a change in the firm's mission. Therefore, strategy formulation, implementation, and evaluation activities should be performed on a continual basis, not just at the end of the year or semiannually. The strategic-management process never really ends.

Figure 1-1 A Comprehensive Strategic- Management Model



Source: Fred R. David, "How companies define their mission" [2]

1.3.1 Strategy Formulation

Strategy formulation includes developing a vision and mission, identifying an organizations 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 longterm 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.

1.3.2 Strategy Implementation

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 organizations 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.

1.3.3 Strategy evaluation

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

- Reviewing external and internal factors that are the bases for current strategies
- Measuring performance
- Taking corrective actions.

1.4 Integrating Intuition and Analysis

Based on past experiences, judgment, and feelings, most people recognize that intuition is essential to making good strategic decisions. Intuition is particularly useful for making decisions in situations of great uncertainty or little precedent. It is also helpful when highly interrelated variables exist or when it is necessary to choose from several plausible alternatives. Some managers and owners of businesses profess to have extraordinary abilities for using intuition alone in devising brilliant strategies.
For example, Will Durant, who organized General Motors Corporation, was described by Alfred Sloan as a man who would proceed on a course of action guided solely, as far as I could tell, by some intuitive flash of brilliance. He never felt obliged to make an engineering hunt for the facts. Yet at times, he was astoundingly correct in his judgment.[3]
Albert Einstein acknowledged the importance of intuition when he said, “I believe in intuition and inspiration. At times I feel certain that I am right while not knowing the reason. Imagination is more important than knowledge, because knowledge is limited, whereas imagination embraces the entire world.”[4]

Although some organizations today may survive and prosper because they have intuitive geniuses managing them, most are not so fortunate. Most organizations can benefit from strategic management, which is based upon integrating intuition and analysis in decision making. Choosing an intuitive or analytic approach to decision making is not an either or proposition. Managers at all levels in an organization inject their intuition and judgment into strategic management analyses.
Analytical thinking and intuitive thinking complement each other.

1.5 Adapting to Change

The strategic management process is based on the belief that organizations should continually monitor internal and external events and trends so that timely changes can be made as needed.
The rate and magnitude of changes that affect organizations are increasing dramatically. Consider, for example, e- commerce, laser surgery, the war on terrorism, the aging population, the Enron scandal, and merger mania. To survive, all organizations must be capable of astutely identifying and adapting to change. The strategic- management process is aimed at allowing organizations to adapt effectively to change over the long run.
As Waterman has noted:
In today's business environment, more than in any preceding era, the only constant is change. Successful organizations effectively manage change, continuously adapting their bureaucracies, strategies, systems, products, and cultures to survive the shocks and prosper from the forces that decimate the competition.[5]

1.6 Strategic Management History

A strong military heritage underlies the study of strategic management. Terms such as objectives, mission, strengths, and weaknesses first were formulated to address problems on the battlefield.
Strategy is the science of planning and directing large-scale military operations, of maneuvering forces into the most advantageous position prior to actual engagement with the enemy.
The word strategy comes from the Greek strategos, which refers to a military general and combines stratos (the army) and ago (to lead). The history of strategic planning began in the military. A key aim of both business and military strategy is to gain competitive advantage. In many respects, business strategy is like military strategy, and military strategists have learned much over the centuries that can benefit business strategists today. Both business and military organizations try to use their own strengths to exploit competitor's weak-nesses. If an organizations overall strategy is wrong (ineffective), then all the efficiency in the world may not be enough to allow success.
Business or military success is generally not the happy result of accidental strategies. Rather, success is the product of both continuous attention to changing external and internal conditions and the formulation and implementation of insightful adaptations to those conditions. The element of surprise provides great competitive advantages in both military and business strategy; information systems that provide data on opponents or competitors strategies and resources are also vitally important.

Of course, a fundamental difference between military and business strategy is that business strategy is formulated, implemented, and evaluated with an assumption of competition, whereas military strategy is based on an assumption of conflict. Nonetheless, military conflict and business competition are so similar that many strategic- management techniques apply

equally to both. Business strategists have access to valuable insights that military thinkers have refined over time. Superior strategy formulation and implementation can overcome an opponent's superiority in numbers and resources.
The first writings that contain thoughts about what today we would call strategic thinking go back to antiquity, authored by Greeks and Romans. Even in the Bible, there are passages where one can perceive the strategies used to win conflicts. Perhaps the oldest text that deals systematically with this matter is "The art of war," written by Sun Tzu (1983) of China in the fourth century, B.C. This book appeared in the West in the 18th century and became well disseminated by the end of the 20th century.
Similarities can be construed from Sun Tzu's writings to the practice of formulating and implementing strategies among businesses today.

- War is a matter of vital importance to the state: a matter of life or death, the road either to survival or ruin. Hence, it is imperative that it be studied thoroughly.
- Warfare is based on deception. When near the enemy, make it seem that you are far away; when far away, make it seem that you are near. Hold out baits to lure the enemy. Strike the enemy when he is in disorder. Avoid the enemy when he is stronger. If your opponent is of choleric temper, try to irritate him. If he is arrogant, try to encourage his egotism. If enemy troops are well prepared after reorganization, try to wear them down. If they are united, try to sow dissension among them. Attack the enemy where he is unprepared, and appear where you are not expected. These are the keys to victory for a strategist. It is not possible to formulate them in detail beforehand.
- A speedy victory is the main object in war. If this is long in coming, weapons are blunted and morale depressed. When the army engages in protracted campaigns, the resources of the state will fall short. Thus, while we have heard of stupid haste in war, we have not yet seen a clever operation that was prolonged.
- Generally, in war the best policy is to take a state intact; to ruin it is inferior to this. To capture the enemy's entire army is better than to destroy it; to take intact a regiment, a company, or a squad is better than to destroy it. For to win one hundred victories in one hundred battles is not the acme of skill. To subdue the enemy without fighting is the supreme excellence. Those skilled in war subdue the enemy's army without battle.
- The art of using troops is this: When ten to the enemy's one, surround him. When five times his strength, attack him. If double his strength, divide him. If equally matched, you may engage him with some good plan. If weaker, be capable of withdrawing. And if in all respects unequal, be capable of eluding him.
- Know your enemy and know yourself, and in a hundred battles you will never be defeated. When you are ignorant of the enemy but know yourself, your chances of winning or losing are equal. If ignorant both of your enemy and of yourself, you are sure to be defeated in every battle.
- He who occupies the field of battle first and awaits his enemy is at ease, and he who comes later to the scene and rushes into the fight is weary. And therefore, those skilled in war bring the enemy to the field of battle and are not brought there by him. Thus, when the enemy is at ease, be able to tire him; when well fed, be able to starve him; when at rest, be able to make him move.
- Analyze the enemy's plans so that you will know his shortcomings as well as his strong points. Agitate him to ascertain the pattern of his movement. Lure him out to reveal his dispositions and to ascertain his position. Launch a probing attack to learn where his strength is abundant and where deficient. It is according to the situation that plans are laid for victory, but the multitude does not comprehend this.
- An army may be likened to water, for just as flowing water avoids the heights and hastens to the lowlands, so an army should avoid strength and strike weakness. And as water shapes its flow in accordance with the ground, so an army manages its victory in accordance with the situation of the enemy. And as water has no constant form, there are

in warfare no constant conditions. Thus, one able to win the victory by modifying his tactics in accordance with the enemy situation may be said to be divine.
- If you decide to go into battle, do not announce your intentions or plans. Project business as usual.
- Unskilled leaders work out their conflicts in courtrooms and battlefields. Brilliant strategists rarely go to battle or to court; they generally achieve their objectives through tactical positioning well in advance of any confrontation.
- When you do decide to challenge another company (or army), much calculating, estimating, analyzing, and positioning bring triumph. Little computation brings defeat.
- Skillful leaders do not let a strategy inhibit creative counter-movement. Nor should commands from those at a distance interfere with spontaneous maneuvering in the immediate situation.
- When a decisive advantage is gained over a rival, skillful leaders do not press on. They hold their position and give their rivals the opportunity to surrender or merge. They do not allow their forces to be damaged by those who have nothing to lose.
- Brilliant strategists forge ahead with illusion, obscuring the area(s) of major confrontation, so that opponents divide their forces in an attempt to defend many areas. Create the appearance of confusion, fear, or vulnerability so the opponent is helplessly drawn toward this illusion of advantage.

1.7 Benefits of Strategic Management

Strategic management allows an organization to
- be more proactive than reactive in shaping its own future
- initiate and influence (rather than just respond to) activities
- exert control over its own destiny
- formulate better strategies through the use of a more systematic, logical, and rational approach

Communication is a key to successful strategic management. Through involvement in the process, managers and employees become committed to supporting the organization.
The worst thing strategists can do is develop strategic plans themselves and then present them to operating managers to execute. Through involvement in the process, line managers become owners of the strategy. Ownership of strategies by the people who have to execute them is a key to success!

Financial benefits
Research indicates that organizations using strategic management are more profitable and successful than those that do not.[6] Businesses using strategic management show significant improvements in:
- sales
- profitability
- productivity

Non-Financial benefits:
- Informed decisions
- Profound competitor knowledge
- Increased employee productivity
- Greater awareness of external threats
- Understanding of performance reward relationships

- Better problem-avoidance
- Lesser resistance to change

1.8 Why Some Firms Do No Strategic Planning?

Some firms do not engage in strategic planning and some firms do strategic planning but receive no support from managers and employees. Some reasons for poor or no strategic planning are as follows:

1. **Poor Reward Structures**—when an organization assumes success, it often fails to reward success. Where failure occurs, then the firm may punish. In this situation, it is better for an individual to do nothing (and not draw attention) than risk trying to achieve something, fail, and be punished.
2. **Fire-fighting**—an organization can be so deeply embroiled in crisis management and fire-fighting that it does not have time to plan.
3. **Waste of Time**—some firms see planning as a waste of time since no marketable product is produced. Time spent on planning is an investment.
4. **Too Expensive**—some organizations are culturally opposed to spending resources.
5. **Laziness**—People may not want to put forth the effort needed to formulate a plan.
6. **Content with Success**—particularly if a firm is successful, individuals may feel there is no need to plan because things are fine as they stand. But success today does not guarantee success tomorrow.
7. **Fear of Failure**—by not taking action, there is little risk of failure unless a problem is urgent and pressing. Whenever something worthwhile is attempted, there is some risk of failure.
8. **Overconfidence**—as individuals amass experience, they may rely less on formalized planning. Rarely, however, is this appropriate. Being overconfident or overestimating experience can bring demise. Forethought is rarely wasted and is often the mark of professionalism.
9. **Prior Bad Experience**—People may have had a previous bad experience with planning, where plans have been long, cumbersome, impractical, or inflexible. Planning, like anything, can be done badly.
10. **Self-Interest**—when someone has achieved status, privilege, or self-esteem through effectively using an old system, they often see a new plan as a threat.
11. **Fear of the Unknown**—People may be uncertain of their abilities to learn new skills, their aptitude with new systems, or their ability to take on new roles.
12. **Honest Difference of Opinion**—People may sincerely believe the plan is wrong. They may view the situation from a different viewpoint, or may have aspirations for themselves or the organization that are different from the plan. Different people in different jobs have different perceptions of a situation.
13. **Suspicion**—Employees may not trust management

1.9 Pitfalls in Strategic Planning

Strategic planning is an involved, intricate, and complex process that takes an organization into non chartered 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 prepared to address them is essential to success. Some pitfalls to watch for and avoid in strategic planning are provided below:
1. Using strategic planning to gain control over decisions and resources
2. Doing strategic planning only to satisfy accreditation or regulatory requirements
3. Too hastily moving from mission development to strategy formulation
4. Failing to communicate the plan to employees, who continue working in the dark
5. Top managers making many intuitive decisions that conflict with the formal plan
6. Top managers not actively supporting the strategic-planning process
7. Failing to use plans as a standard for measuring performance
8. Delegating planning to a "planner" rather than involving all managers
9. Failing to involve key employees in all phases of planning
10. Failing to create a collaborative climate supportive of change
11. Viewing planning to be unnecessary or unimportant
12. Becoming so engrossed in current problems that insufficient or no planning is done
13. Being so formal in planning that flexibility and creativity are stifled.

1.10 Guidelines for Effective Strategic Management

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.

R. T. Lenz offered some important guidelines for effective strategic management:

Keep the strategic management process as simple and nonroutine as possible. Eliminate jargon and arcane planning language. Remember, strategic management is a process for fostering learning and action, not merely a formal system for control. To avoid routinized behavior, vary assignments, team membership, meeting formats, and the planning calendar. The process should not be totally predictable, and settings must be changed to stimulate creativity. Emphasize word- oriented plans with numbers as back- up material. If managers cannot express their strategy in a paragraph or so, they either do not have one or do not understand it. Stimulate thinking and action that challenge the assumptions underlying current corporate strategy. Welcome bad news. If strategy is not working, managers desperately need to know it. Further, no pertinent information should be classified as inadmissible merely because it cannot be quantified. Build a corporate culture in which the role of strategic management and its essential purposes are understood. Do not permit technicians to co-opt the process. It is ultimately a process for learning and action. Speak of it in these terms. Attend to psychological, social, and political dimensions, as well as the information infrastructure and administrative procedures supporting it.[7]

An important guideline for effective strategic management is open- mindedness. A willingness and eagerness to consider new information, new viewpoints, new ideas, and new possibilities is essential; all organizational members must share a spirit of inquiry and learning. Strategists such as chief executive officers, presidents, owners of small businesses, and heads of government agencies must commit themselves to listen to and understand manager’s positions well enough to be able to restate those positions to the manager’s satisfaction.

1.11 Globalization

Global considerations impact virtually all strategic decisions! The boundaries of countries no longer can define the limits of our imaginations. To see and appreciate the world from the perspective of others has become a matter of survival for businesses. The underpinnings of strategic management hinge upon managers gaining an understanding of competitors, markets, prices, suppliers, distributors, governments, creditors, shareholders, and customers worldwide. The price and quality of a firm’s products and services must be competitive on a worldwide basis, not just on a local basis.

1.12 Natural Environment

Natural environment has become an important strategic issue. Global warming, bioterrorism, and increased pollution suggest that perhaps there is now no greater threat to business and society than the continuous exploitation and decimation of our natural environment. Mark Starik at George Washington University says, “Halting and reversing worldwide ecological destruction and deterioration . . . is a strategic issue that needs immediate and substantive attention by all businesses and managers.”

1.13 Business Ethics and Strategic Management

Business ethics can be defined as principles of conduct within organizations that guide decision making and behavior. Good business ethics is a prerequisite for good strategic management; good ethics is just good business!

Newspapers and business magazines daily report legal and moral breaches of ethical conduct by both public and private organizations. The biggest payouts for class-action legal fraud suits ever were against Enron ($7.16 billion), WorldCom ($6.16 billion), Cendant ($3.53 billion), Tyco ($2.98 billion), AOL Time Warner ($2.5 billion), Nortel Networks ($2.47 billion), and Royal Ahold ($1.09 billion).
Some business actions considered to be unethical include misleading advertising or labeling, causing environmental harm, poor product or service safety, padding expense accounts, insider trading, dumping banned or flawed products in foreign markets, overpricing, hostile takeovers, hacking into company computers and spreading viruses,etc.

Managers and employees of firms must be careful not to become scapegoats blamed for company environmental wrongdoings. Harming the natural environment is unethical, illegal, and costly. When organizations today face criminal charges for polluting the environment, firms increasingly are turning on their managers and employees to win leniency for themselves. Employee firings and demotions are becoming common in pollution-related legal suits. Managers being fired at Darling International Inc.and Niagara Mohawk Power Corporation for being indirectly responsible for their firms polluting water exemplifies this corporate trend. Therefore, managers and employees today must be careful not to ignore, conceal, or disregard a pollution problem, or they may find themselves personally liable.

Merely having a code of ethics, however, is not sufficient to ensure ethical business behavior. A code of ethics can be viewed as a public relations gimmick, a set of platitudes, or window dressing. To ensure that the code is read, understood, believed, and remembered, organizations need to conduct periodic ethics workshops to sensitize people to workplace circumstances in which ethics issues may arise. 23 If employees see examples of punishment for violating the code and rewards for upholding the code, this helps reinforce the importance of a firms code of ethics.

Strategists are responsible for developing, communicating, and enforcing the code of business ethics for their organizations. Although primary responsibility for ensuring ethical behavior rests with a firm's strategists, an integral part of the responsibility of all managers is to provide ethics leadership by constant example and demonstration. Managers hold positions that enable them to influence and educate many people. This makes managers responsible for developing and implementing ethical decision making.

Gellerman and Drucker, respectively, offer some good advice for managers:
All managers risk giving too much because of what their companies demand from them. But the same superiors, who keep pressing you to do more, or to do it better, or faster, or less expensively, will turn on you should you cross that fuzzy line between right and wrong. They will blame you for exceeding instructions or for ignoring their warnings. The smartest managers already know that the best answer to the question "How far is too far?" is don't try to find out.

A man or woman might know too little, perform poorly, lack judgment and ability, and yet not do too much damage as a manager. But if that person lacks character and integrity - no matter how knowledgeable, how brilliant, how successful - he destroys. He destroys people, the most valuable resource of the enterprise. He destroys spirit. And he destroys performance. This is particularly true of the people at the head of an enterprise. For the spirit of an organization is created from the top. If an organization is great in spirit, it is because the spirit of its top people is great. If it decays, it does so because the top rots. As the proverb has it, "Trees die from the top." No one should ever become a strategist unless he or she is willing to have his or her character serve as the model for subordinates.

Being unethical is a recipe for headaches, inefficiency, and waste. History has proven that the greater the trust and confidence of people in the ethics of an institution or society, the greater its economic strength. Business relationships are built mostly on mutual trust and reputation. Short- term decisions based on greed and questionable ethics will preclude the necessary self- respect to gain the trust of others. More and more firms believe that ethics training and an ethics culture create strategic advantage.

2 The Business Vision and Mission

Every organization has a unique purpose and reason for being. This uniqueness should be reflected in vision and mission statements. The nature of a business vision and mission can represent either a competitive advantage or disadvantage for the firm. An organization achieves a heightened sense of purpose when strategists, managers, and employees develop and communicate a clear business vision and mission.
Drucker says that developing a clear business vision and mission is the “first responsibility of strategists.”

A good mission statement reveals an organizations customers; products or services; markets; technology; concern for survival, growth, and profitability; philosophy; self- concept; concern for public image; and concern for employees. These nine basic components serve as a practical framework for evaluating and writing mission statements. As the first step in strategic management, the vision and mission statements provide direction for all planning activities. Well- designed vision and mission statements are essential for formulating, implementing, and evaluating strategy. Developing and communicating a clear business vision and mission are the most commonly overlooked tasks in strategic management. Without clear statements of vision and mission, a firms short- term actions can be counterproductive to long- term interests. Vision and mission statements always should be subject to revision, but, if carefully prepared, they will require infrequent major changes. Organizations usually reexamine their vision and mission statements annually. Effective mission statements stand the test of time.

Vision and mission statements are essential tools for strategists, a fact illustrated in a short story told by Porsche former CEO Peter Schultz:
Three people were at work on a construction site. All were doing the same job, but when each was asked what his job was, the answers varied: “Breaking rocks,” the first replied; “Earning a living,” responded the second; “Helping to build a cathedral,” said the third. Few of us can build cathedrals. But to the extent we can see the cathedral in whatever cause we are following, the job seems more worthwhile. Good strategists and a clear mission help us find those cathedrals in what otherwise could be dismal issues and empty causes.[8]

The Vision describes a future identity while the Mission serves as an ongoing and time-independent guide. The Mission describes why it is important to achieve the Vision. A Mission statement defines the purpose or broader goal for being in existence or in the business and can remain the same for decades if crafted well. A Vision statement is more specific in terms of both the future state and the time frame. Vision describes what will be achieved if the organization is successful. A mission statement provides a path to realize the vision in line with its values. These statements have a direct bearing on the bottom line and success of the organization.

Which comes first? The mission statement or the vision statement? That depends. If you have a new start up business, new program or plan to re-engineer your current services, then the vision will guide the mission statement and the rest of the strategic plan. If you have an established business where the mission is established, then many times, the mission guides the vision statement and the rest of the strategic plan. Either way, you need to know your fundamental purpose - the mission, your current situation in terms of internal resources and capabilities (strengths and/or weaknesses) and external conditions (opportunities and/or threats), and where you want to go - the vision for the future. It's important that you keep the end or desired result in sight from the start.

2.1 Vision

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.

Vision defines the desired or intended future state of a specific organization or enterprise in terms of its fundamental objective and/or strategic direction. Vision is the ability to think about the future with imagination or wisdom.

2.1.1 Characteristics of a Vision Statement

Features of an effective vision statement include:
- Clarity and lack of ambiguity
- Vivid and clear picture
- Description of a bright future
- Memorable and engaging wording
- Realistic aspirations
- Alignment with organizational values and culture

2.1.2 Vision Statement Components

Specific questions that help form strategic visions:
- What business are we in now?
- What business do we want to be in?
- What will our customers want in future?
- What are expectations of our stakeholders?
- Who will be our future competitors? suppliers? partners?
- What should our competitive scope be?
- How will technology impact our industry?
- What environmental scenarios are possible?

To become really effective, an organizational vision statement must become assimilated into the organization's culture. Leaders have the responsibility of communicating the vision regularly, creating narratives that illustrate the vision, acting as role-models by embodying the vision, creating short-term objectives compatible with the vision, and encouraging others to craft their own personal vision compatible with the organization's overall vision.

2.1.3 Vision Statement Examples

Stokes Eye Clinic in Florence, South Carolina, is "Our vision is to take care of your vision." (Author comment: excellent statement in one single sentence)

Tyson Foods vision is to be the world's first choice for protein solutions while maximizing shareholder value.
(Author comment: Good statement, unless Tyson provides nonprotein products)

General Motors vision is to be the world leader in transportation products and related services.
(Author comment: Good statement but obviously not followed)

PepsiCos responsibility is to continually improve all aspects of the world in which we operate environment, social, economic creating a better tomorrow than today.
(Author comment: Statement is too vague; it should reveal beverage and food business)

Dells vision is to create a company culture where environmental excellence is second nature.
(Author comment: Statement is too vague; it should reveal computer business in some manner; the word environmental is generally used to refer to natural environment so is unclear in its use here)

The vision of First Reliance Bank is to be recognized as the largest and most profitable bank in South Carolina.
(Author comment: This is a very small, new bank headquartered in Florence, South Carolina, so this goal is not achievable in five years; the statement is too futuristic)

Samsonites vision is to provide innovative solutions for the traveling world.
(Author comment: Statement needs to be more specific, perhaps mention luggage; statement as is could refer to air carriers or cruise lines, which is not good)

Royal Caribbeans vision is to empower and enable our employees to deliver the best vacation experience for our guests, thereby generating superior returns for our shareholders and enhancing the well- being of our communities.
(Author comment: Statement is good, but could end after the word guests)

Procter & Gambles vision is to be, and be recognized as, the best consumer products company in the world.
(Author comment: Statement is too vague and readability is not that good)

Podcasts on Vision Statements :
http://ecorner.stanford.edu/authorMaterialInfo.html?mid=1732
http://ecorner.stanford.edu/authorMaterialInfo.html?mid=1201
http://ecorner.stanford.edu/authorMaterialInfo.html?mid=2221
http://ecorner.stanford.edu/authorMaterialInfo.html?mid=1392
http://ecorner.stanford.edu/authorMaterialInfo.html?mid=915
http://ecorner.stanford.edu/authorMaterialInfo.html?mid=2237

2.3 Mission

Rarick and Vitton found that firms with a formalized mission statement have twice the average return on shareholders' equity than those firms without a formalized mission statement have; Bart and Baetz found a positive relationship between mission statements and organizational performance; BusinessWeek reports that firms using mission statements have a 30 percent higher return on certain financial measures than those without such statement.[9]

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.

2.3.1 Characteristics of a Mission Statement

In addition to being broad in scope, an effective mission statement should not be too lengthy; recommended length is less than 250 words. An effective mission statement should arouse positive feelings and emotions about an organization; it should be inspiring in the sense that it motivates readers to action. A mission statement should be enduring.

- Broad in scope
- Less than 250 words in length
- Inspiring
- Identify the utility of a firms products
- Reveal that the firm is socially responsible
- Reveal that the firm is environmentally responsible
- Include nine components: customers, products or services, markets, technology, concern for survival/ growth/ profits, philosophy, self- concept, concern for public image, concern for employees
- Enduring

All of the above are desired characteristics of a statement. An effective mission statement generates the impression that a firm is successful, has direction, and is worthy of time, support, and investment from all socioeconomic groups of people.

2.3.2 Mission Statement Components

Mission statements can and do vary in length, content, format, and specificity. Because a mission statement is often the most visible and public part of the strategic management process, it is important that it includes all of these essential 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?

A mission statement is a brief written statement of the purpose of a company or organization, basically describing why it exists. Ideally, a mission statement guides the actions of the organization, spells out its overall goal, provides a sense of direction, and guides decision making for all levels of management.

A mission statement defines the fundamental purpose of an organization or an enterprise,

Generally shorter mission statements are more effective than longer ones.

2.3.3 Mission Statement Examples

Computer Sciences Corporation
CSC's mission is to use our extensive IT experience to deliver tangible business results enabling our clients in industry and government to profit from the advanced use of technology. We strive to build long-term client relationships based on mutual trust and respect.

ConocoPhillips
An oil, gas and energy company, ConocoPhillips produces and explores petroleum sources, on top of supplying natural gas, chemicals and plastics in over 40 countries worldwide. Aside from this, ConocoPhillips is also into fuel technology, gas-to-liquids, power generation, etc.

Dole Food Company
Dole Food Company, Inc. is committed to supplying the consumer and our customers with the finest, high-quality products and to leading the industry in nutrition research and education. Dole supports these goals with a corporate philosophy of adhering to the highest ethical conduct in all its business dealings, treatment of its employees, and social and environmental policies.

Harley-Davidson, Inc
We fulfill dreams through the experience of motorcycling, by providing to motorcyclists and to the general public an expanding line of motorcycles and branded products and services in selected market segments.

Microsoft
At Microsoft, we work to help people and businesses throughout the world realize their full potential. This is our mission. Everything we do reflects this mission and the values that make it possible.

NIKE Inc
To Bring Inspiration and innovation to every athlete in the world.

The Walt Disney Company

The mission of The Walt Disney Company is to be one of the world's leading producers and providers of entertainment and information. Using our portfolio of brands to differentiate our content, services and consumer products, we seek to develop the most creative, innovative and profitable entertainment experiences and related products in the world.

Podcast from Standford University:
http://ecorner.stanford.edu/speakersAuthors.html

Mission Statement
http://ecorner.stanford.edu/authorMaterialInfo.html?mid=1172
http://ecorner.stanford.edu/authorMaterialInfo.html?mid=1521
http://ecorner.stanford.edu/authorMaterialInfo.html?mid=364
http://ecorner.stanford.edu/authorMaterialInfo.html?mid=1457

3 The External Assessment

This chapter 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.

3.1 The Nature of an External Audit

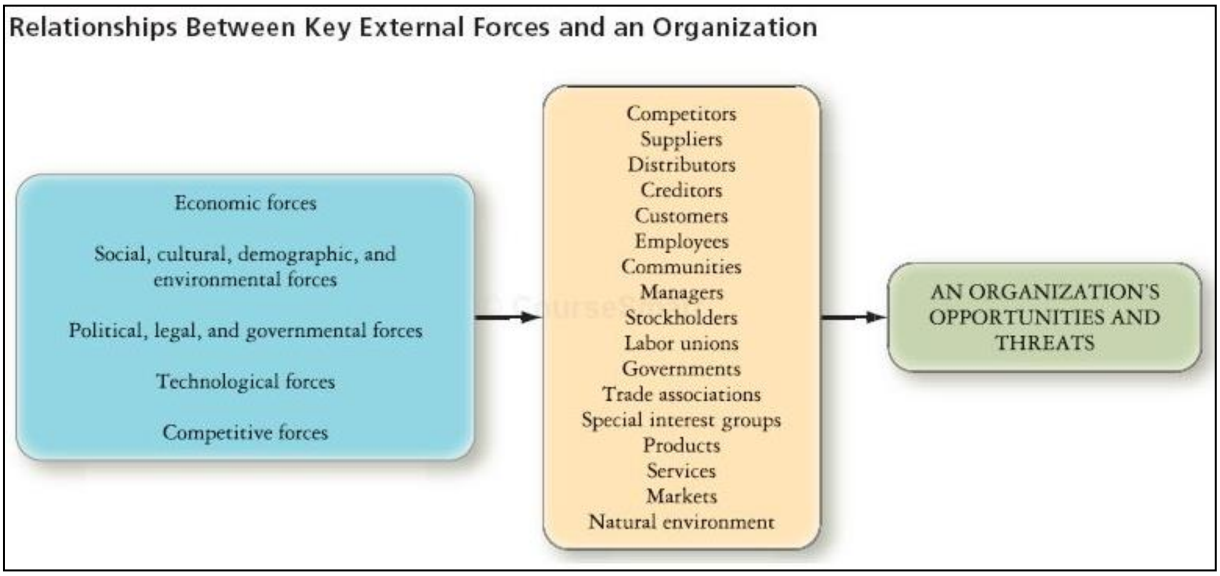
The purpose of an external audit is to develop a finite list of opportunities that could benefit a firm and threats that should be avoided. As the term finite suggests, the external audit is not aimed at developing an exhaustive list of every possible factor that could influence the business; rather, 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.

3.1.1 Key External Forces

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
5. Competitive forces

Changes in external forces translate into changes in consumer demand for both industrial and consumer products and services.
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.



3.2 The Process of Performing an External Audit

The process of performing an external audit must involve as many managers and employees as possible. As emphasized earlier, 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.

3.3 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.

Key Economic Variables to Be Monitored:

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

3.4 Social, Cultural, Demographic, and Environmental Forces

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.

The United States is getting older and less Caucasian. The oldest members of Americas 76 million baby boomers plan to retire in 2011, and this has lawmakers and younger taxpayers deeply concerned about who will pay their Social Security, Medicare, and Medicaid. Individuals age 65 and older in the United States as a percent of the population will rise to 18.5 percent by 2025. By the year 2075, the United States will have no racial or ethnic majority. This forecast is aggravating tensions over issues such as immigration and affirmative action. Hawaii, California, and New Mexico already have no majority race or ethnic group.

The population of the world surpassed 6.8 billion in 2008; the United States has just over 300 million people. That leaves billions of people outside the United States who may be interested in the products and services produced through domestic firms. Remaining solely domestic is an increasingly risky strategy, especially as the world population continues to grow to an estimated 8 billion in 2028 and 9 billion in 2054.

There are now more American households with people living alone or with unrelated people than there are households consisting of married couples with children. American households are making more and more purchases online.

By 2050, the Census Bureau projects that the number of Americans age 100 and older will increase to over 834,000 from just under 100,000 centenarians in the United States in 2000. Americans age 65 and over will increase from 12.6 percent of the U. S. population in 2000 to 20.0 percent by the year 2050. The aging American population affects the strategic orientation of nearly all organizations. Individuals age 65 and older in the United States comprise 13 percent of the total population; Japans elderly population ratio is 17 percent, and Germanys is 19 percent.

Hard number data related to this information can represent key opportunities for many firms and thus can be essential for successful strategy formulation, including where to locate new plants and distribution centers and where to focus marketing efforts.

Key Social, Cultural, Demographic, and Environmental Variables:
- Childbearing rates
- Number of special-interest groups
- Number of marriages
- Number of divorces
- Number of births
- Number of deaths
- Immigration and emigration rates
- Social Security programs
- Life expectancy rates
- Per capita income
- Location of retailing, manufacturing, and service businesses
- Attitudes toward business
- Lifestyles
- Traffic congestion
- Inner-city environments
- Average disposable income
- Trust in government
- Attitudes toward government
- Attitudes toward work
- Buying habits
- Ethical concerns
- Attitudes toward saving
- Sex roles
- Attitudes toward investing
- Racial equality
- Use of birth control
- Average level of education

- Government regulation
- Attitudes toward retirement
- Attitudes toward leisure time
- Attitudes toward product quality
- Attitudes toward customer service
- Pollution control
- Attitudes toward foreign peoples
- Energy conservation
- Social programs
- Number of churches
- Number of church members
- Social responsibility
- Attitudes toward careers
- Population changes by race, age, sex, and level of affluence
- Attitudes toward authority
- Population changes by city, county, state, region, and country
- Value placed on leisure time
- Regional changes in tastes and preferences
- Number of women and minority workers
- Number of high school and college graduates by geographic area
- Recycling
- Waste management
- Air pollution
- Water pollution
- Ozone depletion
- Endangered species

3.5 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.

In Europe, many large multinational firms such as John Deere, Polo Ralph Lauren, Gillette, Cargill, and General Mills are moving their headquarters from France, Netherlands, and Germany to Switzerland and Ireland to avoid costs associated with tax harmonization. About 650 U. S. companies already have operations in Switzerland.

Some Political, Governmental, and Legal Variables:
- Government regulations or deregulations
- Changes in tax laws
- Special tariffs
- Political action committees
- Voter participation rates
- Number, severity, and location of government protests
- Number of patents
- Changes in patent laws

- Environmental protection laws
- Level of defense expenditures
- Legislation on equal employment
- Level of government subsidies
- Antitrust legislation
- Sino-American relationships
- Russian-American relationships
- European-American relationships
- African-American relationships
- Import export regulations
- Government fiscal and monetary policy changes
- Political conditions in foreign countries
- Special local, state, and federal laws
- Lobbying activities
- Size of government budgets
- World oil, currency, and labor markets
- Location and severity of terrorist activities
- Local, state, and national elections

A world market has emerged from what previously was a multitude of distinct national markets, and the climate for international business today is much more favorable than yesterday. Mass communication and high technology are creating similar patterns of consumption in diverse cultures worldwide. This means that many companies may find it difficult to survive by relying solely on domestic markets.

3.6 Technological Forces

The Internet is acting as a national and global economic engine that is spurring productivity, a critical factor in a country’s ability to improve living standards; and it is saving companies billions of dollars in distribution and transaction costs from direct sales to self-service systems.

The Internet is changing 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.

To effectively capitalize on e-commerce, a number of organizations are establishing two new positions in their firms: chief information officer (CIO) and chief technology officer (CTO). This trend reflects the growing importance of information technology (IT) in strategic management

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.

Organizations that traditionally have limited technology expenditures to what they can fund after meeting marketing and financial requirements urgently need a reversal in thinking. The pace of technological change is increasing and literally wiping out businesses every day.

Firms should pursue strategies that take advantage of technological opportunities to achieve sustainable, competitive advantages in the marketplace.

In practice, critical decisions about technology too often are delegated to lower organizational levels or are made without an understanding of their strategic implications.

For strategists in industries affected by rapid technological change, identifying and evaluating technological opportunities and threats can represent the most important part of an external audit.

3.7 Competitive Forces

An important part of an external audit is identifying rival firms and determining their strengths, weaknesses, capabilities, opportunities, threats, objectives, and strategies.

Key questions about competitors:
1. What are the major competitor’s strengths?
2. What are the major competitor’s weaknesses?
3. What are the major competitor’s 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? Why have these rankings changed that way?
11. What is the nature of supplier and distributor relationships in this industry?
12. To what extent could substitute products or services be a threat to competitors in this industry?

Seven characteristics describe the most competitive companies:

1. Market share matters; the 90th share point isn't as important as the 91st, and nothing is more dangerous than falling to 89.
2. Understand and remember precisely what business you are in.
3. Whether its broke or not, fix it make it better; not just products, but the whole company, if necessary.
4. Innovate or evaporate; particularly in technology- driven businesses, nothing quite recedes like success.
5. Acquisition is essential to growth; the most successful purchases are in niches that add a technology or a related market.
6. People make a difference; tired of hearing it? Too bad.
7. There is no substitute for quality and no greater threat than failing to be cost-competitive on a global basis.

These are complementary concepts, not mutually exclusive ones.[10]

3.7.1 Competitive Intelligence Programs

Competitive intelligence (CI), is a systematic and ethical process for gathering and analyzing information about the competitions 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 competitor's weaknesses can represent external opportunities; major competitor's strengths may represent key threats.

According to BusinessWeek, there are more than 5,000 corporate spies now actively engaged in intelligence activities, and 9 out of 10 large companies have employees dedicated solely to gathering competitive intelligence.[11] The article contends that many large US companies spend more than $ 1 million annually tracking their competitors. Evidence suggests that the benefits of corporate spying include increased revenues, lower costs, and better decision making.

The Internet has become an excellent medium for gathering competitive intelligence. Information gathering from employees, managers, suppliers, distributors, customers, creditors, and consultants also can make the difference between having superior or just average intelligence and overall competitiveness.

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

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

Competitive intelligence is not corporate espionage because 95 percent of the information a company needs to make strategic decisions is available and accessible to the public. 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.

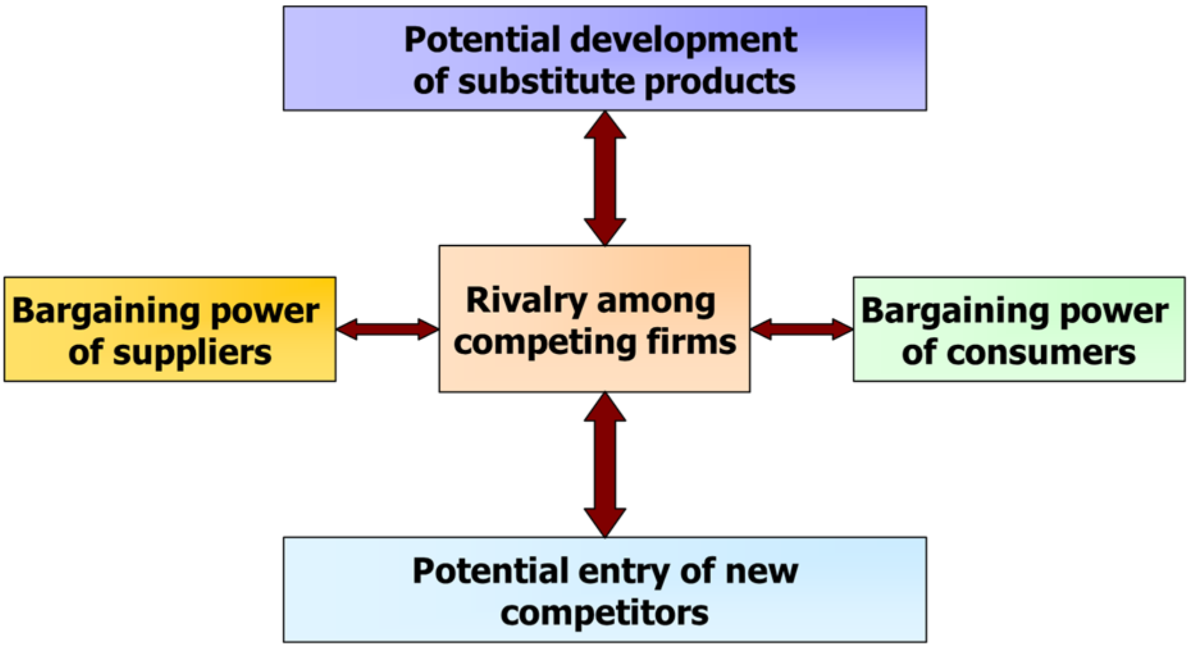
3.7.2 Cooperation Among Competitors

Cooperative agreements between competitors are becoming popular. 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. [12] 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.
Firms are moving to compete as groups within alliances more and more as it becomes increasingly difficult to survive alone in some industries.
Joint ventures and cooperative arrangements among competitors demand a great amount of trust.
U. S. companies often enter alliances primarily to avoid investments, being more interested in reducing the costs and risks of entering new businesses or markets than in acquiring new skills. In contrast, learning from the partner is a major reason why Asian and European firms enter into cooperative agreements.

3.7.3 Competitive Analysis: Porters Five- Forces Model

Rivalry among existing firms is severe, new rivals can enter the industry with relative ease, and both suppliers and customers can exercise considerable bargaining leverage.

According to Porter, the nature of competitiveness in a given industry can be viewed as a composite of five forces:
1. Rivalry among competing firms
2. Potential entry of new competitors
3. Potential development of substitute products
4. Bargaining power of suppliers
5. Bargaining power of consumers



The following three steps for using Porters Five- Forces Model can reveal whether competition in a given industry is such that the firm can make an acceptable profit:

1. Identify key aspects or elements of each competitive force that impact the firm.
2. Evaluate how strong and important each element is for the firm.
3. Decide whether the collective strength of the elements is worth the firm entering or staying in the industry.

1.1.1.1 Rivalry among Competing Firms

Rivalry among competing firms is usually the most powerful of the five competitive forces. Changes in strategy by one firm may be met with retaliatory countermoves, such as lowering prices, enhancing quality, adding features, providing services, extending warranties, and increasing advertising.

The intensity of rivalry among competing firms tends to increase

- as the number of competitors increases
- as competitors become more equal in size and capability
- as demand for the industry's products declines
- as price cutting becomes common

Rivalry also increases when

- consumers can switch brands easily;
- barriers to leaving the market are high;
- fixed costs are high;
- the product is perishable;
- consumer demand is growing slowly or declines such that rivals have excess capacity and/ or inventory;
- the products being sold are commodities (not easily differentiated such as gasoline);
- rival firms are diverse in strategies, origins, and culture;
- merger's and acquisitions are common in the industry.

As rivalry among competing firms intensifies, industry profits decline, in some cases to the point where an industry becomes inherently unattractive.

Rivalry in the automobile industry is fierce. As Ford and General Motors market shares steadily decline, Toyota and Honda have stepped up their marketing and production efforts in the United States. Toyota is currently building its eighth North American assembly plant, in the southeast United States. Toyotas new plant starts production in 2009 and has a capacity of 200,000 vehicles annually. Ford and GM are both losing money in their North American auto operations. When rival firms sense weakness, typically they will intensify both marketing and production efforts to capitalize on the "opportunity."

1.1.1.2 Potential Entry of New Competitors

Whenever new firms can easily enter a particular industry, the intensity of competitiveness among firm's increases. Barriers to entry, however, can include

- the need to gain economies of scale quickly,
- the need to gain technology and specialized know-how,
- the lack of experience,

- strong customer loyalty,
- strong brand preferences,
- large capital requirements,
- lack of adequate distribution channels,
- government regulatory policies, tariffs,
- the lack of access to raw materials,
- possession of patents,
- undesirable locations,
- counterattack by entrenched firms,
- potential saturation of the market

Despite numerous barriers to entry, new firms sometimes enter industries with higher-quality products, lower prices, and substantial marketing resources. The strategist's job, therefore, is to identify potential new firms entering the market, to monitor the new rival firm's strategies, to counterattack as needed, and to capitalize on existing strengths and opportunities.

When the threat of new firms entering the market is strong, incumbent firms generally fortify their positions and take actions to deter new entrants, such as

- lowering prices,
- extending warranties,
- adding features, or
- offering financing specials.

1.1.1.3 Potential Development of Substitute

The presence of substitute products puts a ceiling on the price that can be charged before consumers will switch to the substitute product. Price ceilings equate to profit ceilings and more intense competition among rivals.

Producers of eyeglasses and contact lenses, for example, face increasing competitive pressures from laser eye surgery. Producers of sugar face similar pressures from artificial sweeteners.

Competitive pressures arising from substitute products increase as the relative price of substitute products declines and as consumers switching costs decrease.

1.1.1.4 Bargaining Power of Suppliers

The bargaining power of suppliers affects the intensity of competition in an industry, especially under following conditions:

- large number of suppliers
- only a few good substitute raw materials
- cost of switching raw materials is especially costly

It is often in the best interest of both suppliers and producers to assist each other with reasonable prices, improved quality, development of new services, just-in-time deliveries, and reduced inventory costs, thus enhancing long-term profitability for all concerned.

In more and more industries, sellers are forging strategic partnerships with select suppliers in efforts to

- reduce inventory and logistics costs (e. g., through just- in- time deliveries)
- speed the availability of next-generation components
- enhance the quality of the parts and components being supplied and reduce defect rates
- squeeze out important cost savings for both themselves and their suppliers

Firms may pursue a backward integration strategy to gain control or ownership of suppliers. This strategy is especially effective when suppliers are:
- unreliable
- too costly
- not capable of meeting a firms needs on a consistent basis

1.1.1.5 Bargaining Power of Consumers

When customers are concentrated or large or buy in volume, their bargaining power represents a major force affecting the intensity of competition in an industry.

Rival firms may offer extended warranties or special services to gain customer loyalty whenever the bargaining power of consumers is substantial.
Bargaining power of consumers also is higher when the products being purchased are standard or undifferentiated. When this is the case, consumers often can negotiate selling price, warranty coverage, and accessory packages to a greater extent.

The bargaining power of consumers can be the most important force affecting competitive advantage. Consumers gain increasing bargaining power under the following circumstances:

1. If they can inexpensively switch to competing brands or substitutes
2. If they are particularly important to the seller
3. If sellers are struggling in the face of falling consumer demand
4. If they are informed about sellers products, prices, and costs
5. If they have discretion in whether and when they purchase the product

3.9 Forecasting Tools and Techniques

Forecasts are educated assumptions about future trends and events.
Many publications and sources on the Internet forecast external variables. The reputation and continued success of these publications depend partly on accurate forecasts.

- Industry Weeks “Trends and Forecasts”
- BusinessWeeks “Investment Outlook”
- Standard & Poors Industry Survey
- Bank’s quarterly survey (UBS, CS, Bank Vontobel, etc.)
- KOF Konjunkturforschungsstelle ETH (www.kof.ethz.ch)
- SECO State Secretariat for Economic Affairs (www.seco.admin.ch)
- IMF International Monetary Fund (www.imf.org)
- OECD Organization for Economic Co-operation and Development (www.oecd.org)
- yahoo.com (Just insert a firms stock symbol and go from there)

Sometimes organizations must develop their own projections. Most organizations forecast (project) their own revenues and profits annually. Organizations sometimes forecast market share or customer loyalty in local areas.

Forecasting tools can be broadly categorized into two groups:
- quantitative techniques
- qualitative techniques.

Quantitative forecasts are most appropriate when historical data are available and when the relationships among key variables are expected to remain the same in the future. Linear regression, for example, is based on the assumption that the future will be just like the past which, of course, it never is. As historical relationships become less stable, quantitative forecasts become less accurate.

3.10 Industry Analysis: The External Factor Evaluation (EFE) Matrix

An External Factor Evaluation (EFE) Matrix allows to summarize and evaluate economic, social, cultural, demographic, environmental, political, governmental, legal, technological, and competitive information. 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 10 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.
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 firms 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 firms 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 factors 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.

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 firms 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 firms strategies are not capitalizing on opportunities or avoiding external threats.

EFE Matrix for a Local Ten- Theatre Cinema Complex:

Key External Factors	Weight	Rating	Weighted Score
Opportunities			
1. Rowan County is growing 8% annually in population	0.05	3	0.15
2. TDB University is expanding 6% annually	0.08	4	0.32
3. Major competitor across town recently ceased operations	0.08	3	0.24
4. Demand for going to cinema growing 10% annually	0.07	2	0.14
5. Two new neighborhoods being developed within 3 miles	0.09	1	0.09
6. 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
Threats			
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
Total	**1.00**		**2.58**

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.

3.11 The Competitive Profile Matrix (CPM)

The Competitive Profile Matrix (CPM) identifies a firms major competitors and its particular strengths and weaknesses in relation to a sample firms 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.
An Example Competitive Profile Matrix:

		Company 1		Company 2		Company 3	
Critical Success Factors	Weight	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
Total	**1.00**		**3.15**		**2.50**		**2.70**

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 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.

4 The Internal Assessment

4.1 The Nature of an Internal Audit

The internal assessment focuses on identifying and evaluating a firms strengths and weaknesses in the functional areas of business, including management, marketing, finance/ accounting, production/ operations, research and development, and management information systems.
All organizations have strengths and weaknesses in the functional areas of business. 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.

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 firms weaknesses, turning them into strengths and maybe even into distinctive competencies.

4.1.1 The Process of Performing an Internal Audit

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 firms 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 as described in Chapter 4 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.
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 firms operations. Critical success factors, consisting of both strengths and weaknesses, can be identified and prioritized.

4.2 Integrating Strategy and Culture

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. 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.[13]

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 organizations 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. 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.

4.2.1 Foreign Culture

To successfully compete in world markets, managers must obtain a better knowledge of historical, cultural, and religious forces that motivate and drive people in other countries.

Cultural Pitfalls That You Need to Know:

- Waving is a serious insult in Greece and Nigeria, particularly if the hand is near someone's face.
- Making a good- bye wave in Europe can mean No, but it means Come here in Peru.
- In China, last names are written first.
- A man named Carlos Lopez- Garcia should be addressed as Mr. Lopez in Latin America, but as Mr. Garcia in Brazil.
- Breakfast meetings are considered uncivilized in most foreign countries.
- Latin Americans are on average 20 minutes late to business appointments.
- Direct eye contact is impolite in Japan.
- Don't cross your legs in any Arab or many Asian countries its rude to show the sole of your shoe.
- In Brazil, touching your thumb and first finger an American Okay sign is the equivalent of raising your middle finger.
- Nodding or tossing your head back in southern Italy, Malta, Greece, and Tunisia means "No." In India, this body motion means Yes.
- Snapping your fingers is vulgar in France and Belgium.
- Folding your arms across your chest is a sign of annoyance in Finland.
- In China, leave some food on your plate to show that your host was so generous that you couldn't finish.
- Do not eat with your left hand when dining with clients from Malaysia or India.
- One form of communication works the same worldwide. It's the smile so take that along wherever you go.

4.3 Management

The functions of management consist of five basic activities: planning, organizing, motivating, staffing, and controlling.

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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4.3.1 Planning

The only thing certain about the future of any organization is change, and planning is the essential bridge between the present and the future that increases the likelihood of achieving desired results.
Planning is the process by which one determines whether to attempt a task, works out the most effective way of reaching desired objectives, and prepares to over-come unexpected difficulties with adequate resources. Planning is the start of the process by which an individual or business may turn empty dreams into achievements. Planning enables one to avoid the trap of working extremely hard but achieving little.

Why planning?

- Planning is an up-front investment in success.
- Planning helps a firm achieve maximum effect from a given effort.
- Planning enables a firm to take into account relevant factors and focus on the critical ones.

- Planning helps ensure that the firm can be prepared for all reasonable eventualities and for all changes that will be needed.
- Planning enables a firm to gather the resources needed and carry out tasks in the most efficient way possible.
- Planning enables a firm to conserve its own resources, avoid wasting ecological resources, make a fair profit, and be seen as an effective, useful firm.
- Planning enables a firm to identify precisely what is to be achieved and to detail precisely the who, what, when, where, why, and how needed to achieve desired objectives.
- Planning enables a firm to assess whether the effort, costs, and implications associated with achieving desired objectives are warranted.

Planning is the cornerstone of effective strategy formulation. But even though it is considered the foundation of management, it is commonly the task that managers neglect most. Planning is essential for successful strategy implementation and strategy evaluation, largely because organizing, motivating, staffing, and controlling activities depend upon good planning.

The process of planning must involve managers and employees throughout an organization. The time horizon for planning decreases from two to five years for top-level to less than six months for lower-level managers. The important point is that all managers do planning and should involve subordinates in the process to facilitate employee understanding and commitment.

Planning can have a positive impact on organizational and individual performance. Planning allows an organization to identify and take advantage of external opportunities as well as minimize the impact of external threats. Planning is more than extrapolating from the past and present into the future. It also includes developing a mission, forecasting future events and trends, establishing objectives, and choosing strategies to pursue.

Planning allows a firm to adapt to changing markets and thus to shape its own destiny. Strategic management can be viewed as a formal planning process that allows an organization to pursue proactive rather than reactive strategies. Successful organizations strive to control their own futures rather than merely react to external forces and events as they occur. Historically, organisms and organizations that have not adapted to changing conditions have become extinct. Swift adaptation is needed today more than ever because changes in markets, economies, and competitors worldwide are accelerating.

4.3.2 Organizing

The purpose of organizing is to achieve coordinated effort by defining task and authority relationships. Organizing means determining who does what and who reports to whom.

A well-organized firm generally has motivated managers and employees who are committed to seeing the organization succeed. Resources are allocated more effectively and used more efficiently in a well-organized firm than in a disorganized firm. The organizing function of management can be viewed as consisting of three sequential activities:

1. **Breaking down tasks into jobs** (work specialization) requires the development of job descriptions and job specifications. These tools clarify for both managers and employees what particular jobs entail.
2. **Combining jobs to form departments** (departmentalization) results in an organizational structure, span of control, and a chain of command. Organizational structure dictates how

resources are allocated and how objectives are established in a firm. The most common forms of departmentalization are functional, divisional, strategic business unit, and matrix.

3. **Delegating authority** an important organizing activity. Employees today are more educated and more capable of participating in organizational decision making than ever before. In most cases, they expect to be delegated authority and responsibility and to be held accountable for results.

4.3.3 Motivating

Motivating can be defined as the process of influencing people to accomplish specific objectives. Motivation explains why some people work hard and others do not.

Objectives, strategies, and policies have little chance of succeeding if employees and managers are not motivated to implement strategies once they are formulated. The motivating function of management includes at least four major components: leadership, group dynamics, communication, and organizational change.

When managers and employees of a firm strive to achieve high levels of productivity, this indicates that the firm’s strategists are good leaders. Good leaders establish rapport with subordinates, empathize with their needs and concerns, set a good example, and are trustworthy and fair.
Leadership includes developing a vision of the firms future and inspiring people to work hard to achieve that vision. Kirkpatrick and Locke reported that certain traits also characterize effective leaders: knowledge of the business, cognitive ability, self-confidence, honesty, integrity, and drive.
Research suggests that democratic behavior on the part of leaders results in more positive attitudes toward change and higher productivity than does autocratic behavior.

Drucker said:
Leadership is not a magnetic personality. That can just as well be demagoguery. It is not “making friends and influencing people.” That is flattery. Leadership is the lifting of a person’s vision to higher sights, the raising of a person’s performance to a higher standard, the building of a person’s personality beyond its normal limitations.

Group dynamics play a major role in employee morale and satisfaction. Informal groups or coalitions form in every organization. The norms of coalitions can range from being very positive to very negative toward management. It is important, therefore, that strategists identify the composition and nature of informal groups in an organization to facilitate strategy formulation, implementation, and evaluation. Leaders of informal groups are especially important in formulating and implementing strategy changes.

Communication, perhaps the most important word in management, is a major component in motivation. An organizations system of communication determines whether strategies can be implemented successfully. Good two-way communication is vital for gaining support for departmental and divisional objectives and policies. Top-down communication can encourage bottom-up communication. The strategic-management process becomes a lot easier when subordinates are encouraged to discuss their concerns, reveal their problems, provide recommendations, and give suggestions. A primary reason for instituting strategic management is to build and support effective communication networks through-out the firm.

4.3.4 Staffing

The management function of staffing, also called personnel management or human resource management, includes activities such as recruiting, interviewing, testing, selecting, orienting, training, developing, caring for, evaluating, rewarding, disciplining, promoting, transferring, demoting, and dismissing employees, as well as managing union relations.

Staffing activities play a major role in strategy-implementation efforts, and for this reason, human resource managers are becoming more actively involved in the strategic-management process. It is important to identify strengths and weaknesses in the staffing area.

The complexity and importance of human resource activities have increased to such a degree that all but the smallest organizations now need a full-time human resource manager. The human resources department coordinates staffing decisions in the firm so that an organization as a whole meets legal requirements. This department also provides needed consistency in administering company rules, wages, and policies.

Strategists are becoming increasingly aware of how important human resources are to effective strategic management. Human resource managers are becoming more involved and more proactive in formulating and implementing strategies. They provide leadership for organizations that are restructuring, or they allow employees to work at home.

4.3.5 Controlling

The controlling function of management includes all of those activities undertaken to ensure that actual operations conform to planned operations. All managers in an organization have controlling responsibilities, such as conducting performance evaluations and taking necessary action to minimize inefficiencies. The controlling function of management is particularly important for effective strategy evaluation.

Controlling consists of four basic steps:
1. Establishing performance standards
2. Measuring individual and organizational performance
3. Comparing actual performance to planned performance standards
4. Taking corrective actions

Measuring individual performance is often conducted ineffectively or not at all in organizations. Some reasons for this shortcoming are that evaluations can create confrontations that most managers prefer to avoid, can take more time than most managers are willing to give, and can require skills that many managers lack. No single approach to measuring individual performance is without limitations.
For this reason, an organization should examine various methods, such as the graphic rating scale, the behaviorally anchored rating scale, and the critical incident method, and then develop or select a performance-appraisal approach that best suits the firms needs. Increasingly, firms are striving to link organizational performance with managers and employees pay.

4.3.6 Management Audit Checklist of Questions

The following checklist of questions can help determine specific strengths and weaknesses in the functional area of business. An answer of no to any question could indicate a potential weakness, although the strategic significance and implications of negative answers, of course, will vary by organization, industry, and severity of the weakness. Positive or yes answers to the checklist questions suggest potential areas of strength.

1. Does the firm use strategic-management concepts?
2. Are company objectives and goals measurable and well communicated?
3. Do managers at all hierarchical levels plan effectively?
4. Do managers delegate authority well?
5. Is the organizations structure appropriate?
6. Are job descriptions and job specifications clear?
7. Is employee morale high?
8. Are employee turnover and absenteeism low?
9. Are organizational reward and control mechanisms effective?

4.4 Marketing

Marketing can be described as the process of defining, anticipating, creating, and fulfilling customer’s 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
7. Opportunity analysis.

4.4.1 Customer Analysis

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 customer’s needs and wants. Successful organizations continually monitor present and potential customers buying patterns.

4.4.2 Selling Products/ Services

Selling includes many marketing activities, such as advertising, sales promotion, publicity, personal selling, sales force management, customer relations, and dealer relations. 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.
Advertising on television is declining dramatically while Internet advertising is growing rapidly. Newspaper advertising declined 2.4 percent in 2006 while magazine advertising rose 3.8 percent.[14]

4.4.3 Product and Service Planning

Product and service planning includes activities such as test marketing; product and brand positioning; devising warranties; packaging; determining product options, product features, product style, and product 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.

4.4.4 Pricing

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.
Intense price competition coupled with Internet price- comparative shopping in most industries has reduced profit margins to bare minimum levels for most companies.

4.4.5 Distribution

Distribution includes warehousing, distribution channels, distribution coverage, retail site locations, sales territories, inventory levels and location, transportation carriers, wholesaling, and retailing.

4.4.6 Marketing Research

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.

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.”

4.4.7 Opportunity Analysis

Opportunity analysis 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
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.

4.4.8 Marketing Audit Checklist of Questions

The following questions about marketing are pertinent:

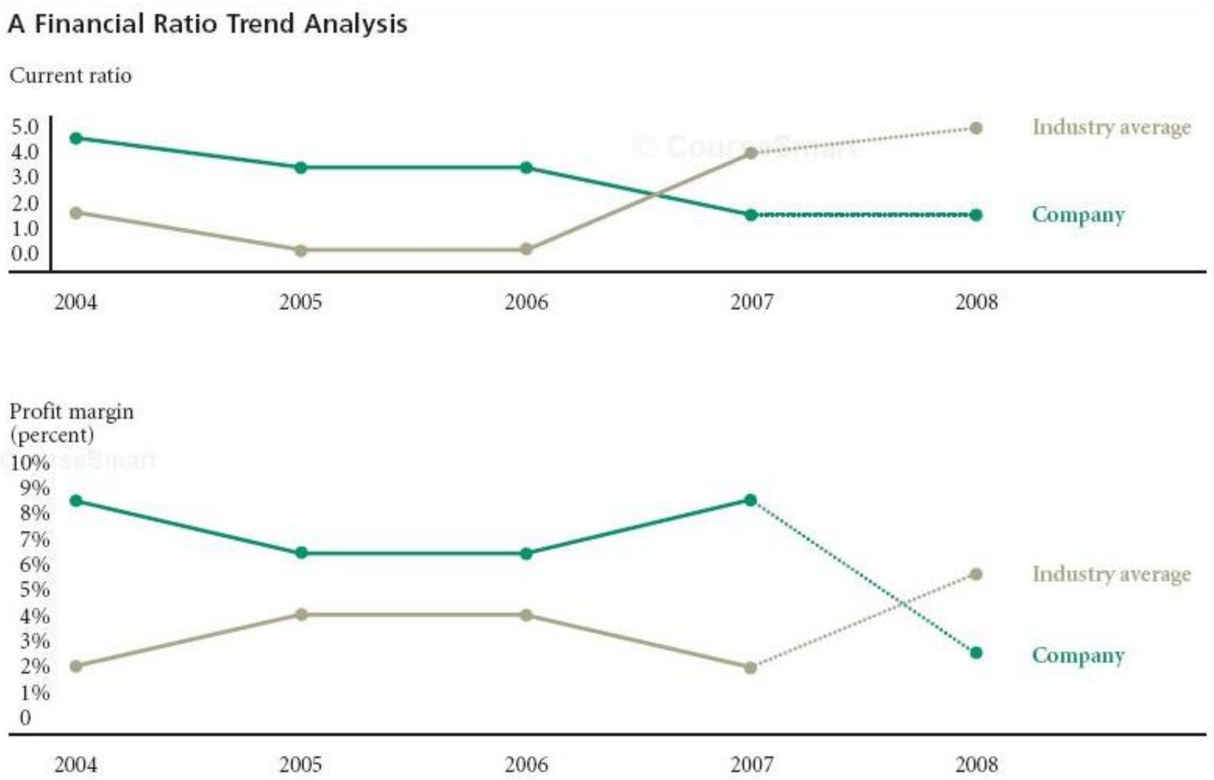
1. Are markets segmented effectively?
2. Is the organization positioned well among competitors?
3. Has the firm's market share been increasing?
4. Are present channels of distribution reliable and cost- effective?
5. Does the firm have an effective sales organization?
6. Does the firm conduct market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

4.5 Finance/ Accounting

Financial condition is often considered the single best measure of a firm's competitive position and overall attractiveness to investors. Determining an organizations 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.

4.5.1 Basic Types of Financial Ratios

Financial ratios are computed from an organizations income statement and balance sheet. Computing financial ratios is like taking a picture because the results reflect a situation at just one point in time. Comparing ratios over time and to industry averages is more likely to result in meaningful statistics that can be used to identify and evaluate strengths and weaknesses. Trend analysis is a useful technique that incorporates both the time and industry average dimensions of financial ratios.



Note that the dotted lines reveal projected ratios. Some Web sites, such as those provided below, calculate financial ratios and provide data with charts.

- http:// marketwatch. multexinvestor. com
- http:// moneycentral. msn. com
- http:// finance. yahoo.com www. clearstation. com
- https:// us. etrade. com/ e/ t/
- https://us.etrade.com/e/t/ invest/ markets

Four major sources of industry-average financial ratios follow:

1. Dun & Bradstreets: Industry Norms and Key Business Ratios Fourteen different ratios are calculated in an industry- average format for 800 different types of businesses. The ratios are presented by Standard Industrial Classification (SIC) number and are grouped by annual sales into three size categories.
2. Robert Morris Associates Annual Statement Studies: Sixteen different ratios are calculated in an industry- average format. Industries are referenced by SIC numbers published by the Bureau of the Census. The ratios are presented in four size categories by annual sales for all firms in the industry.
3. Almanac of Business & Industrial Financial Ratios: Twenty- two financial ratios and percentages are provided in an industry- average format for all major industries. The ratios and percentages are given for 12 different company- size categories for all firms in a given industry.
4. Federal Trade Commission Reports: The FTC publishes quarterly financial data, including ratios on manufacturing companies. FTC reports include analyses by industry group and asset size.

Following table provides a summary of key financial ratios showing how each ratio is calculated and what each ratio measures. However, all the ratios are not significant for all industries and companies.

Ratio	How Calculated	What It Measures
Liquidity Ratios		
Current Ratio	$\frac{\text{Current assets}}{\text{Current liabilities}}$	The extent to which a firm can meet its short-term obligations
Quick Ratio	$\frac{\text{Current assets minus inventory}}{\text{Current liabilities}}$	The extent to which a firm can meet its short-term obligations without relying upon the sale of its inventories
Leverage Ratios		
Debt-to-Total-Assets Ratio	$\frac{\text{Total debt}}{\text{Total assets}}$	The percentage of total funds that are provided by creditors
Debt-to-Equity Ratio	$\frac{\text{Total debt}}{\text{Total stockholders' equity}}$	The percentage of total funds provided by creditors versus by owners
Long-Term Debt-to-Equity Ratio	$\frac{\text{Long-term debt}}{\text{Total stockholders' equity}}$	The balance between debt and equity in a firm's long-term capital structure
Times-Interest-Earned Ratio	$\frac{\text{Profits before interest and taxes}}{\text{Total interest charges}}$	The extent to which earnings can decline without the firm becoming unable to meet its annual interest costs
Activity Ratios		
Inventory Turnover	$\frac{\text{Sales}}{\text{Inventory of finished goods}}$	Whether a firm holds excessive stocks of inventories and whether a firm is slowly selling its inventories compared to the industry average
Fixed Assets Turnover	$\frac{\text{Sales}}{\text{Fixed assets}}$	Sales productivity and plant and equipment utilization
Total Assets Turnover	$\frac{\text{Sales}}{\text{Total assets}}$	Whether a firm is generating a sufficient volume of business for the size of its asset investment
Accounts Receivable Turnover	$\frac{\text{Annual credit sales}}{\text{Accounts receivable}}$	The average length of time it takes a firm to collect credit sales (in percentage terms)
Average Collection Period	$\frac{\text{Accounts receivable}}{\text{Total credit sales/365 days}}$	The average length of time it takes a firm to collect on credit sales (in days)
Profitability Ratios		
Gross Profit Margin	$\frac{\text{Sales minus cost of goods sold}}{\text{Sales}}$	The total margin available to cover operating expenses and yield a profit
Operating Profit Margin	$\frac{\text{Earnings before interest and taxes (EBIT)}}{\text{Sales}}$	Profitability without concern for taxes and interest
Net Profit Margin	$\frac{\text{Net income}}{\text{Sales}}$	After-tax profits per dollar of sales

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Profitability Ratios		
Return on Total Assets (ROA)	$\frac{\text{Net income}}{\text{Total assets}}$	After-tax profits per dollar of assets; this ratio is also called return on investment (ROI)
Return on Stockholders' Equity (ROE)	$\frac{\text{Net income}}{\text{Total stockholders' equity}}$	After-tax profits per dollar of stockholders' investment in the firm
Earnings Per Share (EPS)	$\frac{\text{Net income}}{\text{Number of shares of common stock outstanding}}$	Earnings available to the owners of common stock
Price-Earnings Ratio	$\frac{\text{Market price per share}}{\text{Earnings per share}}$	Attractiveness of firm on equity markets
Growth Ratios		
Sales	Annual percentage growth in total sales	Firm's growth rate in sales
Net Income	Annual percentage growth in profits	Firm's growth rate in profits
Earnings Per Share	Annual percentage growth in EPS	Firm's growth rate in EPS
Dividends Per Share	Annual percentage growth in dividends per share	Firm's growth rate in dividends per share

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1. Liquidity ratios measure a firm's ability to meet maturing short-term obligations.
   Current ratio
   Quick (or acid- test) ratio
2. Leverage ratios measure the extent to which a firm has been financed by debt.
   Debt- to- total- assets ratio
   Debt- to- equity ratio
   Long- term debt-to-equity ratio
   Times- interest-earned (or coverage) ratio
3. Activity ratios measure how effectively a firm is using its resources.
   Inventory turnover
   Fixed assets turnover
   Total assets turnover
   Accounts receivable turnover
   Average collection period
4. Profitability ratios measure managements overall effectiveness as shown by the returns generated on sales and investment.
   Gross profit margin
   Operating profit margin
   Net profit margin
   Return on total assets (ROA)
   Return on stockholder's equity (ROE)
   Earnings per share (EPS)
   Price- earnings ratio
5. Growth ratios measure the firm's ability to maintain its economic position in the growth of the economy and industry.
   Sales
   Net income
   Earnings per share
   Dividends per share

Financial ratio analysis must go beyond the actual calculation and interpretation of ratios. The analysis should be conducted on three separate fronts:

1. **How has each ratio changed over time?**
   This information provides a means of evaluating historical trends. It is important to note whether each ratio has been historically increasing, decreasing, or nearly constant. For example, a 10 percent profit margin could be bad if the trend has been down 20 percent each of the last three years. But a 10 percent profit margin could be excellent if the trend has been up, up, up. Therefore, calculate the percentage change in each ratio from one year to the next to assess historical financial performance on that dimension. Identify and examine large percent changes in a financial ratio from one year to the next.
2. **How does each ratio compare to industry norms?**
   A firm's inventory turnover ratio may appear impressive at first glance but may pale when compared to industry standards or norms. Industries can differ dramatically on certain ratios. For example grocery companies, such as Kroger, have a high inventory turnover whereas automobile dealerships have a lower turnover. Therefore, comparison of a firm's ratios within its particular industry can be essential in determining strength/ weakness.
3. **How does each ratio compare with key competitors?**
   Oftentimes competition is more intense between several competitors in a given industry or location than across all rival firms in the industry. When this is true, financial ratio analysis should include comparison to those key competitors. For example, if a firms profitability ratio is trending up over time and compares favorably to the industry average, but it is trending down relative to its leading competitor, there may be reason for concern.

4.5.2 Finance/ Accounting Audit Checklist

The following finance/ accounting questions 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?

4.6 Production/ Operations

The production/ operations function of a business consists of all those activities that transform inputs into goods and services.

The basic functions of productions management:

1. **Process**: Process decisions concern the design of the physical production system. Specific decisions include choice of technology, facility layout, process flow analysis, facility location, line balancing, process control, and transportation analysis.
2. **Capacity**: Capacity decisions concern determination of optimal output levels for the organization not too much and not too little. Specific decisions include forecasting, facilities planning, aggregate planning, scheduling, capacity planning, and queuing analysis.

3. **Inventory**: Inventory decisions involve managing the level of raw materials, work- in-process, and finished goods. Specific decisions include what to order, when to order, how much to order, and materials handling.
4. **Workforce**: Workforce decisions are concerned with managing the skilled, unskilled, clerical, and managerial employees. Specific decisions include job design, work measurement, job enrichment, work standards, and motivation techniques.
5. **Quality**: Quality decisions are aimed at ensuring that high- quality goods and services are produced. Specific decisions include quality control, sampling, testing, quality assurance, and cost control.

4.6.1 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?

4.7 Research and Development

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. A spirit of partnership and mutual trust between general and R& D managers is evident in the best- managed firms.
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.

4.7.1 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 organizations 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?

4.8 Management Information Systems

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.
A management information systems 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.

Data become information only when they are evaluated, filtered, condensed, analyzed, and organized for a specific purpose, problem, individual, or time.
Benefits of an effective information system include an improved understanding of business functions, improved communications, more informed decision making, a better analysis of problems, and improved control.

4.8.1 Management Information Systems Audit

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

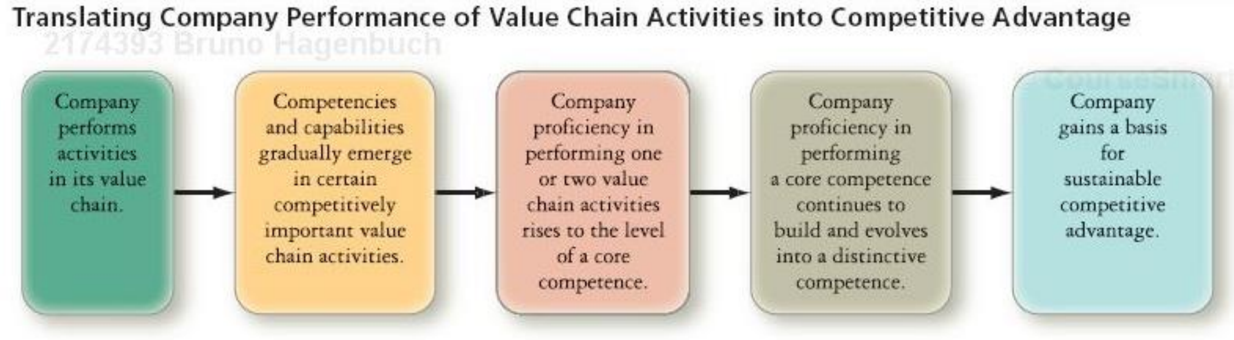
1. Do all managers in the firm use the information system to make decisions?
2. Is there a chief information officer or director of information systems position in the firm?
3. Are data in the information system updated regularly?
4. Do managers from all functional areas of the firm contribute input 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?

4.9 Value Chain Analysis (VCA)

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.

Value Chain Analysis (VCA) aims to identify where low-cost advantages or disadvantages exist anywhere along the value chain from raw material to customer service activities.

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.
Firms should determine where cost advantages and disadvantages in their value chain occur relative to the value chain of rival firms.



Source: Arthur Thompson, Jr., A. J. Strickland III, and John Gamble. *Crafting and Executing Strategy: Text and Readings* (New York: McGraw-Hill/Irwin, 2005): 108. Used by permission of McGraw-Hill.

Benchmarking is an analytical tool used to determine whether a firms 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.

4.10 The Internal Factor Evaluation (IFE) Matrix

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.

Similar to the EFE Matrix and Competitive Profile Matrix, 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.
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 firms 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 factors 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.

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

Key Internal Factors	Weight	Rating	Weighted Score
Strengths			
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
Weaknesses			
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
Total	**1.00**		**2.50**

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.

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 sup-port. 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.

5 Strategies in Action

5.1 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.

5.1.1 The Nature of Long-Term Objectives

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.
Long-term objectives are needed at the corporate, divisional, and functional levels in an organization. They are an important measure of managerial performance.
Clearly stated and communicated objectives are vital to success for many reasons.

5.1.2 Not Managing by Objectives

Strategists should avoid the following alternative ways to "not managing by objectives."

- **Managing by Extrapolation -** adheres to the principle "If it ain't broke, don't fix it." The idea is to keep on doing about the same things in the same ways because things are going well.
- **Managing by Crisis -** based on the belief that the true measure of a really good strategist is the ability to solve problems. Because there are plenty of crises and problems to go around for every person and every organization, strategists ought to bring their time and creative energy to bear on solving the most pressing problems of the day. Managing by crisis is actually a form of reacting rather than acting and of letting events dictate what's and when's of management decisions.
- **Managing by Subjectives -** built on the idea that there is no general plan for which way to go and what to do; just do the best you can to accomplish what you think should be done. In short, "Do your own thing, the best way you know how" (sometimes referred to as *the mystery approach to decision making* because subordinates are left to figure out what is happening and why).
- Managing by Hope—based on the fact that the future is laden with great uncertainty, and that if we try and do not succeed, then we hope our second (or third) attempt will succeed. Decisions are predicted on the hope that they will work and the good times are just around the corner, especially if luck and good fortune are on our side!

5.2 The Balanced Scorecard

5.2.1 The background

- No single measures can give a broad picture of the organization's health.
- So instead of a single measure why not a use a composite scorecard involving a number of different measures.
- Kaplan and Norton devised a framework based on four perspectives – financial, customer, internal and learning and growth.
- The organization should select critical measures for each of these perspectives.

Origins of the balanced scorecard

- R.S. Kaplan and D.P. Norton -"The Balanced Scorecard- measures that drive performance". Harvard Business Review, January 1992
- "The Balanced Scorecard", Harvard University Press, 1996.
- "Kaplan and Norton suggested that organization's should focus their efforts on a limited number of specific, critical performance measures which reflect stakeholders key success factors" (Strategic Management, J. Thompson with F. Martin)

5.2.2 What is the balanced scorecard?

- A system of corporate appraisal which looks at financial and non-financial elements from a variety of perspectives.
- An approach to the provision of information to management to assist strategic policy formation and achievement.
- It provides the user with a set of information which addresses all relevant areas of performance in an objective and unbiased fashion.
- A set of measures that gives top managers a fast but comprehensive view of the business.

5.2.3 The balanced scorecard…

- Allows managers to look at the business from four important perspectives.
- Provides a balanced picture of overall performance highlighting activities that need to be improved.
- Combines both qualitative and quantitative measures.
- Relates assessment of performance to the choice of strategy.
- Includes measures of efficiency and effectiveness.
- Assists business in clarifying their vision and strategies and provides a means to translate these into action.

5.2.4 In what Way is the Scorecard a Balance?

The scorecard produces a balance between:

- Four key business perspectives: financial, customer, internal processes and innovation.
- How the organization sees itself and how others see it.
- The short run and the long run
- The situation at a moment in time and change over time
-

5.2.5 Main Benefits of Using the Balanced Scorecard

- Helps companies focus on what has to be done in order to create a breakthrough performance
- Acts as an integrating device for a variety of corporate programs
- Makes strategy operational by translating it into performance measures and targets
- Helps break down corporate level measures so that local managers and employees can see what they need to do well if they want to improve organizational effectiveness
- Provides a comprehensive view that overturns the traditional idea of the organization as a collection of isolated, independent functions and departments

5.2.6 Balanced Scorecard - four Perspectives

The four perspectives are:
- **Financial perspective** - how does the firm look to shareholders?
- **Customer perspective** - how do customers see the firm?
- **Internal perspective** - how well does it manage its operational processes?
- **Innovation and learning perspective –** can the firm continue to improve and create value? This perspective also examines how an organization learns and grows.

For each of four perspectives it is necessary to identify indicators to measure the performance of the organizations.

Financial Perspectives

This is concerned with the shareholders view of performance. Shareholders are concerned with many aspects of financial performance: Amongst the measures of success are:
- Market share
- Revenue growth
- Profit ratio
- Return on investment
- Economic value added
- Return on capital employed
- Operating cost management
- Operating ratios and loss ratios
- Corporate goals
- Survival
- Profitability
- Growth
- Process cost savings
- Increased return on assets
- Profit growth
- Measures
- Cash flow
- Net profitability ratio
- Sales revenue
- Growth in sales revenue
- Cost reduction
- ROCE
- Share price
- Return on shareholder funds

Customer Perspectives

How do customers perceive the firm?
This focuses on the analysis of different types of customers, their degree of satisfaction and the processes used to deliver products and services to customers.
Particular areas of focus would include:

- Customer service
- New products
- New markets
- Customer retention
- Customer satisfaction
- What does the organization need to do to remain that customer's valued supplier?

Potential goals for the customer perspective could include:

- Customer satisfaction
- New customer acquisition
- Customer retention
- Customer loyalty
- Fast response
- Responsiveness
- Efficiency
- Reliability
- Image

The following metrics could be used to measure success in relation to the customer perspective:

- Customer satisfaction index
- Repeat purchases
- Market share
- On time deliveries
- Number of complaints
- Average time to process orders
- Returned orders
- Response time
- Reliability
- New customer acquisitions
- Perceived value for money

Internal perspectives

This seeks to identify:

- How well the business is performing.
- Whether the products and services offered meet customer expectations.
- The critical processes for satisfying both customers and shareholders.
- Activities in which the firm excels?
- And in what must it excel in the future?
- The internal processes that the company must be improved if it is to achieve its objectives.

This perspective is concerned with assessing the quality of people and processes.
Potential goals for the internal perspective include:

- Improve core competencies

- Improvements in technology
- Streamline processes
- Manufacturing excellence
- Quality performance
- Inventory management
- Quality
- Motivated workforce

The following metrics could be used to measure success in relation to the internal perspective:
- Efficiency improvements
- Reduction in unit costs
- Reduced waste
- Improvements in morale
- Increase in capacity utilization
- Increased productivity
- % defective output
- Amount of recycled waste
- Amount of reworking

<u>Innovation and Learning Perspective</u>

This perspective is concerned with issues such as:
- Can we continue to improve and create value?
- In which areas must the organization improve?
- How can the company continue to improve and create value in the future?
- What should it be doing to make this happen?

Potential goals for the innovation and learning perspective include:
- New product development
- Continuous improvement
- Technological leadership
- HR development
- Product diversification

The following metrics could be used to measure success in relation to the innovation and learning perspective:
- Number of new products
- % sales from new products
- Amount of training
- Number of strategic skills learned.
- Value of new product in sales
- R&D as % of sales
- Number of employee suggestions.
- Extent of employee empowerment

5.3 Types of Strategies

Defined and exemplified in the following table, alternative strategies that an enterprise could pursue can be categorized into 11 actions - forward integration, backward integration, horizontal integration, market penetration, market development, product development, related diversification, unrelated diversification, retrenchment, divestiture, and liquidation. Each alternative strategy has countless variations. For example, market penetration can include adding salespersons, increasing advertising expenditures, coopering, 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.

Alternative Strategies Defined and Exemplified:

Strategy	Definition	2007 Examples
Forward Integration	Gaining ownership or increased control over distributors or retailers	Southwest Airlines just began selling tickets through Galileo
Backward Integration	Seeking ownership or increased control of a firm's suppliers	Hilton Hotels could acquire a large furniture manufacturer
Horizontal Integration	Seeking ownership or increased control over competitors	Huntington Bancshares and Sky Financial Group in Ohio merged
Market Penetration	Seeking increased market share for present products or services in present markets through greater marketing efforts	McDonald's is spending millions on its "Shrek the Third" promotions aimed at convincing consumers it offers healthy items
Market Development	Introducing present products or services into new geographic area	Burger King opened its first restaurant in Japan
Product Development	Seeking increased sales by improving present products or services or developing new ones	Google introduced "Google Presents" to compete with Microsoft's PowerPoint
Related Diversification	Adding new but related products or services	MGM Mirage is opening its first noncasino luxury hotel
Unrelated Diversification	Adding new, unrelated products or services	Ford Motor Company entered the industrial bank business
Retrenchment	Regrouping through cost and asset reduction to reverse declining sales and profit	Discovery Channel closed its 103 mall-based and stand-alone stores to focus on the Internet—and laid off 25% of its workforce
Divestiture	Selling a division or part of an organization	Whirlpool sold its struggling Hoover floor-care business to Techtronic Industries
Liquidation	Selling all of a company's assets, in parts, for their tangible worth	Follow Me Charters sold all of its assets and ceased doing business

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Strategic management 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.

5.4 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.
Forward integration strategy refers to the transactions between the customers and firm. Similarly, the function for the particular supply which the firm is being intended to involve itself will be called backward integration. When the firm looks that other firm which may be taken over within the area of its own activity is called horizontal integration.

Benefits of vertical integration strategy:
Allow a firm to gain control over:

- Distributors (forward integration)
- Suppliers (backward integration)
- Competitors (horizontal integration)

5.4.1 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.

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. Total sales by franchises in the United States are annually about $ 1 trillion.

Six guidelines for when forward integration may be an especially effective strategy are:

- 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

5.4.2 Backward Integration

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 when backward integration may be an especially effective strategy are:
1. 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
2. When the number of suppliers is small and the number of competitors is large
3. 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
4. When an organization has both capital and human resources to manage the new business of supplying its own raw materials
5. 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 through backward integration
6. 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
7. When an organization needs to acquire a needed resource quickly

5.4.3 Horizontal Integration

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.

Five guidelines when horizontal integration may be an especially effective strategy are:
1. 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
2. When an organization competes in a growing industry
3. When increased economies of scale provide major competitive advantages
4. When an organization has both the capital and human talent needed to successfully manage an expanded organization
5. 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 overall industry sales are declining.

5.5 Intensive Strategies

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

5.5.1 Market Penetration

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.

Five Guidelines for Market Penetration:
1. Current markets not saturated
2. Usage rate of present customers can be increased significantly
3. Market shares of major competitors declining while total industry sales increasing
4. Correlation between dollar sales and dollar marketing expenditures historically has been high
5. Increased economies of scale provide major competitive advantages

5.5.2 Market Development

Market development involves introducing present products or services into new geographic areas. The climate for international market development is becoming more favorable. In many industries, such as airlines, it is going to be hard to maintain a competitive edge by staying close to home.

Six guidelines when market development may be an especially effective strategy are:
1. New channels of distribution that are reliable, inexpensive, and good quality
2. A firm is very successful at what it does
3. Untapped or unsaturated markets
4. Capital and human resources necessary to manage expanded operations
5. Excess production capacity
6. Basic industry rapidly becoming global

Examples:
- Wal-Mart plans to open its first stores in Russia and India in 2007. Wal-Mart's international division is growing faster than the firm's flagship U. S. business.
- General Motors sold more cars outside the United States in both 2005 and 2006 than inside the United States.
- Ford Motor and many other domestic firms have greater revenue and profits from business outside the United States than here at home.
- Dunkin Donuts has more than 1,700 restaurants outside the United States in 30 countries and opened its first store in Taiwan in 2007.

- Starbucks plans to eventually have thousands of stores in China, making that country the chains largest market outside the United States.
- Chicago-based United Airlines in 2007 won a four-way contest to provide new service to China. Air service between the United States and China is restricted to a negotiated number of flights and through 2007, United rather than American, Continental, or Northwest will be providing this service. The world's largest trans-Pacific passenger carrier, United has served China for 20 years and is adding new nonstop flights from the United States to both Beijing and Shanghai.

5.5.3 Product Development

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.
The U.S. Postal Service now offers stamps and postage via the Internet, which represents a product development strategy.

Five guidelines when product development may be an especially effective strategy to pursue are:
1. Successful products in maturity stage of life cycle
2. A firm competes in an industry characterized by rapid technological developments
3. Major competitors offer better-quality products at comparable prices
4. Compete in high-growth industry
5. Strong research and development capabilities

- Examples:
  Apple Computer in 2007 introduced the media-playing cell phone, called the iPhone, after working with Cingular Wireless for over a year to develop the phone, which is being sold in both Apple and Cingular stores.
- The iPhone is the latest example of how lines between the entertainment and telecom industries are becoming blurred, with cable companies developing phone products and phone companies developing cable products.
- Examples of such competing products that were recently released are SonyEricsson's Walkman phone, Motorola's RAZR handset, Research in Motions BlackBerry Pearl, and Palm Inc. s Treo 750.

5.6 Diversification Strategies

There are two general types of diversification strategies: related and unrelated. Businesses are said to be related when their value chains posses 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.[15]
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.

Diversification strategies are becoming less popular as organizations are finding it more difficult to manage diverse business activities.
Diversification must do more than simply spread business risk across different industries, however, because shareholders could accomplish this by simply purchasing equity in different firms across different industries or by investing in mutual funds. Diversification makes sense only to the extent the strategy adds more to shareholder value than what shareholders could accomplish acting individually. Thus, the chosen industry for diversification must be attractive enough to yield consistently high returns on investment and offer potential across the operating divisions for synergies greater than those entities could achieve alone.

Many strategists contend that firms should stick to the knitting and not stray too far from the firms basic areas of competence.

5.6.1 Related Diversification

Googles stated strategy is to organize all the worlds information into searchable form, diversifying the firm beyond its roots as a Web search engine that sells advertising. The Google acquisition of YouTube was an example of a related diversification strategy because YouTube contains so many video clips from television shows and commercials. Google wants to diversify further into the television and cablevision business. Google plans to scan millions of books from university and public libraries into a database. Googles acquisition of DoubleClick, also in 2007, was further diversification into the business of placing, or serving, the electronic advertisements that dot Web sites.

Six guidelines for when related diversification may be an effective strategy are as follows.
1. When an organization competes in a no- growth or a slow- growth industry.
2. When adding new, but related, products would significantly enhance the sales of current products.
3. When new, but related, products could be offered at highly competitive prices.
4. When new, but related, products have seasonal sales levels that counterbalance an organizations existing peaks and valleys.
5. When an organizations products are currently in the declining stage of the products life cycle.
6. When an organization has a strong management team.

Examples:
- Seagate Technology pursued related diversification recently when it acquired EVault because this moved the company from disk drives to data-storage services. Now Seagate is a major provider of data backup and archival services for small and mid- size businesses.
- Cisco Systems recently diversified with its acquisition of WebEx Communications because it moved Cisco from manufacturing computer routers, switches, and network gear into online conferencing services.

5.6.2 Unrelated Diversification

An unrelated diversification strategy favors capitalizing upon a portfolio of businesses that are capable of delivering excellent financial performance in their respective industries, rather than striving to capitalize on value chain strategic fits among the businesses.

Wal-Mart recently renegotiated the terms of leases with a number of banks operating in its stores, giving the company itself the explicit right to offer mortgages, home-equity lines of credit, and consumer loans. In some locations, Wal-Mart also may offer debit cards and investment and insurance products either directly or through a third- party vendor. Wal-Mart's desire to enter the banking business has drawn fierce opposition from the banking industry, some members of Congress, and activist groups. There are currently 300 different banks with 1,200 branches inside Wal-Mart stores across the United States, and Wal-Mart plans to add 200 more by 2009. Fifteen commercial firms already own banks, including Harley-Davidson and Target Corp. [16]

Ten guidelines for when unrelated diversification may be an especially effective strategy are:
1. When revenues derived from an organization's current products or services would increase significantly by adding the new, unrelated products.
2. When an organization competes in a highly competitive and/ or a no- growth industry, as indicated by low industry profit margins and returns.
3. When an organizations present channels of distribution can be used to market the new products to current customers.
4. When the new products have countercyclical sales patterns compared to an organizations present products.
5. When an organizations basic industry is experiencing declining annual sales and profits.
6. When an organization has the capital and managerial talent needed to compete successfully in a new industry.
7. When an organization has the opportunity to purchase an unrelated business that is an attractive investment opportunity.
8. When there exists financial synergy between the acquired and acquiring firm.
9. When existing markets for an organizations present products are saturated.
10. When antitrust action could be charged against an organization that historically has concentrated on a single industry.

Examples:
- Wal-Mart recently renegotiated the terms of leases with a number of banks operating in its stores, giving the company itself the explicit right to offer mortgages, home-equity lines of credit, and consumer loans. In some locations, Wal-Mart also may offer debit cards and investment and insurance products either directly or through a third- party vendor. Wal-Mart's desire to enter the banking business has drawn fierce opposition from the banking industry, some members of Congress, and activist groups. There are currently 300 different banks with 1,200 branches inside Wal-Mart stores across the United States, and Wal-Mart plans to add 200 more by 2009. Fifteen commercial firms already own banks, including Harley- Davidson and Target Corp. [17]
- Walt Disney that owns ABC, Viacom that owns CBS, and General Electric that owns NBC. Thus the three major television networks are all owned by diversified firms.
- The brokerage firm Morgan Stanley is pursuing unrelated diversification by building a $ 1 billion casino in Atlantic City. In addition, Morgan Stanley recently obtained an 18 percent stake in Trump Entertainment Resorts. Also in 2007, Morgan Stanley acquired 13 luxury hotels in Japan for $ 2.4 billion from All Nippon Airways, further diversifying the firm into hotel management.
- General Electric (GE) acquisition of Vivendi Universal Entertainment (VUE). VUE is a television and theme park empire, while GE is a highly diversified conglomerate. VUE

owns and operates Universal Studios theme parks. GE owns National Broadcasting Corporation (NBC) and also produces home appliances and scores of other products.
- General Electric is a classic firm that is highly diversified. GE makes locomotives, lightbulbs, power plants, and refrigerators; GE manages more credit cards than American Express; GE owns more commercial aircraft than American Airlines.

5.7 Defensive Strategies

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

5.7.1 Retrenchment

Retrenchment occurs when an organization regroups through cost and asset reduction to reverse declining sales and profits. Sometimes called a turnaround or reorganization strategy, retrenchment is designed to fortify an organization's basic distinctive competence. 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.

In some cases, bankruptcy can be an effective type of retrenchment strategy. Bankruptcy can allow a firm to avoid major debt obligations and to void union contracts.

Five guidelines when retrenchment may be an especially effective strategy to pursue are as follows:
1. Firm has failed to meet its objectives and goals consistently over time but has distinctive competencies
2. Firm is one of the weaker competitors
3. Inefficiency, low profitability, poor employee morale and pressure from stockholders to improve performance.
4. When an organization’s strategic management has failed
5. Very quick growth to large organization where a major internal reorganization is needed

Examples:
- Eastman Kodak completed a three-year retrenchment strategy in 2007 during which the firm laid off 30,000 employees and incurred $ 3.8 billion in restructuring costs. Kodak’s workforce declined to about 28,000 at year- end 2007, down from 40,000 at the end of 2006, and down from its peak of 145,000 in 1984. Kodak rolled out a new inkjet printer in 2007 and does well in motion- picture film for movies, but continues to struggle in consumer film and disposable cameras. Kodak’s new inkjet printers scan and copy documents, Web pages, and photos using cartridges priced far less than those of its competitors.
- The telecommunications equipment vendor, Nortel, cut another 2,900 jobs in 2007, bringing its workforce to about 31,000, down from 95,000 in 2001. The retrenchment strategy is part of CEO Mike Zafirovski’s strategy to stay only in businesses in which Nortel has a 20 percent global market share. Chief Strategy Officer George Riedel of Nortel says, “In the past, we were trying to be all things to all people. Now were focused on doing a few things that matter.”

5.7.2 Divestiture

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.

Five guidelines when divestiture may be an especially effective strategy to pursue are listed below:
1. When firm has pursued retrenchment but failed to attain needed improvements
2. When a division needs more resources than the firm can provide
3. When a division is responsible for the firm’s overall poor performance
4. When a division is a misfit with the organization
5. When a large amount of cash is needed and cannot be obtained from other sources.

Divestiture has become a very popular strategy as firms try to focus on their core strengths, lessening their level of diversification.

Examples:
- Germanys Merck KGaA is selling its generic-drug division in order to focus on branded drugs and chemicals. Merck also is trying to sell its consumer health care business for the same reason.
- Akzo Nobel NV of the Netherlands is trying to sell its pharmaceuticals division, Organon BioSciences, in order to focus on its chemicals and paint operations.
- Switzerland’s Novartis AG recently sold its medical-nutrition division to focus on drugs and vaccines.
- Siemens AG has been divesting its telecommunications businesses to focus on medical diagnostics.

5.7.3 Liquidation

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. However, it may be better to cease operating than to continue losing large sums of money.

Three guidelines when liquidation may be an especially effective strategy to pursue are:
- When both retrenchment and divestiture have been pursued unsuccessfully
- If the only alternative is bankruptcy, liquidation is an orderly alternative
- When stockholders can minimize their losses by selling the firm’s assets

Examples:
- Canadian discount airline, Jetsgo, in 2005, halted operations, filed for bankruptcy, and then liquidated.
- Canadas third-largest airline, Jetsgo was launched three years earlier from Montreal. Jetsgo competed against WestJet, based in Calgary, Alberta, and Air Canada, based in Montreal.
- Analysts had long predicted that Jetsgo would fail, given the companys rock-bottom ticket prices and aggressive expansion.

5.8 Michael Porters Generic Strategies

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

- **Cost leadership** emphasizes producing standardized products at a very low per-unit cost for consumers who are price-sensitive.

- **Differentiation** is 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.

Porter's 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.

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 raising differentiation. In addition to prompting sharing, Porter stresses the need for firms to "transfer" skills and expertise among autonomous business units effectively in order to gain competitive advantage. Depending upon factors such as type of industry, size of firm, and nature of competition, various strategies could yield advantages in cost leadership, differentiation, and focus.

5.8.1 Cost Leadership Strategy

This strategy emphasizes efficiency. By producing high volumes of standardized products, the firm hopes to take advantage of economies of scale and experience curve effects. The product is often a basic no-frills product that is produced at a relatively low cost and made available to a very large customer base. Maintaining this strategy requires a continuous search for cost reductions in all aspects of the business. The associated distribution strategy is to obtain the most extensive distribution possible. Promotional strategy often involves trying to make a virtue out of low cost product features. To be successful, this strategy usually requires a considerable market share advantage or preferential access to raw materials, components, labour, or some other important input. Without one or more of these advantages, the strategy can easily be mimicked by competitors.

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.

A cost leader-ship strategy can be especially effective under the following conditions:
- When price competition among rival sellers is especially vigorous.
- When the products of rival sellers are essentially identical and supplies are readily available from any of several eager sellers.
- When there are few ways to achieve product differentiation that have value to buyers.

- When most buyers use the product in the same ways.
- When buyers incur low costs in switching their purchases from one seller to another.
- When buyers are large and have significant power to bargain down prices.
- 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. Successful implementation benefits from:

- high efficiency
- low overhead
- limited perks
- intolerance of waste
- Tight cost control
- wide spans of control
- rewards linked to cost containment
- broad employee participation in cost control efforts
- Products designed for ease of manufacture

5.8.2 Differentiation Strategy

Differentiation involves creating a product that is perceived as unique. The unique features or benefits should provide superior value for the customer if this strategy is to be successful. Because customers see the product as unrivaled and unequaled, the price elasticity of demand tends to be reduced and customers tend to be more brands loyal. This can provide considerable insulation from competition. However there are usually additional costs associated with the differentiating product features and this could require a premium pricing strategy.

Successful differentiation can mean

- greater product flexibility,
- greater compatibility,
- lower costs,
- improved service,
- less maintenance,
- greater convenience,
- more features
- better design

Product development and design is an example of a strategy that offers the advantages of differentiation.

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 or 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.

A differentiation strategy can be especially effective under the following conditions:

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

5.8.3 Focus Strategy

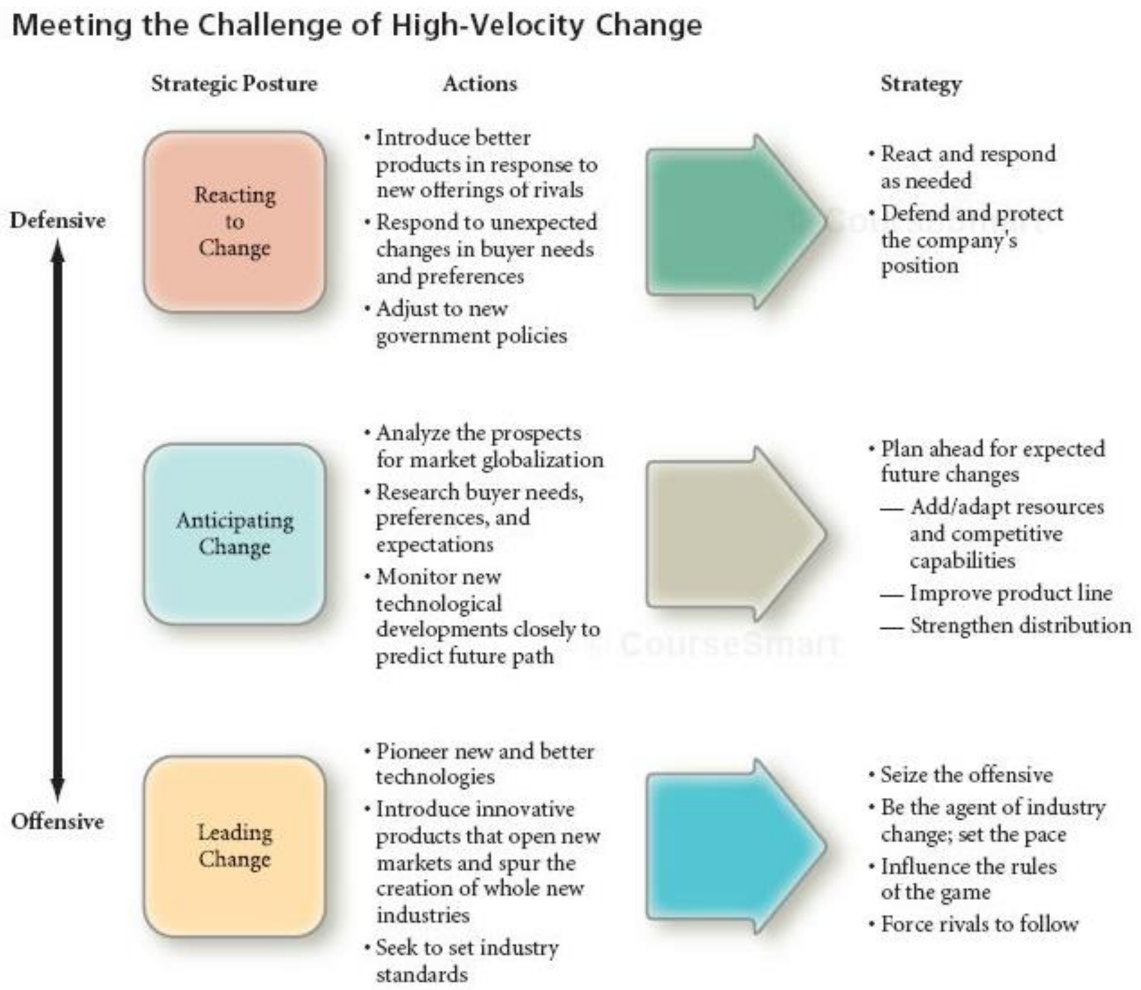
This strategy concentrates on select target markets. It is also called niche strategy.

A focus strategy can be especially attractive when:
- The target market niche is large, profitable, and growing.
- Industry leaders do not consider the niche to be crucial to their own success.
- 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.
- The industry has many different niches and segments, thereby allowing a focuser to pick a competitively attractive niche suited to its own resources.
- Few, if any, other rivals are attempting to specialize in the same target segment.

5.9 Strategies for Competing in Turbulent, High- Velocity Markets

The world is changing more and more rapidly, and consequently industries and firms themselves are changing faster than ever. Some industries are changing so fast that researchers call them turbulent, high- velocity markets, such as telecommunications, medical, biotechnology, pharmaceuticals, computer hardware, software, and virtually all Internet- based industries. High- velocity change is clearly becoming more and more the rule rather than the exception, even in such industries as toys, phones, banking, defense, publishing, and communication.

As illustrated below meeting the challenge of high- velocity change presents the firm with a choice of whether to react, anticipate, or lead the market in terms of its own strategies. Firm's ideally strive to be in a position to lead the changes in high- velocity markets, whereby they pioneer new and better technologies and products and set industry standards.



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5.10 Means for Achieving Strategies

5.10.1 Joint Venture/Partnering

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.

Forbes has reported that about 30 percent of all joint ventures and partner-ship alliances are outright failures, while another 17 percent have limited success and then dissipate due to problems.
There are countless examples of failed joint ventures. 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 strategy to pursue are:
1. 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.
2. 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.
3. When the distinct competencies of two or more firms complement each other especially well.
4. When some project is potentially very profitable but requires overwhelming resources and risks; the Alaskan pipeline is an example.
5. When two or more smaller firms have trouble competing with a large firm.
6. When there exists a need to quickly introduce a new technology.

Examples:
- Burger King recently formed a conceptual agreement with its fierce rival, Hungry Jacks, in Australia, whereby the two firms will join forces against market leader McDonalds. All Burger Kings in Australia are being renamed Hungry Jacks, but Burger King retains ownership under the unusual agreement. With this agreement, Australia becomes Burger Kings fourth- largest country market, tied with Spain.
- Starbucks recent joint venture with Chinas President Coffee to open hundreds of new Starbuck coffee shops in China.
- Wal-Marts successful joint venture with Mexicos Cifra is indicative of how a domestic firm can benefit immensely by partnering with a foreign company to gain substantial presence in that new country.

5.10.2 <u>Merger and Acquisition</u>

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 unfriendly takeover. In contrast, if the acquisition is desired by both firms, it is termed a friendly merger. Most mergers are friendly.

There are numerous and powerful forces driving once-fierce rivals to merge around the world. Some of these forces are

- deregulation,
- technological change
- excess capacity
- inability to boost profits through price increases
- depressed stock market
- the need to gain economies of scale
- increased market power
- reduced entry barriers
- reduced cost of new product development
- increased speed of products to market
- lowered risk compared to developing new products
- increased diversification
- avoidance of excessive competition
- opportunity to learn and develop new capabilities

Research suggests that perhaps 20 percent of all mergers and acquisitions are successful, approximately 60 percent produce disappointing results, and the last 20 percent are clear failures. [18] So a merger between two firms can yield great benefits, but the price and reasoning must be right.
Some key reasons why many mergers and acquisitions fail are:

- 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

There are many reasons for mergers and acquisitions, including the following:

- 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

Examples:

- There were numerous examples in 2007 of hostile takeover attempts. For example, Orlando- based AirTran Airways launched a $345 million tender offer to acquire Milwaukee- based Midwest Airlines shares directly from shareholders in hopes of forcing the Midwest board to sell the firm. AirTran has even offered to keep serving free chocolate chip cookies on all Midwest flights if the board will sell.
- Delta Airlines recently fended off a $ 9.75 billion hostile takeover bid made by U. S. Airways although industry analysts thought the takeover would succeed. Delta CEO

Gerald Grinstein rallied employees, shareholders, and creditors around his Keep Delta My Delta campaign.

A **leveraged buyout** (LBO) occurs when a corporations shareholders are bought (hence buyout) by the company's management and other private investors using borrowed funds (hence leverage).

A **management buyout (MBO)** occurs when the company's management without private investors buys the company

Besides trying to avoid a hostile takeover, other reasons for initiating an LBO are senior management decisions that particular divisions do not fit into an overall corporate strategy or must be sold to raise cash, or receipt of an attractive offering price.

5.10.3 <u>Outsourcing</u>

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:

- it is less expensive
- it allows the firm to focus on its core businesses
- it enables the firm to provide better services.
- It allows the firm to align itself with best- in- world suppliers who focus on performing the special task,
- It provides the firm flexibility should customer needs shift unexpectedly
- It 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. The worldwide BPO market exceeded $173 billion in 2007.

India commands 45 percent of all back-office outsourcing, 29 percent of all call centers, 48 per-cent of all information technology outsourcing, 29 percent of all procurement outsourcing, and 45 percent of all product development outsourcing.[19]

Examples:

- Many firms, such as Dearborn, Michigan- based Visteon Corp. and J. P. Morgan Chase & Co., outsource their computer operations to IBM, which competes with firms such as Electronic Data Systems and Computer Sciences Corp., in the computer outsourcing business.
- 3M Corp. is outsourcing all of its manufacturing operations to Flextronics International Ltd. of Singapore or Jabil Circuit in Florida. 3M is also outsourcing all design and manufacturing of low- end standardized volume products by building a new design center in Taiwan.

Some examples of outsourcing deals which didn't work out:

- J. P. Morgan Chase deal with IBM and Dow Chemicals' deal with Electronic Data Systems. Both outsourcing deals were abandoned after several years.

- Lehman Brothers Holdings and Dell Inc. both recently reversed decisions to move customer call centers to India after a customer rebellion.

5.11 Strategic Management in Small Firms

The strategic-management process is just as vital for small companies. The strategic-management process can significantly enhance small firm's growth and prosperity. Numerous magazine and journal articles have focused on applying strategic- management concepts to small businesses. A major conclusion of these articles is that a lack of strategic-management knowledge is a serious obstacle for many small business owners.
Other problems often encountered in applying strategic-management concepts to small businesses are a lack of both sufficient capital to exploit external opportunities and a day- to-day cognitive frame of reference. Research also indicates that strategic management in small firms is more informal than in large firms, but small firms that engage in strategic management outperform those that do not.

6 Strategy Analysis and Choice

Strategy analysis and choice largely involve making subjective decisions based on objective information. This chapter introduces important concepts that can help strategists generate feasible alternatives, evaluate those alternatives, and choose a specific course of action. The firms present strategies, objectives, and mission, coupled with the external and internal audit information, provide a basis for generating and evaluating feasible alternative strategies. Creativity should be encouraged in this thought process.
When all feasible strategies identified by participants are given and understood, the strategies should be ranked in order of attractiveness by all participants.

6.1 A Comprehensive Strategy-Formulation Framework

Important strategy-formulation techniques can be integrated into a three-stage decision-making framework. 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 Called the Input Stage, summarizes the basic input information needed to formulate strategies and consists of the following techniques:

- **EFE Matrix** (External Factor Evaluation)
- **IFE Matrix**, (Internal Factor Evaluation)
- **CPM Matrix** (Competitive Profile)

Stage 2, called the Matching Stage, focuses upon generating feasible alternative strategies by aligning key external and internal factors. Stage 2 techniques include:

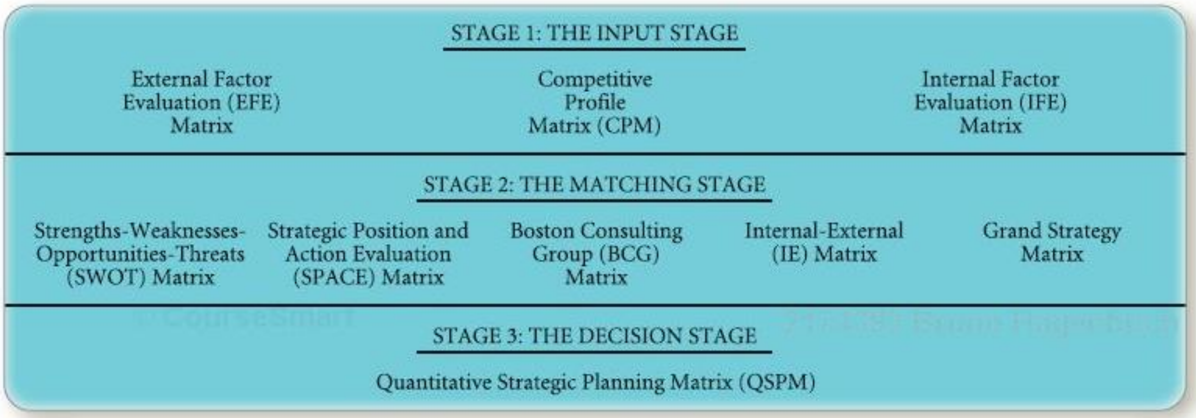
- **SWOT Matrix** (Strengths- Weaknesses- Opportunities-Threats)
- **SPACE Matrix** (Strategic Position and Action Evaluation)
- **BCG Matrix** (the Boston Consulting Group)
- **IE Matrix** (Internal- External)
- **Grand Strategy Matrix**

Stage 3, called the Decision Stage, involves a single technique:

- **QSPM** (Quantitative Strategic Planning Matrix).

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.

The Strategy-Formulation Analytical Framework



6.2 The SWOT Analysis

The SWOT analysis is an extremely useful tool for understanding and decision-making for all sorts of situations in business and organizations. SWOT is an acronym for Strengths, Weaknesses, Opportunities and Threats. The SWOT analysis headings provide a good framework for reviewing strategy, position and direction of a company or business proposition, or any other idea.

A SWOT analysis is a subjective assessment of data which is organized by the SWOT format into a logical order that helps understanding, presentation, discussion and decision-making..

The SWOT analysis template is normally presented as a grid, comprising four sections, one for each of the SWOT headings: Strengths, Weaknesses, Opportunities, and Threats. Here are some examples of what a SWOT analysis can be used to assess:

- a company (its position in the market, commercial viability, etc)
- a method of sales distribution
- a product or brand
- a business idea
- a strategic option, such as entering a new market or launching a new product
- a opportunity to make an acquisition
- a potential partnership
- changing a supplier
- outsourcing a service, activity or resource

an investment opportunity

A scan of the internal and external environment is an important part of the strategic planning process. Environmental factors internal to the firm usually can be classified as strengths (S) or weaknesses (W), and those external to the firm can be classified as opportunities (O) or threats (T). Such an analysis of the strategic environment is referred to as a SWOT analysis. The SWOT analysis provides information that is helpful in matching the firm's resources and capabilities to the competitive environment in which it operates. As such, it is instrumental in strategy formulation and selection. The following diagram shows how a SWOT analysis fits into an environmental scan:

SWOT Analysis Framework

```
                 Environmental Scan
                  /                  \
      Internal Analysis            External Analysis
             / \                           / \
  Strengths   Weaknesses      Opportunities   Threats
                          |
                     SWOT Matrix
```

- **Strengths**: A firm's strengths are its resources and capabilities that can be used as a basis for developing a competitive advantage.
- **Weaknesses**: The absence of certain strengths may be viewed as a weakness. In some cases, a weakness may be the flip side of a strength. Take the case in which a firm has a large amount of manufacturing capacity. While this capacity may be considered a strength that competitors do not share, it also may be a considered a weakness if the large investment in manufacturing capacity prevents the firm from reacting quickly to changes in the strategic environment.
- **Opportunities**: The external environmental analysis may reveal certain new opportunities for profit and growth.
- **Threats**: Changes in the external environmental also may present threats to the firm.

This SWOT example is for a new business opportunity. Many criteria can apply to more than one quadrant. Identify criteria appropriate to your own SWOT situation.

Strengths	**Weaknesses**
▪ Advantages of proposition? ▪ Capabilities? ▪ Competitive advantages? ▪ USP's (unique selling points)? ▪ Resources, Assets, People? ▪ Experience, knowledge, data? ▪ Financial reserves, likely returns? ▪ Marketing - reach, distribution, awareness? ▪ Innovative aspects? ▪ Location and geographical? ▪ Price, value, quality?	▪ Disadvantages of proposition? ▪ Gaps in capabilities? ▪ Lack of competitive strength? ▪ Reputation, presence and reach? ▪ Financials? ▪ Own known vulnerabilities? ▪ Timescales, deadlines and pressures? ▪ Cashflow, start-up cash-drain? ▪ Continuity, supply chain robustness? ▪ Effects on core activities, distraction? ▪ Reliability of data, plan predictability? ▪ Morale, commitment, leadership?

▪ Accreditations, qualifications, certifications? ▪ Processes, systems, IT, communications? ▪ Cultural, attitudinal, behavioral? ▪ Management cover, succession? ▪	▪ Accreditations, etc? ▪ Processes and systems, etc? ▪ Management cover, succession?
Opportunities ▪ Market developments? ▪ Competitors' vulnerabilities? ▪ Industry or lifestyle trends? ▪ Technology development and innovation? ▪ Global influences? ▪ New markets, vertical, horizontal? ▪ Niche target markets? ▪ Geographical, export, import? ▪ New USP's? ▪ Tactics - surprise, major contracts, etc? ▪ Business and product development? ▪ Information and research? ▪ Partnerships, agencies, distribution? ▪ Volumes, production, economies? ▪ Seasonal, weather, fashion influences?	**Threats** ▪ Political effects? ▪ Legislative effects? ▪ Environmental effects? ▪ IT developments? ▪ Competitor intentions - various? ▪ Market demand? ▪ New technologies, services, ideas? ▪ Vital contracts and partners? ▪ Sustaining internal capabilities? ▪ Obstacles faced? ▪ Insurmountable weaknesses? ▪ Loss of key staff? ▪ Sustainable financial backing? ▪ Economy - home, abroad? ▪ Seasonality, weather effects?

6.3 The SWOT Strategies

The Strengths-Weaknesses-Opportunities-Threats (SWOT) Matrix is an important matching tool that helps manager’s develop four types of strategies:

- SO (strengths-opportunities) Strategies
- WO (weaknesses- opportunities) Strategies
- ST (strengths- threats) Strategies
- WT (weaknesses- threats) Strategies.

- **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.

- **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 royaltie's from nine Japanese and Korean firms that infringed on patents for semiconductor memory chips (threat).
- **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. In fact, such a firm may have to fight for its survival, merge, retrench, declare bankruptcy, or choose liquidation.

A SWOT Strategy Matrix is composed of nine cells. As shown below, 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.

Blank	**Strengths–S** List Strengths	**Weaknesses – W** List Weaknesses
Opportunities – O List Opportunities	**SO-Strategies** Use strength to obtain Opportunities	**WO-Strategies** Overcome weaknesses by taking advantage of opportunities
Threats – T List Threats	**ST-Strategies** Use strengths to avoid threats	**WT-Strategies** Minimize weaknesses and avoid threats

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.

Example of a SWOT Matirx:

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		
3. Vehicle traffic passing store up 12%	2. Add 2 new repair/service persons (S6, O5)	2. Install new carpet/paint/bath (W3, W4, O1)
4. Vendors average six new products/yr	3. Send flyer to all seniors over age 55 (S5, O5)	3. Up Web site services by 50% (W6, O7, O8)
5. Senior citizen use of computers up 8%		
6. Small business growth in area up 10%		4. Launch mailout to to all Realtors in city (W5, O7)
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. Install new carpet/paint/bath (W3, W4, T1)
3. New bypass Hwy 34 in 1 yr will divert traffic		
	2. Purchase land to build new store (S8, T3)	
4. New mall being built nearby		
5. Gas prices up 14%	3. Raise out-of-store service calls from $60 to $80 (S6, T5)	
6. Vendors raising prices 8%		

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6.4 The Strategic Position and Action Evaluation (SPACE) Matrix

The Strategic Position and Action Evaluation (SPACE) Matrix' 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

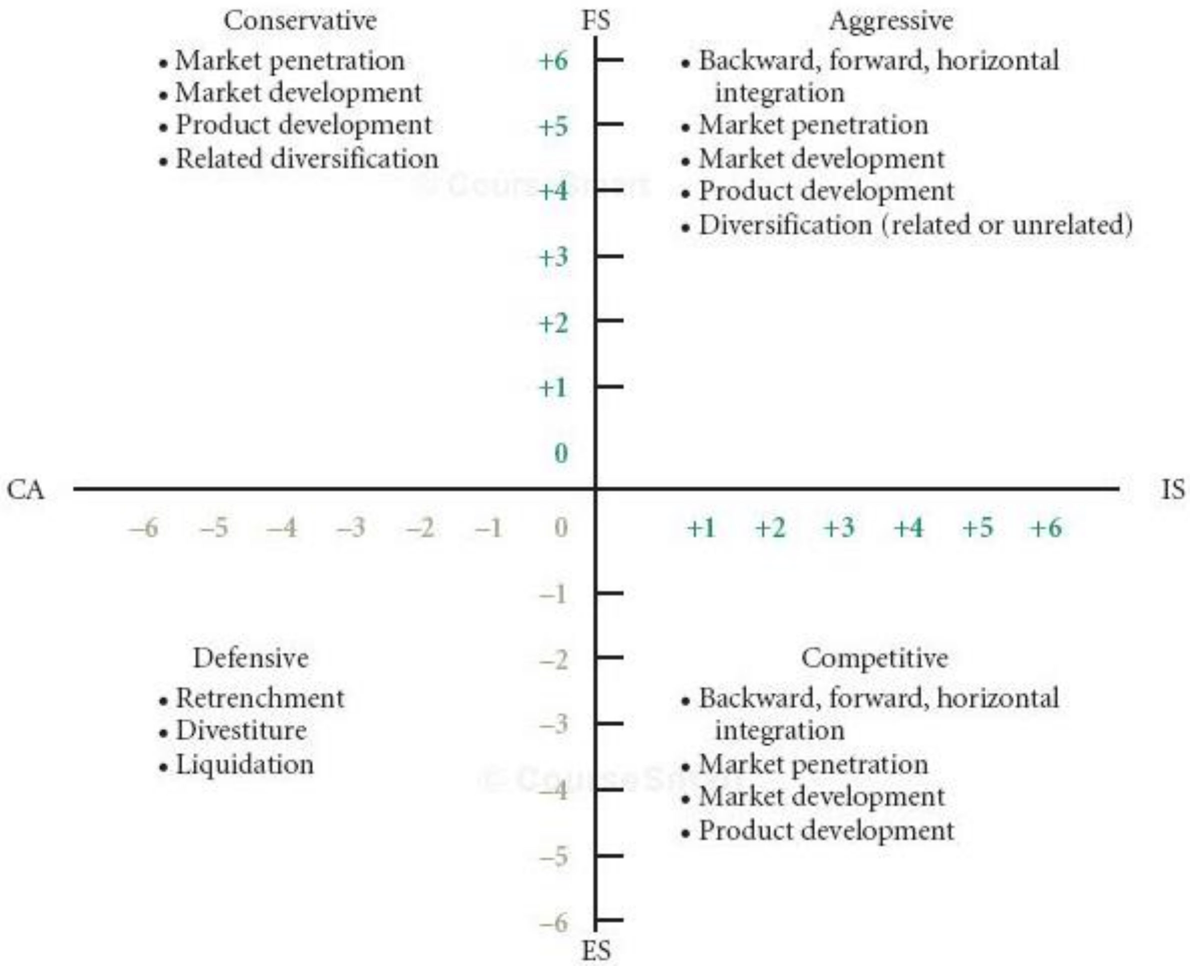
- two internal dimensions: financial strength [FS] and competitive advantage [CA]
- two external dimensions: environmental stability [ES] and industry strength [IS]

These four factors are perhaps the most important determinants of an organizations overall strategic position.

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

1. Select a set of variables to define financial strength (FS), competitive advantage (CA), environmental stability (ES), and industry strength (IS).
2. Assign a numerical value ranging from + 1 (worst) to + 6 (best) to each of the variables that make up the FS and IS dimensions. Assign a numerical value ranging from 1 (best) to 6 (worst) to each of the variables that make up the ES and CA dimensions. On the FS and CA axes, make comparison to competitors. On the IS and ES axes, make comparison to other industries.
3. Compute an average score for FS, CA, IS, and ES 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 FS, IS, ES, and CA 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.

The SPACE Matrix

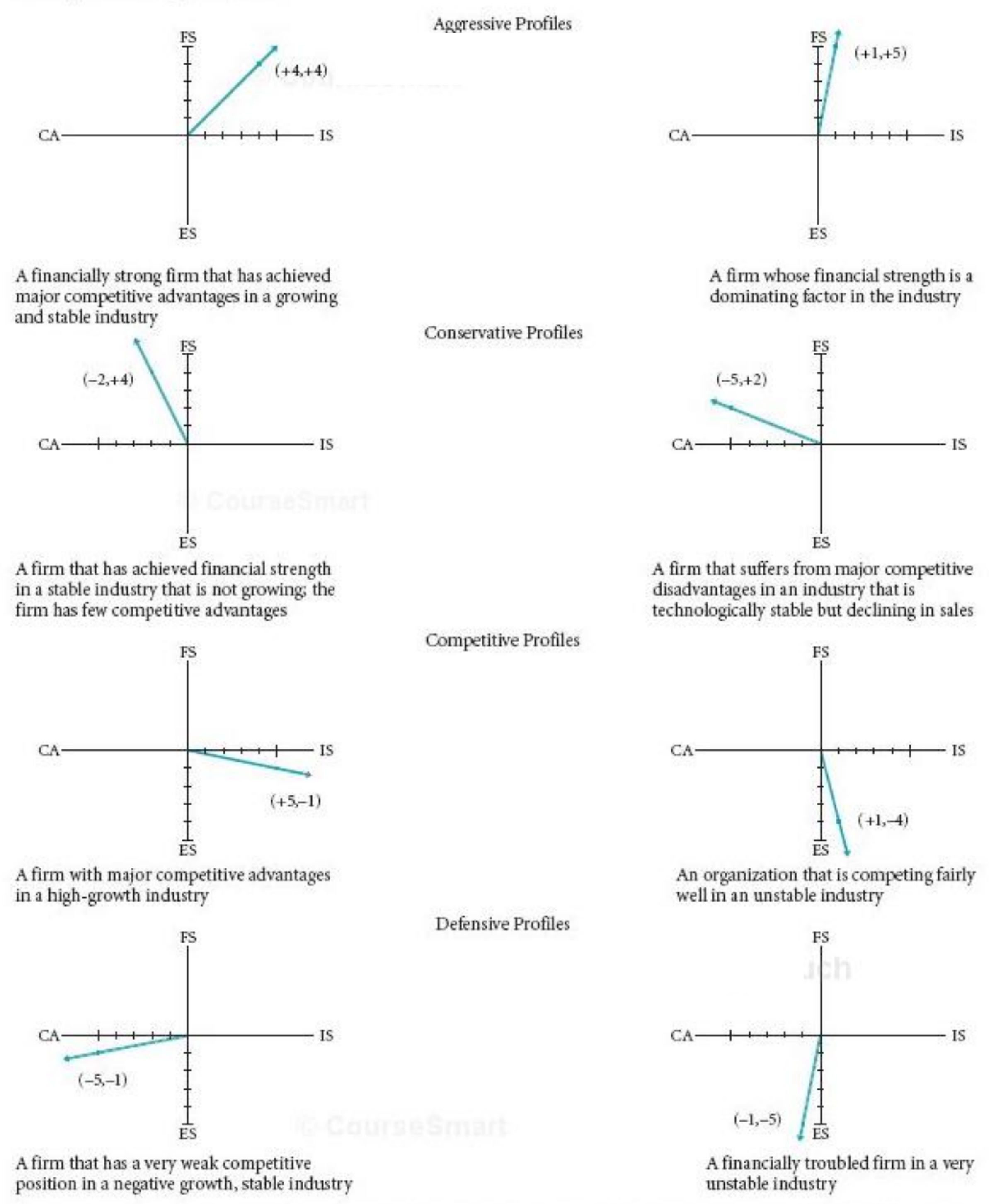


Source: H. Rowe, R. Mason, and K. Dickel, *Strategic Management and Business Policy: A Methodological Approach* (Reading, MA: Addison-Wesley Publishing Co. Inc., © 1982): 155. Reprinted with permission of the publisher.

Internal Strategic Position	External Strategic Position
Financial Strength (FS)	*Environmental Stability (ES)*
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
Competitive Advantage (CA)	*Industry Strength (IS)*
Market share	Growth potential
Product quality	Profit potential
Product life cycle	Financial stability
Customer loyalty	Technological know-how
Competition's capacity utilization	Resource utilization
Technological know-how	Ease of entry into market
Control over suppliers and distributors	Productivity, capacity utilization

Source: H. Rowe, R. Mason, and K. Dickel, *Strategic Management and Business Policy: A Methodological Approach* (Reading, MA: Addison-Wesley Publishing Co. Inc., © 1982): 155–156. Reprinted with permission of the publisher.

Example Strategy Profiles



Source: H. Rowe, R. Mason, and K. Dickel, *Strategic Management and Business Policy: A Methodological Approach* (Reading, MA: Addison-Wesley Publishing Co. Inc., © 1982): 155. Reprinted with permission of the publisher.

The directional vector associated with each profile suggests the type of strategies to pursue: aggressive, conservative, defensive, or competitive.

Aggressive quadrant (upper-right quadrant):

- an organization is in an excellent position to use its internal strengths to take advantage of external opportunities, overcome internal weaknesses and avoid external threats
- Therefore, market penetration, market development, product development, backward integration, forward integration, horizontal integration, diversification, or a combination strategy all can be feasible, depending on the specific circumstances that face the firm.

Conservative quadrant (upper-left quadrant):

- implies staying close to the firms basic competencies and not taking excessive risks
- conservative strategies most often include market penetration, market development, product development, and related diversification.

Defensive quadrant (lower-left quadrant):

- the firm should focus on rectifying internal weaknesses and avoiding external threats
- defensive strategies include retrenchment, divestiture, liquidation, and related diversification.

Competitive quadrant (lower-right quadrant):

- indicates competitive strategies
- competitive strategies include backward, forward, and horizontal integration; market penetration; market development and product development.

6.5 The Boston Consulting Group (BCG) Matrix

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 multi-divisional firms efforts to formulate strategies.

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.

x- axis of the BCG Matrix:

- 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.

y- axis of the BCG Matrix

- 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.

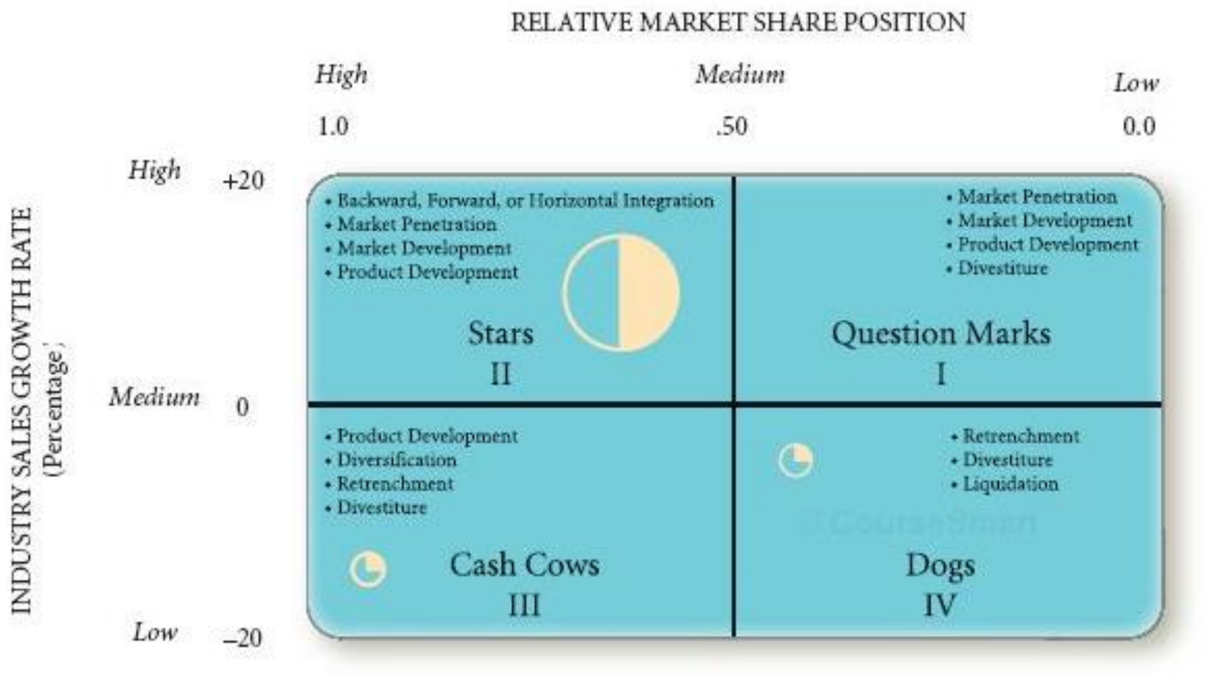
Note in the following table that Budget Rent- a- Cars relative market share position is 6.9 divided by 49.6 = 13.91 percent, which along the x- axis of a BCG Matrix would be pretty close to the right-hand side. Be mindful that relative market share position could also be determined by dividing Budgets revenues by the leader Enterprises revenues.

Market Share Data for Selected Industries in 2007:

U.S. Car Market Share (2007)	
General Motors	24.6%
Nissan	6.2%
DaimlerChrysler	14.4%
Ford	17.5%
Honda	9.2%
Toyota	15.4%
U.S. Top Banks by Domestic Deposits Market Share (2007)	
Bank of America	9.0%
J.P. Morgan Chase	6.9%
Wachovia/Golden West Financial	5.8%
Wells Fargo	4.6%
Citigroup	3.5%
U.S. Top Airlines Market Share (2007)	
American	15.7%
United	12.1%
Delta	11.8%
Southwest	11.5%
Continental	7.5%
Northwest	7.0%
U.S. Airways	4.7%
America West	3.9%
U.S. Top Rental Car Companies (2007)	
Enterprise	49.6%
Hertz	23.7%
Avis	9.9%
Budget	6.9%
Alamo National	5.2%
Dollar	4.7%
Market Share of Top Selling Vodkas Worldwide	
Smirnoff	21.4%
Absolut	9.2%
Stolichnaya	2.4%
Skyy	2.4%
Grey Goose	2.3%
Finlandia	2.1%
Ketel One	1.7%

An example of a BCG Matrix appears in the figure below. 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.

The BCG Matrix:



Source: Adapted from Boston Consulting Group, *Perspectives on Experience* (Boston: The Boston Consulting Group, 1974).

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 organizations 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.

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 yesterdays 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

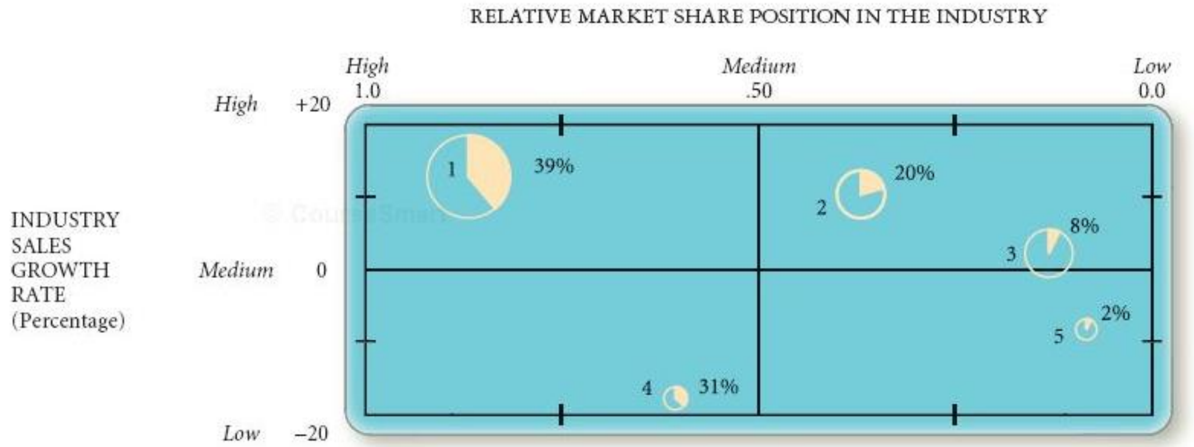
- Quadrant IV divisions of the organization have a low relative market share position and compete in a slow- or no-market-growth industry; they are Dogs in the firms portfolio.
- Because of their weak internal and external position, these businesses are often liquidated, divested, or trimmed down through 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 organizations' 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 counter-clockwise motion.

The BCG Matrix has some limitations:

- 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.
- 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.
- 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.

An Example of the BCG Matrix:

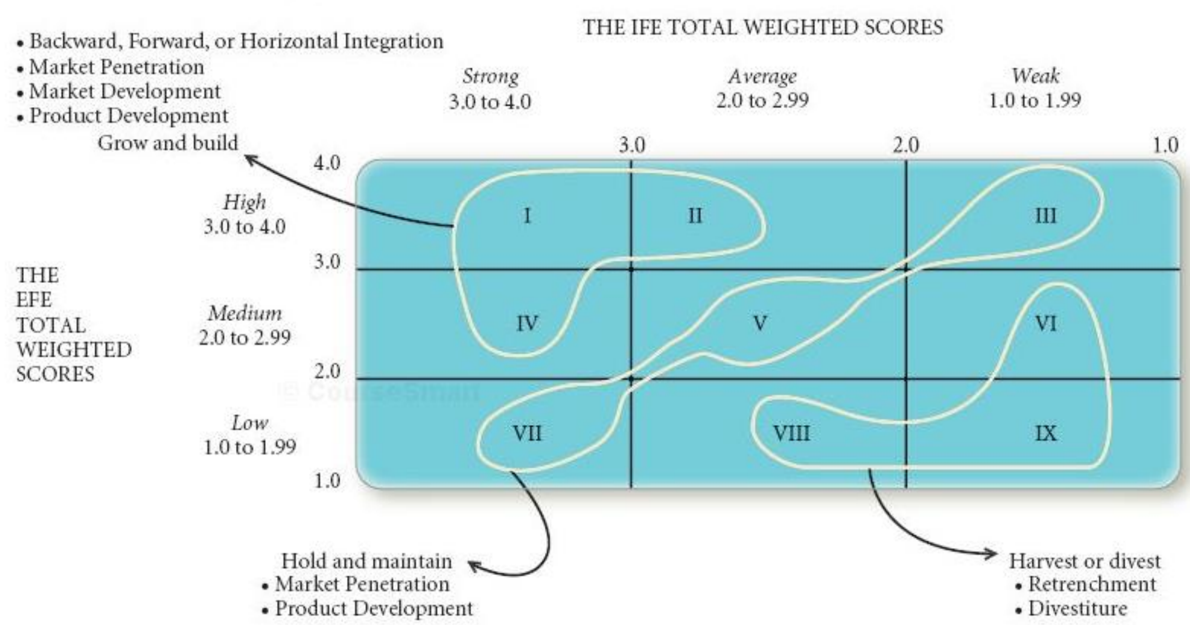


Division	*Revenues*	*Percent Revenues*	*Profits*	*Percent Profits*	*Percent Market Share*	*Percent Growth Rate*
1	$60,000	37	$10,000	39	80	+15
2	40,000	24	5,000	20	40	+10
3	40,000	24	2,000	8	10	+1
4	20,000	12	8,000	31	60	−20
5	5,000	3	500	2	5	−10
Total	**$165,000**	**100**	**$25,500**	**100**	—	—

6.6 The Internal-External (IE) Matrix

The Internal- External (IE) Matrix positions an organizations various divisions in a nine-cell display, illustrated below. 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.

The Internal–External (IE) Matrix



Source: Adapted. The IE Matrix was developed from the General Electric (GE) Business Screen Matrix. For a description of the GE Matrix see Michael Allen, "Diagramming GE's Planning for What's WATT," in R. Allio and M. Pennington, eds., *Corporate Planning: Techniques and Applications* (New York: AMACOM, 1979).

But there are some important differences between the BCG Matrix and the IE Matrix:

- The axes are different
- The IE Matrix requires more information about the divisions than the BCG Matrix.
- The strategic implications of each matrix are different.

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 organizations portfolio of divisions.

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. The total weighted scores derived from the divisions allow construction of the corporate-level IE Matrix:

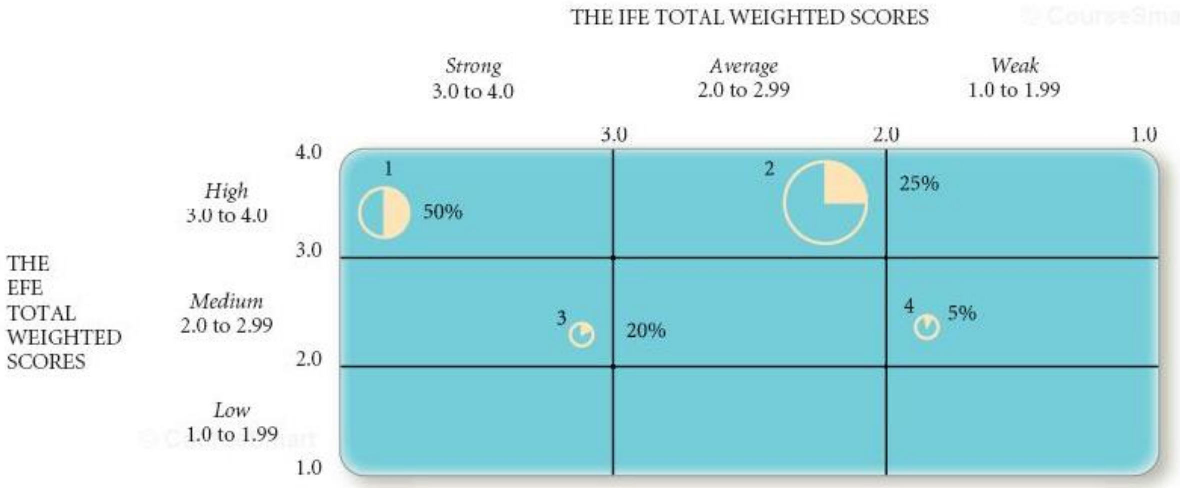
- On the x-axis or y-axis of the IE Matrix, an IFE total weighted score of 1.0 to 1.99 represents a weak internal position;
- A score of 2.0 to 2.99 is considered average
- A score of 3.0 to 4.0 is strong.

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 the figure below, 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.



Division	Sales	Percent Sales	Profits	Percent Profits	IFE Scores	EFE Scores
1	$100	25.0	10	50	3.6	3.2
2	200	50.0	5	25	2.1	3.5
3	50	12.5	4	20	3.1	2.1
4	50	12.5	1	5	1.8	2.5
Total	**400**	**100.0**	**20**	**100**		

6.7 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 below, the Grand Strategy Matrix is based on two evaluative dimensions: **competitive position and market** (industry) **growth**.

Source: Adapted from Roland Christensen, Norman Berg, and Malcolm Salter, *Policy Formulation and Administration* (Homewood, IL: Richard D. Irwin, 1976): 16–18.

Any industry whose annual growth in sales exceeds 5 percent could be considered to have rapid growth.

Quadrant I:

- 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.

Quadrant II:

- 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 firms 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.
- 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:

- 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.

Quadrant IV:

- 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.

6.8 The Quantitative Strategic Planning Matrix (QSPM)

The Quantitative Strategic Planning Matrix (QSPM), determines the relative attractiveness of feasible alternative actions. 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).
Like other strategy-formulation analytical tools, the QSPM requires good intuitive judgment.

The basic format of the QSPM is illustrated below. 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).

The Quantitative Strategic Planning Matrix QSPM				
		Strategic Alternatives		
	Weight	Strategy 1	Strategy 2	Strategy 3
Key External Factors				
Economy				
Political/Legal/Governmental				
Social/ Cultural/ Demographic/ Environmental				

Technological				
Competitive				
Key Internal Factors				
Management				
Marketing				
Finance/ Accounting				
Production/ Operations				
Research and Development				
Management Information Systems				

Six steps required to develop a QSPM:

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.

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

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.

6.8.1 Positive Features and Limitations of the QSPM

- Sets of strategies can be examined sequentially or simultaneously.
- 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.
- 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 con-sidered at once. It also has been applied successfully by a number of small businesses.

A QSPM Example for a Retail Computer Store:

		STRATEGIC ALTERNATIVES			
		1		2	
		Buy New Land and Build New Larger Store		Fully Renovate Existing Store	
Key Factors	*Weight*	*AS*	*TAS*	*AS*	*TAS*
Opportunities					
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	0.80	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	—		—	
Threats					
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		1	
4. New mall being built nearby	0.08	2		4	
5. Gas prices up 14%	0.04	—		—	
6. Vendors raising prices 8%	0.03	—		—	
	1.00				
Strengths					
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	—		—	
Weaknesses					
1. Revenues from software segment of store down 12%	0.10	—		—	
2. Location of store negatively impacted by new Highway 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		3.72		2.83

6.9 Cultural Aspects of Strategy Choice

All organizations have a culture. 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 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.

All organizations are political. Unless managed, political maneuvering consumes valuable time, subverts organizational objectives, diverts human energy, and results in the loss of some valuable employees. Sometimes political biases and personal preferences get unduly embedded in strategy choice decisions. Internal politics affect the choice of strategies in all organizations. The hierarchy of command in an organization, combined with the career aspirations of different people and the need to allocate scarce resources, guarantees the formation of coalitions of individuals who strive to take care of themselves first and the organization second, third, or fourth. Coalitions of individuals often form around key strategy issues that face an enterprise.
A major responsibility of strategists is to guide the development of coalitions, to nurture an overall team concept, and to gain the support of key individuals and groups of individuals.

7 Implementing Strategies

Less than 10 percent of strategies formulated are successfully implemented! There are many reasons for this low success rate, including failing to appropriately segment markets, paying too much for a new acquisition, and falling behind competitors in R& D. Implementing strategy affects an organization from top to bottom; it affects all the functional and divisional areas of a business.

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)!

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.

7.1 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
- represent the basis for allocating resources
- are a primary mechanism for evaluating managers
- are the major instrument for monitoring progress toward achieving long-term objectives
- establish organizational, divisional, and departmental priorities.

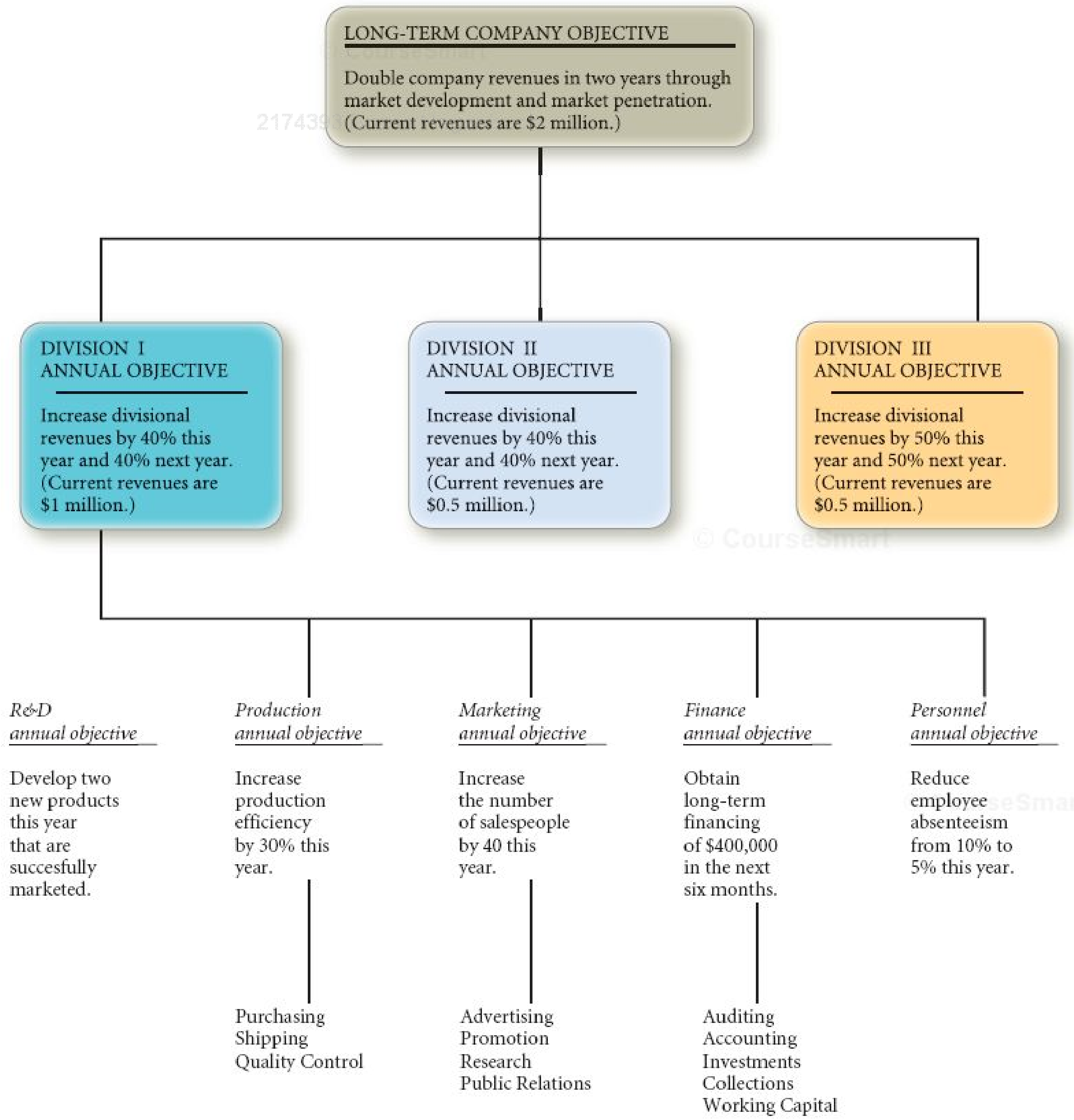
Considerable time and effort should be devoted to ensuring that annual objectives are well conceived, consistent with long-term objectives, and supportive of strategies to be implemented.

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.

The figure below illustrates how the Stamus Company could establish annual objectives based on long-term objectives. Note that, according to plan, the Stamus Company will slightly exceed its long- term objective of doubling company revenues between 2008 and 2009.

The figure below also reflects how a hierarchy of annual objectives can be established based on an organizations 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.

The Stamus Company's Hierarchy of Aims



Annual objectives should contain the following **SMART** criteria's:

- **Specific** - the objective should state exactly what is to be achieved.
- **Measurable** - an objective should be capable of measurement, so that it is possible to determine whether (or how far) it has been achieved
- **Achievable** - the objective should be realistic given the circumstances in which it is set and the resources available to the business.
- **Relevant** - objectives should be relevant to the people responsible for achieving them
- **Time Bound** - objectives should be set with a time-frame in mind. These deadlines also need to be realistic.

7.2 Policies

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, Carnivals Paradise ship has a no smoking policy anywhere, anytime aboard ship. It is the first cruise ship to comprehensively ban smoking. 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.

Example of a Hierarchy of Policies:

Company Strategy
Acquire a chain of retail stores to meet our sales growth and profitability objectives.

Supporting Policies

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 currently are open only 40 hours a week.)
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. (This policy could allow the company to establish a national reputation.)
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.)

Divisional Objective
Increase the division's revenues from $ 10 million in 2007 to $ 15 million in 2008.

Supporting Policies

1. Beginning in January 2008, each one of their divisions 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 2008, 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 2008, inventory levels carried in warehouses will be decreased by 30 percent in accordance with a just-in- time (JIT) manufacturing ajust-in-time (JIT) manufacturing approach. (This policy could reduce production expenses and thus free funds for increased marketing efforts.)

Production Department Objective
Increase production from 20,000 units in 2007 to 30,000 units in 2008.

Supporting Policies
1. Beginning in January 2008, 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 2008, 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 2008, 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.)

7.3 Matching Structure with Strategy

Changes in strategy often require changes in the way an organization is structured for two major reasons.
1. 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.
2. Structure dictates how resources will be allocated. If an organizations structure is based on customer groups, then resources will be allocated in that manner. Similarly, if an organizations 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.

7.3.1 The Functional Structure

The most widely used structure is the functional or centralized type. A functional structure groups tasks and activities by business function, such as production/ operations, marketing, finance/ accounting, research and development, and management information systems.

Advantage of a functional structure:
- simple
- inexpensive
- promotes specialization of labor
- encourages efficient use of managerial and technical talent
- minimizes the need for an elaborate control system
- allows rapid decision making

Disadvantages of a functional structure:
- forces accountability to the top
- minimizes career development opportunities
- is sometimes characterized by low employee morale, line/ staff conflicts, poor delegation of authority, and inadequate planning for products and markets
- often leads to short- term and narrow thinking (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)
- communication is often not as good in a functional structure

7.3.2 The Divisional Structure

The divisional or decentralized structure is the second most common type. The divisional structure can be organized in one of four ways: by geo-graphic 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:
- accountability is clear (Divisional managers can be held responsible for sales and profit levels and therefore)
- extensive delegation of authority
- managers and employees can easily see the results of their good or bad performances
- employee morale is generally higher in a divisional structure than it is in a centralized structure.
- It creates career development opportunities for managers
- allows local control of situations
- leads to a competitive climate within an organization
- allows new businesses and products to be added easily.

The divisional design is not without some limitations. Perhaps the most important limitation is that a divisional structure is costly, for a number of reasons:
- Each division requires functional specialists who must be paid.
- There exists some duplication of staff services, facilities, and personnel; for instance, functional specialists are also needed centrally (at headquarters) to coordinate divisional activities.

- 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.
- 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.

7.3.3 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. The span of control becomes too large at top levels of the firm. In multidivisional organizations, an SBU structure can greatly facilitate strategy-implementation efforts.

The SBU structure group's 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.

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.

7.3.4 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.

Advantages of a matrix structure:
- project objectives are clear
- many channels of communication
- workers can see the visible results of their work
- shutting down a project can be accomplished relatively easily
- 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, individuals may develop their own skills and competencies more than in other structures

Disadvantage of a matrix structure:
- higher overhead because it creates more management positions
- increases the 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
- need for an extensive and effective communication system

7.4 Restructuring

Restructuring and reengineering are becoming commonplace on the corporate landscape across the United States and Europe. Restructuring also called *downsizing, rightsizing, or delayering* involves reducing the size of the firm in terms of number of employees, number of divisions or units, and number of hierarchical levels in the firm's organizational structure. This reduction in size is intended to improve both efficiency and effectiveness. Restructuring is concerned primarily with shareholder well-being rather than employee well-being. Recessionary economic conditions have forced many companies to down-size, laying off managers and employees.

The primary benefit sought from restructuring is cost reduction. For some highly bureaucratic firms, restructuring can actually rescue the firm from global competition and demise. But the downside of restructuring can be reduced employee commitment, creativity, and innovation that accompanies the uncertainty and trauma associated with pending and actual employee layoffs.

7.5 Reengineering

Reengineering is concerned more with employee and customer well-being than shareholder well-being. Reengineering also called process management, process innovation, or process redesign involves reconfiguring or redesigning work, jobs, and processes for the purpose of improving cost, quality, service, and speed. Reengineering does not usually affect the organizational structure or chart, nor does it imply job loss or employee layoffs. Whereas restructuring is concerned with eliminating or establishing, shrinking or enlarging, and moving organizational departments and divisions, the focus of reengineering is changing the way work is actually carried out.

In reengineering, a firm uses information technology to break down functional barriers and create a work system based on business processes, products, or outputs rather than on functions or inputs. Cornerstones of reengineering are decentralization, reciprocal inter-dependence, and information sharing.

7.6 Managing Resistance to Change

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

1. Force 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.
2. Educative change strategy: this 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.
3. 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. Managers can improve the likelihood of successfully implementing change by carefully designing change efforts.

Igor Ansoff summarized the need for strategists to manage resistance to change as follows: “Observation of the historical transitions from one orientation to another shows that, if left unmanaged, the process becomes conflict- laden, prolonged, and costly in both human and financial terms. Management of resistance involves anticipating the focus of resistance and its intensity. Second, it involves eliminating unnecessary resistance caused by misperceptions and insecurities. Third, it involves mustering the power base necessary to assure support for the change. Fourth, it involves planning the process of change. Finally, it involves monitoring and controlling resistance during the process of change.”[20]

http://ecorner.stanford.edu/authorMaterialInfo.html?mid=1965

7.7 Production/Operations

Production/ operations capabilities, limitations, and policies can significantly enhance or inhibit the attainment of objectives. Production processes typically constitute more than 70 percent of a firm's total assets. A major part of the strategy-implementation process takes place at the production site. Production-related decisions on plant size, plant location, product design, choice of equipment, kind of tooling, size of inventory, inventory control, quality control, cost control, use of standards, job specialization, employee training, equipment and resource utilization, shipping and packaging, and technological innovation can have a dramatic impact on the success or failure of strategy-implementation efforts.

The largest bicycle company in the United States, Huffy, recently ended its own production of bikes and now contracts out those services to Asian and Mexican manufacturers. Huffy focuses instead on the design, marketing, and distribution of bikes, but it no longer produces bikes itself.

Just- in- time (JIT) production approaches have withstood the test of time. JIT significantly reduces the costs of implementing strategies. With JIT, parts and materials are delivered to a production site just as they are needed, rather than being stockpiled as a hedge against later deliveries. Harley- Davidson reports that at one plant alone, JIT freed $ 22 million previously tied up in inventory and greatly reduced reorder lead time.
Factors that should be studied before locating production facilities include;

- availability of major resources
- prevailing wage rates in the area
- transportation costs related to shipping and receiving
- location of major markets
- political risks in the area or country
- availability of trainable employees

7.8 Human Resources

The job of human resource manager is changing rapidly as companies continue to down-size and reorganize. Strategic responsibilities of the human resource manager include assessing the staffing needs and costs for alternative strategies proposed during strategy formulation and developing a staffing plan for effectively implementing strategies.

A well-designed strategic-management system can fail if insufficient attention is given to the human resource dimension. Human resource problems that arise when businesses implement strategies can usually be traced to one of three causes:

- disruption of social and political structures,
- failure to match individuals aptitudes with implementation tasks, and
- inadequate top management support for implementation activities

A number of other guidelines can help ensure that human relationships facilitate rather than disrupt strategy-implementation efforts. Specifically, managers should do a lot of chatting and informal questioning to stay abreast of how things are progressing and to know when to intervene. Managers can build support for strategy- implementation efforts by giving few orders, announcing few decisions, depending heavily on informal questioning, and seeking to probe and clarify until a consensus emerges. Key thrusts that succeed should be rewarded generously and visibly.

Perhaps the best method for preventing and overcoming human resource problems in strategic management is to actively involve as many managers and employees as possible in the process. Although time- consuming, this approach builds understanding, trust, commitment, and ownership and reduces resentment and hostility. The true potential of strategy formulation and implementation resides in people.

7.9 Marketing

Countless marketing variables affect the success or failure of strategy implementation. Two variables are of central importance to strategy implementation: market segmentation and product positioning. Market segmentation and product positioning rank as marketing's most important contributions to strategic management.

7.9.1 Market segmentation

Market segmentation can be defined as the subdividing of a market into distinct subsets of customers according to needs and buying habits. The marketing concept calls for understanding customers and satisfying their needs better than the competition. But different customers have different needs, and it rarely is possible to satisfy all customers by treating them alike.

Market segmentation is an important variable in strategy implementation for at least three major reasons.

1. Strategies such as market development, product development, market penetration, and diversification require increased sales through new markets and products. To successfully implement these strategies, new or improved market- segmentation approaches are required.
2. Market segmentation allows a firm to operate with limited resources because mass production, mass distribution, and mass advertising are not required. Market segmentation enables a small firm to compete successfully with a large firm by maximizing per-unit profits and per-segment sales.
3. Market segmentation decisions directly affect marketing mix variables: product, place, promotion, and price.

Examples:

- SnackWells, a pioneer in reduced-fat snacks, has shifted its advertising emphasis from low-fat to great taste as part of its new market- segmentation strategy.
- Perhaps the most dramatic new market- segmentation strategy is the targeting of regional tastes. Firms from McDonalds to General Motors are increasingly modifying their products to meet different regional preferences within the United States. Campell's has a spicier version of its nacho cheese soup for the Southwest, and Burger King offers breakfast burritos in New Mexico but not in South Carolina. Geographic and demo-graphic bases for segmenting markets are the most commonly employed.

Evaluating potential market segments requires strategists to determine the

- characteristics and needs of consumers
- consumer similarities and differences
- develop consumer group profiles

The requirements for successful segmentation are:

- Homogeneity within the segment
- Heterogeneity between segments
- Segments are measurable and identifiable
- Segments are accessible and actionable
- Segment is large enough to be profitable

Note in the figure below that customer age is used to segment automobile car purchases.

Average Age of Automobile Buyers, by Brand

Plymouth	38	Pontiac	42	Infiniti	45
Mitsubishi	38	Acura	42	Subaru	45
Volkswagen	38	Hyundai	42	Oldsmobile	46
Honda	41	Suzuki	42	Saturn	46
Isuzu	41	Audi	42	Chrysler	47
Kia	41	Daewoo	43	Lexus	47
Land Rover	41	Chevrolet	43	Jaguar	49
Mazda	41	Porsche	43	Mercury	50
Nissan	41	Saab	43	Lincoln	51
BMW	42	GMC	44	Cadillac	53
Dodge	42	Toyota	44	Buick	57
Jeep	42	Volvo	44		
Ford	42	Mercedes-Benz	45		

Source: Adapted from Norihiko Shirouzu, "This Is Not Your Father's Toyota," *Wall Street Journal* (March 26, 2002): B1.

Following segmentation for consumer markets:

- Geographic
- Demographic
- Psychographic
- Behavioral

Alternative Bases for Market Segmentation:

Variable	Typical Breakdowns
	Geographic
Region	Pacific, Mountain, West North Central, West South Central, East North Central, East South Central, South Atlantic, Middle Atlantic, New England
County Size	A, B, C, D
City Size	Under 5,000; 5,000–20,000; 20,001–50,000; 50,001–100,000; 100,001–250,000; 250,001–500,000; 500,001–1,000,000; 1,000,001–4,000,000; 4,000,001 or over
Density	Urban, suburban, rural
Climate	Northern, southern
	Demographic
Age	Under 6, 6–11, 12–19, 20–34, 35–49, 50–64, 65+
Gender	Male, female
Family Size	1–2, 3–4, 5+
Family Life Cycle	Young, single; young, married, no children; young, married, youngest child under 6; young, married, youngest child 6 or over; older, married, with children; older, married, no children under 18; older, single; other
Income	Under $10,000; $10,001–$15,000; $15,001–$20,000; $20,001–$30,000; $30,001–$50,000; $50,001–$70,000; $70,001–$100,000; over $100,000
Occupation	Professional and technical; managers, officials, and proprietors; clerical and sales; craftspeople; foremen; operatives; farmers; retirees; students; housewives; unemployed
Education	Grade school or less; some high school; high school graduate; some college; college graduate
Religion	Catholic, Protestant, Jewish, Islamic, other
Race	White, Asian, Hispanic, African American
Nationality	American, British, French, German, Scandinavian, Italian, Latin American, Middle Eastern, Japanese
	Psychographic
Social Class	Lower lowers, upper lowers, lower middles, upper middles, lower uppers, upper uppers
Personality	Compulsive, gregarious, authoritarian, ambitious
	Behavioral
Use Occasion	Regular occasion, special occasion
Benefits Sought	Quality, service, economy
User Status	Nonuser, ex-user, potential user, first-time user, regular user
Usage Rate	Light user, medium user, heavy user
Loyalty Status	None, medium, strong, absolute
Readiness Stage	Unaware, aware, informed, interested, desirous, intending to buy
Attitude Toward Product	Enthusiastic, positive, indifferent, negative, hostile

Source: Adapted from Philip Kotler, *Marketing Management: Analysis, Planning and Control,* © 1984: 256. Adapted by permission of Prentice-Hall, Inc., Upper Saddle River, New Jersey.

1.1.1.6 <u>Marketing Mix</u>

Marketing decisions generally fall into the following four controllable categories, the so called 4P’s:

- Product
- Price
- Place (distribution)
- Promotion

These four P's are the parameters that the marketing manager can control, subject to the internal and external constraints of the marketing environment. The goal is to make decisions that center the four P's on the customers in the target market in order to create perceived value and generate a positive response.

The Marketing Mix Component Variables:

Product	Place	Promotion	Price
Quality	Distribution channels	Advertising	Level
Features and options	Distribution coverage	Personal selling	Discounts and allowances
Style	Outlet location	Sales promotion	Payment terms
Brand name	Sales territories	Publicity	
Packaging	Inventory levels and locations		
Product line	Transportation carriers		
Warranty			
Service level			
Other services			

Source: E. Jerome McCarthy, *Basic Marketing: A Managerial Approach*, 9th ed. (Homewood, IL: Richard D. Irwin, Inc., 1987): 37–44.

7.9.2 Product Positioning

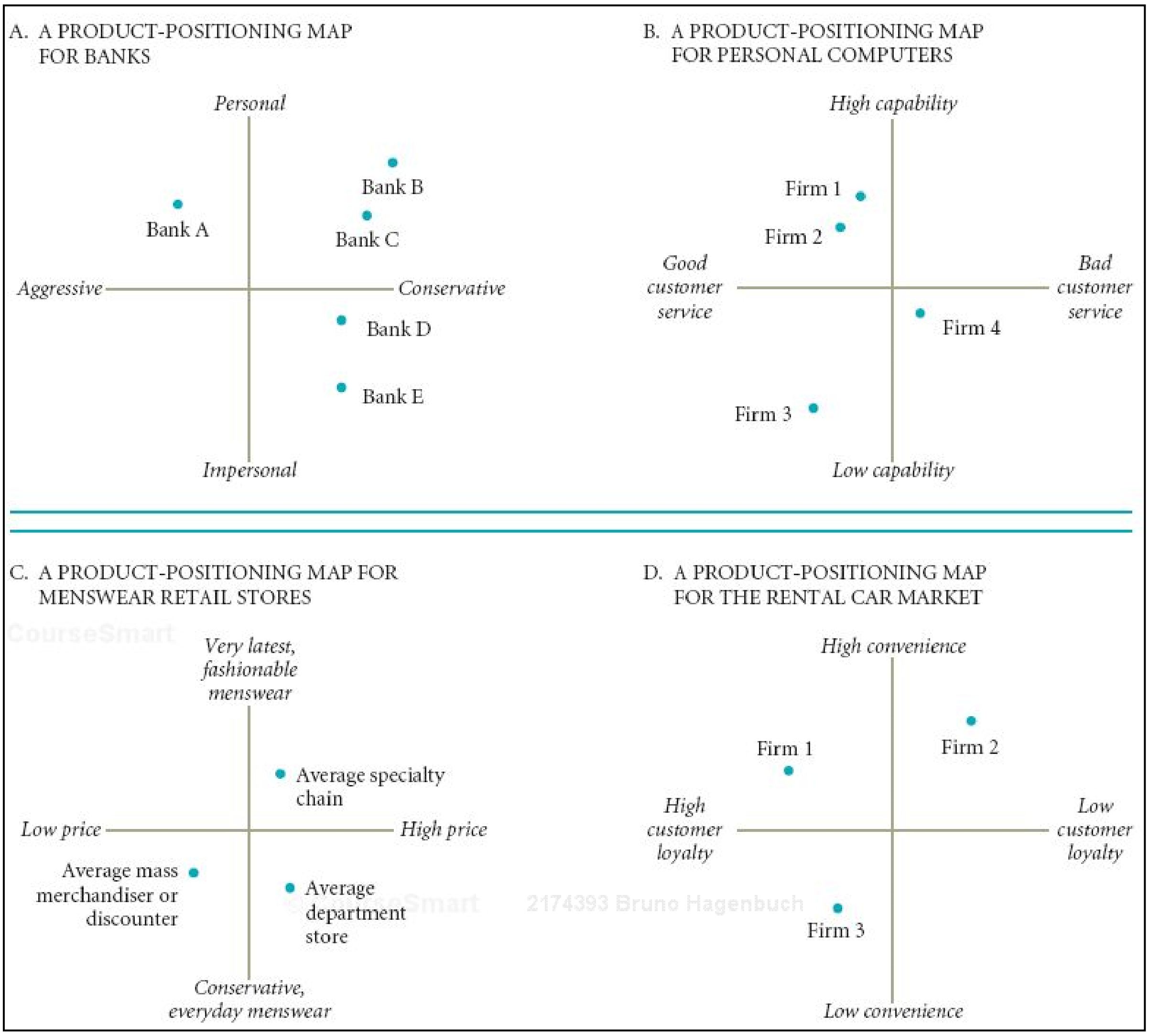
After markets have been segmented so that the firm can target particular customer groups, the next step is to find out what customers want and expect. This takes analysis and research.

Positioning entails developing schematic representations that reflect how your products or services compare to competitors on dimensions most important to success in the industry. The following steps are required in product positioning:

1. Select key criteria that effectively differentiate products or services in the industry.
2. Diagram a two-dimensional product-positioning map with specified criteria on each axis.
3. Plot major competitor's products or services in the resultant four-quadrant matrix.
4. Identify areas in the positioning map where the company's products or services could be most competitive in the given target market. Look for vacant areas (niches).
5. Develop a marketing plan to position the company's products or services appropriately.

Because just two criteria can be examined on a single product- positioning map, multiple maps are often developed to assess various approaches to strategy implementation.
An effective product-positioning strategy meets two criteria: (1) it uniquely distinguishes a company from the competition, and (2) it leads customers to expect slightly less service than a company can deliver. Firms should not create expectations that exceed the service the firm can or will deliver.

Examples of Product-Positioning Maps:



7.10 Finance/Accounting

7.10.1 Acquiring Capital to Implement Strategies

Successful strategy implementation often requires additional capital. Besides net profit from operations and the sale of assets, two basic sources of capital for an organization are debt and equity. Determining an appropriate mix of debt and equity in a firm's capital structure can be vital to successful strategy implementation. An Earnings Per Share/Earnings Before Interest and Taxes (EPS/ EBIT) analysis is the most widely used technique for determining whether debt, stock, or a combination of debt and stock is the best alternative for raising capital to implement strategies. This technique involves an examination of the impact that debt versus stock financing has on earnings per share under various assumptions as to EBIT.

EPS/ EBIT may be best explained by working through an example. Let's say the Brown Company needs to raise $ 1 million to finance implementation of a market-development strategy. The company's common stock currently sells for $ 50 per share, and 100,000 shares are outstanding. The prime interest rate is 10 percent, and the company's tax rate is 50 percent. The company's earnings before interest and taxes next year are expected to be $ 2 million if a recession occurs, $ 4 million if the economy stays as is, and $ 8 million if the economy significantly improves. EPS/ EBIT analysis can be used to determine if all stock, all debt, or some combination of stock and debt is the best capital financing alternative. The EPS/ EBIT analysis for this example is provided in the table below.

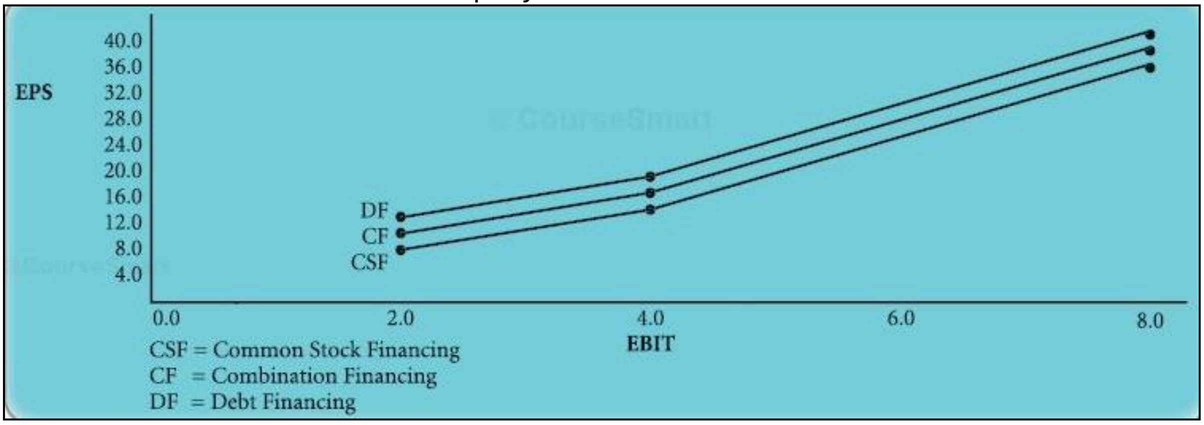
EPS/ EBIT Analysis for the Brown Company (In Millions):

	Common Stock Financing			Debt Financing			Combination Financing		
	Recession	*Normal*	*Boom*	*Recession*	*Normal*	*Boom*	*Recession*	*Normal*	*Boom*
EBIT	$2.0	$ 4.0	$ 8.0	$2.0	$ 4.0	$ 8.0	$2.0	$ 4.0	$ 8.0
Interest[a]	0	0	0	.10	.10	.10	.05	.05	.05
EBT	2.0	4.0	8.0	1.9	3.9	7.9	1.95	3.95	7.95
Taxes	1.0	2.0	4.0	.95	1.95	3.95	.975	1.975	3.975
EAT	1.0	2.0	4.0	.95	1.95	3.95	.975	1.975	3.975
#Shares[b]	.12	.12	.12	.10	.10	.10	.11	.11	.11
EPS[c]	8.33	16.66	33.33	9.5	19.50	39.50	8.86	17.95	36.14

[a]The annual interest charge on $1 million at 10% is $100,000 and on $0.5 million is $50,000. This row is in $, not %.
[b]To raise all of the needed $1 million with stock, 20,000 new shares must be issued, raising the total to 120,000 shares outstanding. To raise one-half of the needed $1 million with stock, 10,000 new shares must be issued, raising the total to 110,000 shares outstanding.
[c]EPS = Earnings After Taxes (EAT) divided by shares (number of shares outstanding).

As indicated by the EPS values of 9.5, 19.50, and 39.50 in the table, debt is the best financing alternative for the Brown Company if a recession, boom, or normal year is expected. An EPS/ EBIT chart can be constructed to determine the break- even point, where one financing alternative becomes more attractive than another. The figure below indicates that issuing common stock is the least attractive financing alternative for the Brown Company.

EPS/ EBIT Chart for the Brown Company:



EPS/ EBIT analysis is a valuable tool for making the capital financing decisions needed to implement strategies, but several considerations should be made whenever using this technique. First, profit levels may be higher for stock or debt alternatives when EPS levels are lower. For example, looking only at the earnings after taxes (EAT) values, you can see that the common stock option is the best alternative, regardless of economic conditions. If the Brown Company's mission includes strict profit maximization, as opposed to the maximization of stockholders wealth or some other criterion, then stock rather than debt is the best choice of financing. Another consideration when using EPS/ EBIT analysis is flexibility. As an organizations, capital structure changes, so does its flexibility for considering future capital needs. Using all debt or all stock to raise capital in the present may impose fixed obligations, restrictive covenants, or other constraints that could severely reduce a firm's ability to raise additional capital in the future. Control is also a concern. When additional stock is issued to finance strategy implementation, ownership and control of the enterprise are diluted. This can be a serious concern in today's business environment of hostile takeovers, mergers, and acquisitions.

7.10.2 Projected Financial Statements

Projected financial statement analysis is a central strategy-implementation technique because it allows an organization to examine the expected results of various actions and approaches. This type of analysis can be used to forecast the impact of various implementation decisions (for example, to increase promotion expenditures by 50 percent to support a market- development strategy, to increase salaries by 25 percent to support a market-penetration strategy, to increase research and development expenditures by 70 percent to support product development, or to sell $ 1 million of common stock to raise capital for diversification).
Nearly all financial institutions require at least three years of projected financial statements whenever a business seeks capital. A projected income statement and balance sheet allow an organization to compute projected financial ratios under various strategy-implementation scenarios. When compared to prior years and to industry averages, financial ratios provide valuable insights into the feasibility of various strategy-implementation approaches.

A 2008 projected income statement and a balance sheet for the Litten Company are provided in the table below. The projected statements for Litten are based on five assumptions:

- The company needs to raise $ 45 million to finance expansion into foreign markets
- $ 30 million of this total will be raised through increased debt and $ 15 million through common stock

- sales are expected to increase 50 percent
- three new facilities, costing a total of $ 30 million, will be constructed in foreign markets
- land for the new facilities is already owned by the company

Note that Littens strategies and their implementation are expected to result in a sales increase from $ 100 million to $ 150 million and in a net increase in income from $ 6 million to $ 9.75 million in the forecasted year.

A Projected Income Statement and Balance Sheet for the Litten Company (In Millions):

	Prior Year 2007	Projected Year 2008	Remarks
PROJECTED INCOME STATEMENT			
Sales	$100	$150.00	50% increase
Cost of Goods Sold	70	105.00	70% of sales
Gross Margin	30	45.00	
Selling Expense	10	15.00	10% of sales
Administrative Expense	5	7.50	5% of sales
Earnings Before Interest and Taxes	15	22.50	
Interest	3	3.00	
Earnings Before Taxes	12	19.50	
Taxes	6	9.75	50% rate
Net Income	**6**	**9.75**	
Dividends	2	5.00	
Retained Earnings	4	4.75	
PROJECTED BALANCE SHEET			
Assets			
Cash	5	7.75	Plug figure
Accounts Receivable	2	4.00	100% increase
Inventory	20	45.00	
Total Current Assets	27	56.75	
Land	15	15.00	
Plant and Equipment	50	80.00	Add three new plants at $10 million each
Less Depreciation	10	20.00	
Net Plant and Equipment	40	60.00	
Total Fixed Assets	55	75.00	
Total Assets	**82**	**131.75**	
Liabilities			
Accounts Payable	10	10.00	
Notes Payable	10	10.00	
Total Current Liabilities	20	20.00	
Long-term Debt	40	70.00	Borrowed $30 million
Additional Paid-in-Capital	20	35.00	Issued 100,000 shares at $150 each
Retained Earnings	2	6.75	$2 + $4.75
Total Liabilities and Net Worth	**82**	**131.75**	

There are six steps in performing projected financial analysis:

1. Prepare the projected income statement before the balance sheet. Start by forecasting sales as accurately as possible. Be careful not to blindly push historical percentages into the future with regard to revenue (sales) increases. Be mindful of what the firm did to achieve those past sales increases, which may not be appropriate for the future unless the firm takes similar or analogous actions (such as opening a similar number of stores, for example). If dealing with a manufacturing firm, also be mindful that if the firm is

operating at 100 percent capacity running three eight-hour shifts per day, then probably new manufacturing facilities (land, plant, and equipment) will be needed to increase sales further.

2. Use the percentage-of- sales method to project cost of goods sold (CGS) and the expense items in the income statement. For example, if CGS is 70 percent of sales in the prior year (as it is in above table), then use that same percentage to calculate CGS in the future year unless there is a reason to use a different percentage. Items such as interest, dividends, and taxes must be treated independently and cannot be forecasted using the percentage- of- sales method.
3. Calculate the projected net income.
4. Subtract from the net income any dividends to be paid for that year. This remaining net income is retained earnings (RE). Bring this retained earnings amount for that year (NI - DIV = RE) over to the balance sheet by adding it to the prior year's RE shown on the balance sheet. In other words, every year a firm adds it's RE for that particular year (from the income statement) to its historical RE total on the balance sheet. Therefore, the RE amount on the balance sheet is a cumulative number rather than money available for strategy implementation! Note that RE is the first projected balance sheet item to be entered. Due to this accounting procedure in developing projected financial statements, the RE amount on the balance sheet is usually a large number. However, it also can be a low or even negative number if the firm has been incurring losses. The only way for RE to decrease from one year to the next on the balance sheet is (1) if the firm incurred an earnings loss that year or (2) the firm had positive net income for the year but paid out dividends more than the net income. Be mindful that RE is the key link between a projected income statement and balance sheet, so be careful to make this calculation correctly.
5. Project the balance sheet items, beginning with retained earnings and then forecasting stockholders equity, long- term liabilities, current liabilities, total liabilities, total assets, fixed assets, and current assets (in that order). Use the cash account as the plug figure that is, use the cash account to make the assets total the liabilities and net worth. Then make appropriate adjustments. For example, if the cash needed to balance the statements is too small (or too large), make appropriate changes to borrow more (or less) money than planned.
6. List comments (remarks) on the projected statements. Any time a significant change is made in an item from a prior year to the projected year, an explanation (remark) should be provided. Remarks are essential because otherwise pro forma's are meaningless.

7.10.3 Evaluating the Worth of a Business

Evaluating the worth of a business is central to strategy implementation because integrative, intensive, and diversification strategies are often implemented by acquiring other firms. Other strategies, such as retrenchment and divestiture, may result in the sale of a division of an organization or of the firm itself.
The various methods for determining a business's worth can be grouped into three main approaches: what a firm owns, what a firm earns, or what a firm will bring in the market.

But it is important to realize that valuation is not an exact science. The valuation of a firms worth is based on financial facts, but common sense and intuitive judgment must enter into the process. It is difficult to assign a monetary value to some factors such as a loyal customer base, a history of growth, legal suits pending, dedicated employees, a favorable lease, a bad credit rating, or good patents that may not be reflected in a firms financial statements.

Also, different valuation methods will yield different totals for a firms worth, and no prescribed approach is best for a certain situation. Evaluating the worth of a business truly requires both qualitative and quantitative skills.

The first approach in evaluating the worth of a business is determining its net worth or stockholders equity. Net worth represents the sum of common stock, additional paid-in capital, and retained earnings. After calculating net worth, add or subtract an appropriate amount for goodwill, overvalued or undervalued assets, and intangibles. Whereas intangibles include copyrights, patents, and trademarks, goodwill arises only if a firm acquires another firm and pays more than the book value for that firm. For example, in late 2007 when M& F Worldwide acquired the much larger check- printing and software firm John H. Harland Company for $ 1.7 billion, that equated to $ 52.75 per share, even though John Harlands stock price was only $ 44.47. So M& F paid a 19 percent premium over the book value (number of shares outstanding times stock price) for John Harlands stock. M& F now carries this on its balance sheet as goodwill. Paying over book value happens quite often. Cisco Systems in late 2007 paid a 23 percent premium in their acquisition of WebEx Communications.

The second approach to measuring the value of a firm grows out of the belief that the worth of any business should be based largely on the future benefits its owners may derive through net profits. A conservative rule of thumb is to establish a business’s worth as five times the firm’s current annual profit. A five- year average profit level could also be used. When using the approach, remember that firms normally suppress earnings in their financial statements to minimize taxes.

The third approach, letting the market determine a business’s worth, involves three methods. First, base the firm’s worth on the selling price of a similar company. A potential problem, however, is that sometimes comparable figures are not easy to locate, even though substantial information on firms that buy or sell to other firms is available in major libraries. The second approach is called the price-earnings ratio method. To use this method, divide the market price of the firm’s common stock by the annual earnings per share and multiply this number by the firms average net income for the past five years. The third method can be called the outstanding shares method. To use this method, simply multiply the number of shares outstanding by the market price per share and add a premium. The premium is simply a per-share dollar amount that a person or firm is willing to pay to control (acquire) the other company.

Company Worth Analysis for Mattel, Nordstrom, and Pfizer (year- end 2006, in $ millions, except stock price and EPS):

Input Data	Mattel	Nordstrom	Pfizer
Shareholders' Equity	$2,432	$2,168	$71,358
Net Income (NI)	592	677	19,337
Stock Price	25	55	25
EPS	1.48	2.55	2.58
# of Shares Outstanding	393	257	7,090
Goodwill	845	51	20,876
Total Assets	4,955	4,821	114,837
Company Worth Analyses			
1. Shareholders' Equity plus Goodwill	$3,277	$2,219	$92,244
2. Net Income × 5	2,960	3,385	96,685
3. (Stock Price/EPS) × NI	10,000	14,601	187,374
4. # of Shares Out × Stock Price	9,825	14,135	177,250
5. Enterprise Value according to http://finance.yahoo.com	10,840	14,480	168,990
6. Five Method Average	7,380	9,764	144,508
$Goodwill/$Total Assets	17.1%	1.1%	18.7%

The table above provides the cash value analyses for three companies Mattel, Nordstrom, and Pfizer for year- end 2006. Notice that there is significant variation among the four methods used to determine cash value. For example, the worth of the toy company Mattel ranged from $ 2.29 billion to $ 10.84 billion. Obviously, if you were selling your company, you would seek the larger values, while if purchasing a company you would seek the lower values. In practice, substantial negotiation takes place in reaching a final compromise (or averaged) amount. Also recognize that if a firm's net income is negative, theoretically the approaches involving that figure would result in a negative number, implying that the firm would pay you to acquire them. Of course, you obtain all of the firm's debt and liabilities in an acquisition, so theoretically this would be possible.

7.10.4 Deciding Whether to Go Public

Going public means selling off a percentage of your company to others in order to raise capital; consequently, it dilutes the owner's control of the firm. Going public is not recommended for companies with less than $ 10 million in sales because the initial costs can be too high for the firm to generate sufficient cash flow to make going public worthwhile. One dollar in four is the average total cost paid to lawyers, accountants, and underwriters when an initial stock issuance is under $ 1 million; 1 dollar in 20 will go to cover these costs for issuances over $ 20 million. In addition to initial costs involved with a stock offering, there are costs and obligations associated with reporting and management in a publicly held firm. For firms with more than $ 10 million in sales, going public can provide major advantages: It can allow the firm to raise capital to develop new products, build plants, expand, grow, and market products and services more effectively.

7.11 Management Information Systems (MIS)

Firms that gather, assimilate, and evaluate external and internal information most effectively are gaining competitive advantages over other firms. Recognizing the importance of having an effective management information system (MIS) will not be an option in the future; it will be a requirement. Information is the basis for understanding in a firm. In many industries, information is becoming the most important factor in differentiating successful from unsuccessful firms.
The process of strategic management is facilitated immensely in firms that have an effective information system. Many companies are establishing a new approach to information systems, one that blends the technical knowledge of the computer experts with the vision of senior management.

Information collection, retrieval, and storage can be used to create competitive advantages in ways such as cross-selling to customers, monitoring suppliers, keeping managers and employees informed, coordinating activities among divisions, and managing funds.
Like inventory and human resources, information is now recognized as a valuable organizational asset that can be controlled and managed. Firms that implement strategies using the best information will reap competitive advantages in the twenty-first century.

A good information system can allow a firm to reduce costs. For example, online orders from salespersons to production facilities can shorten materials ordering time and reduce inventory costs. Direct communications between suppliers, manufacturers, marketers, and customers can link together elements of the value chain as though they were one organization. Improved quality and service often result from an improved information system.

In many firms, information technology is doing away with the workplace and allowing employees to work at home or anywhere, anytime. The mobile concept of work allows employees to work the traditional 9- to- 5 workday across any of the 24 time zones around the globe. Affordable desktop videoconferencing software developed by AT& T, Lotus, or Vivo Software allows employees to beam in whenever needed. Any manager or employee who travels a lot away from the office is a good candidate for working at home rather than in an office provided by the firm. Salespersons or consultants are good examples, but any person whose job largely involves talking to others or handling information could easily operate at home with the proper computer system and software.

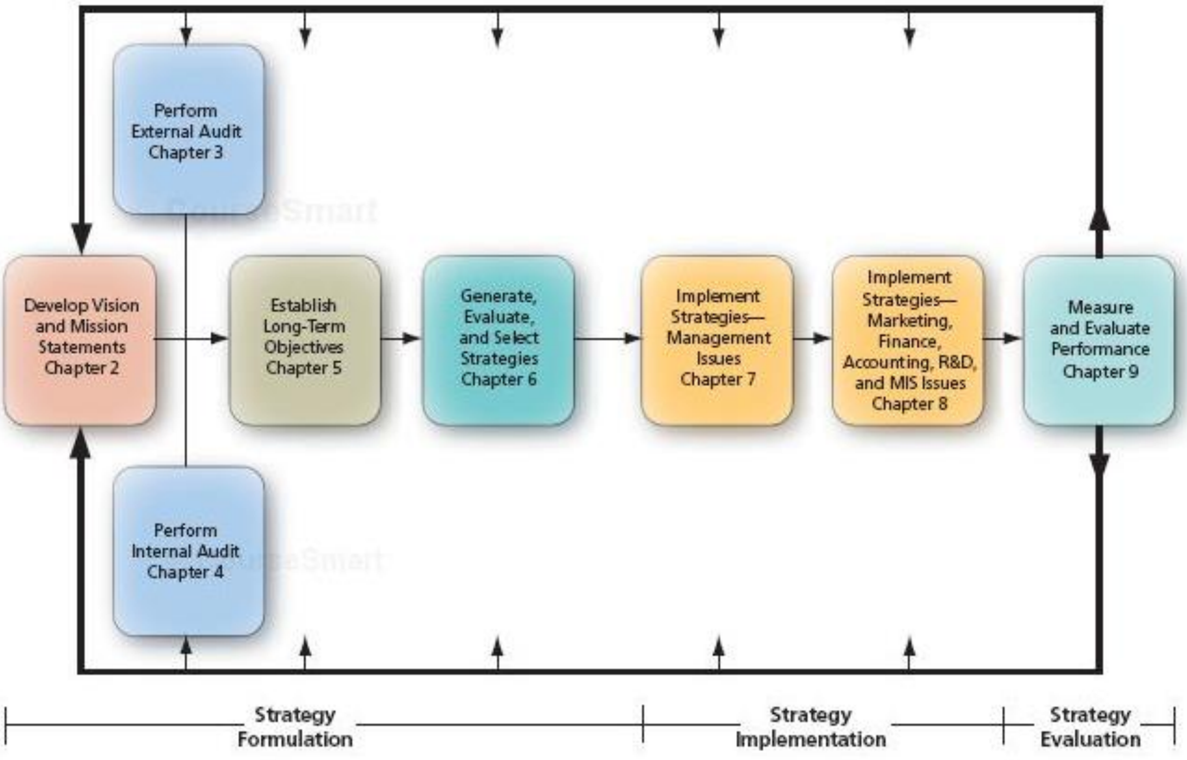
8 Strategy Review, Evaluation, and Control

8.1 Strategy Evaluation

Strategy evaluation includes three basic activities:
1. review the underlying bases of a firms strategy
2. measure organizational performance (comparing expected results with actual results)
3. taking corrective actions to ensure that performance conforms to plans

The strategy-evaluation stage of the strategic-management process is illustrated in the figure below:

Figure 8-1 The Strategic Evaluation Process



Source: Fred R. David, "How Companies Define Their Mission," *Long Range Planning* 22, no. 3 (June 1988): 40.

8.2 A Strategy- Evaluation Framework

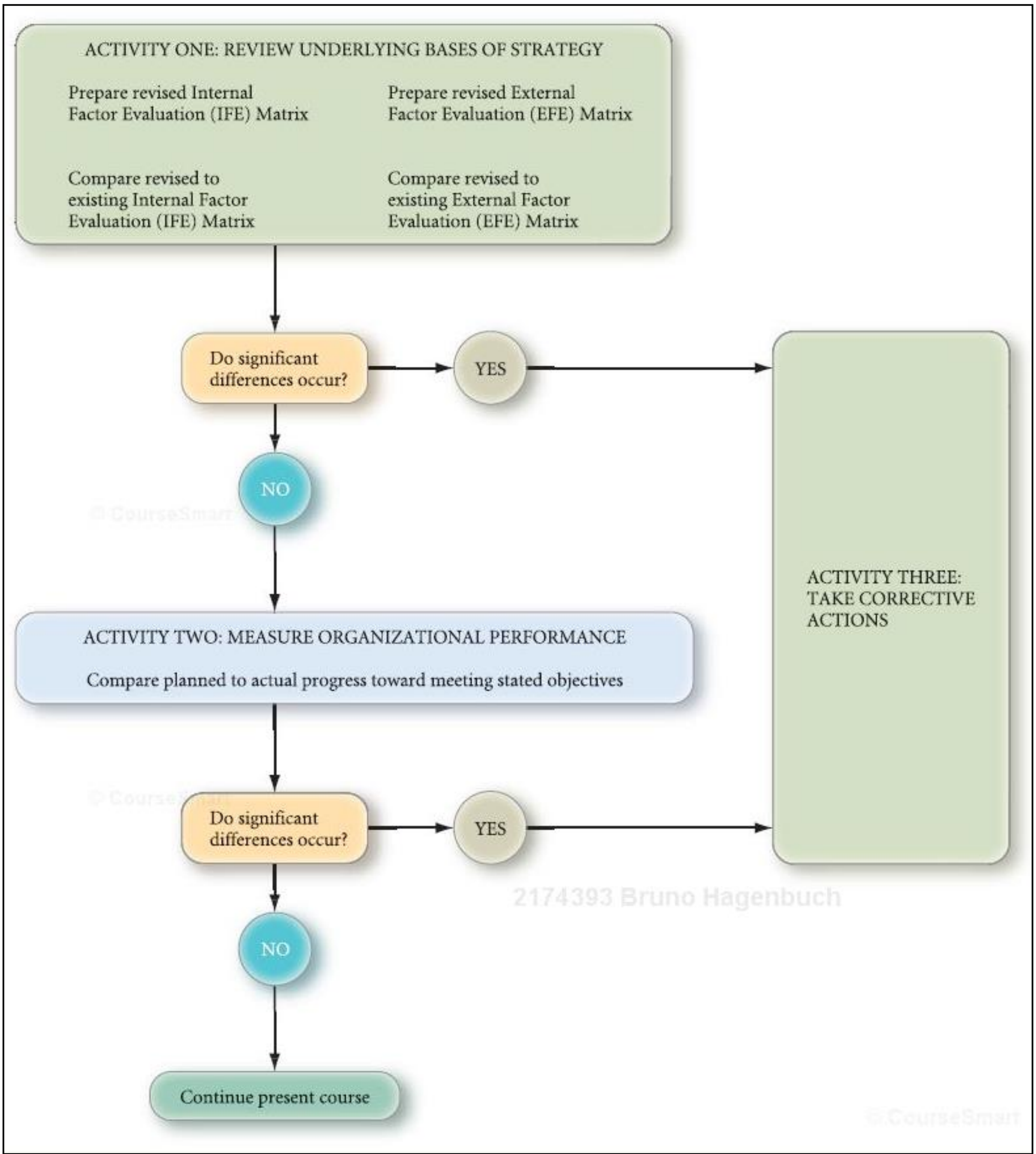
The table below summarizes strategy-evaluation activities in terms of key questions that should be addressed, alternative answers to those questions, and appropriate actions for an organization to take. Notice that corrective actions are almost always needed except when external and internal factors have not significantly changed and the firm is progressing satisfactorily toward achieving stated objectives.

Table 8-1 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

Relationships among strategy-evaluation activities are illustrated in this Strategy Evaluation Framework:

Figure 8-2 A Strategy Evaluation Framework



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8.2.1 Reviewing Bases of Strategy

As shown in the Figure 8-2 A Strategy Evaluation Framework, reviewing the underlying bases of an organizations strategy could be approached by developing a revised EFE Matrix and IFE Matrix. A revised IFE Matrix should focus on changes in the organizations 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?

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.

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.
Some key questions to address in evaluating strategies follow:

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?

8.2.2 Measuring Organizational Performance

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
- 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)**.

Quantitative criteria commonly used to evaluate strategies are financial ratios, which strategists use to make three critical comparisons:
- comparing the firms performance over different time periods
- comparing the firms performance to competitors
- comparing the firms 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

But there are some potential problems associated with using quantitative criteria for evaluating strategies.
- Most quantitative criteria are geared to annual objectives rather than long-term objectives.
- Different accounting methods can provide different results on many quantitative criteria.
- 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.
- 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.

8.2.3 Taking Corrective Actions

The final strategy-evaluation activity, taking corrective actions, requires making changes to competitively reposition a firm for the future. Examples of changes that may be needed are altering an organizations 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 sales-persons, 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.
Taking corrective actions is necessary to keep an organization on track toward achieving stated objectives.

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.

8.2.4 The Balanced Scorecard

The Balanced Scorecard Introduced earlier in the Chapter 6 discussion of objectives, the 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?

8.3 Contingency Planning

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 firms 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.

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, tornados, 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?

Alternative strategies not selected for implementation can serve as contingency plans in case the strategy or strategies selected do not work.

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 counterimpact 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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