

Strategic Management –The Competitive Edge

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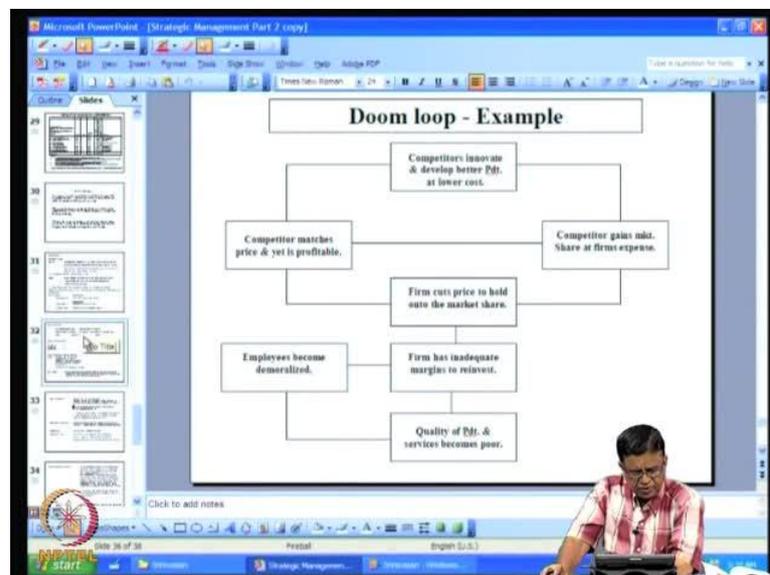
Indian Institute of Science, Bangalore

Module No. # 04

Lecture No. # 21

Corporate Strategy– 1

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Welcome to this class. In the last class, we were looking at dooms loop- what happens for a firm when it gets caught in a dooms loop and how it finds itself difficult to extricate from that doom loop.

So, just getting you back to that figure- the firm tries to cut prices to hold on to market share and what does the competitor do- the competitor matches the price of the firm and still it is profitable, and then the competitors start innovating and develop the better product at lower cost.

Competitor gains market share at the firm's expense.

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The screenshot shows a PowerPoint slide titled "Experience Curve". The slide content is as follows:

Experience Curve:

Unit Manufacturing Cost	When Production Quantity
When Production Quantity	of time of Dir. Lab components for each item
80%	Experience Curve

Accumulated Production	Cost/Unit (RS)
2	100
4 (100*0.80)	80
8 (80*0.80)	64
16 (64*0.80)	51

Plot give 80% Exp. Curve - Hyperbola

Causes:

- Improved Lab. Productivity
- Increased specialisation
- Innovation in production methods
- Value engineering & fine tuning
- Line balancing
- Rationalisation of methods & systems

Exp. Curves - Simple approximations of extremely complex real-time relationships; extreme care is to be exercised to get reliable results - distinguish between exp. unit exp; consider influence of time

What is the result of all these on the employees of the firm and the firm itself? Firm has inadequate margins to readjust then the quality of the product suffers, the services also suffer, then the employees become demoralized. This is how when a firm gets caught in the dooms loop, it has a chain reaction running throughout the firm.

This is an important part of business strategy for a firm to be very cautious and not get caught into this dooms loop. In order not to get caught into this dooms loop, the type of precautions or the proactive strategies that the firm should adopt is, the company should always be having an evaluation of its business strategies- that is it should be a continuous evaluation of business strategies. It should be constantly trying to innovate, phase out old products and introduce new products into the marketplace.

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The screenshot shows a PowerPoint presentation slide with the following content:

- Sensitivity Analysis:**
 - Can be w.r.t., FC, VC, and/or price
 - decrease in FC results in decrease in B-E-P. Profitability at a particular volume of production improves with lower FC
 - ↑ in VC has marked effect on B-E-P & eats up profits
 - ↓ in VC improves profitability
 - in permissible price, B-E-P ↑ and vice-versa. At a particular volume of production profitability improves. Price-most sensitive instrument followed by VC & FC
- Non-Linear BE Analysis**
 - When prices may be consciously reduced to gain additional sales vol. & market share or in response to competitors action
- Assumptions (often unrealistic)**
 - FC Fixed for all production volumes
 - VC do not fall with increasing level of production
 - TC && TR vary in linear relationship with output
 - Maximize profit BEF int. & tax is the desirable BUS. objective

So, the company should be willing to a certain extent, experiment with the characteristics of the product in order to see that the product offering it puts out into the market is differentiated from the competitors so that it can stay in business.

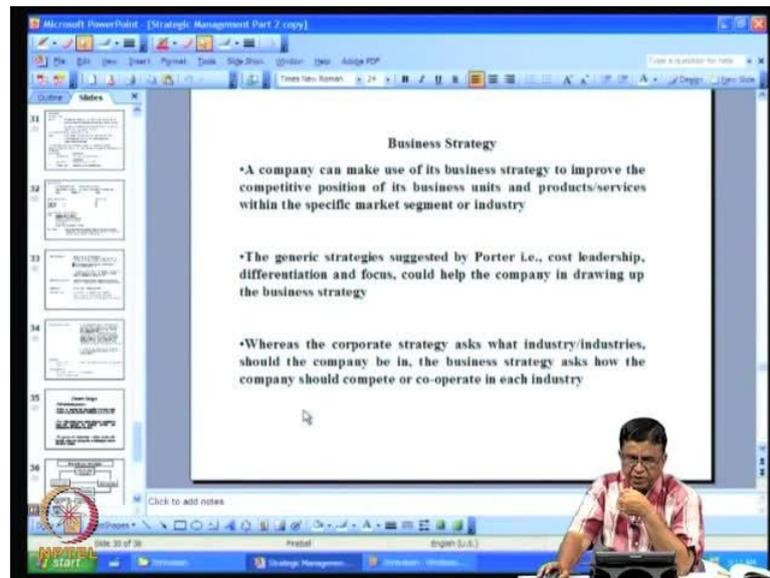
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The screenshot shows a PowerPoint presentation slide with the following content:

- Experience curve relationship**
 - Good framework for marginal considerations for predicting industrial scenario w.r.t., future costs, profit margins and corresponding cash flows for own & competitor's apps
 - Has done very well in segments such as PC mkt; implications - a few large plants with standardised productions would be able to supply global market marketing efforts SH. Be fully coordinated with manufacturing plans; lowering prices S/E. Not be inferior quality; more applicable when dem is elastic
 - Limitations: detn. of cost; data reg. competitors; a late market entrants has to operate at lower initial prices to survive
- B.E Analysis**
 - $TC = FC + VC * Q$ (VC: Unit Var. Cost-RM, electricity, fuel, packing etc)
 - $TR = P * Q$
 - At B E point $TR = TC$
 - $p * QB = FC + VC * QB$ $QB = FC / (P-VC)$
 - $[P - VC = \text{Unit Contribution}]$

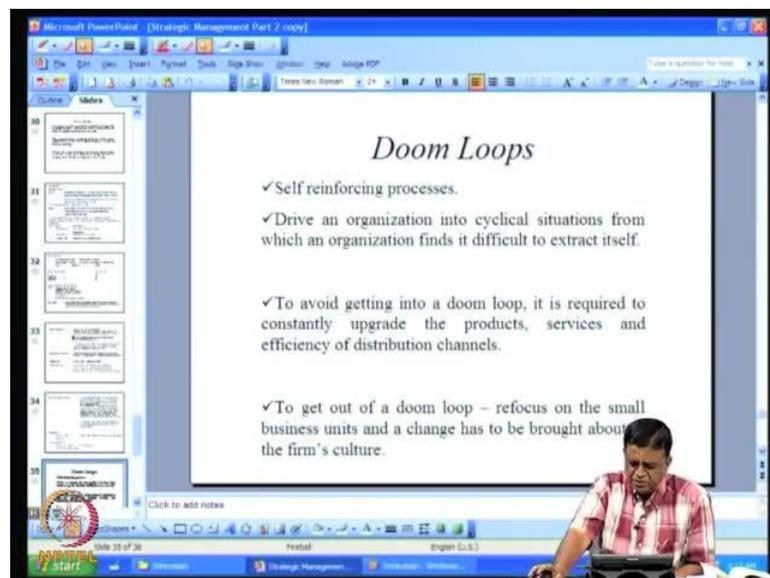
So, this is the most important characteristic which the firm has to follow. Suppose, it does not do it on for a long time- let us say it keeps on going long time in the market depends on the type of product and the product life cycle that comes or gets attached to that particular product.

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An electronic product might be having a shorter lifecycle, a consumer durable may be having a slightly longer lifecycle; depends on the type of the product, but it is for the firm to constantly innovate, phase out old products and come out with new products.

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If the firm does not do it, then there is a very good chance that it might get caught in the present day competitive market, in this dooms loop and if it gets caught in this dooms loop it may find itself difficult to extricate because this is a self-reinforcing process.

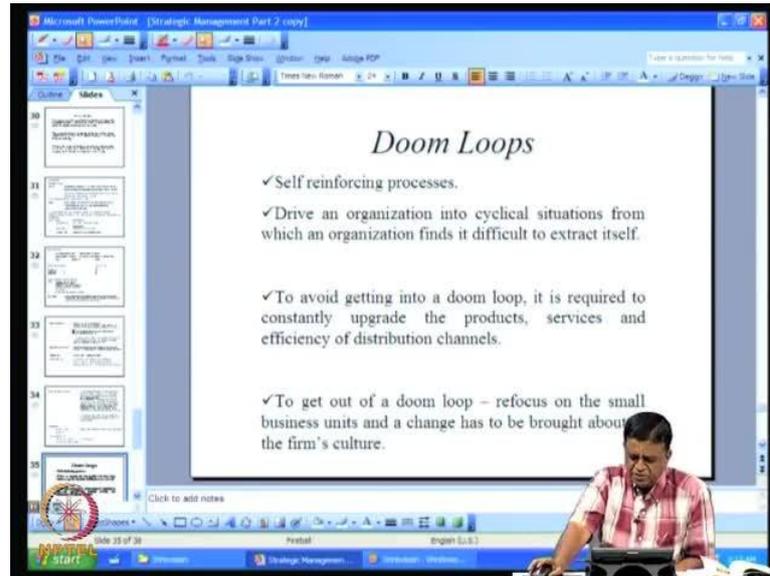
It can drive an organization to cyclical situations, from which it finds difficult to extricate itself or get out of this whole scenario to extract itself. So, it is constantly required for the firm to upgrade the products, services and efficiency of the distribution channels.

Now, we have looked at this dooms loop, how it can get an organization into this cyclical situation, where it finds difficult to extricate itself and we have also suggested what can be done by the organization to not to get itself into this type of a situation. What does it mean? It just means that for an organization, it is always required to have a continuous evaluation of business strategy for all the business units of the company. It is a continuous process; it is not that you can just say I did the business strategy for this; I will revisit it again after the next quarter. No, it has to be an ongoing process many times you have to keep on watching it continuously, as to what is happening in the market.

So that if any corrections are required, within the quarter itself you should be able to do. This is what the competition in the market is driving firms towards and that is where strategy and strategic management is becoming more and more important.

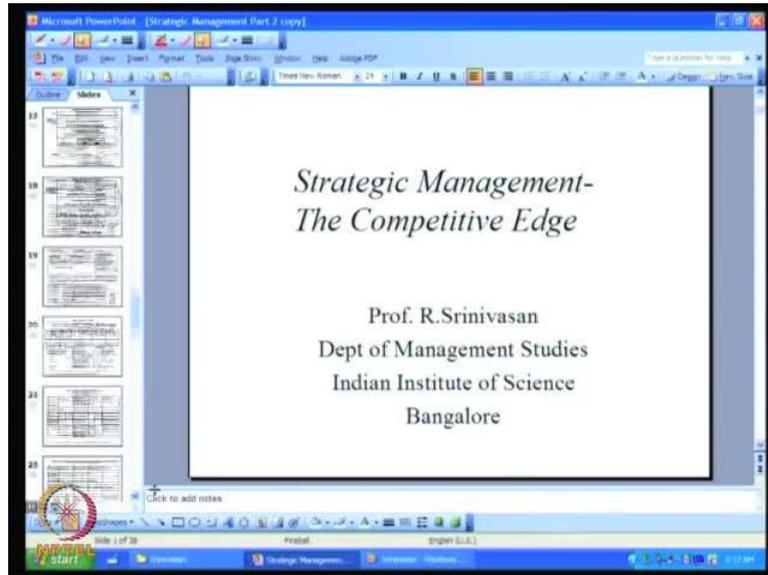
Now, why are we interested in the business strategy? We are interested in the business strategy, because every firm has got number of business units these firms, these business and business units can be strategic business units and the corporate strategy that you are drawing is, for the entire firm as a whole. So, in order to draw the corporate strategy for the entire firm or the entire organization, you are required to be clear about the business strategies of every business unit or every strategic business unit. So, this is where the whole crux of the problem comes.

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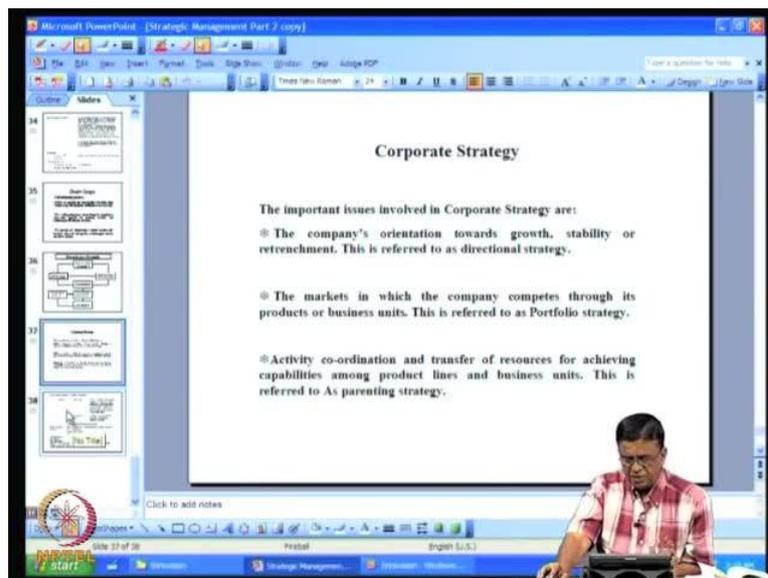


So, this is where the corporate planners and strategic planners have to think very hard before drawing up a strategy. This is called a strategy map- mapping the strategy of a business unit many times; they required to draw the strategy road map. What is the road map of strategy? For the business unit, for the next few quarters all this has to be presented. We will look at that a little more in detail in the next few classes. So, all this business strategies are required to drop as I said in the corporate strategy. What are the important issues that are involved in corporate strategy? If you look at the type of issues that are involved in the corporate strategy- this is what we are likely to have in the corporate strategy is something like this.

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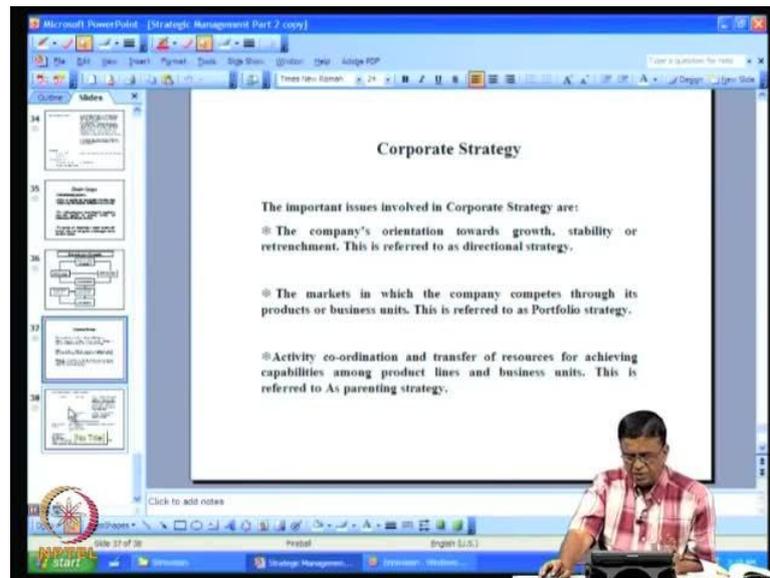


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The company's orientation towards growth, stability or retrenchment - this is referred to as directional strategy. What is the company's policy, some policy issues are involved; what is the orientation of the company towards growth, stability or retrenchment- refers to as directional strategy. Then the second one which the company has to think about is the markets in which the company competes through its products or business units refer to as Portfolio strategy.

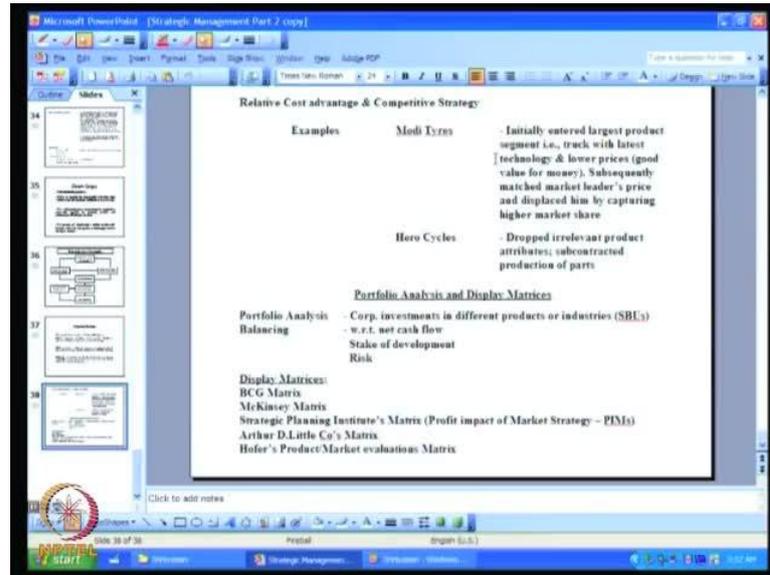
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The third issue - that becomes important is the activity coordination and transfer of resources for achieving capabilities among product lines and business units. This is referred to as parenting strategy and second and third points that is the markets in which the company competes through its products or business units. Then this parenting strategy- we will discuss this in more detail when we discuss the portfolios or the portfolio matrices- these are called. Actually, if you really look at it, the whole system comes under the category of portfolio analysis and display matrices.

The portfolio analysis, we are looking at corporate investments in different products or industries SBUs. Then we do a balancing of the portfolios; the balancing of the portfolios is done with respect to net cash flow, the state of development and the risk that is involved. We will be discussing several display matrices which can help in portfolio analysis.

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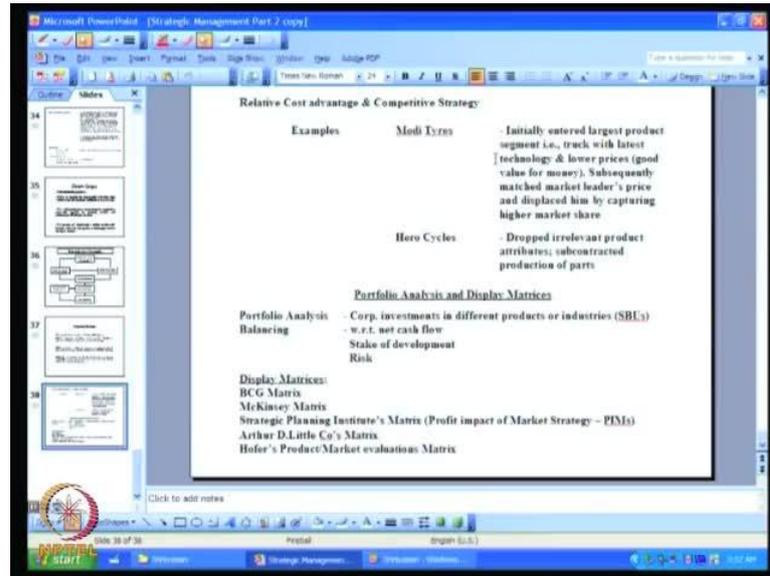


We discussed all these issues with respect to the business strategy and we discussed this some of the main issues with respect to the corporate strategy. Why did we do this- we try to bring out the type of advantages which the business in India tend to assume are there, because of the lower labour cost- may not really be there; this is what, was really brought out in this whole thing.

So, many of these labor cost advantages- the firms might be losing due to the different types of duties which may be charged or which are charged by the government depending on the sectors concerned. So, this brings you to one important thing with respect to the firm. Looking at this type of environment, firms themselves have to think what is the type of relative cost advantage they can get; and what is the type of competitive strategy they can draw up in the present scenario in the Indian market.

So, I will give here 2 examples: 1 example is that of Modi tires- initially entered the largest products segment, that is trucks with latest technology and lower prices. The strategy that was adopted was good value for money. What did it do? It subsequently matched the market leader's price and displaced him by capturing higher market share. So, this is the way a corporate strategy of the firm got redrawn after the market entry. Similarly, we see the cycles- dropped irrelevant product attributes, subcontracted production of parts to have a good market share in the cycle's market. So, if you really see in the present day market situation also, Hero cycles are enjoying very good strategy.

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So, in other words this brings you to very good competitive advantage. This strategy brings you to the question of what type of strategies a firm should adopt when these types of situations crop up. In other words, what is the type of diversifications that one can go in for? So, I take you to 2 types of the diversification. The diversification strategies can be vertical and horizontal growth strategies, which can help the firm.

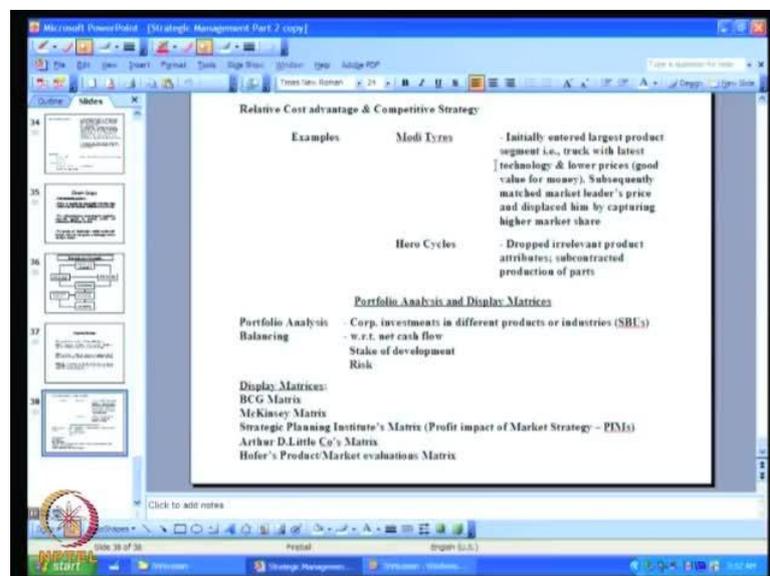
The 2 basic diversification strategies are: 1- which can be concentric that is related to the industry in which the parent operates; that is, if you are operating in a tyre industry, let us say the related industry is again with respect to tires and you do not want to go away from the tyre business. When this is not an appropriate strategy that is when this concentric or related diversification is not an appropriate strategy, this is dealt within detail in my book. You can refer to chapter 7 for greater detail. I am just reading out a few points from there.

Concentric or related diversification refers to growth into a related industry. This is not an appropriate strategy when the firm has a strong competitive position, but industry attractiveness is low. Note that this is not an appropriate strategy when the firm has a strong competitive position, but industry attractiveness is low. This type of diversification looks for synergy in relation to technology, customer usage, logistic skills and product similarity.

Related diversification can take place through internal or external means. Similarly, unrelated diversification - when the firm realizes that the current industry is unattractive or it does not have the abilities or skills which could be easily transferred to other industries; it employs the conglomerate diversification strategy. It diversifies into unrelated products or market lines. What is a firm mainly concerned with here? Cash flow considerations and reduction of risk. So, this is the way a firm goes through different strategy changes or different strategy responses.

This chapter also gives you a few more strategies, which I am just reading out. One of them could be exporting, that is, where you shift goods from the home countries to other countries. The warehouse in Bangalore could be a good example that produces readymade garments for exporting to developed countries; then there could be a licensing agreement, where a firm grants rights to another firm to produce or sell its products in the host country and in return to the licensee the firm pays compensation to the licensing firm for the technical expertise. This can be a useful strategy when the licensing brand is well known.

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If you take the defense sector, the Sukhoi fighter planes are produced in HAL under a licensing agreement. Then the joint ventures could be another strategic option, that is where formulation of a new company which combines the resources and they expertise in relation to product and technology available in different companies. Companies could

also look at acquisition. It can be a relatively easier way to enter the international market, refers to a firm buying out a firm that is already operating in a market. So, Maytag in US acquired Hoover.

Turnkey operations could be one more strategy - refers to contract for construction of operating facilities in exchange for a fee; the facilities may be transferred to the host country when they are complete. So, Tata consulting engineers are in this business. The BOT - that is the Build Operate Transfer is a variation of the turn key operation. Many infrastructure projects are taken up through this route; the Bangalore, Mysore infrastructure corridor project is to be operated on the Build Own Operate Transfer - that is the BOOT concept; a double O coming in.

Then you can also go in for a turnaround strategy; what does the turnaround strategy do? It lays emphasis on the improvement of efficiency and it is appropriate when the company is facing problems. So, it involves 2 steps: one is construction that is effort to stop the bleeding of the firm; then consolidation is where you implement a stabilizing program.

Many of the PSUs have gone in for turnaround strategies in India also; some of the private companies have also gone in for turnaround strategies; Sylvania Laxman is one example. Similarly you can sight different examples both from the public sector and the private sector of turnaround.

I give you, here, one very important example of a private sector turnaround and this, I am reading it from my book - this is the turnaround strategy adopted by IBM. During the 70s and 80s, IBM dominated the computer industry worldwide. It was the market leader in both large main frames and small personal computers; along with apple, IBM set the standards for all personal computers. Even now when IBM no longer dominates the field, personal computers are still identified as being either apple or IBM style PCs. IBM's problems came to ahead in the 90s with the computer sales falling. More companies were choosing to replace their large expensive mainframes with personal computers, but they were not buying the PCs from IBM.

An increasing number of firms like Havlet Packard, Dell, Gateway and Compaq had entered the industry. They offered IBM type PC clones that were considerably cheaper

and more advanced than the IBM PCs. IBM's falling revenues meant corporate losses in 1992 and 1993.

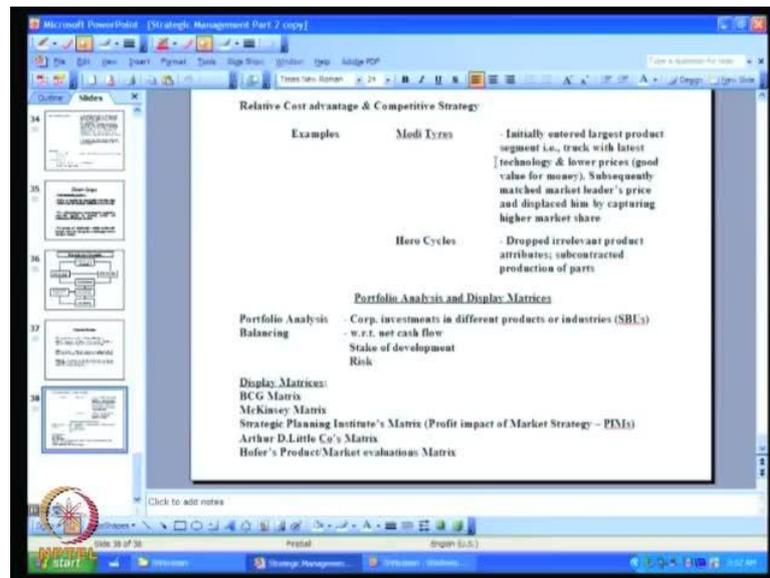
Industry experts perceived the company as a bureaucratic dinosaur that could no longer adopt to changes. Its stock price fell to 40 dollars with no end in sight. IBM's board of directors hired a new CEO Louis Gerstner, to lead a corporate turnaround strategy at big blue, the nick name IBM earned from its rigid dress code policies. To stop the flow of red ink the company held its long held, no layoffs policy by reducing its work force by 40 percent. Under Gerstner, IBM reorganized its sales force around specific industries such as retailing and banking; decision making was made easier. Previously according to Joseph Formichelli, a top executive with the PC division, had to go through 7 layers to get things done; firing incompetent employees could take a year; so, you pond then off on another group. Strategy presentations were hashed over so many times that they got watered down to nothing, but under Gerstner, formal presentations were no longer required. The emphasis shifted to quicker decision making and a stronger customer orientation.

In 1987, customers had been forced to wait for 5 to 7 years for a new mainframe series. Now, IBM produces a new line almost every year. Gerstner personally talks with at least one customer every day. The company's PC business, which had low market share and had generated huge losses in 90s has becomes profitable; its market share goes almost 1 to 8.9 percent in 1996 - second place in global market share. Its stock price topped 140 dollars by N96. Customers are pleased with the company's customer service. Over the last couple of years, they have been going out of their way to have a contact person you could call with any issue, reported Linda Wiersema, chief information officer at LTV steel unit, part of the LTV Corporation.

The corporation has still a long way to go to complete its turnaround, even though the revenue increased by 40 percent over the past decade; profit increased only by 3.2 percent. In 1996 IBM's revenue increased by just 5.6 percent compared to 19 percent at HP and 29 percent at Intel. According to the chief financial officer, Richard Thormann we have done a lot, but still have a lot to do. Now the position is- IBM has really turned around and has been able to hold on to its market niche very well. So, this is the way the different strategies work.

Now, when it is impossible for a firm to hold on in this competitive marketplace, the last resort that it does or it goes in for is to divest; that is divest the operations of the firm- it can be through selling the firm itself or going for liquidation. These are essentially strategies which are adopted by firms when they are in a weak competitive position.

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They virtually find no way out; they do not see any way out at all of the situation in which they are in the market place. So, this is the reason why I mention to you that a company should always be on its toes in the present competitive scenario and try to avoid getting into doom loops; and when it gets into a doom loop for a company, it finds itself difficult to extricate from that scenario or extract itself from that is position. So, this being the case, this may drive the company towards this desperate situation of selling the company, or liquidating the assets, divesting many products or product lines and things like that- which also happens in competitive markets.

So, these are strategies which are followed by firms with a weak competitive position, that is, when they are unable to pull up their bootstraps. If a firm has multiple product lines, it can diverse the product line which is not profitable, but many times- suppose the company does not have too many product lines, then dropping product lines also becomes a big question mark for the firm; bankruptcy refers to giving up of the management of the firm to courts in return for the settlement of the company's obligations.

So, you saw in the recent economic crises many of the US firms doing this type of last ditch resort. This is a last strategy which a firm can adopt, that is, going out of business. So, you saw many of the giants of the American firms like Morgan and Stanley pulling the curtains, applying for bankruptcy. Then, liquidation refers to termination of the firm because the industry is unattractive. What the benefit of liquidation is over bankruptcy? The benefit is that the Board Of Directors with the top management makes the decision instead of turning them over to the court. So, the BOD still makes the decision.

Now, in order to have a good Portfolio, why are we looking at all these strategies? We are looking at all these strategies so that the company can have a good portfolio analysis or a balancing of portfolios is possible. So, as I mentioned to you, 3 important things with respect to balancing: one is with respect to net cash flow; second is with respect to the state of development; and third is with respect to the risk that is involved. So, this becomes extremely crucial.

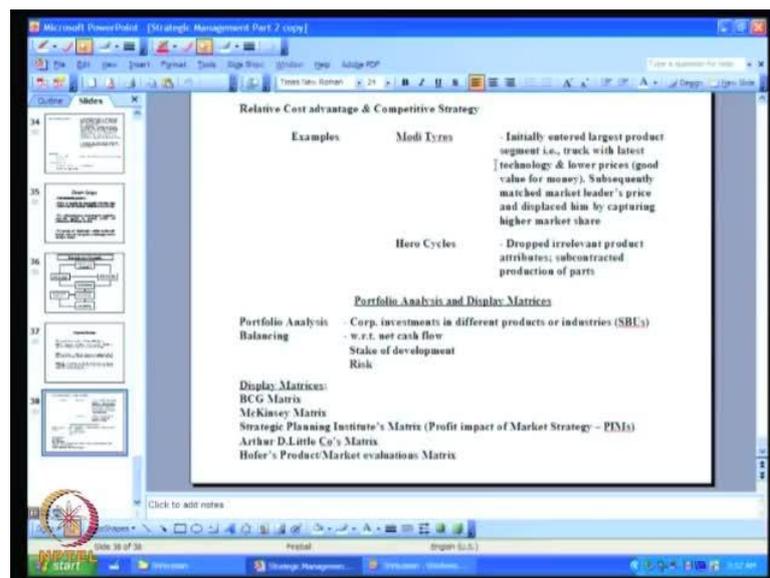
So, what is meant by this net cash flow? I will be just explaining a few points from my book - a company may have different businesses behaving differently in terms of their cash flow. A growing new business, though profitable, may also require additional cash investments. A mature business on the other hand though less profitable, may not require such investment. It has to balance different businesses so that there is an overall cash flow position with the desired financial strategy and condition of the company.

In other words, for every business you have to draw a business lifecycle and at what lifecycle is that business in - is the business in the growth stage, or is the business in the introduction stage, or is it in the maturity stage, or is it in the decline stage. Note that a business unit may have number of products or product lines. One is that of drawing a PLC for a particular product; the other is that of drawing the PLC for the business itself; the third is that of drawing the PLC's for all the different business units concerned, which the firm has; and the last stage or the fourth stage is that of drawing the PLC for the firm itself - how does it look like. But the assumption is that the firm is going to be a continuous entity. A business unit might go, but the firm will remain. So, keeping that in mind a firm's existence is drawn up; that is how the corporate planners or the strategic planners exert themselves to do this.

Now, this brings you to the state of development. Businesses or products are likely to go through different lifecycle phases such as embryonic development, growth, maturity and decline. A company cannot depend on one product line; when it comes to the decline stage, it may be too late to start on a new product. For a company to have stability it is necessary to match the different businesses at different stages in their lifecycles to achieve immortality.

The objective is, while the individual business units grow, mature and decline, the companies should continue to grow. That is what I just mentioned. You expect the company to have a continuous existence; you do not expect the company to come down, but some of the greatly unforeseen circumstances, like what happened a few years back in the US market. A company might come down; unheard of, not usually the case.

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Risk: A corporate portfolio should aim at reducing the risk of a critical financial set back. This may be achieved by putting together diverse business activities with different or even opposing market forces.

A solution may be to diversify internationally, because of the different market and economic forces resulting in different cycles of development, growth and decline. Opposing exchange rate movements also can produce the same effect. Businesses with different seasonal sale cycles may be combined to ensure a more stable domestic market, though it is possible that the macro economic trends at national levels affect all business

sectors. So, in other words this ability to predict risk is becoming very important now. This is where the planners or the strategic business unit is putting all its energies and putting all its efforts.

Suppose there is an investment which a company wants to make. The risk analysis group comes into focus - it advises the company whether it is worthwhile to get into this investment at all. So, many of the large companies, if you really see, almost all the software majors in India have this risk analysis group. This risk analysis group continuously advises the top management on their major investments and sometimes even on minor investments, which investments they have to come out of and all these types of things. So, this is very important area of strategic management and all this comes under this portfolio balancing. So, this portfolio balancing forms an important section of strategic management and in order to do this portfolio balancing, these 3 things - that is the net cash flow, the state of development and the risk - have to be considered predominantly. They become vital inputs, before we can say this is the type of strategy that we are going to adopt.

In order to help the firm in this balancing the firm makes use of different matrices for portfolios and these are called portfolio matrices. What does the portfolio matrices do? It tries to map the business units of the firm according to where they stand in the market at a particular point of time. So, it can be with respect to the state of development or it can be with respect to the relative market share. When we say relative market share, market share with respect to the leader – so, where do we stand with respect to the leader or it can be with respect to the relative market growth rate.

Suppose a company is operating or the business unit is operating in a market growth rate, which is less than the average, then the company's strategies has to be different. So, the portfolio matrices help the company to map the business units properly. So, this is where the whole question comes - how you map this business unit? Mapping the business units is facilitated by drawing the portfolios.

Now why do you want to map the business units? You want to map the business units so that you can take the most appropriate portfolio balancing which is good for the firm or in the interest of the firm. So, this is where we are interested. Some of the matrices which can be of interest or which we will consider in the next class on this portfolio are these 5

- that is, 1: the BCG matrix that is the Boston Consulting Group matrix; the second is the Mckenzie matrix, the third is the strategic planning institutes matrix or it is also called the Profit Impact of Market Strategy that is PIMS; The forth is the Arthur D - Little company's matrix; the fifth is the Hofer's product/market evaluation matrix. So, this is where we are going to consider some of these matrices. As I have mentioned, why are we interested in this portfolio analysis? We are interested in portfolio analysis to allocate resources for best total revenue.

So, in fact most of the fortune 500 companies - if you really look at them, world over, they make use of this display matrices for portfolio balancing. So, from that angle all these display matrices become extremely important and every company should be able to map their business units in with respect to these matrices and take that matrix, which is appropriate to the firm.

So, we will stop here. We will take up each of these matrices, one by one, in the next class. Thank you.