Strategies and Policies

Dr. Vinod Sharma

Session Objectives:

- To familiarize the students with the concepts of strategies and policies
- To discuss various levels of strategies
- To discuss the importance of strategic planning for an organization.
- To understand competitive analysis in strategy formulation
- To discuss the various kinds of strategies and policies
- To analyze Porter's competitive strategies
- To identify the important steps in the strategy implementation

Definitions of Strategy and Policies

Strategy

Strategy refers to the determination of the purpose and basic long term objectives of an enterprise; and the adoption of different courses of action, with proper allocation of resources in order to achieve the aims.

> The strategy of Royal Dutch/ Shell is as follows: "Our aim is to be world leaders in energy and petrochemicals. We will grow the value of Shell by delivering robust profitability and leveraging our competitive edge. Our success will ensure highly competitive returns to shareholders and give us the financial flexibility to take advantage of new commercial opportunities. Profits are also a vital part of our ability to contribute to society and meet the economic, environmental and social requirements of sustainable development."

In other words, strategy is a means to achieve an organization's missions and objectives.

Policy

Policies are general statements that guide managers' thought process in decision making.

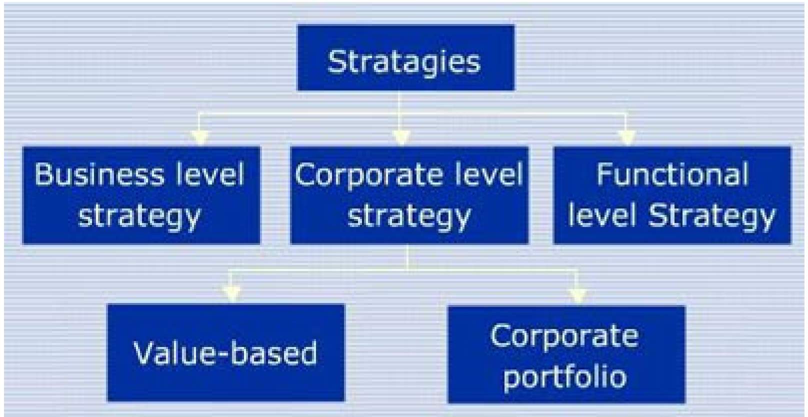
In simple terms, policies act as guidelines; enabling organizations to achieve their goals.

Nature and Purpose of Strategies and Policies

Following elements describe the nature and purpose of the strategies and policies:

- ***Direction***: Directing the employees (all levels) in achieving long-term goals.
- ***Framework for plans***: Mere setting of organizational goals, does not serve the purpose. Broad guidelines should be laid-down, to help employees understand how the objectives can be achieved.
- ***Need for operational planning***: Strategic plans are set by the top-level management in consultation with the middle and low level management.
- ***All perspective***: Objectives set by the top-management are based on the requirements at all management levels.

Levels of Strategy



Strategies are classified on the basis of organizational hierarchy. There are three levels of strategies. These are:

- Corporate level strategy
- Business level strategy
- Functional level strategy

Corporate level strategy

Formulated at the top-level, corporate strategy addresses the overall business objectives. This strategy is ideal for those organizations having more than one business unit.

Two approaches in the formulation of corporate strategy are: *values based approach* and *corporate portfolio approach*.

- ***Value-based approach****:* Value-based approach takes into account the individual's beliefs and values, and thereafter sets the organization's objectives. These objectives not only act as a guide to the firm to conduct its business, but also enables them to do business ethically.
- ***Corporate portfolio approach****:* The top management evaluates business units (on the basis of marketplace and organizational structure), and an appropriate strategy is suggested for each unit, to improve its overall performance within the organization

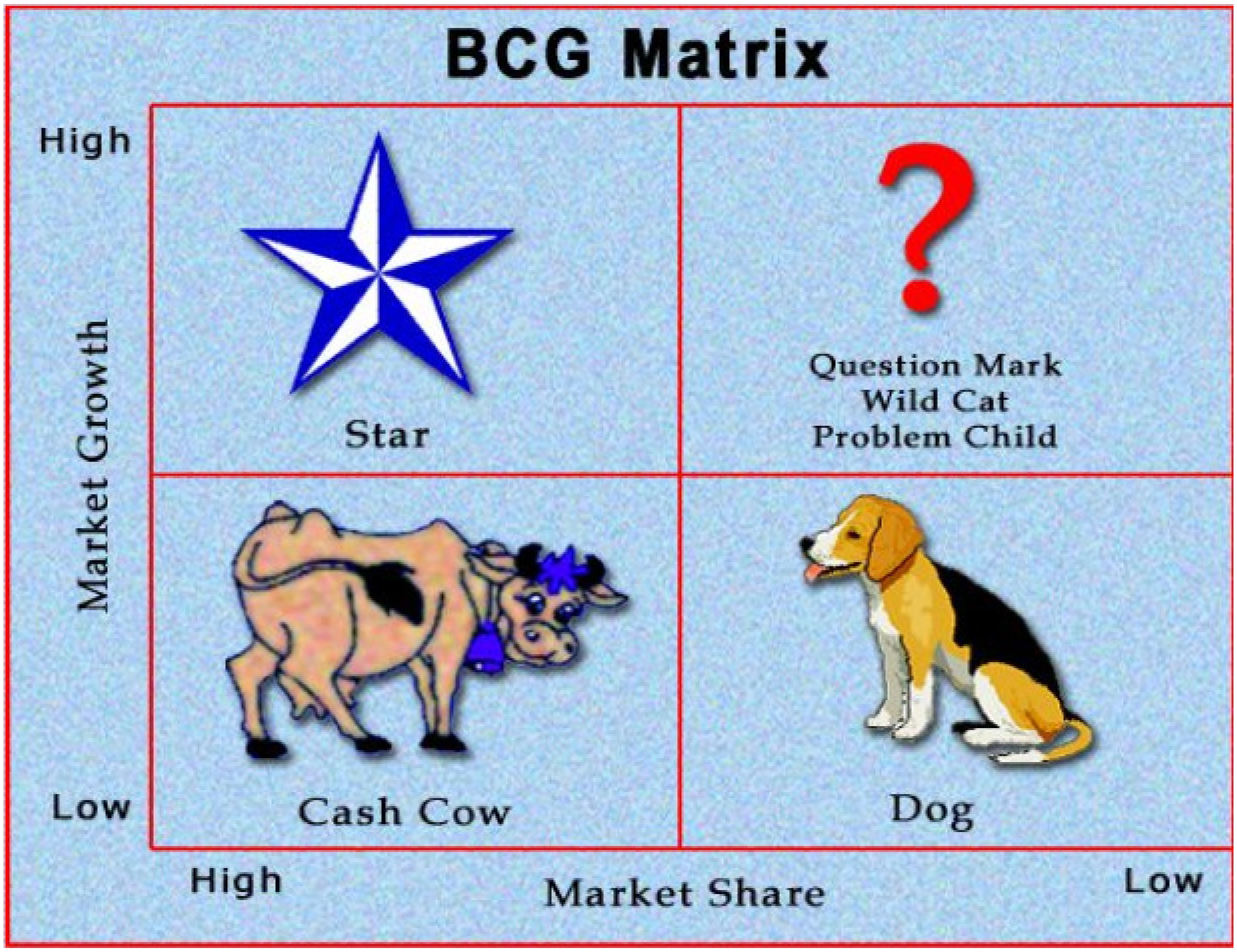
Business level strategy

Unlike the Corporate strategy (deciding what business to be in), Business strategy focuses on a firm's competitiveness in the marketplace. Developed by the heads of respective departments, and approved by the top management; these strategies are designed in response to the changing environment and competitive conditions.

Functional level strategy

Functional strategies are designed to emphasize functional competencies (research and development, manufacturing, finance etc.), so that firms can gain the competitive advantage. These strategies are designed and developed by the functional heads, and are approved by the top management.

BCG Matrix



It is a widely used portfolio management method for evaluating the performance of business units. There are four quadrants in a BCG matrix: *question marks, stars, cash cows* and *dogs*. On the X axis, market growth is measured, which indicates the level of market attractiveness On the Y axis, market share is measured, that serves as a measure of the company's strength in the market

Question marks: Question marks, are low-share business units, in a high-growth market. They require a lot of cash, for maintaining the market share. Any business has to think between building a question mark into stars or whether they have to be phased out.

Stars: Stars are high-growth, high-share businesses. Very often, they need heavy investment for financing their rapid growth. Eventually, their growth slows down and they turn into cash cows.

***Cash cows**:* Cash cows are low-growth and high-share businesses. Such established and successful SBU's, require less investment to maintain their market share. They generate a lot of surplus that a company can use to pay its bills, or invest in other businesses.

Dogs: Dogs are low-growth and low-share businesses. They may generate enough surplus to maintain themselves, but do not hold out the promise to be a large source of cash.

Strategic Planning

Strategic planning is the process of selecting an organization's goals, and determining the polices and programs necessary to achieve specific objectives.

The characteristics of strategic planning are given below:

- Strategic planning provides direction to the business.
- It provides a framework for detailed planning
- It is based on predictions about the environment
- It enables to identify and focus resources on key areas
- Top management takes initiative in planning process.

Significance of Strategic Planning

Strategic planning is important, because it provides the framework for organizational activities that can lead to improved organizational functioning and responsiveness. Other reasons are:

- It provides direction for an organization's missions, objectives and strategies facilitating the development of plans for each of the functional areas.
- It helps in designing clear-cut objectives
- It enables the organization to deal with dynamic environments

Benefits of strategic planning

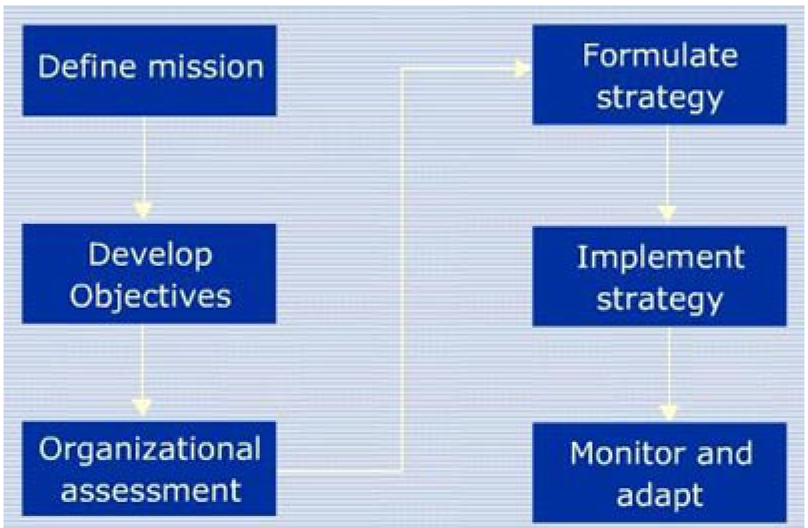
- Strategic planning provides consistent guidelines for overall organizational activities.
- It enables managers to anticipate problems and handle them accordingly
- It helps mangers to take appropriate decisions
- It minimizes the chances of mistakes and unpleasant surprises.

Limitations of strategic planning

The limitations of strategic planning are:

- It is expensive, as many firms hire in consultants, and adopt sophisticated planning models.
- It is based on concepts rather than real needs of the business.
- It is time-consuming, as a result the ends (results) are delayed.
- It is long-term activity, and may take many years to complete the project.
- Managers may avoid alternative opportunities that involve high degree of uncertainty.

Strategic Planning Process



Strategic planning aims at translating the general intentions of the firm, into more concrete and measurable strategic plans.

The following are the six steps involved in the planning process.

- ***Define the mission***: Mission statement should focus clearly on three aspects – business, customers and goods or services.
- ***Develop objectives***: Objectives that are developed, should aim at increasing the effectiveness of organizations. They also form the basis for planning, and policy-making activities.
- ***Assess opportunities and threats***: SWOT analysis must be carried out, to evaluate organizational strengths and opportunities (both for the internal and external environment).
- ***Formulate strategy***: Formulation of strategy involves the identification and exploring of new markets, (introduction of new or modified products etc.), evaluation (check whether strategy is capable of producing the intended results) and selection (best suited for the organization's capabilities) of strategic alternatives.
- ***Implement strategy***: It involves the implementation of tactical and operational plans (current and short-term activities), and allocation of resources towards performance of those activities.

- ***Monitor and adopt strategic plans***: It involves establishing a control mechanism to determine whether actual performance is consistent with the strategies formulated.

Competitive Analysis in Strategy Formulation

SWOT Analysis

Analyzing an organization's competitiveness, involves an assessment of both the environmental and organizational factors, that influence an organization's ability to compete effectively. SWOT analysis is one such method, where an organization's strengths, weaknesses, environmental opportunities and threats can be assessed. (refer table 9.1)

- ***Strength***: Internal characteristics that have the potential to improve the organization's competitive situation. R&D, technology, vast distribution network, geographic location. All these, comprise of organizational strength.

  The success of General Motors in the automobile industry, is due to its innovations in R&D and technology.

  HLL's strength, lies in its vast distribution network.

- ***Weakness*** is an internal characteristic that leaves the organization potentially vulnerable to strategic moves by its competitors. Competition, government regulations etc. comprise organization's weakness.

During the early 80's, AllSeasons Limited was the market leader in the electronics industry (Refrigerators). But the change in the government policy (globalization) in the 90's, enabled many new firms to enter the Indian market. The tough competition posed by them virtually edged out AllSeasons Ltd. from the electronics industry.

- ***Opportunity*** is an environmental condition, that offers significant prospects for improving an organization's situation, in relation to its competitors.

Changes in the consumers' tastes have increased the demand for fast-food outlets. McDonalds, Domino's, Pizza hut etc. cater to this changing requirements.

- ***Threat*** is an environmental condition that can undermine an organization's competitive situation.

Entry of private players (Tata), posed a threat to the public sector companies in Indian telecom industry (BSNL).

Table 9.1: SWOT analysis

Strengths	Weakness
Adequate financial resources Technology leader Better manufacturing facilities Product innovation Wide distribution network	No clear strategy direction High overall unit cost relative to competitors Obsolete facilities Narrow product line
Opportunities	**Threats**
Enter new markets or segments Diversify into related areas Decline in trade barriers Complacency among rival firms Increase in customer base	Entry of low-cost foreign competitors Changing buyer needs and tastes Slower market growth rate Adverse shifts in foreign exchange and trade polices of foreign governments

Porter's Five Forces Model

Developed by Michael Porter, this model analyzes the nature and intensity of competition in an industry through five forces (rivalry, customers, supplier, new entrants, and substitutes).

- ***Rivalry**:* Rivalry is the means through which competitors fight for position by using tactics such as price, competition, advertisement battles, new product introduction, to lower the profits of competitors in the industry.

  Coke and Pepsi are the classic examples of rivalry in soft drink industry.

- ***Bargaining power of customers**:* It is the extent to which customers are successful in forcing prices down, or securing high quality or more service at the same price. Customers tend to be powerful when the quantities they purchase form a large portion of the seller's total sales

- ***Bargaining power of suppliers**:* It is the extent to which suppliers can exert power on manufacturers in the industry, by threatening to either increase the prices or reduce the quality of goods and services. The greater the bargaining power of suppliers, the lower the profit potential for businesses operating in the industry.

- ***Threat of new entrants**:* It is the ease with which new competitors can enter the same product or service markets. New entrants have substantial resources and bring added capacity leading to price war and reduced profile.

  Times of India, launched its daily in Andhra Pradesh at Re.1, compelling its competitors (Deccan Chronicle and The Hindu) to reduce their prices.

- ***Threat of substitutes products or services:*** It implies the extent to which business in other industries, offer substitute products, for an established product line. The availability of substitute products or services thus reduces the profit potential in the industry

  Coca-Cola experimented with a small customer group, to switch their drinking habits from coffee to coke. It replaced the coffee machine with a new machine called Breakmate, which chills water, carbonates, and mixes with Coca-Cola syrup and dispenses the soft drink into 6 1/2 ounce cups. The success of this experiment, lead to the installing of Breakmate in most organizations replacing coffee machines.

Types of Strategies and Policies

There are three types of strategies: growth, stability and defensive.

Growth strategy

Growth strategies enable the organization to expand, either through mergers or acquisitions, or establishing a new plant.

> McDonald has pursed its growth strategy through direct expansion. It never purchased other fast-food restaurants' chains. It has grown only by granting franchises to people who are willing to be retained in "McDonald's Way"

Major forms of growth strategies are concentration, vertical integration and diversification.

- ***Concentration*****:** Concentration focuses on growth through single product or a small number of closely related products. Concentration usually takes place through market development (gaining a larger share of current market or expanding new ones), product development (improving a basic product or service or expanding into closely related product or service) or horizontal integration (adding one or more businesses).

- ***Vertical integration*****:** It is a means through which the firm produces its own inputs (backward) or disposes its own outputs (forward).

> Ford popularized the concept of vertical integration (backward). This powerful corporation used to manufacture everything from nuts and bolts to car framework to enjoy a competitive advantage.
>
> The automaker (Maruti) sells their cars through the company's own distribution outlets, and follows forward integration.

- ***Diversification*:** Diversification involves entering into a new business, that is distinct from the current business. Diversification can also take place, to reduce the risk associated with one's business. If an organization diversifies into an unrelated business, it is then known as conglomerated diversification. But if an organization diversifies into a related, but distinct business, concentric diversification occurs.

GE is the classic example for conglomerated diversification. It diversified into 12 areas, such as Aircraft engineering, appliances, information systems and NBC, which are not related to each other.

Britannia Industries Limited (BIL) has adopted a diversification strategy to become the market leader in the food industry. It diversified into related businesses such as cheese, dairy products and additional bakery products.

Stability strategy

Stability strategy involves the maintenance of status quo or , achieve growth in a methodical, but, slow manner. The main reasons for an organization, to adopt this strategy are when it wants to take low risk, choose stability and anticipate the changes, to recover in the business.

Kellogg's is the classic example for stability strategy. Its emphasis on breakfast food, has given it a unique niche to explore. The company's management has little or no interest to diversify into other areas.

Defensive strategy

Defensive strategy focuses on the desire or need to reduce organizational operations, usually through cost reductions (cutting on non-essential expenditure) and asset reduction (disposing off equipment, selling land etc.).

The most common forms of defensive strategies are harvest, turnaround, divestiture, and bankruptcy.

- ***Harvest strategy*:** Harvest strategy entails minimum amount of investment with maximum short-term profits.

- ***Turnaround strategy*:** Turnaround strategy is designed to reverse the negative state of business.

- ***Divestiture strategy:*** If the company is not doing well, it can sell or divest its business.

- ***Bankruptcy:*** A situation where the company is unable to pay its debts, and seeks legal support. After it regains its financial position, it can repay its debts.

Porter's Competitive Strategy

Porter has outlined three generic strategies that can be used to gain competitive advantage over other firms operating in the same industry. They are cost leadership, differentiation and focus.(ref table 2)

Cost leadership: It involves emphasizing organizational efficiency, so that the overall costs of providing products and services are low. It entails developing efficient production methods, keeping tight controls on over-head and administrative costs and seek savings by supplying at low prices.

Wal-mart has always kept its prices low (but maintained quality) in order to attract customers.

Differentiation: It attempts to develop products that are unique in the industry. Uniqueness can be in the form of service (British Airways), product (Mercedes Benz) , quality (Xerox), features (Nike shoes) etc.

Focus: It relies on low-cost, or differentiation, or both; in order to establish a strong position within the particular market segment or niche.

Table 9.2

Generic strategies	Commonly required skills and resources
Cost leadership:	Capital investment Technical skills Intense supervision of labor Low-cost distribution system

Differentiation:	Strong marketing abilities Product engineering Strong capability in research Technology leadership
Focus:	Combination of the above policies, directed at the particular strategic target

Effective Implementation of Strategy

Effective implementation of the strategy has eight prerequisites:

- ***Communicate strategies*****:** Strategies designed by the top management must be communicated (written) to all managers who are involved in the process of decision making. They in turn should communicate the lower levels and ensure that the strategies are implemented.
- ***Develop and communicate planning premises*****:** This process consists of developing the premise (assumptions about the environment in which plans operate) and communicating the same to managers, who are involved in decision making. Managers should provide feedback, and suggest alternatives if any, that can be adopted.
- ***Develop organization culture*****:** An organization's culture is developed, based on its values and beliefs. It guides the employees to accomplish organizational goals set by the top management.
- ***Monitoring*****:** Monitoring helps in ensuring that action plans are in tune with strategies. Managers should continuously review the strategies, and incorporate changes recommended by the Staff advisers.
- ***Develop contingency strategies and programs*****:** Uncertainty and risk occur in every business. Managers should be able to foresee such uncertainties and develop contingency strategy.
- ***Emphasize on planning and implementation*****:** Strategies become obsolete, if they are not upgraded. Managers must ensure that necessary elements in the system are upgraded.
- ***Create proper organizational climate*****:** Organizational climate (internal environment existing within the organization – commitment, dedication etc.) enables the implementation of strategy, in tune with the organizational objectives.

Effective Planning Premises

Anticipation about the environment (both external and internal) is referred to as planning premises.

Following are the pre-requisites for effective planning.

- ***Selection of premises*****:** Top management should select the premise based on the environmental factors, which influence their course of action.

- ***Develop alternative plans*:** As the future is uncertain, alternative plans must be developed.
- ***Verify premises:*** Verification ensures that the premises are consistent with each other.
- ***Communicate premises*:** A Planning premise can be effective, if it is communicated to employees.

Summary

- Definition of strategies and policies
- Levels of strategy

    Corporate level strategy (value based and corporate based)

    Business level strategy

    Functional level strategy
- Characteristics of strategic planning
- Significance of strategic planning
- Benefits of strategic planning
- Limitations of strategic planning
- Strategic planning process

    Define mission

    Develop objectives

    Organizational assessment

    Formulate strategy

    Implementation

    Monitoring
- Competitive assessment of strategy formulation
    - *Swot Analysis*
    - *Porters five force model*
- Porter's competitive strategies
    - *Cost leadership*
    - *Differentiation*
    - *Focus*
- Strategy implementation

- Planning premises