

## Unit – 1

### Vision, Mission, Objective and Goal



#### Learning Objectives

After completion of the unit, you should be able to:

- Explain the meaning and concept of vision.
- Describe the purpose of having a mission.
- Know the different types of objectives and goals of an organization.
- Assess the concept of strategic intent and business definition.
- Also understand the difference between vision, mission, objective and goal.

#### Structure

- 1.1 Introduction
- 1.2 Vision
- 1.3 Mission
- 1.4 Objective
- 1.5 Goal
- 1.6 Strategic Intent
- 1.7 Business Definition
- 1.8 Difference between vision, mission, objective and goals
- 1.9 Let's Sum-up
- 1.10 Key Terms
- 1.11 Self-Assessment Questions
- 1.12 Further Readings
- 1.13 Model Questions

#### 1.14 Introduction

Management of companies is essential for the systematic growth and development of the company. The management strategies are formulated on the basis of company mission and vision. In line with them, the goals and objectives are set for the company. The vision and mission statements play a significant role in the development of strategies by providing a basis for screening the strategic options. Thus, understanding the concept of mission, vision, goals, objectives and related concepts is essential for implementing successful strategic management.

#### 1.15 Vision

A vision articulates the position that an organization would like to attain in the distant future. It helps in creating a common identity and a shared sense of

purpose. A good vision is one which foster risk taking and experimentation. It answers the question: ‘What will success look like?’



The vision of an organization must possess the following characteristics:

- It is created by consensus.
- It forms a company’s future mental image.
- It forms the basis for formulating the mission statement.

A good vision possesses the following features:

- It should be inspiring.
- It should foster long term thinking.
- It should be original and unique.
- It should be competitive.
- It should be realistic.

Examples:

<b>Company</b>	<b>Vision</b>
Walt Disney	Make people happy
Stokes Eye Clinic	Our vision is to take care of your vision
Infosys	To be a globally respected organization that provides best of breed business solutions, leveraging technology, delivered by best-in-class people.

### 1.16 Mission

Mission refers to the purpose of an organization. Mission states the business reason for the organization's existence. It relates the organization to the society. The mission of an organization should aim high and at the same time it must be realistic. It should provide a strategic direction for the organization.

“Mission is the fundamental work given by the society to an organization”.

**By Koontz & Q’ Ponnell**

“The company mission is defined as the fundamental unique purpose that sets a business apart from other firms of its type & identifies the scope of its operations in product & market terms”.

**By Pearce & Robinson**

In order to be effective, a mission statement should possess the following characteristics:



(i) A mission statement should be realistic and achievable. Impossible statements do not motivate people.

(ii) It should neither be too broad nor too narrow. If it is broad, it will become meaningless. A narrower mission statement restricts the activities of organization. The mission statement should be precise.

(iii) A mission statement should not be ambiguous. It must be clear for action. Highly philosophical statements do not give clarity.

(iv) A mission statement should be distinct. If it is not distinct, it will not have any impact. Copied mission statements do not create any impression.

(v) It should have societal linkage. Linking the organization to society will build long term perspective in a better way.

(vi) It should not be static. To cope up with ever changing environment, dynamic aspects should be considered.

(vii) It should be motivating for members of the organization and of society. The employees of the organization may enthuse themselves with mission statement.

(viii) The mission statement should indicate the process of accomplishing objectives. The clues to achieve the mission will be the motivating factor.

Examples:

<b>Company</b>	<b>Mission Statement</b>
Mayo Clinic	To inspire hope and contribute to health and well-being by providing the best care to every patient through integrated clinical practice, education and research.
The Bank of New York	We strive to be the acknowledged global leader and preferred partner in helping our clients succeed in the world's rapidly evolving financial markets.
NIKE Inc.	To Bring Inspiration and innovation to every athlete in the world.

There are diverse issues which need to be covered while framing the mission statement of a company. The various components of a well framed mission statement are stated as follows:

- Product or service
- Customers
- Technology
- Survival, growth and profitability

- Company philosophy
- Public image



✓ **Check your progress**

**Exercise 1**

Suppose you are appointed as the head of the strategy planning department of a automobile company dealing in luxury segment cars. Frame a vision and mission statement for the company. Make necessary assumptions.

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**1.17 Objective**

Objectives are the end results of a planned activity. They are stated in quantifiable terms. Objectives are stated differently at various levels of management. Objectives play a very important role in enhancing the efficiency and effectiveness of an organization. The following characteristics must be present in fairly framed objectives:

- They should be specific and unambiguous.
- They should have a particular time horizon within which it is expected to be achieved.
- They should be flexible enough so that if changes are required, they may be incorporated easily.
- They should be attainable.
- They should be measurable.
- They should be understandable
- They should help in the achievement of the organization’s mission and vision.
- They should be challenging.

There are many factors which have an impact on the formulation of objectives in an organization. These factors are kept in mind before making objectives. These factors are mentioned as below:

- Size of the organization.
- Level of management
- Organization culture

- Social responsiveness



Objectives are the milestones expressed in specific terms which a person plan to achieve in a limited time period. Following are a few examples:

<b>Basis</b>	<b>Objectives</b>
Financial Objectives	To achieve 10% growth in earning per share.
Market Coverage	To have 900 million subscriber base in the country by 2020.

Objectives may be of various types. Some of these are explained as below:

**Profit Objective** – It is the most important objective for any business enterprise. In order to earn a profit, an enterprise has to set multiple objectives in key result areas such as market share, new product development, quality of service etc. These may also be termed as performance objectives.

**Marketing Objective** may be expressed in terms of percentage increase or decrease in market share. They are related to a functional area.

**Productivity Objective** may be expressed in terms of ratio of input to output. This objective may also be stated in terms of cost per unit of production.

**Product Objective** may be expressed in terms of product development, product diversification, branding etc.

**Social Objective** may be described in terms of social orientation. It may be tree plantation or provision of drinking water or development of parks.

**Financial Objective** relate to cash flow, debt equity ratio, working capital, new issues, stock exchange operations, collection periods, debt instruments etc.

**Human resources objective** may be described in terms of absenteeism, turnover, number of grievances, strikes and lockouts etc. For example: the objective may be to decrease the rate of absenteeism.

### 1.18 Goal

Goals are an intermediate result which is expected to be achieved by a certain span of time. It is a target which an organization wishes to achieve in long term. It provides the basis for judging the performance of the organization. Goals may be classified into two categories:

- Financial goals: They are related to the return on investment or growth in revenues.



- Strategic goals: They focus on the achievement of the competitive advantage in the industry.

Goals should be well constructed and realistic in nature. Following are the examples of well framed goals:

<b>Basis</b>	<b>Goals</b>
Customer service	Provide quality service to the customers at least at par with the highest standard in the industry.
Community service	Provide job opportunities which promote a higher standard of living for all the citizens.

✓ **Check your progress**

**Exercise 2**

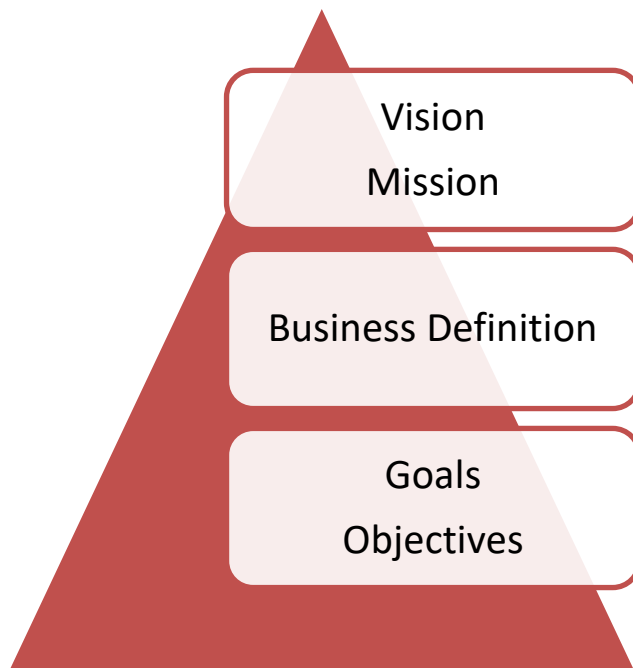
Assuming yourself the marketing manager of a luxury chain hotel. Frame the marketing objectives.

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## 1.19 Strategic Intent



Strategic intent refers to the purpose for which the organization strives for. It is the philosophical framework of strategic management process. The hierarchy of strategic intent covers the vision and mission, business definition and the goals and objectives. The following figure indicates the hierarchy of the strategic intent framework:



Following are the characteristics of strategic intent:

- It should have an essence of winning.
- It should remain stable over a period of time.
- It should encourage personal effort and commitment.
- It should foster creativity.

The strategic intent notion helps the managers to focus on creating new capabilities to exploit future opportunities.

## 1.20 Business Definition

It explains business operations of a company stated in terms of customer needs, product specifications and technology.

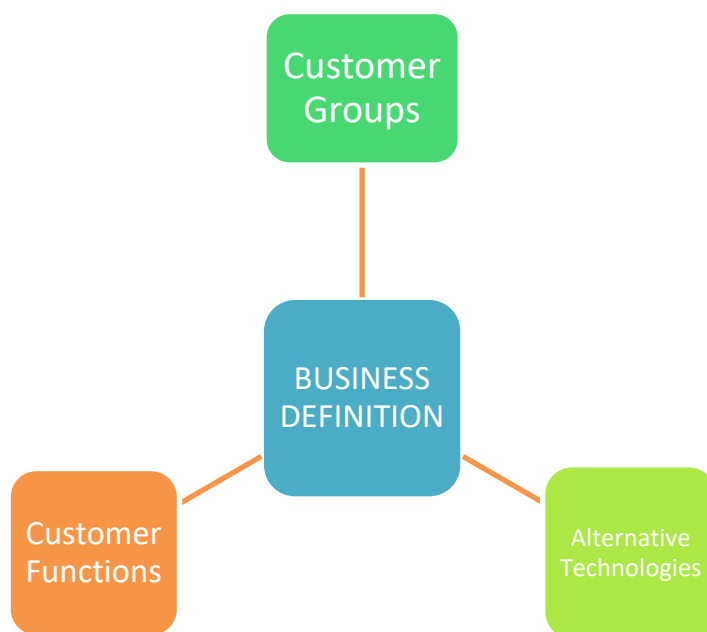
<b>Company</b>	<b>Business Definition</b>
HUL	To meet every day needs of people everywhere with branded products.



**Oerik Abell** suggests defining business along the three dimension of customer groups. Customer functions and alternative technologies. They are developed as follows:

- i. Customer groups are created according to the identity of the customers.
- ii. Customer functions are based on provision of goods/services to customers.
- iii. Alternative Technologies describe the manner in which a particular function can be performed for a customer.
  - For a watch making business, these dimensions may be outlined as follows:
  - Customer groups are individual customers, commercial organizations, sports organization, educational institutions etc.
  - Customer functions are record time, finding time, alarm service etc. It may be a gift item also.
  - Alternative technologies are manual, mechanical and automatic.

The following figure depicts the three dimensions of business definition:



A clear business definition is helpful in identifying several strategic choices. The choices regarding various customer groups, various customer functions and alternative technologies give the strategists various strategic alternatives. The diversification, mergers and turnaround depend upon the business definition. Customer oriented approach of business makes the organization competitive. On the same lines, product/ service concept could also give strategic alternatives from a different angle. Business can be defined at the corporate or SBU levels. At the corporate level, it will concern itself with the wider meaning of customer groups, customer functions and alternative technologies. If strategic alternatives are linked through a business definition, it results in considerable amount of synergic advantage.



✓ **Check your progress**



**Exercise 3**

Prepare a list of business definitions of any five Fast Moving Consumer Goods Companies in India.

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**1.21 Difference between vision, mission, objective and goals**

The concept of vision, mission, objective and goals are interlinked and interrelated to each other. Besides from this connection there are certain focal points on the basis of which some differentiation can be done. Following are some distinctions among these terms:

<b>Basis</b>	<b>Mission</b>	<b>Vision</b>
Concept	It defines the purpose and primary objectives related to your customer needs and team values.	It communicates both – purpose and values of your business.
Answer	It answers the question: How you will get to where you want to be?	It answers the question: Where you want to be?
Purpose	The purpose is to inform what the organization does.	The purpose is to inspire people and motivate their emotional drives to achieve it.
Time Frame	A mission statement talks about the present which ultimately leads to the future.	A vision statement talks about the future of the organization.

<b>Basis</b>	<b>Objectives</b>	<b>Goals</b>
Concept	It represents managerial commitment to achieve specified results in a specified period of time.	It refers to the long term purpose which an organization strives to achieve.
Measurement	It is easy to measure them as they are generally quantifiable.	It is difficult to measure them.
Time Period	They are mid-term or short term in nature.	They are long term in nature.
Action	It refers to the specific action which supports the associated goal.	It refers to a generic action towards which one strives.

✓ **Check your progress**



**Exercise 4**

Differentiate between Business Definition and Strategic Intent.

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**1.22 Let's Sum-up**

Every business organization is incorporated with a common aim to achieve heights in their respective industries. This calls for the setting up of an inspiring vision, motivating mission, goals and objectives. This forms a hierarchy which is stated as Strategic Intent. Apart from these, the business definition must be specified to have a clarity about the customer groups it wants to cater, possible products which could be offered and the alternative technologies which may be employed.

**1.23 Key Terms**

**Vision:** Vision serves the purpose of stating what an organization wishes to achieve in the long run.

**Mission:** A written declaration of an organization's core purpose and focus that normally remains unchanged over time.

**Objective:** Objectives refer to the ultimate end results which are to be accomplished by the overall plan over a specified period of time.

**Goal:** Goals denote a broad category of financial and non-financial issues that a firm sets for itself.

**Strategic Intent:** The strategic intent concept encompasses an active management process that includes focusing the organization's attention on the essence of winning.

**Business Definition:** It explains business operations of a company stated in terms of customer needs, product specifications and technology.

**1.24 Self-Assessment Questions**

1. What is the need of setting objectives in an organization?
2. Differentiate between vision and mission.



### 1.25 Further Readings

- J. David Hunger & Thomas L. Wheelen, *Strategic Management*, Addison Wesley Longman.
- Azhar Kazmi, *Business Policy & Strategic Management*, Tata McGraw Hill.
- Thompson & Strickland, *Strategic Management-Concepts and Cases*, Tata McGraw Hill.
- Garth Saloner, Andrea Shepard and Joel Podolny, *Strategic Management*, John Wiley & Sons.

### 1.26 Model Questions

1. What do you understand by vision? Explain with the help of an example.
2. Discuss the various areas in which objectives may be set.
3. Differentiate between goals and objectives.
4. Write a short note on Business Definition.
5. Explain the concept of Strategic Intent.

### Answer to Self-Assessment Questions

1. The following points specifically emphasize the need for establishing objectives:
  - Objectives provide yardstick to measure performance of a department or SBU or organization.
  - Objectives serve as a motivating force. All people work to achieve the objectives.
  - Objectives help the organization to pursue its vision and mission. Long term perspective is translated in short-term goals.
  - Objectives define the relationship of organization with internal and external environment.
  - Objectives provide a basis for decision-making. All decisions taken at all levels of management are oriented towards the accomplishment of objectives.

2. Following are the differences between mission and vision:



<b>Basis</b>	<b>Mission</b>	<b>Vision</b>
Concept	It defines the purpose and primary objectives related to your customer needs and team values.	It communicates both – purpose and values of your business.
Answer	It answers the question: How you will get to where you want to be?	It answers the question: Where you want to be?
Purpose	The purpose is to inform what the organization does.	The purpose is to inspire people and motivate their emotional drives to achieve it.
Time Frame	A mission statement talks about the present which ultimately leads to the future.	A vision statement talks about the future of the organization.



## Unit – 2

### Porter's 5-Forces Model

#### Learning Objectives

After completion of the unit, you should be able to:

- Explain the Porter's 5-Forces Model.
- Describe the basic components of Porter's 5-Forces Model.
- Understand the process of conducting industry analysis through Porter's 5-Forces Model.
- Know the benefits of Porter's 5-Forces Analysis.

#### Structure

- 2.1 Introduction
- 2.2 Porter's 5-Forces Model
- 2.3 Threat of New Entrants
- 2.4 Threat of Substitutes
- 2.5 Bargaining Power of Customers
- 2.6 Bargaining Power of Suppliers
- 2.7 Rivalry among Existing Firms
- 2.8 Process of conducting industry analysis through Porter's 5-Forces Model
- 2.9 Benefits of Porter's 5-Forces Analysis
- 2.10 Let's Sum-up
- 2.11 Key Terms
- 2.12 Self-Assessment Questions
- 2.13 Further Readings
- 2.14 Model Questions

#### 2.1 Introduction

Strategy formulation is an important part of every business organization. Before framing the strategy, environment scanning needs to be done. Business has two types of environment which need to be assessed – Internal and External. To carry out this environment analysis in a systematic manner, Michael Porter has suggested a model which is popularly known as Porter's 5-Forces Model. This model is also used for industry analysis. It is explained in the coming paragraphs.

#### 2.2 Porter's 5-Forces Model

Porter's Five Forces of Competitive Position Analysis were developed in 1979 by Michael E Porter of Harvard Business School as a simple framework for assessing and evaluating the competitive strength and position of a business organisation.



This theory is based on the concept that there are five forces that determine the competitive intensity and attractiveness of a market. Porter's five forces help to identify where power lies in a business situation. This is useful in understanding the strength of an organisation's current competitive position.

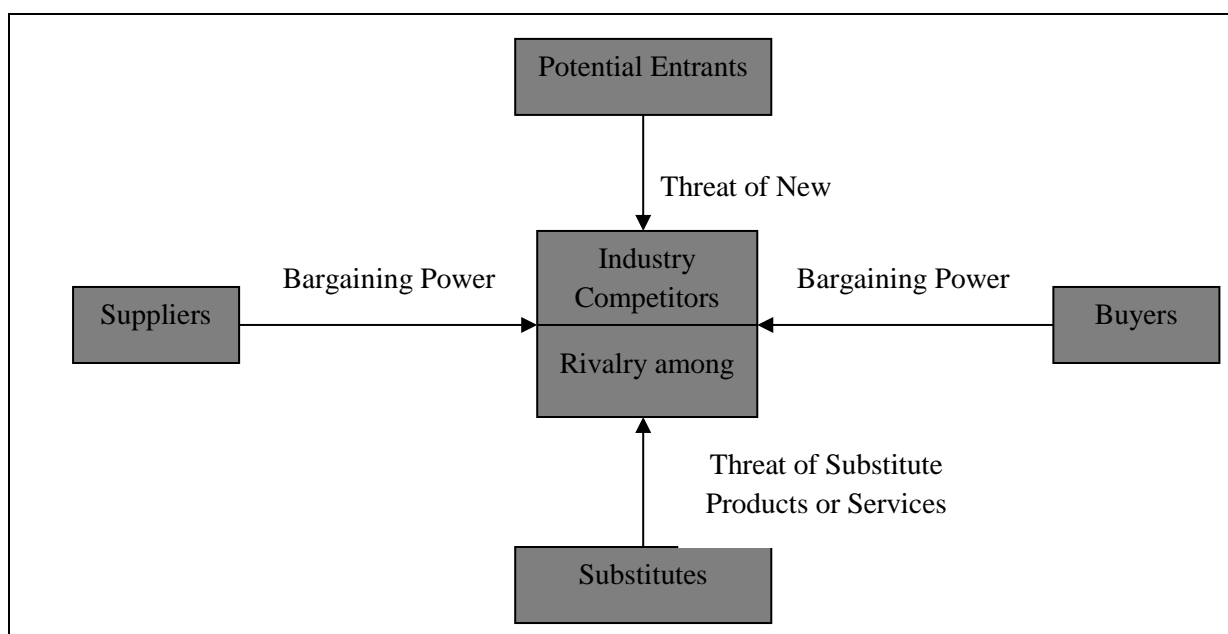
Strategic analysts often use Porter's five forces to understand whether new products or services are potentially profitable. By understanding where power lies, the theory can also be used to identify areas of strength, to overcome weaknesses and to avoid mistakes.

The five competitive forces plays an important role in determining the profitability in any industry. These five competitive forces are:

- The threat of new entrants
- The threat of substitute products or services
- The bargaining power of customers
- The bargaining power of suppliers
- The rivalry amongst current competitors in the industry.

Whatever the industry, these five competitive forces are central to formulating and implementing business strategy. The relative strength of each competitive force tends to be a function of industry structure i.e. its underlying economic and technological characteristics. This can change overtime, with the result that the relative strength of competitive forces will also change, hence the industry's profitability. The porter's five competitive forces model is powerful and widely used tool for systematic diagnosis of principal competitive pressures prevailing in the industry and assessing the strength and importance of each such force on the particular firm in the industry.

### **Porter's Five Forces Model**



The above mentioned five forces are explained next page.



### 2.3 Threat of New Entrants

The new entrants represent the firms that are outside the particular firm's industry and contemplating entry into the industry. A new entrant will bring extra capacity into an industry. This poses a threat to established firms because they may lose market share with a consequent potential loss of economies of scale. The threat of entry will place a limit on prices and shapes the investment requirement to discourage entrants.

*Porter* list main barriers to entry as:

- a. Economies of scale
- b. Product differentiation
- c. Capital requirements
- d. Switching costs
- e. Access to distribution channels
- f. Government policy

The new entrant firm may bring with it new technology, innovative ideas, substantial resources, new and quality products. The greater the power and resources the new entrant has, the greater will be the probability that it will eat away the market share of existing firms. The strength of the threat from new entrant depends on the strength of the barriers to entry and the likely response of existing competitors to the new entrants. The entry barriers are not static. They can be raised by a number of measures and also might be lowered by changes in the environment.

#### ✓ Check your progress

##### Exercise 1

Suppose you are amongst the strategic planning team in a leading hospital. Prepare a list of competitors and potential entrants in the business.

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### 2.4 Threat of Substitutes

The products or services that are produced in one industry are likely to have substitutes that are produced in another industry which satisfy the same customer need. Substitute products or services are those that apparently are different, but



satisfy the same set of customer needs. The availability of close substitute constitutes are more attractive than those that have one or more such substitutes. When firms in an industry are faced with threats from substitute products they are likely to find that demand for their products is relatively sensitive to price. Substitutes limit the potential returns of an industry by placing a ceiling on the prices firms in the industry can profitably change. The substitute products offering a price advantage or performance improvement to the consumer can significantly affect the competitive character of an industry.

*Porter* suggests that those substitutes which should be monitored most closely are:

- Those products which are providing a better performance / price standard than the industry standard.
- Products produced by industries earning high profits.

## **2.5 Bargaining Power of Customers**

Customers require better quality products and services at a lower price. If they have the power to get what they want, they will force down the profitability of an industry and it is, therefore, dependent very much on the consumer's bargaining power. The strength of the threat from the bargaining power of customers will depend on a number of factors including the level of differentiation amongst products in the industry, the cost to the customer of switching from one supplier to another and whether a customer's purchases from an industry represent a large or small proportion of the customer's total purchases.

*Porter* identified that power of customers seems to be strongest when the following conditions apply:

- The concentrated purchases of large volumes relative to seller sales.
- The products it purchases represent a significant fraction of the buyer's cost of purchases.
- The products it purchases from the industry are standard or undifferentiated.
- Less switching costs.
- It earns low profits.
- The buyers will pose a credible threat of backward integration.
- The industry's product is unimportant to the quality of the buyer's product.
- The buyer has full information.

Buyers must be willing to pay a price for a product that exceeds the sellers' cost of production; otherwise the industry cannot survive in the long-run. On account of competition, users of industrial products may come together formally or informally and exert pressure on producer in matters such as price, quality, and





delivery. A high buyer bargaining power constitutes a negative feature for existing firms or new entrants of an industry. The more powerful buyers from an industry are, the greater will be their influence on the industry in general and its profits in particular.

## 2.6 Bargaining Power of Suppliers

The bargaining power of suppliers determines the cost of raw material and other inputs. The business of a firm is to a great extent dependent upon its suppliers who supply it with resources like raw materials, spare-parts, equipment, machineries, labour and other supplies. The ability of suppliers to get higher prices depends on a number of factors including the number of suppliers in the industry, the importance of the supplier’s product to the firm, the cost to the firm of switching from one suppliers to another and the case with which the supplier could integrate forward.

According to *Porter*, the main determinants of suppliers having power over an industry occur when:

- It is dominated by a few companies and is more concentrated than the industry to which it sells.
- It is not obliged to contend with other substitute products for sale to the industry.
- The industry is not an important customer of the supplier group.
- The supplier’s products are differentiated or it has built-up stitching costs.
- The supplier poses a credible threat of forward integration.

### ✓ Check your progress

#### Exercise 2

State the situations in which the buyer’s will have a weak bargaining power.

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## 2.7 Rivalry among Existing Firms

The intensity of rivalry among existing competitors will influence prices as well as certain other areas like advertising, sales, promotion, product development etc.

The intensity of competitive rivalry within an industry will affect the profitability of industry as a whole.



According to *Porter*, rivalry is intensified by the following factors:

- Numerous or equally balanced competitors
- Slow industry growth
- High fixed or storage costs
- Lack of differentiation or switching costs
- Capacity augmented in large increments
- Diverse competitors
- High strategic stakes
- High exit barriers

The intensity of rivalry plays a major role in determining whether existing firms will expand capacity aggressively or choose to maintain profitability. Although rivalry can be beneficial in helping the industry to expand, it might leave demand unchanged. The intensity of competition will depend on a number of factors including the rate of growth in the industry and whether there are a large number of equally balanced competitors.

The intensity of competition depends on several factors as mentioned below:

- Where large numbers of equally balanced competitors exist, in situation of intense competition, firms may try to avoid competing on price.
- Where the growth rate of the industry is slow or stagnant, rivalry may intensify and the firms may indulge in competing with each other for a greater market share.
- Ease of switching will encourage suppliers to compete.
- Competitors may guess each other intentions and this may lead to uncertainty because of competitive strategy.
- Industries, characterized by economies of scale from substantial capacity increase, may face recurring periods of over-capacity and price-cutting.
- High fixed costs and relatively low variable costs tempt the firms to compete on price and sell at prices above marginal costs. As a result, there may be a failure to recover fixed costs.
- A firm putting in high capital funds and extensive efforts to achieve targets and making success (a strategic action), is likely to be more proactive and competitive to attain further high targets.



Forces	Problem	Way out
1. New entrants	They will play all sorts of tricks to capture market share	<ul style="list-style-type: none"> <li>- They have to incur huge initial outlay</li> <li>- They have lack of experience and concentrate to capitalize on these loose grounds.</li> </ul>
2. Buyers	Buyers will create problems when they come to know that they are the major customers or there are many sellers for the product / service under reference	In this case offer the best quality product / service at the most competitive price.
3. Suppliers	Suppliers will create problems when they come to know that there are only a few suppliers for the product or service or where the sellers' are not their predominant customer or where their product is a vital component of sellers' product.	Go for alternative sources of supply or develop own sources to manufacture the same.
4. Competitors	The competitors will always try to pull down its rivals.	
5. Substitutes	Substitutes always try to eat away market share of sellers' product.	<p>Depending on the dominance of the competitor, adopt an appropriate strategy.</p> <p>Try to convince the customers that the best product is being sold.</p>

The collective strength of the above mentioned five forces determines the ultimate profit potential of an industry. A company's competitive strategy in increasingly effective to the degree it provides good defenses against the five competitive forces, influences the industry's competitive rules in the company's favour and helps create a sustainable competitive advantage. The straight's goal should be to find a position in the industry where his company can best defend itself against these five forces or can influence them in his company's favour. Such a strategic fit obviously require a proper understanding of the objectives, the ever changing environment and the organization. These five competitive forces will influence

price, cost, investment, return on investment etc. Firms through their strategies can influence these five forces.



The basic assumptions of the model are:

- Constant return to sale, rationality of each operator in the business.
- The stronger each of these forces, the more limited is the ability of any operator to raise prices and earn greater profitability.

But, these assumptions do not hold well in all industry situations. The relative strength of each competitive force tends to be a function of industry structure i.e. its underlying economic and technological characteristics. This can change overtime, with the result that the relative strength of competitive forces will also change, hence the industry's profitability. The basic way an enterprise might seek to achieve above average returns in the long-term is through sustainable competitive advantage.

## 2.8 Process of conducting industry analysis through Porter's 5-Forces Model

Porter's five forces framework is used to analyse industry's competitive forces and to shape organization's strategy according to the results of the analysis. The process of conducting industry analysis through Porter's 5-Forces Model includes the following steps:

Step 1. Gather the information on each of the five forces

Step 2. Analyse the results and display them on a diagram

Step 3. Formulate strategies based on the conclusions

**Step 1. Gather the information on each of the five forces** .The managers should gather information about their industry and check it against each of the factors influencing the force. Some of the most important factors are enlisted below:

Porter's Five Forces Factors	
Threat of new entry	
•	Amount of capital required
•	Retaliation by existing companies
•	Legal barriers (patents, copyrights, etc.)
•	Brand reputation
•	Product differentiation
•	Access to suppliers and distributors
•	Economies of scale
•	Sunk costs
•	Government regulation



<b>Supplier power</b>
<ul style="list-style-type: none"><li>• Number of suppliers</li><li>• Suppliers' size</li><li>• Ability to find substitute materials</li><li>• Materials scarcity</li><li>• Cost of switching to alternative materials</li><li>• Threat of integrating forward</li></ul>
<b>Buyer power</b>
<ul style="list-style-type: none"><li>• Number of buyers</li><li>• Size of buyers</li><li>• Size of each order</li><li>• Buyers' cost of switching suppliers</li><li>• There are many substitutes</li><li>• Price sensitivity</li><li>• Threat of integrating backward</li></ul>
<b>Threat of substitutes</b>
<ul style="list-style-type: none"><li>• Number of substitutes</li><li>• Performance of substitutes</li><li>• Cost of changing</li></ul>
<b>Rivalry among existing competitors</b>
<ul style="list-style-type: none"><li>• Number of competitors</li><li>• Cost of leaving an industry</li><li>• Industry growth rate and size</li><li>• Product differentiation</li><li>• Competitors' size</li><li>• Customer loyalty</li><li>• Threat of horizontal integration</li><li>• Level of advertising expense</li></ul>

**Step 2. Analyse the results and display them on a diagram.** After gathering all the information display it on the Porter's 5-Forces model, then analyse it and determine how each force is affecting an industry. For example, if there are many companies of equal size operating in the slow growth industry, it means that rivalry between existing companies is strong. The five forces affect different industries differently so same results of analysis should not be used even for similar industries.

**Step 3. Formulate strategies based on the conclusions.** At this stage, managers should formulate firm's strategies using the results of the analysis. For example, if it is hard to achieve economies of scale in the market, the company should pursue cost leadership strategy. Product development strategy should be used if the current market growth is slow and the market is saturated.

Porter's 5-Forces Model is an important tool for industry analysis but it should be supplemented by SWOT analysis and Value Chain Analysis.



✓ **Check your progress**

**Exercise 3**

Conduct the industry analysis for a sport shoes manufacturing company.

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**2.9 Benefits of Porter's 5-Forces Analysis**

Porter's 5-Forces Model is very significant in market analysis and strategy formulation. The benefits of Porter's 5-Forces Model are enlisted below:

- It helps organisations to understand the factors affecting profitability in a specific industry.
- It can help in taking decisions relating to whether to enter a specific industry or whether to increase capacity in a specific industry.
- It helps in developing competitive strategies.
- It helps to analyse the strategic position of a business.
- It helps to analyse the current position before entering any merger.
- The extent of benefits which can be derived from a forward or backward integration can be known by conducting Porter's 5-Forces analysis.

**2.10 Let's Sum-up**

Porter's Five Forces Analysis is an important tool for assessing the potential for profitability in an industry. With a little adaptation, it is also useful as a way of assessing the balance of power in more general situations.

It works by looking at the strength of five important forces that affect competition:

- **Supplier Power:** The power of suppliers to dictate the terms of supply.



- **Buyer Power:** The power of your customers to dictate the terms of purchase.
- **Competitive Rivalry:** The degree of available competition in the relevant industry.
- **The Threat of Substitution:** The degree to which different products and services can act as substitutes for the products offered by the business.
- **The Threat of New Entry:** It refers to the entry barriers available for the potential competitors who aspire to enter in the industry.

By thinking about how each force affects a business and by identifying the strength and direction of each force, one can quickly assess the strength of the position of its business and its ability to make a sustained profit in the industry.

## 2.11 Key Terms

**Supplier Power:** The power of suppliers to drive up the prices of your inputs.

**Buyer Power:** The power of your customers to drive down your prices.

**Competitive Rivalry:** The strength of competition in the industry.

**Threat of Substitution:** The extent to which different products and services can be used in place of your own.

**Threat of New Entry:** The ease with which new competitors can enter the market if they see that you are making good profits.

## 2.12 Self-Assessment Questions

1. Suggest the ways in which a business can gain advantage over its rivals.
2. Under what situations the suppliers have a strong bargaining power.

## 2.13 Further Readings

- Philip Kotler, Kevin Keller, Abraham Koshy, Mithileshwar Jha, *Marketing Management, A South Asian Perspective*; Pearson Education.



- Rajan Saxena, *Marketing Management*, Tata McGraw Hill.
- Michael J Evely, Bruce J. Walker, William J. Stanton, Ajay Pandit, *Marketing Management*, Tata Mc Graw Hill Education.
- Bose B.S., *Marketing Management*, Himalaya Publishing House.

## 2.14 Model Questions

1. What do you understand by Porter's 5-Forces Model?
2. Explain the conditions in which suppliers has a strong bargaining power.
3. Discuss the process of industry analysis using Porter's 5-Forces Model.
4. Enumerate the benefits from Porter's 5-Forces Model.
5. Differentiate between bargaining power of suppliers and buyers.

## Answer to Self-Assessment Questions

1. In pursuing an advantage over its rivals, a firm can choose from several competitive moves:

- Changing prices - raising or lowering prices to gain a temporary advantage.
- Improving product differentiation - improving features, implementing innovations in the manufacturing process and in the product itself.
- Creatively using channels of distribution - using vertical integration or using a distribution channel that is new to the industry.
- Exploiting relationships with suppliers by setting high quality standards and inviting suppliers to meet its demands for product specifications and price.

2. The suppliers has a strong bargaining power under the following situations:

- There are few suppliers but many buyers
- Suppliers are large and threaten to forward integrate
- Few substitute raw materials exist
- Suppliers hold scarce resources
- Cost of switching raw materials is especially high



## Unit – 3

### SWOT Analysis



#### Learning Objectives

After completion of the unit, you should be able to:

- Explain the meaning and objectives of conducting SWOT analysis.
- Describe the concepts of strength, weakness, opportunity and threat.
- Understand the benefits and applications of SWOT analysis.

#### Structure

- 3.1 Introduction
- 3.2 History of SWOT Analysis
- 3.3 Meaning & Objectives of SWOT Analysis
- 3.4 Strength
- 3.5 Weakness
- 3.6 Opportunity
- 3.7 Threat
- 3.8 Benefits of SWOT Analysis
- 3.9 Essentials for a successful SWOT Analysis
- 3.10 Applications of SWOT Analysis
- 3.11 Let's Sum-up
- 3.12 Key Terms
- 3.13 Self-Assessment Questions
- 3.14 Further Readings
- 3.15 Model Questions

#### 3.1 Introduction

A significant part of environment scanning is analyzing the internal as well as external environment of the organization. Internal analysis accounts for the analysis of the strengths and weaknesses of the organization. On the other hand, external analysis demands the screening of the threats and opportunities available in the relevant business environment. This sometimes is referred as SWOT analysis. The origin of this concept and the constituents are explained in the coming paragraphs.



### 3.2 History of SWOT Analysis

The SWOT analysis technique was developed by Albert Humphrey, who led a research project at Stanford University in the 1960s and 1970s using data from many top companies. The goal was to identify why corporate planning failed. The resulting research identified a number of key areas and the tool used to explore each of the critical areas was called SOFTanalysis. Humphrey and the original research team used the categories “What is good in the present is Satisfactory, good in the future is an Opportunity; bad in the present is a Fault and bad in the future is a Threat.” Thus, this was later refined and restated as SWOT analysis.

### 3.3 Meaning & Objectives of SWOT Analysis

SWOT analysis refers to the identification of the strengths and weaknesses of a company, the opportunities available to it, and the threats facing it at any given situation so as to facilitate the enterprise to develop a suitable strategy. While strengths and weaknesses relate to the enterprise internally, opportunities and threats are often products of the external environment. The important methodologies to be applied using SWOT analysis are as mentioned below:

- Convert weaknesses into strengths
- Eliminate or minimize weaknesses
- Analyze strengths to take advantage of the opportunities
- Convert threats into opportunities

The following figure depicts SWOT analysis:





The objectives of SWOT analysis are enlisted below:

- SWOT analysis can be used effectively to build organizational or personal strategy.
- It is used to find competitive advantage by matching the strengths to opportunities.
- It is useful in converting weaknesses or threats of a business into strengths or opportunities.
- It is used as a tool for environmental scanning.
- Gap analysis may be done with the help of SWOT analysis and then the strategies may be devised to reduce this gap.
- It is helpful in identifying the critical success factors of the business.
- It is used as a basis for developing new strategies and preparing project plans for strategy implementation.
- To explore new solutions to problems.
- To identify barriers that will limit goals or objectives.
- To reveal possibilities and limitations for change.

### **3.4 Strength**

Strengths are internal competency of a firm, particularly in comparison with that of its competitors. Strengths may incorporate the following aspects:

- Company image
- brand image
- business synergies
- Functional areas such as marketing, finance, personnel, production and R&D.
- human competencies
- process capabilities
- financial resources
- products and services
- customer goodwill
- brand loyalty
- huge financial resources
- broad product line
- no debt
- committed employees

Strengths are the positive tangible and intangible attributes, which are internal to an organization. They are within the organization's control.



✓ **Check your progress**

**Exercise 1**

Making necessary assumptions, prepare a list of probable strengths of a company dealing in industrial machinery parts.

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**3.5 Weakness**

Weaknesses are those factors, which tend to decrease the competencies of the firm, particularly in comparison with its competitors. Weaknesses are controllable. They must be minimized and eliminated. Such weaknesses may include the following:

- poor product quality
- obsolete technology
- high production costs
- lack of R&D back up
- poor distribution infrastructure
- poor financial position
- weak management
- depreciating machinery
- narrow product range
- poor decision-making
- huge debts
- high employee turnover
- complex decision making process
- large wastage of raw materials

They indicate the factors that are within an organization's control that detract from its ability to attain the desired goal. It suggests as to which areas the organization might improve.

The following figure-1 provides a brief illustrative list of strengths and weaknesses.



### STRENGTHS AND WEAKNESS

STRENGTHS	WEAKNESSES
<b>Marketing</b>	
Strong brand image Strong distribution network Deep product mix Efficient and motivated sales force High quality product	Poor brand image Weak distribution Narrow product mix Poor sales force Poor product quality
<b>Production</b>	
Economics of scale State of the art technology Efficient input sourcing Efficient inventory management Strong R&D support	High cost due to small size Obsolete technology Inefficient input sourcing Poor inventory management No R&D support
<b>Finance</b>	
Comfortable debt-equity ratio Large internal accruals High dividends and market Capitalization High credit rating	Lop-sided capital structure Very high interests payments Poor reserves Low credit rating Poor receivable management
<b>Human Resource</b>	
Qualified and experienced Human resource Motivated human resource Good industrial relations Good human resource management	Redundant human resource Excess manpower Poor morale Poor industrial relations Poor human resource management
<b>Management</b>	
Efficient board of directors  Efficient and motivated managers	Inefficient board of directors Unhealthy conflict between members of Board Conflict between members of Board and top managers Inefficient managers

### 3.6 Opportunity

Opportunities refer to those favourable external factors that an organization can use to give it a competitive advantage. They are basically the external attractive factors that represent the reason for an organization to exist and develop. It focuses on the identification of what opportunities exist in the environment, which will propel the organization. Also they must be identified in association with specified time frames.



Opportunities arise when an organization can take benefit of conditions in its environment to plan and execute strategies that enable it to become more profitable. Organizations can gain competitive advantage by making use of opportunities.

Opportunities may arise from market, competition, industry/government and technology. For example - increasing demand for telecommunications accompanied by deregulation is a great opportunity for new firms to enter telecom sector and compete with existing firms for revenue.

### ✓ Check your progress

#### Exercise 2

Differentiate between strengths and opportunities.

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### 3.7 Threat

Threats refers to factors that have the potential to harm an organization .They are basically those external factors, beyond an organization’s control, which could place the organization mission or operation at risk .The organization may benefit by having contingency plans to address them if they should occur .The business should classify the threats by their “seriousness” and “probability of occurrence”.

Threats arise when conditions in external environment put at risk the reliability and profitability of the organization’s business. They compound the vulnerability when they relate to the weaknesses. Threats are uncontrollable. When a threat comes, the stability and survival can be at stake. Examples of threats are - unrest among employees; ever changing technology; increasing competition leading to excess capacity, price wars and reducing industry profits; etc.

The figure-2 provides an illustrative list of threats and opportunities.



### OPPORTUNITIES AND THREATS

OPPORTUNITIES	THREATS
Regulatory / Political	
Delicensing MRTPA relaxations Import liberalization Price decontrol Liberalization of foreign investment and technology policy Capital market reforms	Delicensing MRTPA relaxations Import liberalization  Liberalization of foreign investment and technology policy Political instability
Economic	
Boom Steady and fast increase in income	Recession Economic instability
Social / Demographic	
Favourable change in consumer attitude Increase population Change in age composition of population Growth of consumerism	Favourable change in consumer attitude Stagnating / declining population Change in age composition of population Growth of consumerism Growth of environmentalism

In the above figure, several factors figure under opportunities as well as threats. This is because what is an opportunity for some firms is a threat for some others. For example, declining is an opportunity for many firms to enter new business or to expand existing business but it poses a threat to existing firms who were enjoying the benefits of a protected market. Similarly, while import liberalization is a threat to import competing industries, it is an opportunity for some other firms to obtain materials / technology at lower prices.

### 3.8 Benefits of SWOT Analysis

A SWOT analysis is a great way to guide business-strategy discussions. Often the SWOT analysis reflect those factors of which we are unaware and would never be able to capture them without conducting such an analysis.

SWOT analysis offers the following benefits:

- It filters down to the specific segments like marketing, production, or sales and then it may be decided whether particular strategy may be adopted or not.
- Segment specific SWOT analysis can be done and then focused functional strategy may be developed.



- It is a source of information for strategic planning.
- It helps in building organization's strengths.
- It helps in reversing its weaknesses.
- It helps in maximizing its response to opportunities.
- It focuses on overcoming the organization's threats.
- It helps in identifying core competencies of the firm.
- It helps in setting of objectives for strategic planning.
- It helps in knowing past, present and future so that by using past and current data, future plans can be chalked out.

SWOT Analysis provide information that helps in synchronizing the firm's resources and capabilities with the competitive environment in which the firm operates.

✓ **Check your progress**

**Exercise 3**

Conduct a SWOT analysis for a company running airlines in India.

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**3.9 Essentials for a successful SWOT Analysis**

Before conducting the SWOT analysis, there are certain pre considerations which must be kept in mind. Following points illustrate the essentials for conducting SWOT analysis and will lead to successful outcomes:

- Be realistic about the strengths and weaknesses of your organization.
- The analysis should distinguish between where your organization is today, and where it could be in the future.
- Be specific and avoid grey areas.
- Always analyse in relation to your competition i.e. better than or worse than your competitors.
- Keep your SWOT analysis short and simple – but only as short and simple as the situation demands.
- Avoid unnecessary complexity and over analysis.





- There is no point listing an opportunity if the same opportunity is available to the competitors also.
- It is pointless to say you have strengths if your competitors also have the same.

### 3.10 Applications of SWOT Analysis

SWOT analysis is an influential tool of analysis which may be used for multifaceted purposes. Thus, SWOT analysis may have the following applications:

- Brainstorm meetings
- Problem solving
- Planning
- Product evaluation
- Competitor evaluation
- Personal Development Planning
- Decision Making
- Used to address individual issues like staffing issues, organizational structure, operational efficiency etc.
- Can be used in identifying and prioritizing the information to guide choices.
- Can be used to take advantage of a new business opportunity
- Can be used to respond to new trends
- Can be used to implement new technology

Application of SWOT analysis improves the performance of the company and reduces the business risks.

### 3.11 Let's Sum-up

SWOT Analysis, also known as TOWS Analysis, can be regarded as an outside-in and inside-out analysis of an organization's position. SWOT is an acronym for Strengths, Weaknesses, Opportunities and Threats.

For an organization seeking to improve its performance, SWOT Analysis is often used as an evaluation framework for analysing its position in order to define a strategy for moving forward.

SWOT Analysis is a strategic planning method used to evaluate the Strengths, Weaknesses, Opportunities, and Threats involved in a project or in a business venture. It involves specifying the objective of the business venture or project and identifying the internal and external factors that are favourable and unfavourable to achieve that objective. The technique is credited to Albert Humphrey, who led a convention at Stanford University in the 1960s and 1970s using data from Fortune 500 companies.



A SWOT Analysis must first start with defining a desired end state or objective. A SWOT analysis may be incorporated into the strategic planning model. The components of SWOT analysis are as follows:

1. **Strengths:** characteristics of the business or team that give it an advantage over others in the industry.
2. **Weaknesses:** are characteristics that place the firm at a disadvantage relative to others.
3. **Opportunities:** external chances to make greater sales or profits in the environment.
4. **Threats:** external elements in the environment that could cause trouble for the business.

After completing the SWOT analysis, the firm should try to configure its overall position in the marketplace by seeking the best combination of strengths and opportunities that can optimize returns. Not every opportunity can be pursued and every strength is not necessarily an exploitable advantage to the firm. Choices need to be made by the firm to take complete advantage of its position; likewise, the firm should seek to improve its weaknesses and minimize its threats.

### 3.12 Key Terms

**SWOT analysis:** SWOT analysis enables organizations to identify both internal and external influences. SWOT's primary objective is to help organizations develop a full awareness of all the factors involved in a decision.

**Strength:** It refers to the characteristics of the business or project that give it an advantage over others.

**Weakness:** It refers to the characteristics of the business that place the business or project at a disadvantage relative to others.

**Opportunity:** It refers to the elements in the environment that the business or project could exploit to its advantage.

**Threat:** It refers to the elements in the environment that could cause trouble for the business or project.

### 3.13 Self-Assessment Questions

1. Conduct a SWOT analysis for a company in web business that sells toys online.
2. Explain the components of SWOT analysis.



### 3.14 Further Readings

- J.D. Hunger and T. L. Wheelen, *Strategic Management and Business Policy*, Pearson Education.
- V.P. Michael, *Business Policy and Environment*, S. Chand & Co.
- Ramaswamy and Namakumari, *Strategic Planning -Formulation of Corporate Strategy*, MacMillan.
- P.K. Ghosh, *Strategic Planning and Management*, Sultan Chand & Sons.

### 3.15 Model Questions

1. How and when did the concept of SWOT analysis originated?
2. Discuss the objectives of conducting SWOT analysis.
3. Differentiate between opportunities and threats.
4. 'Managing with the weaknesses is more important than maximizing the strengths'. Comment.
5. Explain the benefits of SWOT analysis.

### Answer to Self-Assessment Questions

1. The following table represents the SWOT analysis for a web business selling toys online (necessary assumptions are made):

<b>Internal</b>	
<b>Strengths</b>	<b>Weaknesses</b>
<ol style="list-style-type: none"><li>1. Global reach of business</li><li>2. Low cost to maintain and enhance the site, not restricted by foot print</li><li>3. Stock is recognized brands</li><li>4. Purchase price can be less than off line shops</li><li>5. Strong competition for warehousing and distribution keeps costs down</li><li>6. Easy to remain in touch and build relationships with customers (Email, SMS)</li><li>7. Use existing distribution networks (Postage)</li></ol>	<ol style="list-style-type: none"><li>1. No shop front to accept returns</li><li>2. People need to find our site, there is no other marketing</li><li>3. Lack of shop brand recognition</li><li>4. Hard to scale up to respond to peaks and troughs in demand</li><li>5. Limited financial capital to fund web site optimization</li><li>6. Larger or heavy toys have high delivery cost diminishing the online price advantage.</li><li>7. Low web development skills in house we are reliant on outsourcing.</li></ol>



<b>External</b>	
<b>Opportunities</b>	<b>Threats</b>
<ol style="list-style-type: none"> <li>1. Established traffic and high number of repeat customers may enable increased sales through the addition of complimentary product lines</li> <li>2. Increased use of the internet for shopping with the 18 to 35 age group suggests that additional sales may come from stocking toys for this age group</li> <li>3. Improve organic search ranking to reduce advertising costs.</li> </ol>	<ol style="list-style-type: none"> <li>1. The internet has no barriers to entry which means a better financed business or an established retail business may seek to compete in this niche.</li> <li>2. e'Bay and other online auction sites have traders selling similar products</li> <li>3. Buyer reluctance to shop over the net</li> <li>4. Quality issues from overseas suppliers damaging the reputation of brands we sell</li> <li>5. Lager business with greater buying power may undercut our prices to gain online market share.</li> </ol>

2. SWOT analysis is a business analysis process that ensures that objectives for a project are clearly defined and that all factors related to the project are properly identified. The SWOT analysis process involves four areas: Strengths, Weaknesses, Opportunities and Threats. Both internal and external components are considered when doing SWOT Analysis, as they both have the potential to impact the success of a project or venture. The following is a brief summary of SWOT Analysis components:

### 1. **Strengths**

Strengths in SWOT analysis are the attributes within an organization that are considered to be necessary for the ultimate success of a project. Strengths are resources and capabilities that can be used for competitive advantage. Examples of strengths that are often cited include:

- Strong brand names
- Good reputation
- Cost advantages of proprietary know-how

### 2. **Weaknesses**

The factors within the SWOT analysis formula that could prevent successful results within a project are Weaknesses. Weaknesses include factors such as an abundance of rivalry between departments, a weak internal communication system, lack of funding and an inadequate amount of materials. Weaknesses can derail a project before it even begins. Other Weaknesses include:

- Weak brand name
- Poor reputation

- Ineffective and high cost structure



### 3. **Opportunities**

Opportunities are classified as external elements that might be helpful in achieving the goals set for the project. These factors could involve vendors who wish to work with the company to help achieve success, the positive perception of the company by the general public, and market conditions that could make the project desirable to the a segment of the market. Additional Opportunities include:

- Arrival of new technology
- Unfulfilled customer needs
- Taking business courses (training)

### 4. **Threats**

These external factors could gravely affect the success of the project or business venture. The possible threats that are critical to any SWOT analysis include a negative public image, no ready-made market for the final product and the lack of vendors who are able to supply raw materials for the project. Some other threats include:

- Trend changes
- New regulations
- New substitute products

## Unit – 4

### Competitive Strategies



#### Learning Objectives

After completion of the unit, you should be able to:

- Explain the meaning and objectives of competitive strategies.
- Describe the generic business strategies.
- Understand the difference between offensive and defensive strategies.
- Illustrate the generic competitive strategies given by Porter.

#### Structure

- 4.1 Introduction
- 4.2 Meaning & Objectives of Competitive Strategies
- 4.3 Classification of Competitive Strategies
- 4.4 Generic Business Strategies
- 4.5 Offensive and Defensive Strategies
- 4.6 Porter's Generic Competitive Strategies
- 4.7 Limitations of Generic Strategies
- 4.8 Let's Sum-up
- 4.9 Key Terms
- 4.10 Self-Assessment Questions
- 4.11 Further Readings
- 4.12 Model Questions

#### 4.1 Introduction

In the dynamic corporate world, competition has become an invariable component of every industry. New companies are entering the market with new products and services. The competition has even become intense with the increasing use of technology in product formulation and marketing. Thus, developing appropriate strategy and implementing it successfully has become the key to success today. This unit focuses on the varied types of competitive strategies which may be adopted to face competition and survive in the market in a profitable manner.

#### 4.2 Meaning & Objectives of Competitive Strategies

Competitive strategies refers to long-term action plan that is devised to help a company gain a competitive advantage over its rival. This type of strategy is often used in advertising campaigns by somehow discrediting the competition's product or service. Competitive strategies are essential to companies competing in markets

that are heavily saturated with alternatives for consumers. The companies adopt the competitive strategies to fulfil the following objectives:

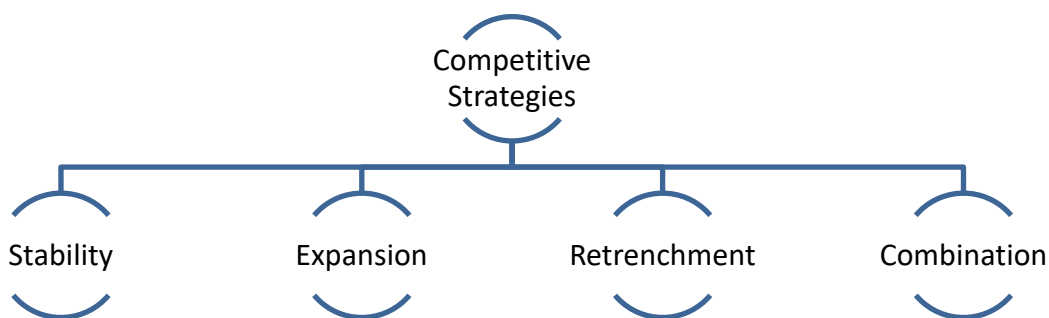


- To face the competition.
- To survive in the market.
- To increase their market presence.
- To enhance their profitability.
- To become market leader.
- To cope up with the market situations.

Apart from the above mentioned objectives, there are other specific objectives related to individual competitive strategies which are discussed in the following paragraphs.

### 4.3 Classification of Competitive Strategies

Competitive strategies may be classified into various categories depending upon the purpose and level of its applicability. The broad categorization of strategies which may be adopted at corporate level are:



### 4.4 Generic Business Strategies

Following are the competitive strategies which may be adopted by the companies to compete in the dynamic environment.

#### A. Stability Strategy

Stability strategy is adopted when the firm tries to bring incremental improvements in business operations. Its focus is on improving upon functional efficiencies. This strategy followed by small and medium size firms and generally adopted for short run. It is safety oriented, low risk, no much fresh investment and used when expansion is not possible.

Types of Stability strategy:-

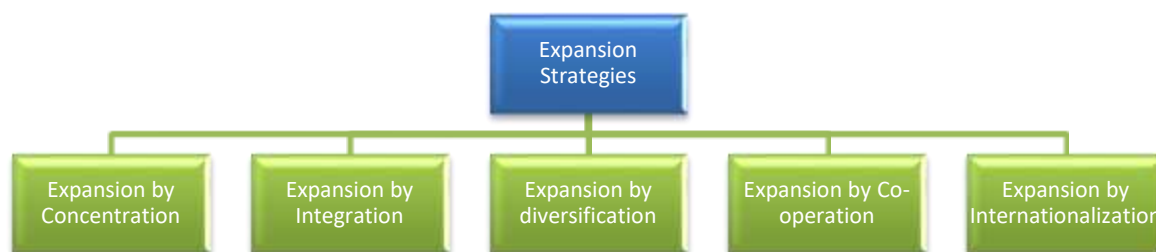


- (i) No change strategy – In this strategy firm does not introduce anything new and continue with the present business definition.
- (ii) Profit strategy – Profit strategy is adopted for sustaining its profitability by adopting artificial and temporary measures like reducing investment, cost cutting, raising prices and increasing productivity. This strategy is also adopted to overcome temporary difficulties like government attitude, industry down turn and competitive resources.
- (iii) Pause/ Proceed with caution strategy – This strategy is adopted to test the ground before moving ahead with a full-fledged grand strategy. It is also temporary like profit strategy.

**B. Expansion Strategy**

Expansion strategy is opposite to stability strategy. It involves redefining of business definition and fresh investment. Expansion strategy is fast and allows immediate utilization of acquired assets. It is less risky as it does not result in expansion in capacity. The most frequent increase indicating a growth strategy is to raise the market share or sales objectives upward significantly.

The various types of expansion strategies are explained below:



**1. Expansion by concentration**

Concentration means to go deeper in the existing business. It also means product or market expansion in existing business. For example, a printing firm changes from traditional printing to computerized printing.

**Existing market      New Market**

**Existing Product**

**New Product**

Market Penetration	Market Development
Product Development	Diversification



## ANSOFF'S Product market expansion grid



By adopting concentration strategy the following advantages and disadvantages:

Advantages:

- It involves minimum organizational changes.
- It helps the business to specialize in particular product and market.

Disadvantages:

- Costly – It requires R&D which incurs high cost to the company because R&D use many resources which are highly costly.
- Time consuming – Both market penetration and product penetration require time of management team to decide scope of penetration.
- Risk – There is high risk in focus as all attention is on a product or a market.

### ✓ Check your progress

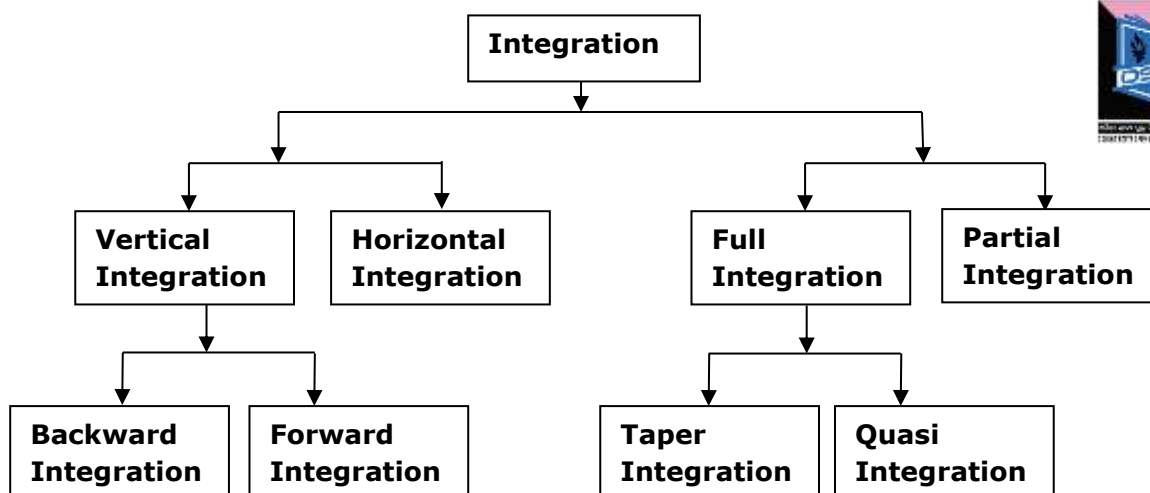
#### Exercise 1

Prepare a list of top five automobile companies. Analyze the history of these companies and find as to which competitive strategies they have adopted to face competition.

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## 2. Expansion by integration

Integration means combining the activities related to the present activity of the firm. Integration is the best way to obtain synergy in supplies. It also eliminate the future problems of scarcity of raw material. Integration strategies allow a firm to gain control over distributors, suppliers, or competitors.



Types of Integration:-

(i) **Vertical integration:** Vertical integration means integrating with the distributors of any firm in the value chain. It further can be of two types:

- **Backward integration** – Backward integration means integration with the sources of raw-material. It leads to the combining of a company with its suppliers of raw material. It also refers to a strategy of seeking ownership or increased control of a firm's suppliers. This strategy can be especially appropriate when the firm's current suppliers are unreliable, too costly or cannot meet the firm's needs.
- **Forward integration** – Forward integration involves the activities that bring the organization near to the customer and reduces the intermediaries in the channels of distribution. This strategy involves gaining ownership or increased control over distribution and retailers. An effective means of implementing forward integration is franchising. Business can expand rapidly because cost and opportunities are spread among many individuals.

(ii) **Horizontal integration:** It refers to a strategy of seeking ownership of or increased control over a firm's competitors. Mergers, acquisitions, and takeovers among competitors allow for increased economies of scale and enhanced transfer of resources and competencies.

**Objectives of horizontal integration:**

- Its main objective is to expand geographically.
- To increase the market share.
- To enjoy economies of scale.



- (iii) **Partial integration:** When only a part or particular section of a company is combined with another company's part, it is termed as partial integration.
- (iv) **Full integration:** Integration by a company in a full-fledged way i.e. all the functions of the company are combined with that of another company, it is termed as full integration.

### 3. Expansion by diversification

Diversification means entering into different area of business for the purpose of expansion. Although it is very difficult to manage diverse business activities, but sometimes diversification is still appropriate and successful strategy.

Types of Diversification:-

- I. **Concentric diversification:** In concentric diversification strategy a company diversifies into a related but different business. In other words adding new but related products or services is widely called concentric diversification strategy. The new business can be related with the existing business through product, technology, market. This strategy is followed when a company diversify into market by taking up an activity related to its existing business.
- II. **Conglomerate Diversification:** When a company diversifies its business into the areas that are unrelated to the current business is called conglomerate diversification.

Advantages of Diversification:

- It helps to minimize the risk by spending it over several business.
- It helps to capitalize on organization strengths.
- It is the only way if growth is blocked in the existing business due to environmental and regulatory factors.

Disadvantages of Diversification:

- i. Diversification of resources and attention to other areas lead to lack of concentration.
- ii. There is lack of managing entirely new business.
- iii. **Time consuming:** It requires lot of analysis before entering into a new field. Also, a new product line will require a start up from the scratch which consumes more time.

- iv. Need extra cost and efforts: For diversification, many options are open to a company. To be successful it requires extra-ordinary pre-determined efforts to be carried out which requires lot of expenditure also.



#### 4. Expansion by co-operation

When two or more companies desire to come together, fully or partly, and want to pool up their resources for obtaining mutual benefits is termed as co-operation. It may be in any of the following forms:

- (i) Merger: A merger refers to the absorption of one firm by another, i.e. the acquiring firm retains its name and its identity, and it acquires all of the assets and liabilities of the acquired firm. It is an external approach to expansion, In this approach the objective of buyer and seller are much to a certain extent, in which an organization acquires assets and liabilities in exchange of shares or cash or both.

Types of Merger:-

- a) Horizontal merger – When there is combination of two or more organizations in the same business it is known as horizontal merger.
- b) Vertical merger – In vertical merger there is a combination of two or more organizations in complementary items in terms of supply of materials. It reduces the supply chain and brings synergy in material cost.

Examples: - A footwear company combines with leather tannery or a chain of shoe retail stores.

- c) Concentric merger – When one company combines with other company related in either product, market or technology. The company may not be visibly alike but there are some common links between them in terms of market they are serving, technology used or product offered.

Example: - A footwear company combines with a hosiery company making socks.

- d) Conglomerate merger – When a company merges with another company totally unrelated from each other, this merger is known as conglomerate merger.

Examples: - Footwear company merges with cosmetic company.

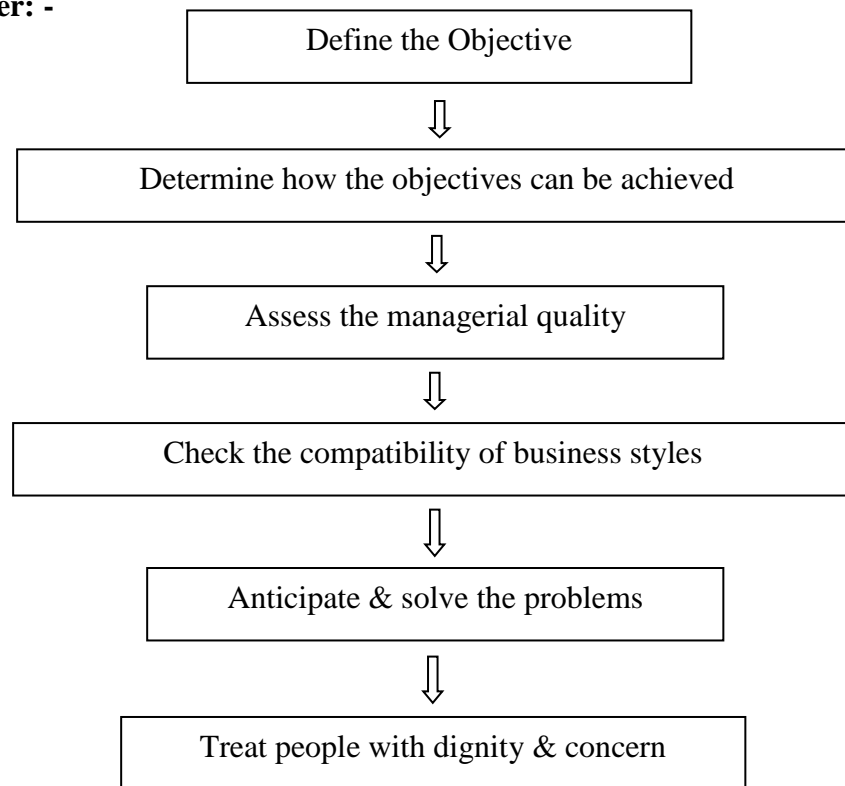
- (ii) Takeover – When comparatively large company establishes control over other company is called takeover.

Acquisition refers to acquiring of working control by one company over another company. It can be done by holding majority of shares and by controlling the composition of board of directors of another company. When

a company takes over the control of another company through mutual agreement, it is called acquisition. If the control is acquired through unwilling acquisition i.e. when it is opposed by 'target' company, it is 'takeover'.



**Process of Takeover: -**



Types of takeover:

- ❖ Friendly takeover: It refers to acquiring a part of the equity capital of another firm through mutual consent; reasons for convincing may be unable to fight competition or lack of funds for expansion or willingness to exit from the business.
- ❖ Hostile takeover: It means acquiring a portion of the equity capital against the wishes of the acquired firm. Takeover is a corporate action where an acquiring company makes a bid for an acquiree.

✓ **Check your progress**

**Exercise 2**

Differentiate between acquisition and takeover.

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- (iii) Joint Ventures – Joint venture is the special case of consolidation where two or more companies form a temporary partnership for a specified purpose. This strategy can be considered defensive only because the firm is not undertaking the project alone. It allows companies to improve communication and networking, to globalize operation and minimize risk. Joint ventures are very common in the oil and gas industry, and are often co-operations between a local and foreign company. It is also called as consortium.

Reasons for adopting Joint Venture are given below:-

- Joint venture is required when risk has to be shared.
- It is adopted when activities are uneconomical for a company alone.
- It is required when it is possible to bring together the different competencies of two or more companies.

Joint venture forms may be between two firms in the same industry or between two firms in different industry or between an Indian firm and a foreign company in India or between an Indian firm and a foreign company in a third country.

Benefits of Joint Venture:-

- a. Minimize risk: Risk is reduced as project will affect limited part of a company, also losses incurred would be shared.
- b. Access to foreign technology: When approach to foreign technology is difficult and ample opportunity is there, it is an easy way.
- c. Entering of new fields of business: Entering into new areas becomes easy as the other company has knowledge about it and we can avail the benefits via joint venture.

Limitations of Joint Venture:-

- a. Foreign Exchange Regulations (FER): Joint venture leads to transactions which may require different foreign currencies. It may be possible that different foreign regulations are there.
- b. Lack of co-ordination between firms: This problem arises when firms from different origins, different management approaches or different policies join hands to form a joint venture.
- c. Cultural difference: cultural difference may create diverse problems. For example if a Japanese firm join hands with an Indian firm then the salary



and recruitment policies are very different. Also, there will be no unanimity in terms of rewards, working pattern etc.

- (iv) **Strategic Alliances** – Strategic alliances means two or more firms unite to achieve agreed goals but remains independent after the formation of the alliance and they contribute on a continuous basis in one or more key strategic areas like technology, product etc.

Reasons for adopting Strategic Alliance:-

- Strategic alliance helps a firm to enter into new markets of which it has no in-depth knowledge.
- The manufacturing generally takes place where the cost is less. Also strategic alliance facilitates cost reduction, low promotion cost and less research.
- They are formed to create opportunities to learn either the new way of doing a thing or doing new thing.

Limitations of Strategic Alliance:-

- **Lack of trust:** Companies belonging to different origins, generally do not trust each other, as they work independently according to their own policies in all other matters except strategic alliance.
- **Conflicting interests:** The goal of both firms forming strategic alliance may differ. Lack of harmony leads to mutual misunderstanding and conflicts.
- **Focus on controlling rather than managing the relationship.** Both companies try to dominate each other, so their main emphasis is on controlling.

## 5. **Expansion by Internationalization**

Internationalization strategy is a type of expansion strategy that require firms to market their products or services beyond the domestic or national market. Firm would have to assess the international environment, evaluate its own capabilities, and devise strategies to enter foreign markets.

## C. **Retrenchment Strategy**

Retrenchment involves a total or partial withdrawal from either a customer group or customer functions, or the use of an alternative technology in one or more of firms businesses. This strategy denote separation of employees mainly due to decreased amount of work or due to converting a loss bearing company into a profit making company or to improve the performance.

Retrenchment occurs when an organization regroups through cost and asset reduction to reverse declining sales and profits.



Types of Retrenchment Strategy:-

(i) Turnaround Strategy: Turnaround strategy is also called cut-back strategy. It involves the ways to reverse the process of decline. Firms merge with the healthy unit and get advisory support. They may change the staff. The overall goal of turnaround strategy is to return an underperforming or distributed company to normal in terms of acceptable levels of profitability, solvency, liquidity and cash flow.

(ii) Divestment Strategy: It involves the sale or liquidation of a major portion of business or SBU or division. Reasons for adopting Divestment Strategy:-

- Continuous negative cash flow.
- Technological up gradation is must for survival but it is not possible to invest further in it.
- When organizational survival is dependent upon selling up of that business.
- Inability to manage that business.

Approaches to Divestment:-

(a) Spinning off – Making that division financially and managerially independent. It means treating the division as divested and detach it in all respects.

(b) Marketing concept – It means selling of the unit.

(iii) Liquidation Strategy: Liquidation strategy involves closing down a firm and selling its assets. Liquidation is recognition of defeat and consequently can be an emotionally difficult strategy. However, it may be better to cease operating than to continue losing large sum of money.

It mostly occurs in small scale sectors. Reasons for adopting Liquidation Strategy:-

- When organizations present liquidation value is more than its discounted present value of future cash flows.
- Loss of employment to employees.
- Termination of future opportunities.
- When the business is at peak but the future is uncertain.





✓ **Check your progress**

**Exercise 3**

Find and analyze two mergers in the IT industry.

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**D. Combination Strategy**

Combination strategy is the combination of all other grand strategies like stability, growth and retrenchment strategy. It would be difficult to find any organization that has survived and grown by adopting a single ‘pure’ strategy. Conditions when a company adopt the Combination Strategy:-

- When organization is large: A single strategy may not suit according to different SBUs. Thus in large organizations combination strategies may be applied.
- When environment is complex: Complex environment necessitate a blend of different strategies to cope up with changing premises.
- When organization have different businesses and each require different strategy.

**4.5 Offensive and Defensive Strategies**

**Offensive strategy-** This strategy is adopted by the company to attack on the market leader. There are many offensive strategies which may be adopted. Some of them are as follows:

- (i) Attack on competitor’s strength: Many options are available for attacking a competitor’s strength like:-
  - Offer equally good product at a lower price.
  - Leapfrog into next-generation technologies.
  - Construct new plant capacity in rival’s market strongholds.
  - Offer a wider product line.

- (ii) Attack on competitor’s weakness: The company utilize its strengths to exploit a rival’s weakness. Weaknesses to attack are as follows:-



- Rival providing sub-par customer services.
  - Market segments which a competitor is neglecting.
  - Geographic regions where rival is weak.
  - Customers that a rival is least equipped to serve.
- (iii) Simultaneously attack on many fronts. Here companies objective is to launch several major initiatives to:-
- Throw rivals off-balance.
  - Splinter their attention.
  - Force them to use substantial resources to define their position.
- (iv) Guerrilla offensive: It works on lit and run principle. It use principles of surprise to attack in locations and at times where conditions are favorable to initiator. For example- Increase promotional activities occasionally like reducing price to win a big order.
- (v) Pre-Emptive strategies: It is adopted to secure advantageous position by discouraging duplication by competitors.

**Defensive strategy-** This strategy is adopted by market leader to defend it from competitors. Following are the defensive strategies:

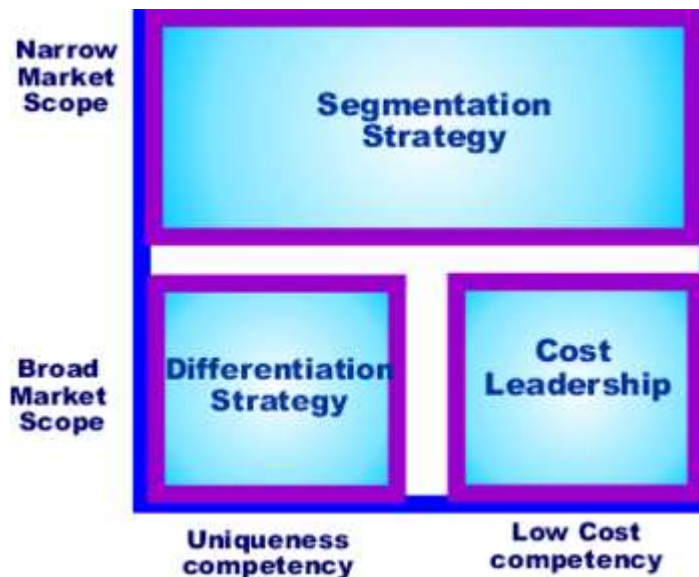
- (i) Method of protecting competitive position
- Publicity for maintaining firms present market share.
  - Publicity to meet increasing demand by increasing production capacity.
  - Counter response.
- (ii) First mover advantage and disadvantage: Whenever a company takes initiative to launch a technology or product it faces some pros and cons mentioned below:
- Advantages: a. Build image and reputation.  
b. First time customer remain loyal generally.
- Disadvantages: a. Technology change may soon become obsolete.  
b. Easy for late comers to crack the market.  
c. Danger of duplicity.

## 4.6 Porter's Generic Competitive Strategies



Michael Porter has described a category scheme consisting of three general types of strategies that are commonly used by businesses to achieve and maintain competitive advantage. These three generic strategies are defined along two dimensions: strategic scope and strategic strength. *Strategic scope* is a demand-side dimension and looks at the size and composition of the market you intend to target. *Strategic strength* is a supply-side dimension and looks at the strength or core competency of the firm. In particular he identified two competencies that he felt were most important: product differentiation and product cost.

He originally ranked each of the three dimensions (level of differentiation, relative product cost, and scope of target market) as either low, medium, or high, and juxtaposed them in a three dimensional matrix.



### Porter's Generic Competitive Strategies

In his 1980 classic *Competitive Strategy: Techniques for Analysing Industries and Competitors*, Porter simplifies the scheme by reducing it down to the three best strategies. They are cost leadership, differentiation, and market segmentation (or focus). Market segmentation is narrow in scope while both cost leadership and differentiation are relatively broad in market scope.

Empirical research on the profit impact of marketing strategy indicated that firms with a high market share were often quite profitable, but so were many firms with low market share. The least profitable firms were those with moderate market share. This was sometimes referred to as the hole in the middle problem. Porter's explanation of this is that firms with high market share were successful because



they pursued a cost leadership strategy and firms with low market share were successful because they used market segmentation to focus on a small but profitable market niche. Firms in the middle were less profitable because they did not have a viable generic strategy.

Some commentators have made a distinction between cost leadership, that is, low cost strategies, and best cost strategies. They claim that a low cost strategy is rarely able to provide a sustainable competitive advantage. In most cases firms end up in price wars. Instead, they claim a best cost strategy is preferred. This involves providing the best value for a relatively low price.

### ***Cost Leadership Strategy***

This strategy involves the firm winning market share by appealing to cost-conscious or price-sensitive customers. This is achieved by having the lowest prices in the target market segment, or at least the lowest price to value ratio. To succeed at offering the lowest price while still achieving profitability and a high return on investment, the firm must be able to operate at a lower cost than its rivals. There are three main ways to achieve this.

The first approach is achieving a high asset turnover. In service industries, this may mean for example a restaurant that turns tables around very quickly, or an airline that turns around flights very fast. In manufacturing, it will involve production of high volumes of output. These approaches mean fixed costs are spread over a larger number of units of the product or service, resulting in a lower unit cost, i.e. the firm hopes to take advantage of economies of scale and experience curve effects. For industrial firms, mass production becomes both a strategy and an end in itself. Higher levels of output both require and result in high market share, and create an entry barrier to potential competitors, who may be unable to achieve the scale necessary to match the firms low costs and prices.

The second dimension is achieving low direct and indirect operating costs. This is achieved by offering high volumes of standardized products, offering basic no-frills products and limiting customization and personalization of service. Production costs are kept low by using fewer components, using standard components, and limiting the number of models produced to ensure larger production runs. Overheads are kept low by paying low wages, locating premises in low rent areas, establishing a cost-conscious culture, etc. Maintaining this strategy requires a continuous search for cost reductions in all aspects of the business. This will include outsourcing, controlling production costs, increasing asset capacity utilization, and minimizing other costs including distribution, R&D and advertising. The associated distribution strategy is to obtain the most extensive distribution possible. Promotional strategy often involves trying to make a virtue out of low cost product features.



The third dimension is control over the supply/procurement chain to ensure low costs. This could be achieved by bulk buying to enjoy quantity discounts, squeezing suppliers on price, instituting competitive bidding for contracts, working with vendors to keep inventories low using methods such as Just-in-Time purchasing or Vendor-Managed Inventory. Wal-Mart is famous for squeezing its suppliers to ensure low prices for its goods. Dell Computer initially achieved market share by keeping inventories low and only building computers to order. Other procurement advantages could come from preferential access to raw materials, or backward integration.

A cost leadership strategy may have the disadvantage of lower customer loyalty, as price-sensitive customers will switch once a lower-priced substitute is available. A reputation as a cost leader may also result in a reputation for low quality, which may make it difficult for a firm to rebrand itself or its products if it chooses to shift to a differentiation strategy in future.

### ***Differentiation Strategy***

Differentiate the products in some way in order to compete successfully. Examples of the successful use of a differentiation strategy are Hero Honda, Asian Paints, HLL, Nike athletic shoes, etc. A differentiation strategy is appropriate where the target customer segment is not price-sensitive, the market is competitive or saturated, customers have very specific needs which are possibly under-served, and the firm has unique resources and capabilities which enable it to satisfy these needs in ways that are difficult to copy. These could include patents or other Intellectual Property (IP), unique technical expertise (e.g. Apple's design skills or Pixar's animation prowess), talented personnel or brand bananas, Starbucks could brand coffee, and Nike could brand sneakers. Fashion brands rely heavily on this form of image differentiation.

### ***Focus or Strategic Scope***

This dimension is not a separate strategy, but describes the scope over which the company should compete based on cost leadership or differentiation. The firm can choose to compete in the mass market with a broad scope, or in a defined, focused market segment with a narrow scope. In either case, the basis of competition will still be either cost leadership or differentiation.

In adopting a narrow focus, the company ideally focuses on a few target markets (also called a segmentation strategy or niche strategy). These should be distinct groups with specialized needs. The choice of offering low prices or differentiated products/services should depend on the needs of the selected segment and the resources and capabilities of the firm. It is hoped that by focusing your marketing efforts on one or two narrow market segments and tailoring your marketing mix to



these specialized markets, you can better meet the needs of that target market. The firm typically looks to gain a competitive advantage through product innovation and/or brand marketing rather than efficiency. It is most suitable for relatively small firms but can be used by any company. A focused strategy should target market segments that are less vulnerable to substitutes or where a competition is weakest to earn above-average return on investment.

In adopting a broad focus scope, the principle is the same: the firm must ascertain the needs and wants of the mass market, and compete either on price (low cost) or differentiation (quality, brand and customization) depending on its resources and capabilities. Apple also targets the mass market with its iPhone and iPod products, but combines this broad scope with a differentiation strategy based on design, branding and user experience that enables it to charge a price premium due to the perceived unavailability of close substitutes.

✓ **Check your progress**

**Exercise 4**

Explain the focus on market segment strategy as given by Porter.

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**4.7 Limitations of Generic Strategies**

Several commentators have questioned the use of generic strategies will have the following limitations:

- lack of specificity
- lack of flexibility
- Practicing more than one strategy will lose the entire focus of the organization hence clear direction of the future trajectory could not be established.
- Two focal objectives of low cost leadership and differentiation clash with each other resulting in no proper direction for a firm.



## 4.8 Let's Sum-up

In this dynamic world, the companies are constantly involved in devising strategies to cope up with the tough competition. The strategies are deployed at corporate level, business level and functional level. The corporate level strategies are also called grand strategies. Grand strategies can be classified into four categories – Stability, Expansion, Retrenchment and Combination Strategies. Porter has also devised a model for understanding the generic competitive strategies. Porter's generic strategies describe how a company pursues competitive advantage across its chosen market scope. There are three generic strategies, either lower cost, differentiated, or focus. All strategies are adopted under different market conditions and have their own pros as well as cons.

## 4.9 Key Terms

**Competitive Strategy:** Competitive Strategy is defined as the long term plan of a particular company in order to gain competitive advantage over its competitors in the industry. It is aimed at creating defensive position in an industry and generating a superior Return on Investment.

**Stability Strategy:** A stability strategy refers to a strategy by a company where the company stops the expenditure on expansion, in other words it refers to situation where company do not venture into new markets or introduce new products.

**Retrenchment Strategy:** This strategy is often used in order to cut expenses with the goal of becoming a more financial stable business. Typically the strategy involves withdrawing from certain markets or the discontinuation of selling certain products or service in order to make a beneficial turnaround.

**Differentiation Strategy:** Differentiation is about setting your company, product, or service apart. It distinguishes your brand from all others. The differentiation strategy is an integrated set of action designed to produce or deliver goods or services that customers perceive as being different in ways that are important to them.

## 4.10 Self-Assessment Questions

1. What do you understand by retrenchment strategy? Explain the various types of retrenchment strategies.
2. Write a short note on Cost Leadership.



#### 4.11 Further Readings

- J. David Hunger & Thomas L. Wheelen, *Strategic Management*, Addison Wesley Longman.
- Azhar Kazmi, *Business Policy & Strategic Management*, Tata McGraw Hill.
- Ramaswamy and Namakumari, *Strategic Planning -Formulation of Corporate Strategy*, MacMillan.
- P.K. Ghosh, *Strategic Planning and Management*, Sultan Chand & Sons.

#### 4.12 Model Questions

1. What do you understand by Competitive Strategies?
2. Differentiate between offensive and defensive strategies.
3. Explain the objectives of framing the competitive strategies.
4. State the limitations of competitive strategies.
5. Discuss the generic competitive strategies given by Porter.

#### Answer to Self-Assessment Questions

**1. Retrenchment** primarily means reduction in product, services or personnel. This strategy is generally useful in the face of tough competition, scarcity of resources and declining economy. Under certain situations, retrenchment strategy becomes highly necessary for the very survival of the company, even though it may reflect poorly on the management of such a company.

Retrenchment strategies include harvest, turnaround, divestiture, bankruptcy and liquidation.

##### **Harvest:**

This strategy entails minimizing investments while at the same time attempting to maximize short-run cash flow and profits with the intention of eventually liquidating the company. A harvest strategy is often used when future growth in the market is doubtful.

If this strategy becomes apparent, the morale of employees as well as the confidence of customers and suppliers in the company declines, making it difficult for the company to attain its short-term goals.





### **Turnaround:**

This strategy is designed to shift from a negative direction to a positive one. This can be achieved by restructuring the organizational operations in order to restore the appropriate levels of profitability.

A successful turnaround can be achieved by giving high priority to the core business area and divesting from diversified activities. Some of the common features in turnaround situations are:

- a. Changes in leadership
- b. Redefining the company's strategic focus.
- c. Divesting or closing unwanted assets
- d. Taking steps to improve the profitability of remaining operations.
- e. Making acquisitions to rebuild core operations.

### **Divestiture:**

It is a process of selling off divisions or subsidiaries to restructure a company around a smaller but stronger portfolio of businesses. This strategy is especially useful when these divisions are performing poorly.

Selling off a division or a unit is a frequently used strategy, when the unit is sold to a company which is in the same line of business as the unit. The purchaser may be willing to pay a higher price in such a case in order to increase the size of his own business. The money thus realized can be used to restructure the declining business into profitability.

### **Bankruptcy:**

Also known as going into chapter 11 in America, bankruptcy is a form of court protection from creditors when an organization has been in decline for a long period of time and is unable to meet its obligations and needs time and opportunity to reorganize itself for a turnaround.

The time period for reorganization is determined by the court and during that period the organization is protected from its creditors and other contract obligations while it attempts to regain financial stability.

### **Liquidation:**

Liquidation simply means end or termination of the business. The company moves to exit the business either by liquidating its assets or by selling the whole business, thus ending its existence in the current form.

2. Cost leadership is a term used when a company projects itself as the cheapest manufacturer or provider of a particular product or commodity in a competition. It is difficult to deploy the strategy because the management must constantly work on reducing cost at every level to remain competitive.



Cost leadership is a part of marketing strategy. Although, it is highly effective in gaining market share as well as drawing the customers' attention, it is difficult to deploy. To deploy this strategy, a company has to produce goods which are of acceptable quality and specific to a set of customers at a price which is much lower or competitive than other companies producing the same product. The most famous cost leader in India is Big Bazaar.

## Unit – 5

### Value Chain Analysis



#### Learning Objectives

After completion of the unit, you should be able to:

- Explain the meaning and objectives of value chain analysis.
- Describe the Porter's value chain framework.
- Understand the applications of value chain analysis.

#### Structure

- 5.1 Introduction
- 5.2 Meaning & Objectives of Value Chain Analysis
- 5.3 Porter's Value Chain Framework
- 5.4 Value Chain Model
- 5.5 Primary Activities
- 5.6 Support Activities
- 5.7 Procedure to understand company's value chain using Porter's model
- 5.8 Applications of Value Chain Analysis
- 5.9 Let's Sum-up
- 5.10 Key Terms
- 5.11 Self-Assessment Questions
- 5.12 Further Readings
- 5.13 Model Questions

#### 5.1 Introduction

Value Chain Analysis is the framework most commonly used to guide analysis of any firm's strengths and weaknesses. In this framework, any business is seen as a number of linked activities, each producing value for the customer. By creating additional value, the firm may charge more or is able to deliver same value at a lower cost, either of this leading to a higher profit margin. This ultimately adds to the organization's financial performance. This concept is useful for getting competitive advantage also.

#### 5.2 Meaning & Objectives of Value Chain Analysis

Value chain analysis is a strategy tool used to analyze internal firm activities. Its goal is to recognize, which activities are the most valuable to the firm and which ones could be improved to provide competitive advantage. The idea of the value



chain is based on the process view of organizations, the idea of seeing a manufacturing (or service) organization as a system, made up of subsystems each with inputs, transformation processes and outputs. Inputs, transformation processes, and outputs involve the acquisition and consumption of resources – money, labour, materials, equipment, buildings, land, administration and management. How value chain activities are carried out determines costs and affects profits.

The objectives of value chain analysis are as follows:

- To create the greatest possible value for the customers.
- It helps in thinking as to how we can maximize this value - whether through superb products or great services.
- To improve the processes used in the organization.
- It helps in identifying those key areas which might be worked upon and converted into company's strength.
- It helps in understanding the nature of relationship existing between the various processes.
- On the basis of value chain analysis, strategies may be formulated which can further lead to the development of the value chain.
- To understand the reasons and constraints prevailing in the current value chain which are restricting it to achieve the desired outcomes.

### 5.3 Porter's Value Chain Framework

The value chain framework is a typical value chain within an organization. Using this framework, it is possible to analyze the organization's contributions of individual activities in a business and how they add up to the overall level of customer value, the firm produces. The value chain framework provides the interweaving of the primary and support operating activities in the organization. This framework proves to be very beneficial in the supply chain management study. It helps in understanding the minute details of the operating activities which further can be used to reduce the cost or formulate strategies to gain competitive advantage. Porter's value chain framework encompasses a value chain model which establishes a relationship flow among the value adding activities of the organization.

#### ✓ Check your progress

##### Exercise 1

Analyze the value chain of Mc Donalds. List out the pros and cons in their value chain model.



## 5.4 Value Chain Model

Instead of emphasizing on the departments or cost centres, Porter's Value Chain focuses on systems, and how inputs are changed into the outputs purchased by consumers. Using this viewpoint, Porter described a chain of activities common to all businesses, and he divided them into primary and support activities, as shown below.

Figure 1: Porter's Generic Value Chain



## 5.5 Primary Activities

Primary activities relate directly to the physical creation, sale, maintenance and support of a product or service. They consist of the following:

- **Inbound logistics** – It refers to all the processes related to receiving, storing, and distributing inputs internally. Your supplier relationships are a key factor in creating value here.
- **Operations** – These are the transformation activities that change inputs into outputs that are sold to customers. Here, your operational systems create value.
- **Outbound logistics** – These activities deliver your product or service to your customer. These are things like collection, storage, and distribution systems, and they may be internal or external to your organization.



- **Marketing and sales** – These are the processes you use to persuade clients to purchase from you instead of your competitors. The benefits you offer, and how well you communicate them, are sources of value here.
- **Service** – These are the activities related to maintaining the value of your product or service to your customers, once it's been purchased.

## 5.6 Support Activities

These activities support the primary activities. Support activities are also called secondary activities. In the value chain model, the dotted lines show that each support activity supports in the role of each primary activity. For example, procurement supports operations with certain activities, but it also supports marketing and sales with other activities.

- **Procurement (purchasing)** – It is an activity which an organization does to get the resources it needs to operate. This includes finding vendors and negotiating best prices.
- **Human resource management** – This is related to the recruitment policy of the company. It also relates to how a company hires, trains, motivates, rewards, and retains its workers. People are a significant source of value, so businesses can create a clear advantage with good HR practices.
- **Technological development** – These activities relate to managing and processing information, as well as protecting a company's knowledge base. Minimizing information technology costs, staying current with technological advances, and maintaining technical excellence are sources of value creation.
- **Infrastructure** – This forms a part of company's support systems, and the functions that allow it to maintain daily operations. Accounting, legal, administrative, and general management are examples of necessary infrastructure that businesses can use to their advantage.

Companies use these primary and support activities as "building blocks" to create a valuable product or service.

### ✓ Check your progress

#### Exercise 2

Differentiate between primary and support activities. Also explain the concept of inbound and outbound logistics.

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## 5.7 Procedure to understand company's value chain using Porter's model

To identify and understand the company's value chain, Porter's model may be adopted. The procedure includes the following steps:

### Step 1 – Identify sub-activities for each primary activity

For each primary activity, determine which specific sub-activities create value. There are three different types of sub-activities:

- **Direct activities** create value by themselves. For example, in a book publisher's marketing and sales activity, direct sub-activities include making sales calls to bookstores, advertising, and selling online.
- **Indirect activities** allow direct activities to run smoothly. For the book publisher's sales and marketing activity, indirect sub-activities include managing the sales force and keeping customer records.
- **Quality assurance** activities ensure that direct and indirect activities meet the necessary standards. For the book publisher's sales and marketing activity, this might include proofreading and editing advertisements.

### Step 2 – Identify sub-activities for each support activity.

For each of the Human Resource Management, Technology Development and Procurement support activities, determine the sub-activities that create value within each primary activity. For example, consider how human resource management adds value to inbound logistics, operations, outbound logistics, and so on. As in Step 1, look for direct, indirect, and quality assurance sub-activities.

Then identify the various value-creating sub-activities in your company's infrastructure. These will generally be cross-functional in nature, rather than specific to each primary activity. Again, look for direct, indirect, and quality assurance activities.

### Step 3 – Identify links

Find the connections between all of the value activities you've identified. This will take time, but the links are key to increasing competitive advantage from the value chain framework. For example, there's a link between developing the sales force (an HR investment) and sales volumes. There's another link between order turnaround times, and service phone calls from frustrated customers waiting for deliveries.

### Step 4 – Look for opportunities to increase value

Review each of the sub-activities and links that you've identified, and think about how you can change or enhance it to maximize the value you offer to customers.



✓ **Check your progress**

**Exercise 3**

Illustrate the benefits of having mergers in the value chain of a company.

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**5.8 Applications of Value Chain Analysis**

Value chain analysis offers numerous applications and utilities in variety of ways. Some of the significant applications are mentioned below:

- Value Chain Analysis is a tool for determining competitive advantage.
- It is a powerful analysis tool for strategic planning.
- The value-chain concept has been extended beyond individual firms. It can apply to whole supply chains and distribution networks. The delivery of a mix of products and services to the end customer will mobilize different economic factors, each managing its own value chain. The industry wide synchronized interactions of those local value chains create an extended value chain, sometimes global in extent. Porter terms this larger interconnected system of value chains the "value system". A value system includes the value chains of a firm's supplier, the firm itself, the firm distribution channels, and the firm's buyers.
  - Capturing the value generated along the chain is the new approach taken by many management strategists. For example, a manufacturer might require its parts suppliers to be located nearby its assembly plant to minimize the cost of transportation. By exploiting the upstream and downstream information flowing along the value chain, the firms may try to bypass the intermediaries creating new business models, or in other ways create improvements in its value system.
  - Value chain analysis has also been successfully used in large petrochemical plant maintenance organizations to show how work selection, work planning, work scheduling and finally work execution can help drive lean approaches to maintenance.
  - A value chain approach could also offer a meaningful alternative to evaluate private or public companies when there is a lack of publicly known data from direct competition, where the subject company is compared with, for example, a known downstream industry to have a good



feel of its value by building useful correlations with its downstream companies.



## 5.9 Let's Sum-up

Porter's Value Chain is a useful strategic management tool. It works by breaking an organization's activities down into strategically relevant pieces, so that you can see a fuller picture of the cost drivers and sources of differentiation, and then make changes appropriately.

Value Chain Analysis is a useful way of thinking through the ways in which you deliver value to your customers, and reviewing all of the things you can do to maximize that value.

It takes place as a three stage process:

- **Activity Analysis**, where you identify the activities that contribute to the delivery of your product or service.
- **Value Analysis**, where you identify the things that your customers value in the way you conduct each activity, and then work out the changes that are needed.
- **Evaluation and Planning**, where you decide what changes to make and plan how you will make them.

Porter's value chain model divides the firm's activities into two broad categories – primary activities and support activities. It focuses on identifying these activities in every organization and then find out the extent of relevance and value addition made by these activities.

By using Value Chain Analysis and by following it through to action, a company can achieve excellence in the things that hold relevance for the customers.

## 5.10 Key Terms

**Value Chain:** A *value chain* is a set of activities that a firm operating in a specific industry performs in order to deliver a valuable product or service for the market.

**Value Chain Analysis:** Value chain analysis is a strategy tool used to analyze internal firm activities. Its goal is to recognize, which activities are the most valuable to the firm and which ones could be improved to provide competitive advantage.

**Primary Activities:** Primary activities relate directly to the physical creation, sale, maintenance and support of a product or service.

**Support Activities:** These activities support the primary activities. Support activities are also called secondary activities.



### 5.11 Self-Assessment Questions

1. What do you understand by 'Value System'?
2. Illustrate the primary activities and support activities as given by Porter's Value Chain Model.

### 5.12 Further Readings

- Richard R Chase, *Operations Management for Competitive Advantage*, McGraw-Hill.
- John M Nicholas, *Competitive Manufacturing Management*, Tata McGraw Hill Publishing.
- Nigel Slack, *Operations Strategy*, Pearson Education.
- M E Porter, *Competitive Strategy*, Free Press Publisher.

### 5.13 Model Questions

1. What do you understand by Value Chain Analysis?
2. Explain the objectives of conducting value chain analysis.
3. Differentiate between primary activities and support activities.
4. Discuss briefly the applications of value chain analysis.
5. Explain the procedure of understanding the company value chain using Porter's value chain framework.

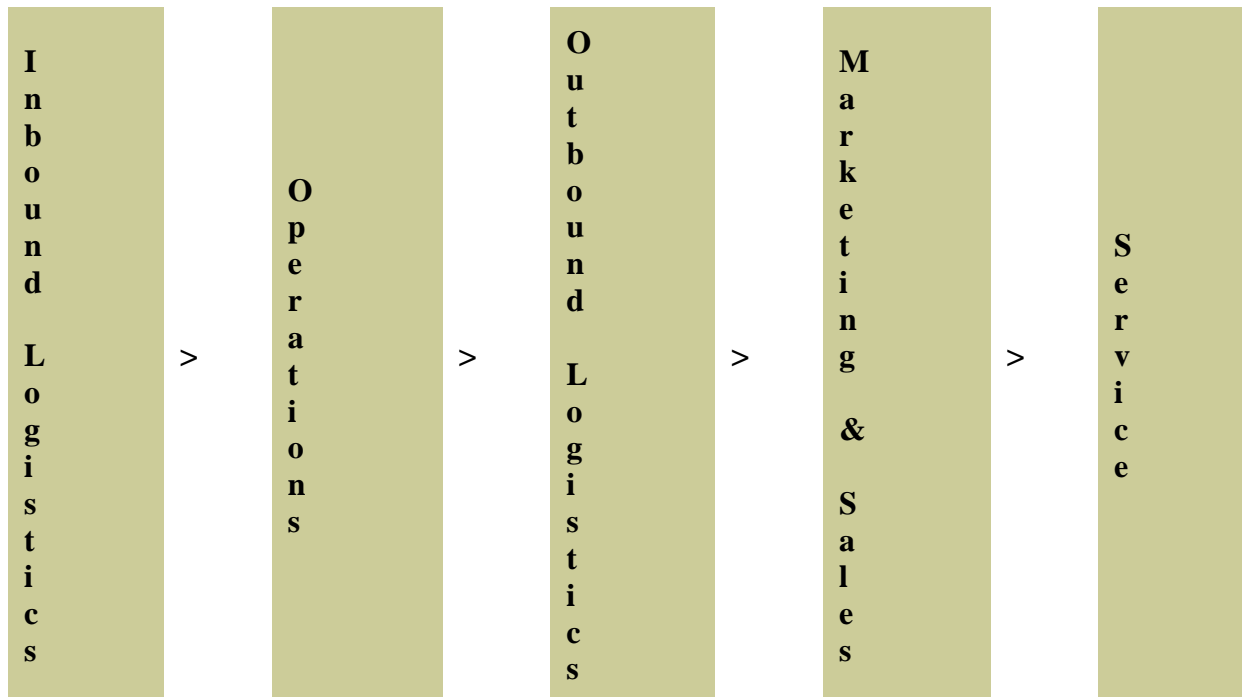
## Answer to Self-Assessment Questions



1. The firm's value chain links to the value chains of upstream suppliers and downstream buyers. The result is a larger stream of activities known as the *value system*. The development of a competitive advantage depends not only on the firm-specific value chain, but also on the value system of which the firm is a part.

2.

### Primary Value Chain Activities



The goal of these activities is to create value that exceeds the cost of providing the product or service, thus generating a profit margin.

- **Inbound logistics** include the receiving, warehousing, and inventory control of input materials.
- **Operations** are the value-creating activities that transform the inputs into the final product.
- **Outbound logistics** are the activities required to get the finished product to the customer, including warehousing, order fulfillment, etc.
- **Marketing & Sales** are those activities associated with getting buyers to purchase the product, including channel selection, advertising, pricing, etc.
- **Service** activities are those that maintain and enhance the product's value including customer support, repair services, etc.

Any or all of these primary activities may be vital in developing a competitive advantage. For example, logistics activities are critical for a provider of

distribution services, and service activities may be the key focus for a firm offering on-site maintenance contracts for office equipment.



## Support Activities

The primary value chain activities described above are facilitated by support activities. Porter identified four generic categories of support activities, the details of which are industry-specific.

- **Procurement** - the function of purchasing the raw materials and other inputs used in the value-creating activities.
- **Technology Development** - includes research and development, process automation, and other technology development used to support the value-chain activities.
- **Human Resource Management** - the activities associated with recruiting, development, and compensation of employees.
- **Firm Infrastructure** - includes activities such as finance, legal, quality management, etc.

Support activities often are viewed as "overhead", but some firms successfully have used them to develop a competitive advantage, for example, to develop a cost advantage through innovative management of information systems.