4
Strategic Planning

Syllabus Covered

Meaning, stages, alternatives, strategy formulation.

Question 1

State with reasons which of the following statements is correct / incorrect:

(a) The first step of strategy formulation in strategic management model is to undertake internal analysis. *(2 Marks, May, 2007)*

(b) Retrenchment implies downsizing of business. *(2 Marks, May, 2007)*

(c) Acquisition is a strategy. *(2 Marks, Nov., 2007)*

(d) A company's strategy has always to be proactive in nature. *(2 Marks, Nov., 2008)*

(e) *Stability strategy is not a 'do-nothing' strategy.* *(2 Marks, May, 2014)*

Answer

(a) Incorrect: Identifying an organisation's existing vision, mission, objectives, and strategies is the starting point for any strategic management process because an organisation's existing situation and condition may preclude certain strategies and may even dictate a particular course of action. Determining vision and mission provides long-term direction, delineate what kind of enterprise the company is trying to become and infuse the organisation with a sense of purposeful action.

(b) Incorrect: In the context of strategic management, retrenchment implies giving up certain products and reducing the level of business as a compulsive measure to cope up with certain adverse developments on which the firm has little control. Downsizing (or rightsizing) is planned elimination of positions or jobs. Retrenchment does not imply downsizing, however, the latter is often used to implement a retrenchment strategy.

(c) Correct: An acquisition is a strategy through which one firm buys a controlling or complete interest in another firm. Acquisition of an existing concern is an instant means of achieving growth through expansion and/or diversification. Ideally, acquisition strategy should be used when the acquiring firm is able to enhance its economic value through ownership and the use of the assets that are acquired.

(d) Incorrect: A company's strategy is a blend of proactive actions and reactive actions by the management. Reactive actions are required to address unanticipated developments and environmental conditions. Thus, not every strategic move is the result of proactive and deliberate management actions. At times, some kind of strategic reaction or adjustments are required.

(e) Correct: Stability strategies are implemented by approaches wherein few functional changes are made in the products or markets. It is not a 'do nothing' strategy. It involves keeping track of new developments to ensure that the strategy continues to make sense. This strategy is typical for mature business organizations. Some small organizations will also frequently use stability as a strategic focus to maintain comfortable market or profit position.

Question 2

(a) Fill in the blanks in the following statements with the most appropriate word:

(i) Michael Porter's Generic strategies allow organizations to gain competitive advantages by cost leadership, _____and focus. (1 Mark, May, 2011)

*(ii) Divestment is a part of rehabilitation and is adopted when a _____has been attempted but has proved to be unsuccessful. (*1 Mark, *Nov., 2011)*

*(iii) Strategy is a deliberate search for a plan of action that will develop a business _____and compound it. (*1 Mark, *May, 2012)*

(b) Explain the meaning of the Combination Strategies. (1 Mark, May, 2011)

(c) Explain the meaning of Directional Strategies. (1 Mark, May, 2012))

(d) Explain the meaning of Cost Leadership Strategies. (1 Mark, May, 2012)

(e) Explain the meaning of Best-cost provider strategy. (1 Mark, Nov., 2012)

Answer

(a) (i) Differentiation.

(ii) Turnaround.

(iii) Competitive Advantage

(b) Combination Strategies refer to a mix of different strategies like stability; expansion, diversification or retrenchment to suit particular situations that an enterprise is facing. For instance, a strategy of diversification/acquisition may call for retrenchment in some obsolete product lines.

(c) The corporate strategies a firm can adopt have been classified into four broad categories: stability, expansion, retrenchment, and combination known as directional/grand strategies. They are often called master or business strategies to provide basic direction for strategic actions toward achieving long-term business objectives.

(d) A number of cost elements affect the relative attractiveness of generic strategies. A successful cost leadership strategy usually permeates the entire firm, as evidenced by

high efficiency, low overhead cost, and waste reduction. The low cost leadership should be such that no competitors are able to imitate so that it can result in sustainable competitive advantage to the cost leader firm.

(e) Best-cost provider strategy: Best-cost provider strategy involves providing customers more value for the money by emphasizing low cost and better quality difference. It can be done:

(i) through offering products at lower price than what is being offered by rivals for products with comparable quality and features or

(ii) charging similar price as by the rivals for products with much higher quality and better features.

Question 3

Briefly answer the following question in 2-3 sentences:

(a) What is meant by retrenchment strategy? (2 Marks, May, 2008)

(b) Need for Turnaround Strategy (2 Marks, May, 2010)

(c) Grand Strategy Alternative during Recession. (2 Marks each, May, 2010)

(d) What is meant by Concentric diversification? (2 Marks, Nov., 2007)

Answer

(a) Retrenchment strategy implies substantial reduction in the scope of organization's activity. A business organization can redefine its business by divesting a major product line or market. While retrenching organizations might set objectives below the past level of objectives. It is essentially a defensive strategy adopted as a reaction to operating problems stemming from either internal mismanagement, unanticipated actions by competitors or hostile and unfavourable changes in the business environmental conditions. With a retrenchment strategy the endeavour of management is to raise the level of enterprise achievements focusing on improvements in the functional performance and cutting down operations with negative cash flows.

(b) Turnaround is needed when an enterprise's performance deteriorates to a point that it needs a radical change of direction in strategy, and possibly in structure and culture as well. It is a highly targeted effort to return an organization to profitability and increase positive cash flows to a sufficient level. It is used when both threats and weaknesses adversely affect the health of an organization so much that its basic survival is difficult.

The overall goal of turnaround strategy is to return an underperforming or distressed company to normalcy in terms of acceptable levels of profitability, solvency, liquidity and cash flow. To achieve its objectives, turnaround strategy must reverse causes of distress, resolve the financial crisis, achieve a rapid improvement in financial performance, regain stakeholder support, and overcome internal constraints and unfavourable industry characteristics.

(c) Stability strategy is advisable option for the organisations facing recession. During recession businesses face reduced demand for their products even at low prices. Funds become scarce, expenditure on expansion is stopped, profits decline and businesses try to minimise the costs. They work hard to maintain the existing market share, so that company survives the recessionary period.

(d) Concentric diversification: Concentric diversification amounts to related diversification. In this form of diversification, the new business is linked to the existing businesses through existing systems such as process, technology or marketing. The new product is a spin-off from the existing facilities and products/processes. There are benefits of synergy with the current operations. However, concentric diversification differs from vertically integrated diversification in the nature of the linkage the new product has with the existing ones.

While in vertically integrated diversification, the new product falls within the firm's current process-product chain, in concentric diversification, there is a departure from this vertical linkage. The new product is only connected in a loop-like manner at one or more points in the firm's existing process/technology/product chain. In concentric diversification there are benefits of synergy with the current operations.

Question 4

Distinguish between the following:

(a) Forward and backward integration. (2 Marks, June, 2008 & 2009)

(b) Top-Down and Bottom-Up Strategic Planning.(4 Marks, Nov., 2010 & 3 Marks, May, 2013)

(c) Concentric Diversification and Conglomerate Diversification (3 Marks, Nov., 2011 & 4 Marks, Nov., 2013)

(d) Expansion Strategy and Retrenchment Strategy. (3 Marks, May, 2012)

(e) Vertically Integrated Diversification and Horizontally Integrated Diversification. (3 Marks, Nov., 2012)

(f) Cost Leadership and Differentiation Strategies. (4 Marks, May, 2014)

(g) Divestment strategy and Liquidation strategy. (4 Marks, Nov., 2014)

Answer

(a) Forward and backward integration forms part of vertically integrated diversification. In vertically integrated diversification, firms opt to engage in businesses that are vertically related to the existing business of the firm. The firm remains vertically within the same process. While diversifying firms opt to engage in businesses that are linked forward or backward in the chain and enters specific product/process steps with the intention of making them into new businesses for the firm.

Backward integration is a step towards, creation of effective supply by entering business of input providers. Strategy employed to expand profits and gain greater control over production of a product whereby a company will purchase or build a business that will increase its own supply capability or lessen its cost of production. On the other hand forward integration is moving forward in the value chain and entering business lines that use existing products. Forward integration will also take place where organisations enter into businesses of distribution channels.

(b) Top-Down and Bottom-Up Strategic Planning

Strategic planning determines where an organization is going over the next year or more and the ways for going there. The process is organization-wide, or focused on a major function such as a division or other major function. As such strategic planning is a top level management function. The flow of planning can be from corporate to divisional level or vice-versa. There are two approaches for strategic planning - top down or bottom up.

Top down strategic planning describes a centralized approach to strategy formulation in which the corporate centre or head office determines mission, strategic intent, objectives and strategies for the organization as a whole and for all parts. Unit managers are seen as implementers of pre-specified corporate strategies.

Bottom up strategic planning is the characteristic of autonomous or semi-autonomous divisions or subsidiary companies in which the corporate centre does not conceptualize its strategic role as being directly responsible for determining the mission, objectives, or strategies of its operational activities. It may prefer to act as a catalyst and facilitator, keeping things reasonably simple and confining itself to perspective and broader strategic intent.

(c) Concentric diversification occurs when a firm adds related products or markets. On the other hand conglomerate diversification occurs when a firm diversifies into areas that are unrelated to its current line of business.

In concentric diversification, the new business is linked to the existing businesses through process, technology or marketing. In conglomerate diversification, no such linkages exist; the new business/product is disjointed from the existing businesses/products.

The most common reasons for pursuing a concentric diversification are that opportunities in a firm's existing line of business are available. However, common reasons for pursuing a conglomerate growth strategy is that opportunities in a firm's current line of business are limited or opportunities outside are highly lucrative.

(d) Expansion strategy is implemented by redefining the business by adding the scope of business substantially increasing the efforts of the current business. On the other hand, Retrenchment Strategy involves redefinition of business by divesting a major product line or market. Expansion is a promising and popular strategy that tends to be equated with dynamism, vigour, promise and success. Retrenchment or retreat becomes necessary or

expedient for coping with particularly hostile and adverse situations in the environment and when any other strategy is likely to be suicidal.Expansion may take the enterprise along relatively unknown and risky paths, full of promises and pitfalls. Retrenchment involves regrouping and recouping of the resources.

(e) In vertically integrated diversification, firms opt to engage in businesses that are related to the existing business of the firm. The firm remains vertically within the same process. Sequence moves forward or backward in the chain and enters specific product/process steps with the intention of making them into new businesses for the firm.

On the other hand, horizontal Integrated Diversification is the acquisition of one or more similar business operating at the same stage of the production-marketing chain that is going into complementary products, by-products or taking over competitors' businesses.

(f) According to Porter, strategies allow organizations to gain competitive advantage from three different bases: cost leadership, differentiation, and focus. 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.

A primary reason for pursuing forward, backward, and horizontal integration strategies is to gain cost leadership benefits. But cost leadership generally must be pursued in conjunction with differentiation. Different strategies offer different degrees of differentiation. A differentiation strategy should be pursued only after a careful study of buyers' needs and preferences to determine the feasibility of incorporating one or more differentiating features into a unique product. A successful differentiation strategy allows a firm to charge a higher price for its product and to gain customer loyalty.

(g) Divestment strategy involves the sale or liquidation of a portion of business, or a major division, profit centre or SBU. Divestment is usually a part of rehabilitation or restructuring plan and is adopted when a turnaround has been attempted but has proved to be unsuccessful. The option of a turnaround may even be ignored if it is obvious that divestment is the only answer.

Liquidation as a form of retrenchment strategy is considered as the most extreme and unattractive. It involves closing down a firm and selling its assets. It is considered as the last resort because it leads to serious consequences such as loss of employment for workers and other employees, termination of opportunities a firm could pursue, and the stigma of failure.

Question 5

What do you understand by 'Strategy'? Explain the four generic strategies as discussed by Glueck and Jauch. *(10 Marks, May, 2007)*

Answer

Businesses have to respond to a dynamic and often hostile environment for pursuit of their mission. Strategies provide an integral framework for management and negotiate their way through a complex and turbulent external environment. Strategy seeks to relate the goals of the organisation to the means of achieving them.

A company's strategy is the game plan management is using to stake out market position and conduct its operations. A company's strategy consists of the combination of competitive moves and business approaches that managers employ to please customers, compete successfully and achieve organisational objectives.

Strategy may be defined as a long range blueprint of an organisation's desired image, direction and destination what it wants to be, what it wants to do and where it wants to go. Strategy is meant to fill in the need of organisations for a sense of dynamic direction, focus and cohesiveness.

Question 6

Michael E. Porter has suggested three generic strategies. Briefly explain them. What is the basic objective to follow a generic strategy? In what situations can the three strategies be used? Identify the type of strategy used in the following examples:

(a) Dell Computer has decided to rely exclusively on direct marketing.

(b) "Our basic strategy was to charge a price so low that microcomputer makers couldn't do the software internally for that cheaply."

(c) 'NDTV', a TV Channel has identified a profitable audience niche in the electronic media. It has further exploited that niche through the addition of new channels like 'NDTV' Profit and 'Image'. (3 + 1 + 3 + 3 = 10 Marks, May, 2010)

Identify the Generic Strategy used in the following examples:

(i) Bell Computer has decided to rely exclusively on direct marketing.

(ii) Our basic strategy was to charge a price so low that micro computer makers couldn't do the software internally for that cheaply.

(iii) 'MD TV', a TV channel has identified a profitable audience niche in the electronic media. It has further exploited that niche through the addition of new channels like 'MD TV' Profit and Image. (3 Marks, November, 2013)

According to Michael Porter, strategies allow organizations to gain competitive advantages from different bases. Explain these bases as mentioned by Porter. (3 Marks, May, 2013)

Answer

According to Porter, strategies allow organizations to gain competitive advantage from three different bases: cost leadership, differentiation, and focus. These bases form different generic strategies as follows:

Cost leadership emphasizes producing standardized products at a very low per-unit cost for consumers who are price-sensitive. It frequently results from productivity increases and aggressive pursuit of cost reduction throughout the development, production, marketing, and distribution processes. It allows a firm to earn higher profits than its competitors.

Differentiation is a strategy aimed at producing products and services considered unique industry wide and directed at consumers who are relatively price-insensitive. It concerns with distinguishing a product/service from that of its competitors through unique design features, technological leadership, unique uses of products and attributes like quality, environmental impact and customer service.

Focus means producing products and services that fulfil the specific needs of small groups of consumers. It involves selecting or focussing a market or customer segment in which to operate.

The basic purpose of following a generic strategy is to gain competitive advantage so as to ensure long-time survival and growth.

Situations under which these generic strategies can be used are:

Cost Leadership - When the market is price-sensitive, not much room is left for differentiation. Cost leadership is a better option when buyers do not care much about differences between the brands.

Differentiation – This strategy is suitable when the customers want or can get attracted to specific attribute(s) of the products. It is directed towards creating separate market with a product with different attribute(s). The strategy is useful in a perfectly competitive market where all products look similar.

Focus - Smaller firms may compete on a focus basis. When the customers have distinctive preferences or requirements and the rival firms are not attempting to specialise in the same target segment.

In the given examples the generic strategies that are being followed are given as follows:

(i) Differentiation: Dell Computers is differentiating on product delivery. Computer market is highly competitive and the products are very similar.

(ii) Cost Leadership: Keeping the prices low so that microcomputer makers acquire the software rather than developing themselves is a case of cost leadership.

(iii) Focus. NDTV has identified a profitable area (audience niche) and is focusing on it.

The Generic Strategies

According to Glueck and Jauch there are four generic ways in which strategic alternatives can be considered. These are stability, expansion, retrenchment and combinations.

(i) Stability strategies: One of the important goals of a business enterprise is stability to safeguard its existing interests and strengths, to pursue well established and tested objectives, to continue in the chosen business path, to maintain operational efficiency on a sustained basis, to consolidate the commanding position already reached, and to optimise returns on the resources committed in the business.

(ii) Expansion Strategy: Expansion strategy is implemented by redefining the business by adding the scope of business substantially increasing the efforts of the current business. Expansion is a promising and popular strategy that tends to be equated with dynamism, vigor, promise and success. It is often characterised by significant reformulation of goals and directions, major initiatives and moves involving investments, exploration and onslaught into new products, new technology and new markets, innovative decisions and action programmes and so on. Expansion includes diversifying, acquiring and merging businesses.

(iii) Retrenchment Strategy: A business organisation can redefine its business by divesting a major product line or market. Retrenchment or retreat becomes necessary or expedient for coping with particularly hostile and adverse situations in the environment and when any other strategy is likely to be suicidal. In business parlance also, retreat is not always a bad proposition to save the enterprise's vital interests, to minimise the adverse environmental effects, or even to regroup and recoup the resources before a fresh assault and ascent on the growth ladder is launched.

(iv) Combination Strategies: Stability, expansion or retrenchment strategies are not mutually exclusive. It is possible to adopt a mix to suit particular situations. An enterprise may seek stability in some areas of activity, expansion in some and retrenchment in the others. Retrenchment of ailing products followed by stability and capped by expansion in some situations may be thought of. For some organisations, a strategy by diversification and/or acquisition may call for a retrenchment in some obsolete product lines, production facilities and plant locations.

Question 7

What is Divestment strategy? When is it adopted? *(3 Marks, Nov., 2012)*

Answer

Divestment strategy involves the sale or liquidation of a portion of business, or a major division, profit centre or SBU. Divestment is usually a part of rehabilitation or restructuring plan.

A divestment strategy may be adopted due to various reasons:

- When a turnaround has been attempted but has proved to be unsuccessful.

- A business that had been acquired proves to be a mismatch and cannot be integrated within the company.
- Persistent negative cash flows from a particular business create financial problems for the whole company.
- Severity of competition and the inability of a firm to cope with it.
- Technological upgradation is required if the business is to survive but where it is not possible for the firm to invest in it.
- A better alternative may be available for investment.

Question 8

What is meant by backward integration? Name any two backward integration strategies that hospitals may pursue. *(1 + 2 = 3 Marks, Nov., 2014)*

Answer

Backward integration is a step towards, creation of effective supply by entering business of input providers. Strategy employed to expand profits and gain greater control over production of a product whereby a company will purchase or build a business that will increase its own supply capability or lessen its cost of production.

In case of hospitals there can be number of businesses that can be entered. Following are indicative list of backward integration strategies that hospitals may pursue:

- Drugs and pharmaceuticals – Specific drugs can be manufactured or traded.
- Business of gases required in hospitals – oxygen.
- Pathology labs / diagnostic services. This can be created in-house if not available already. Alternatively, a chain can be started.
- Blood Banks.
- Ambulance services.

Question 9

Explain the meaning of the following strategies and also give suitable examples:

(i) Forward Integration

(ii) Backward Integration

(iii) Horizontal Integration

(iv) Conglomerate Diversification

(v) Divestment

(vi) Liquidation

(vii) Concentric Diversification *(7 ×1 = 7 Marks, Nov., 2010)*

Answer

Strategy	Meaning	Example
(i) Forward Integration	Gaining ownership or increased control over the next level in the value chain (Manufacturing or intermediaries)	Reliance Industries (owning refineries) diversified into petrol pumps
(ii) Backward Integration	Gaining ownership or increased control over the previous level in the value chain (Manufacturing or suppliers)	An automobile manufactures diversifying into tyre production.
(iii) Horizontal Integration	Seeking ownership or increased control of a firm's competitors	ICICI Bank taking over Bank of Rajasthan
(iv) Conglomerate Diversification	Adding new, unrelated products or services	Yash Birla Group (auto & engineering) decides to enter wellness, solar power and schools.
(v) Divestment	Divestment strategy involves the sale or liquidation of a portion of business, or a major division, profit centre or SBU.	Godrej Group's withdrawal from the JV with Sara Lee from Africa
(vi) Liquidation	Liquidation strategy is an extreme and unattractive strategy as it involves closing down a firm and selling its assets. It is considered as the last resort when all other options fail.	Those companies whose products are no more in demand sell all their assets.
(vii) Concentric Diversification	In concentric diversification, the new business are added that are linked to the existing businesses through process, technology or marketing.	Kotak Mahindra Bank gets into insurance and asset management businesses.

Question 10

Under what conditions would you recommend the use of Turnaround strategy in an organization? What could be a suitable work plan for this? (5 + 5 = 10 Marks) (May, 2008)

Answer

Rising competition, business cycles and economic volatility have created a climate where no business can take viability for granted. Turnaround strategy is a highly targeted effort to return an organization to profitability and increase positive cash flows to a sufficient level.

Organizations those have faced a significant crisis that has negatively affected operations requires turnaround strategy. Turnaround strategy is used when both threats and weaknesses adversely affect the health of an organization so much that its basic survival is a question. When organization is facing both internal and external pressures making things difficult then it has to find something which is entirely new, innovative and different. Being organization's first objective is to survive and then grow in the market; turnaround strategy is used when organization's survival is under threat. Once turnaround is successful the organization may turn to focus on growth.

Conditions for turnaround strategies

When firms are losing their grips over market, profits due to several internal and external factors, and if they have to survive under the competitive environment they have to identify danger signals as early as possible and undertake rectification steps immediately. These conditions may be, inter alia cash flow problems, lower profit margins, high employee turnover and decline in market share, capacity underutilization, low morale of employees, recessionary conditions, mismanagement, raw material supply problems and so on.

Action plan for turnaround strategy

Stage One – Assessment of current problems: The first step is to assess the current problems and get to the root causes and the extent of damage the problem has caused. Once the problems are identified, the resources should be focused toward those areas essential to efficiently work on correcting and repairing any immediate issues.

Stage Two – Analyze the situation and develop a strategic plan: Before you make any major changes; determine the chances of the business's survival. Identify appropriate strategies and develop a preliminary action plan. For this one should look for the viable core businesses, adequate bridge financing and available organizational resources. Analyze the strengths and weaknesses in the areas of competitive position. Once major problems and opportunities are identified, develop a strategic plan with specific goals and detailed functional actions.

Stage Three – Implementing an emergency action plan: If the organization is in a critical stage, an appropriate action plan must be developed to stop the bleeding and enable the organization to survive. The plan typically includes human resource, financial, marketing and operations actions to restructure debts, improve working capital, reduce costs, improve budgeting practices, prune product lines and accelerate high potential products. A positive operating cash flow must be established as quickly as possible and enough funds to implement the turnaround strategies must be raised.

Stage Four – Restructuring the business: The financial state of the organization's core business is particularly important. If the core business is irreparably damaged, then the outlook for the entire organization may be bleak. Prepare cash forecasts, analyze assets and debts, review profits and analyze other key financial functions to position the organization for rapid improvement.

During the turnaround, the "product mix" may be changed, requiring the organization to do some repositioning. Core products neglected over time may require immediate attention to remain competitive. Some facilities might be closed; the organization may even withdraw from certain markets to make organization leaner or target its products toward a different niche.

The 'people mix" is another important ingredient in the organization's competitive effectiveness. Reward and compensation systems that encourage dedication and creativity encourage employees to think profits and return on investments.

Stage Five – Returning to normal: In the final stage of turnaround strategy process, the organization should begin to show signs of profitability, return on investments and enhancing economic value-added. Emphasis is placed on a number of strategic efforts such as carefully adding new products and improving customer service, creating alliances with other organizations, increasing the market share, etc.

Question 11

Write short note on the Expansion through acquisitions and mergers. *(3 Marks, Nov., 2014)*

Answer

Acquisitions and mergers are basically combination strategies. Some organizations prefer to grow through mergers. Merger is considered to be a process when two or more companies come together to expand their business operations. In such a case the deal gets finalized on friendly terms and both the organizations share profits in the newly created entity. In a merger two organizations combine to increase their strength and financial gains along with breaking the trade barriers.

When one organization takes over the other organization and controls all its business operations, it is known as acquisition. In this process of acquisition, one financially strong organization overpowers the weaker one. Acquisitions often happen during recession in economy or during declining profit margins. In this process, one that is financially stronger and bigger establishes it power. The combined operations then run under the name of the powerful entity. A deal in case of an acquisition is often done in an unfriendly manner, it is more or less a forced association where the powerful organization either consumes the operation or a company in loss is forced to sell its entity.