

4

Strategic Planning

Basic Concepts

The chapter of strategic planning discusses corporate strategy and its formulation. It also introduces strategic formulation process, knowing different strategies and so on.

1. Introduction

Corporate strategy is the game plan that actually steers the firm towards success. The degree of aptness of this game plan decides the extent of the firm's success. That is why formulation of corporate strategy forms the crux of the strategic planning process.

2. Planning

Planning is future oriented. It relates to deciding what needs to be done in the future and generating blueprints for action. Planning involves determining what resources are available, what resources can be obtained, and allocating responsibilities according to the potential of the employees.

2.1 Dealing with strategic uncertainty

The strategic uncertainty is represented by a future trend or event that has inherent unpredictability. Each strategic uncertainty involves potential trends or events that could have an impact on present, proposed, and even potential strategic business units (SBUs).

3. The Stages of Corporate Strategy Formulation-Implementation process

Crafting and executing a company's strategy is a five-stage managerial process as given below:

3.1 Developing a strategic vision of where the company needs to head and what should be its future product-customer-market-technology focus.

3.2 Setting objectives and using them as yardsticks for measuring the company's performance and progress.

3.3 Crafting a strategy to achieve the desired outcomes and move the company along the strategic course that management has charted.

3.4 Implementing and executing the chosen strategy efficiently and effectively.

3.5 Monitoring developments and initiating corrective adjustments in the company's long-term direction, objectives, strategy, or execution in light of the company's actual performance, changing conditions, new ideas, and new opportunities.

4. Strategic Alternatives

4.1. Generic Strategic Alternatives

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

- **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.
- **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 also includes diversifying, acquiring and merging businesses.
- **Expansion through diversification:** Diversification is defined as entry into new products or product lines, new services or new markets, involving substantially different skills, technology and knowledge.
- **Expansion through acquisitions and mergers:** Acquisition or merger with an existing concern is an instant means of achieving the expansion.
- **Retrenchment Strategy:** A business organization 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.
- **Combination Strategies:** The above strategies are not mutually exclusive. It is possible to adopt a mix of the above to suit particular situations

4.2 Michael Porter's Generic Strategies

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

- **Cost Leadership Strategies:** A primary reason for pursuing forward, backward, and horizontal integration strategies is to gain cost leadership benefits. A number of cost elements affect the relative attractiveness of generic strategies, including economies or diseconomies of scale achieved, learning and experience curve effects, the percentage of capacity utilization achieved, and linkages with suppliers and distributors. A successful cost leadership strategy usually permeates the entire firm, as evidenced by high efficiency, low overhead, limited perks, intolerance of waste, intensive screening of budget requests, wide spans of control, rewards linked to cost containment, and broad employee participation in cost control efforts.

- **Differentiation Strategies:** Different strategies offer different degrees of differentiation. Differentiation does not guarantee competitive advantage, especially if standard products sufficiently meet customer needs or if rapid imitation by competitors is possible. A successful differentiation strategy allows a firm to charge a higher price for its product and to gain customer loyalty because consumers may become strongly attached to the differentiation features. A risk of pursuing a differentiation strategy is that the unique product may not be valued highly enough by customers to justify the higher price. When this happens, a cost leadership strategy easily will defeat a differentiation strategy.
- **Focus Strategies:** A successful focus strategy depends on an industry segment that is of sufficient size, has good growth potential, and is not crucial to the success of other major competitors. Strategies such as market penetration and market development offer substantial focusing advantages. Focus strategies are most effective when consumers have distinctive preferences or requirements and when rival firms are not attempting to specialize in the same target segment.

4.3 Best-Cost Provider Strategy

The new model of best cost provider strategy is a further development of above three generic strategies.

4.4 Grand strategies/directional strategies

Various strategy alternatives are available to a firm for achieving its growth objective. The corporate strategies a firm can adopt have been classified into four broad categories: *stability*, *expansion*, *retrenchment* and *combination* known as grand strategies.

- **Stability strategy:** The firm stays with its current businesses and product markets; maintains the existing level of effort; and is satisfied with incremental growth.
- **Expansion strategy:** Here, the firm seeks significant growth—maybe within the current businesses; maybe by entering new business that are related to existing businesses; or by entering new businesses that are unrelated to existing businesses.
- **Retrenchment strategy:** The firm retrenches some of the activities in a given business(es), or drops the business as such through sell-out or liquidation.
- **Combination strategy:** The firm combines the above strategic alternatives in some permutation/combination so as to suit the specific requirement of the firm.

Expansion or growth strategy can either be through intensification or diversification.

Intensification Strategy

- **Market Penetration:** The most common expansion strategy is market penetration/concentration on the current business. The firm directs its resources to the profitable growth of a single product, in a single market, and with a single technology.
- **Market Development:** It consists of marketing present products, to customers in related market areas by adding different channels of distribution or by changing the content of advertising or the promotional media.

4.4 Strategic Management

- **Product Development:** Product Development involves substantial modification of existing products or creations of new but related items that can be marketed to current customers through established channels.

Diversification Strategy:

Diversification endeavours can be related or unrelated to existing businesses of the firm. Based on the nature and extent of their relationship to existing businesses, diversification endeavours have been classified into four broad categories:

Vertically integrated diversification

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 It 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.

- **Horizontal integrated diversification:** Through 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' products.
- **Concentric diversification:** Concentric diversification too amounts to related diversification. In concentric diversification, the new business is linked to the existing businesses through process, technology or marketing. The new product is a spin-off from the existing facilities and products/processes. This means that in concentric diversification too, 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.
- **Conglomerate diversification:** In conglomerate diversification, no such linkages exist; the new businesses/ products are disjointed from the existing businesses/products in every way; it is a totally unrelated diversification. In process/technology/function, there is no connection between the new products and the existing ones. Conglomerate diversification has no common thread at all with the firm's present position.

Retrenchment, Divestment and Liquidation Strategies

Retrenchment grand strategy is followed when an organization substantially reduces the scope of its activity. This is done through an attempt to find out the problem areas and diagnose the causes of the problems. Sometimes simple solutions do not exist. To safeguard the overall interest hard decisions are required. If the organization chooses to focus on ways and means to reverse the process of decline, it adopts a turnaround strategy. If it cuts off the loss-making units, divisions, or SBUs, curtails its product line, or reduces the functions performed, it adopts a divestment (or divestiture) strategy. If none of these actions work, then it may choose to abandon the activities totally, resulting in a liquidation strategy. We deal with each of these strategies below.

Turnaround Strategies
Retrenchment may be done either internally or externally. For internal retrenchment to take place, emphasis is laid on improving internal efficiency, known as turnaround strategy. There are certain conditions like persistent negative cash flow, negative profits, declining market share, deterioration in physical facilities, high turnover of employees, and low morale, uncompetitive products or services and mismanagement which point out that a turnaround is needed if the organization has to survive. For turnaround strategies to be successful, it is imperative to focus on the short and long-term financing needs as well as on strategic issues.
Divestment Strategies:
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 Strategies:
A retrenchment strategy considered the most extreme and unattractive is liquidation strategy, which 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 where a firm could pursue any future activities, and the stigma of failure.
5. Merger and Acquisition Strategy
<p>Merger and acquisition in simple words are defined as a process of combining two or more organizations together. There is a thin line of difference between the two terms but the impact of combination is completely different in both the cases.</p> <p>In a merger two organizations combine to increase their strength and financial gains along with breaking the trade barriers.</p> <p>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.</p> <p>Types of Mergers</p> <ul style="list-style-type: none"> ◆ Horizontal Merger ◆ Vertical Merger ◆ Co-generic Merger ◆ Conglomerate Merger

Very Short Answer Type Questions

Question 1

- (i) Explain the meaning of the Combination Strategies.
- (ii) Explain the meaning of Directional Strategies.

4.6 Strategic Management

(iii) Explain the meaning of Cost Leadership Strategies.

(iv) Explain the meaning of Best-cost provider strategy.

Answer

- (i) 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.
- (ii) 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.
- (iii) 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.
- (iv) 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:
 - (a) through offering products at lower price than what is being offered by rivals for products with comparable quality and features or
 - (b) charging similar price as by the rivals for products with much higher quality and better features.

Short Answer Type Questions

Question 2

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

- (a) Strategic planning is an attempt to improve operational efficiency.
- (b) The first step of strategy formulation in strategic management model is to undertake internal analysis.
- (c) Balance scorecard is a combination of strategic and marketing objectives.
- (d) Divesting a major product line or market in an organization can be termed as retrenchment strategy.
- (e) Acquisition is a strategy.
- (f) Diversification only involves entering in new businesses that are related to the existing business of an organisation

- (g) *Vertical diversification integrates firms forward or backward in the product chain.*
- (h) *Concentric diversification amounts to unrelated diversification.*
- (i) *Liquidation is the last resort option for a business organisation.*
- (j) *Retrenchment implies downsizing of business.*
- (k) *Stability strategy is not a 'do-nothing' strategy.*

Answer

- (a) **Incorrect:** Strategic planning, an important component of strategic management, involves developing a strategy to meet competition and ensure long-term survival and growth. Strategic Planning is a function of top management level in the organisation and relate the organisation with its environment. Operational efficiency is not a direct outcome of strategic planning.
- (b) **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.
- (c) **Incorrect:** Balance scorecard is a combination of strategic and financial objectives. It measure company performance, requires setting both financial and strategic objectives and tracking their achievement. Unless a company is in deep financial difficulty, such that its very survival is threatened, company managers are well advised to put more emphasis on achieving strategic objectives than on achieving financial objectives whenever a trade-off has to be made.
- (d) **Correct:** An organization can redefine its business by divesting a major product line or market. The divesting can be termed as retrenchment strategy. The enterprise may withdraw from marginal markets, withdraw some brands or sizes of products. It may also withdraw some of slow moving products. In an extreme manner it may seek retirement either from the production or the marketing activity.
- (e) **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.
- (f) **Incorrect:** Although, organisations can diversify into businesses that are vertically or horizontally related to the existing businesses, the diversification is not limited to the related businesses. In conglomerate diversification; the new businesses/ products are disjointed from the existing businesses/products in every way. There is no connection between the new products and the existing ones in process, technology or function.

4.8 Strategic Management

- (g) **Correct:** In vertically integrated diversification, firms opt to engage in businesses that are related to the existing business of the firm. It moves forward or backward in the chain and enters specific product with the intention of making them part of new businesses for the firm.
- (h) **Incorrect:** Concentric diversification amounts to related diversification. Concentric diversification takes place when the products or services added are in different industry but are similar to the existing product or service line with respect to technology or production or marketing channels or customers.
- (i) **Correct:** 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. The company management, government, banks and financial institutions, trade unions, suppliers, creditors, and other agencies are extremely reluctant to take a decision, or ask for liquidation.
- (j) **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.
- (k) **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 3

Briefly answer the following questions:

- (a) *Differentiate clearly between forward and backward integration. What is forward and Backward integration.*
- (b) *What is meant by concentric diversification?*
- (c) *Explain conglomerate diversification.*
- (d) *Need for Turnaround Strategy.*
- (e) *Grand Strategy Alternative during Recession.*
- (f) *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*
- (g) Distinguish between the following:*
 - (i) Top-Down and Bottom-Up Strategic Planning.*
 - (ii) Concentric Diversification and Conglomerate Diversification*
 - (iii) Expansion Strategy and Retrenchment Strategy*
 - (iv) Vertically Integrated Diversification and Horizontally Integrated Diversification.*
 - (v) Cost Leadership and Differentiation Strategies*
 - (vi) Divestment strategy and Liquidation strategy.*
- (h) What is meant by retrenchment strategy?*
- (i) What is Divestment strategy? When is it adopted?*
- (j) What is meant by backward integration? Name any two backward integration strategies that hospitals may pursue.*
- (k) Write short note on expansion through acquisitions and mergers.*
- (l) Write short note on Conglomerate Merger.*
- (m) A Bakery starts producing pastries and other similar products. What type of diversification strategy is being following by it and why?*
- (n) Identify with reasons the type of growth strategies followed in the following cases:*
 - (i) A leading producer of confectionery products advertising the new uses of its product 'Chokoo Mix' aggressively.*
 - (ii) A company in publishing industry deciding to revise college text books.*
 - (iii) A renowned company in textile industry starting to manufacture PFY and PSF, critical raw materials for textiles.*
 - (iv) A business giant in auto manufacturing enters into edible oils, hotels, financial services and dairy businesses.*

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

4.10 Strategic Management

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 lower 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) 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.

- (b) When an organization adopts a strategy which requires taking up those activities which are unrelated to the existing businesses, either in terms of their respective customer groups, customer functions or alternative technologies, it is called conglomerate diversification. Conglomerate diversification has no common thread at all with the firm's present position. For example, the businesses of Godrej are diversified into furniture, soaps, oils, insecticides and so on.
- (d) 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.

- (e) 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.

(f)

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.

- (g) (i) **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. 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.

- (ii) 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.

- (iii) 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.

- (iv) 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.

- (v) 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.

- (vi) **Divestment Strategy:** 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 Strategy: 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.

- (h) 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

4.14 Strategic Management

level of enterprise achievements focusing on improvements in the functional performance and cutting down operations with negative cash flows.

- (i) 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.
- (j) 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.
- (k) 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 its 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.

- (l) *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.*

Conglomerate merger happens in case of organizations that are unrelated to each other combine together. There are no linkages with respect to customer groups, customer functions and technologies being used. There are no important common factors between the organizations in production, marketing, research and development and technology. In practice, however, there is some degree of overlap in one or more of these factors.

- (m) *A bakery normally is a small organization that produces and sells flour-based food baked in an oven. Typically, a bakery produces breads, cakes, cookies, pastries, pies, etc. A bakery that is hitherto not into producing pastries starts producing them and other similar products is following concentric diversification which is basically related diversification.*

In this form of diversification, the new business is linked to the existing businesses through existing systems such as processes, 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. The most common reasons for pursuing a concentric diversification are that opportunities in existing line of business are available.

- (n) (i) *The organisation has adopted market penetration strategy (intensification) through advertising the new uses of its product 'chokoo mix' aggressively. Here the organisation seeks significant growth – within the current business by selling existing products in the existing markets without changing the product in a major way.*
- (ii) *The company has adopted product development strategy (intensification) by deciding to revise college text books. The company is already in publishing industry and must be having appropriate competencies in dealer network and acceptance amongst the student community. Revising the college text books (new product) would enable it to expand in the college text books segment (existing market).*
- (iii) *The company has adopted backward integration strategy (vertically integrated diversification) by starting to manufacture PFY and PSF, critical raw materials*

for textiles. This strategy, apart from overall growth of the organisation, ensures uninterrupted supply of critical raw materials for the present business of the firm. It will also enable the organization to retain the margins in dealing with the raw materials which otherwise would have gone to its suppliers.

- (iv) *The business giant in auto manufacturing has adopted conglomerate diversification strategy by entering into edible oils, hotels, financial services and dairy businesses. In conglomerate diversification a business enters into new businesses that may have little or no linkages with existing business. The organisation has mammoth growth ambition.*

Questions with Descriptive Answers

Question 3

Under what conditions would you recommend the use of Turnaround strategy in an organization? What could be a suitable work plan for this?

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 that 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 4

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."

4.18 Strategic Management

- (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'.*

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:

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

- (b) Cost Leadership: Keeping the prices low so that microcomputer makers acquire the software rather than developing themselves is a case of cost leadership.
- (c) Focus. NDTV has identified a profitable area (audience niche) and is focusing on it.

Question 5

What do you understand by 'Strategy'? Explain the four generic strategies as discussed by Glueck and Jauch.

Answer

Businesses have to respond to a dynamic and often hostile environment in 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.

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

4.20 Strategic Management

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 6

The Management of a sick company manufacturing various electrical home appliances seeks your advice for an appropriate retrenchment strategy. What will be your advice and why?

Answer

A sick company has huge accumulated losses that have eroded its net worth. The electric home appliance company may analyse its various products to take decisions on their individual viability.

Retrenchment becomes necessary for coping with hostile and adverse situations in the environment and when any other strategy is likely to be suicidal. The nature, extent and timing of retrenchment are matters to be carefully decided by management, depending upon each contingency.

Retrenchment strategy is adopted because:

- ◆ *The management no longer wishes to remain in business either partly or wholly due to continuous losses and unviability.*
- ◆ *The environment faced is threatening.*
- ◆ *Stability can be ensured by reallocation of resources from unprofitable to profitable businesses.*

Retrenchment grand strategy is followed when an organization substantially reduces the scope of its activity. This is done through an attempt to find out the problem areas and diagnose the causes of the problems. Next, steps are taken to solve the problems. These steps result in different kinds of retrenchment strategies.

Turnaround strategy: If the organization chooses to transform itself into a leaner structure and focuses on ways and means to reverse the process of decline, it adopts a turnaround strategy. It may try to reduce costs, eliminate unprofitable outputs, generate

revenue, improve coordination, better control, and so on. It may also involve changes in top management and reorienting leadership.

Divestment Strategy: 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.

Liquidation Strategy: In the retrenchment strategy, the most extreme and unattractive is liquidation strategy. 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 where a firm could pursue any future activities, and the stigma of failure. Many small-scale units, proprietorship firms, and partnership ventures liquidate frequently but medium-and large-sized companies rarely liquidate in India. The company management, government, banks and financial institutions, trade unions, suppliers and creditors, and other agencies are extremely reluctant to take a decision, or ask, for liquidation.

Liquidation strategy may be unpleasant as a strategic alternative but when a "dead business is worth more than alive", it is a good proposition.

The management of a Sick company manufacturing various electrical home appliances be explained about the each of the above three options of retrenchment strategy with their pros and cons. But the appropriate advice with respect to a particular option of retrenchment strategy will depend on the specific circumstances of each electrical home appliances and management goals of the company.

Questions with Hints

Question 7

What is a Corporate Strategy? How organisations can deal with strategic uncertainty?

Answer

Corporate strategy is basically the growth design of the firm. It spells out the growth objective of the firm - the direction, extent, pace and timing of the firm's growth. It also spells out the strategy for achieving the growth. Thus, we can also describe corporate strategy as the objective-strategy design of the firm. And, to arrive at such an objective-strategy design is the basic burden of corporate strategy formulation. Strategic uncertainty, uncertainty that has strategic implications, is a key construct in strategy formulation. A typical external analysis will emerge with dozens of strategic uncertainties. To be manageable, they need to be grouped into logical clusters or themes. It is then useful to assess the importance of each cluster in order to set priorities with respect to Information gathering and analysis.

Question 8

What are acquisitions? Discuss with example of two companies?

4.22 Strategic Management

Answer

Acquisition or merger with an existing concern is an instant means of achieving the expansion. It is an attractive and tempting proposition in the sense that it circumvents the time, risks and skills involved in screening internal growth opportunities, seizing them and building up the necessary resource base required to materialise growth. Organizations consider merger and acquisition proposals in a systematic manner, so that the marriage will be mutually beneficial, a happy and lasting affair.

Apart from the urge to grow, acquisitions and mergers are resorted to for purposes of achieving a measure of synergy between the parent and the acquired enterprises. Synergy may result from such bases as physical facilities, technical and managerial skills, distribution channels, general administration, research and development and so on. Only positive synergistic effects are relevant in this connection which denote that the positive effects of the merged resources are greater than the sum of the effects of the individual resources before merger or acquisition.

Students may give two examples from the industry. Some of the recent / popular instances of acquisition are listed below:

Tata's acquisition of Anglo Dutch steelmaker Corus

Tata's acquisition of British Jaguar Land Rover

Mittal Steel's takeover of Arcelor

HPCL's acquisition of Kenya Petroleum Refinery Ltd.

Hindalco's acquisition Canada based Novelis.

Question 9

What is Strategic Management Process? Briefly explain its each step.

Answer

The term strategic management refers to the managerial process of forming a strategic vision, setting objectives, crafting a strategy, implementing and executing the strategy, and then subsequently initiating whatever corrective adjustments in the vision, objectives, strategy, and execution are deemed appropriate. The strategy-making/strategy-implementing process consists of five interrelated managerial tasks. These are

- Setting vision and mission.
- Setting objectives.
- Crafting a strategy.
- Implementing and executing.
- Evaluating performance and initiating corrective adjustments.

Question 10

Discuss strategic alternatives with reference to Michael Porter's strategies.

Answer

According to Porter, strategies allow organizations to gain competitive advantage from three different bases: cost leadership, differentiation, and focus. Porter calls these bases as 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 even small groups of consumers who are in need of distinctive services.

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.

Question 11

What are the various bases on which an existing firm can diversify strategically?

Answer

Diversification endeavours can be related or unrelated to existing businesses of the firm. Based on the nature and extent of their relationship to existing businesses, diversification endeavours have been classified into four broad categories:

- (i) Vertically integrated diversification
- (ii) Horizontally integrated diversification
- (iii) Concentric diversification
- (iv) Conglomerate diversification

Questions for Practice

1. How a company can deal with strategic uncertainty.
2. Differentiate concentric diversification with vertically integrated diversification.

Activity

Select Financial Newspapers for a period of two months and identify and segregate different strategies being adopted by companies in terms of expansion, diversification, retrenchment, liquidation etc. Find out the reasons for choosing a particular strategy.