CHAPTER 9
FUNDAMENTALS OF STRATEGIC MANAGEMENT

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Learning Outcomes

• Define Strategic Management.
• Understand the advantages of Strategic Management.
• Explain Strategic Management Process in Detail.
• Outline the three levels of Strategy.
• Describe the Michael Porter’s Five Force Model.
• Understand the Different Types of Strategy.
• Explain Porter’s Generic Strategies.
• Understanding Competitive Advantage.
Strategic Management

• “You’ve got to think about big things while you’re doing small things, so that all the small things go in the right direction.” — Alvin Toffler

• “Focus on a few key objectives ... I only have three things to do. I have to choose the right people, allocate the right number of dollars, and transmit ideas from one division to another with the speed of light. So I’m really in the business of being the gatekeeper and the transmitter of ideas.” - Jack Welch

• “Innovation has nothing to do with how many R&D dollars you have. When Apple came up with the Mac, IBM was spending at least 100 times more on R&D. It’s not about money. It’s about the people you have, and how you’re led.” – Steve Jobs
Defining Strategic Management

• “Strategic management is the set of decisions and actions used to formulate and implement strategies that will provide a competitively superior fit between the organization and its environment so as to achieve organizational goals” (Daft).

• Strategic Management is an “Art and science of formulating, implementing, and evaluating, cross-functional decisions that enable an organization to achieve its objectives” (Fred R. Davis).

• Strategic Management is “the set of managerial decisions and actions that determines the long-run Performance of an organization” (Stephen Robbins).
Why Strategic Management?

• Recognizing the changes occurring in the environment well in advance.

• Guiding the organization in a better way especially when compared to the competitors.
According to Daft, strategic management answers the following questions:

• What developments and transformation are seen in the environment?

• What sort of products should we come up with?

• How are we going to come up with these products efficiently?
Principles of Management

Why Strategic Management?

Strategic Management has noteworthy and positive impact on the organizational performance and has highlighted the following (Stephen Robbins and Mary Coulter):

• The success is brought by the right type of strategic adoption by the organization.

• Change is unavoidable for all organizations in today’s world irrespective of its type and size.

• By following the strategic management process, they should decide what to do and how to do things in the best possible way.

• Strategic management coordinates all cross functional activities and decisions, and help managers to achieve the organizational goals efficiently.
Key Terms

• Strategies: Integrating a set of actions which helps to exploit core competencies which helps to gain competitive advantage.

• Strategic Planning: Helping an organization’s decision about its direction and focus through a review of internal and external realities.
Key Terms

• Long-term Objectives: They aim to achieve specific result to accomplish the mission providing a specific direction focusing on coordination.

• Annual Objectives: They are usually short-term targets that organizations achieve in order to reach long-term objectives.

• Policies: They are the means to achieve annual objectives.
a) **Strategy formulation:**

- building up a vision and mission;
- recognizing the external opportunity and threat, strength and weakness;
- creating long-term goals, creating alternative strategies and selecting an ideal strategy to follow.
Three Stages of Strategic Management

b) Strategy Implementation:

• facilitating to execute the formulated strategy by establishing annual objectives, policies, procedures and efficient allocation of resources;

• creating an advantageous strategic culture, and excellent organizational structure;

• improving marketing efforts, and effective utilization of information systems; and

• linking employee compensation to the overall organizational performance.

c) Strategy evaluation

• Helping the managers to identify whether the implemented strategy is working well according to the present standards.
The Strategic Management Process

Exhibit 9.1: Model of the strategic management process.

**STEP 1**  IDENTIFYING THE VISION, MISSION, GOALS AND STRATEGIES

**STEP 2**  EXTERNAL ANALYSIS - OT
INTERNAL ANALYSIS - SW

**STEP 3**  FORMULATION OF STRATEGY

**STEP 4**  IMPLEMENTATION OF STRATEGY

**STEP 5**  EVALUATION OF STRATEGY
Step 1: Identifying the organizational vision, mission, goals and relevant strategies.

- Vision: Explains what we want to become in future. The PepsiCo Vision is:

  "PepsiCo's responsibility is to continually improve all aspects of the world in which we operate - environment, social, economic - creating a better tomorrow than today."
• **Mission:**
  • Explaining the purpose of an organization.
  • “What is our business?” is synonymous with the question, “What is our mission?”
Components of the Mission Statement

Exhibit 9.2: The components of a mission statement

- Customers
- Products or Services
- Concern for employees
- Concern for public image
- Mission Statement
- Markets: Technology
- Concern for survival growth, and profitability
- Self-concept
- Philosophy
The mission statement of the PepsiCo Company is:

"Our mission is to be the world's premier consumer Products Company focused on convenient foods and beverages. We seek to produce financial rewards to investors as we provide opportunities for growth and enrichment to our employees, our business partners and the communities in which we operate. And in everything we do, we strive for honesty, fairness and integrity."

The goals of PepsiCo. to direct the organization’s strategy and operations:

- Performance-for better long-term performance and sustained value for shareholder.
- Human-refining the food and beverage choices in accordance with customer needs.
- Environmental-conserve global water supplies and provide access to safe water, production facilities to eliminate solid waste to landfills and continue to support sustainable agriculture by expanding best practices with suppliers
- Talent-create a healthy, safe workplace that reflects global communities.
Step 2 - (SWOT analysis)

- Conducting an external analysis (i.e., Identifying opportunities and threats) in order to identify strategic factors which may require some changes.
  - Opportunities are the positive chance and a bright opening seen in the environment.
  - Threats which are risky and dangerous trends in the external environment.

- Conducting an internal analysis (i.e., identifying strengths and weaknesses).
  - Strengths are the activities performed very well.
  - Weaknesses are activities the organization does not do well or do not possess.
SWOT Analysis

Exhibit 9.3: SWOT Analysis

- Strength
- Weakness
- Opportunity
- Threat

SWOT Analysis
SWOT Analysis

Step 3 - (Formulating strategy)

• It Formulates strategy for corporate, business and functional levels.
• Matching the strengths to the external opportunities and minimizing the weaknesses and guard against the threats.

Step 4 - (Strategic implementation )

• Execution of the formulated strategy.
• It occurs after environmental analysis, SWOT analysis and identification of strategic goals.
• It attempts to fit the organizational structure and activities to the environment.
SWOT Analysis

Step 5 - (Evaluating the strategy)

• This step is subject to future modification. If the organization is successful today it does not guarantee tomorrow’s success.

• Focusing on the effectiveness and efficiency of the strategic plans in getting the desired results.

• Helping to assess the suitability of the implemented strategy against the socio-economic, political and technological changes around them.
Strategic Evaluation Steps

• Fixing benchmark of performance by setting a standard;
• The measurement of performance in which the actual performance is compared with the preset standards;
• Analyzing the variance. Variances could be identified when measuring the performance;
• Taking corrective action. If the deviation is very high, the strategist must carry out an intensive analysis of the responsible factors.
Strategic Evaluation Steps

Exhibit 9.4: Strategic Evaluation Steps

1. Fixing Benchmark of Performance
2. Measurement of Performance
3. Analyzing the Variance
4. Taking Corrective Action
Benefits of Strategic Management

• It helps to identify and prioritize the available opportunities.
• Achieves better coordination and control.
• Facilitates better support to reach the objectives.
• Effective allocation of resources in accordance with the opportunities.
• Creates a favorable attitude towards change.
• Encourages forward thinking and provides enthusiastic approach to face problems.
• Integrate individual behavior with clear-cut responsibilities.
Three Levels of Strategies

Exhibit 9.5: Levels of Strategy

- **Corporate Level Strategy**: MULTINATIONAL CORPORATION
  - **Business Level**
    - STRATEGIC BUSINESS UNIT 1
    - STRATEGIC BUSINESS UNIT 2
    - STRATEGIC BUSINESS UNIT 3
  - **Functional Level**
    - OPERATIONS
    - MARKETING
    - HUMAN RESOURCE
    - ACCOUNTING
Three Levels of Strategies

1. Corporate-Level Strategies

- It helps to determine what business a company should be in.
- It indicates the path in which the organization is going.
- It indicates the role played by the respective business unit in pursuing that direction.
- Three types of corporate strategies: Growth strategy, Stability strategy, Renewal strategy.
Three Levels of Strategies

I. Growth Strategy
   • It is used when an organization intends to expand and increase its products offered or markets served, either through its existing businesses or through new businesses.
   • It is classified into: concentration, vertical integration, horizontal integration, and diversification.

➢ Concentration
   • Expanding in a primary line of business by increasing the products or services or both.
   • Growth is through increased business operations.
Three Levels of Strategies

Concentration (Continued)

- They compete within a single industry.
- Starbucks, McDonald’s and Subway relied on concentrated strategies to become dominant players.
- There are three types of concentration strategies which are market penetration, market development and product development.

Market penetration

- Gaining additional share of existing markets using current products.
Three Levels of Strategies

- **Market Development**
  - Selling the existing products in new markets (e.g., Starbucks has started selling coffee beans not only in its stores but also in grocery shops)

- **Product Development**
  - Creating new products to serve existing markets (e.g., McDonalds has started offering healthy items to satisfy customers who are keen on nutrition).
Three Levels of Strategies

- **Vertical Integration**
  - This is classified into backward and forward vertical integration.

- **Backward vertical integration:**
  - It gains control of inputs by becoming a self-supplier.
  - The organization prefers this when their existing suppliers are unreliable and too costly and when the number of suppliers is small compared to the competitors.
  - Sometimes the organization may acquire resources very quickly by using this strategy (e.g., an ice-cream company can buy a diary farm to ensure a steady supply of milk at an affordable price).
Three Levels of Strategies

- **Forward vertical integration:**
  - It gains control of output by controlling the distribution channel by eliminating intermediaries.
  - Franchising is a valuable means of implementing forward integration.
  - Organization prefers this integration when current distributors are expensive or limited.
  - A simple example is, when movie studio owns a chain of theaters.
Three Levels of Strategies

Horizontal Integration
- Competitors from the same industry combine their operations to improve their competitive strengths and to lessen the competition among industry rivals.
- This integration will appeal to many, based on the similarity of products and ends competition between businesses and to maximize profit by monopolizing.
- An example is, if Zenith merges with Sony it is horizontal integration.
Three Levels of Strategies

- **Related Diversification**
  - They expand by merging or acquiring organizations in different, but somewhat related industries that are “strategic fits”.
  - It is used to sell new products through an existing distribution.
  - An example is, when a company which is manufacturing summer clothing decides to invest in winter clothing.

- **Unrelated Diversification**
  - Expand by merging or acquiring organizations in totally unrelated industries for higher financial returns.
  - For example, if a toy manufacturer is also manufacturing mobile phones it is unrelated diversification.
II. Stability Strategy

• It is a corporate strategy in which noteworthy and momentous changes of the organization will be absent.
• Organizations maintain the status quo to deal with uncertain environment which is dynamic.
• When Organizations experience slow growth or no growth conditions they may follow this.
• It is a corporate level strategy with no significant change. If the organization does well and the environment is stable, it may prefer to make no changes.
Renewal Strategy

Another type of corporate strategy is renewal strategy which addresses the organizational weaknesses towards performance declines.

These strategies redirect the organization into new markets.

They are classified as retrenchment strategy and turnaround strategy.
Retrenchment:

- They identify and eliminate less critical weaknesses and reinstate strengths in order to overcome existing performance problems.
- When an organization faces minor performance issues, a retrenchment strategy will stabilize and even out the operations, invigorate the resources and capabilities of the organization and prepare to compete in the industry again.
- They mainly focus on cost cutting and using resources more carefully. For example, due to economic downtown, the Fujitsu unit in UK slashed 1,200 jobs.
Three Levels of Strategies

Fred Turnaround:
- It is used when the organization’s performance problems are dangerous and critical.
- They address these serious issues by organizational restructuring and through the use of strong cost elimination.
- It involves restructuring the sick unit, a time-consuming strategy requiring detailed planning.
- Accenture is a good example where they failed to grow with current products and decided to expand into other industries with new product development using their company image and loyal customers.
Corporate Portfolio Analysis

• It is usually used when the organization involves many businesses.
• It was created by Bruce D. Henderson for Boston Consulting Group in 1970.
• The BCG matrix is a strategy tool which helps the company to allocate resources based on their market share and growth rate of strategic business units (SBUs).

Exhibit 9.6: BCG Matrix

- **Stars**: High market share and high growth rate.
- **Question Marks**: High growth rate but low market share.
- **Cash Cows**: Low growth rate but high market share.
- **Dogs**: Low market share and growth rate.
BCG Matrix

• BCG matrix Classifies firms as:
  • Cash cows: when the organization has low growth rate, high market share, and generating huge amount of cash to maintain the business, but their prospects for future growth are limited.
  • Stars: a unit with high growth rate, high market share in a fast growing market with a prominent market share. Their cash flow contribution depends on the need for resources.
  • Question marks: high growth rate, low market share also called as problem child and a starting point for many businesses. These businesses are in an attractive industry, but do not hold a large market share. Question marks can gain better market share and become stars and eventually can become cash cows when the market share slows down.

• Dogs: Units with low growth rate, low market share with a slow growing mature industry. Businesses do not produce much cash and show no promise for improved performance.
• It helps to determine how an organization should compete within its Strategic Business Unit (SBUs).

• Some corporations have different business divisions called as Strategic Business Units (SBUs) which have a unique mission, competitors, product line and markets when compared to other SBUs.

• Executives in charge of the corporate level define a broad strategy and finally bring together a portfolio of SBUs to implement the strategy.
Threat of new entrants:
• “How easy or difficult will it be for new competitors to enter an industry”? 
• Economies of scale and capital requirements are examples of entry barriers to new competitors.

Threat of Substitutes:
• The extent to which other industry products act as a substitute for the existing product.
Porter’s Competitive Forces Model

- **Bargaining Power of Buyers:**
  - The degree to which buyers influence competitors in an industry.

- **Bargaining Power of Suppliers:**
  - The comparative number of buyers to supplier, availability of substitute suppliers and new entrants affect the buyer supplier relationship acting as crucial factors to determine the supplier power.

- **Current Rivalry:**
  - The intensity among rivals increases when the demand and growth rate slows down and product price come down. This is influenced by the previous four forces.
Porter’s Competitive Forces Model

Exhibit 9.7: Michael Porter’s Five Forces Model

• An organization’s core competency which helps to gain an edge over its competitors is competitive advantage.

• The organizations does something better than others, which has an advantage over others (e.g., offering better value, lower prices, better service and greater benefits).

• If these continues for a longer period of time exploiting the resources and developing these competencies to be better than their rivals it is known as sustainable competitive advantage.
Porter’s Generic Strategies

- **Cost Leadership Strategy**
  - Objective is to attain the low cost producer when compared to other competitors.
  - Organizations produce on large scale business with less differentiation which helps them to exploit economies of scale.
  - This strategy requires close cooperation between all functional units.

- **Cost Focus**
  - Organizations go for a lower cost advantage in a small market segment.
Porter’s Generic Strategies

**Differentiation Focus**
- Business aims to create a unique and distinctive product or service.
- The organizations aim to differentiate within a small number of target market segments by providing products totally different from competitors who may target broader group of customers.

**Differentiation Leadership**
- The organizations target larger markets across whole of an industry with an objective of achieving competitive advantage.
- The organizations charge a premium price for the product which reflects higher production costs and extra value-added features provided for the consumers.
Porter’s Generic Strategies

Exhibit 9.8: Porter’s Generic Strategies

- **Scope of Business Products**
  - Broad
  - Narrow

- **Source of Competitive Advantage**
  - Costs
  - Differentiation

- **Strategies**
  - **COST LEADERSHIP**
  - **COST FOCUS**
  - **DIFFERENTIATION LEADERSHIP**
  - **DIFFERENTIATION FOCUS**
Functional Level Strategy

• An organizational strategy used by various functional departments’ supporting business and competitive strategy.

• It is a functional approach taken to achieve corporate as well as a business unit’s objectives and strategies by increasing resource production and nurturing distinctive competence.

• Examples of functional strategies are marketing strategies, R&D strategies, HRM strategies, operations strategies and financial strategies. For example, Nike uses R&D strategy to differentiate its athletic shoes from those of rivals.
Planning

• It is primary management function because it creates a basis for all functions performed by managers namely organizing, leading and controlling.

• Planning gives direction, minimizes uncertainty, waste and unwanted activities, and sets standards for controlling.

• Planning can be formal or informal planning.

• Informal planning is not written down and it will be short-term focus which will be specific to an organizational unit and requires no sharing of goals, commonly followed in small organizations.

• Formal plans are written, more specific with a long term focus with commonly shared goals for the organization.
- Efficient planning and its implementation results in greater performance. It involves goals and plans.

- Goals are craving outcomes for the organizations.

- Stated goals are official statements of whatever an organization says and real goals are those actually pursued by organizations.
Planning Types

• Plans can be depicted by their breadth, specificity, time frame and frequency of use.

• Based on breath, they are classified as strategic and operational plans.
  a. **Strategic plans** are usually long term plans applicable to the entire organization by establishing the overall goals and position the organization according to the changes in the environment.
  b. **Tactical plans** also called as operational plans are short term oriented plans specifying how the overall goals are to be achieved.
Planning Types

• Based on specificity they are classified a Specific versus Directional plans.
  a. Specific plans have clear cut objectives specifically defined and requires no interpretation.
  b. Directional plans are very flexible and only give general guidelines. Based on time, it is classified as short-time and long time plans.

• Short time plans are will last for one year or even less and long term plans will be beyond three years.

• Depending on the use of plan they are classifies as single use plan which is a one time plan to handle a unique situation and standing plans are ongoing plans giving directions for activities that are repeatedly done.
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