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Strategic Management

ICWAI Group III

Target Costing: Businesses secure competitive advantage by creating superior value for customers and investors. To leverage value creation; more successful firms are adopting Target Costing.

The objective of target costing is:

- "to 'engineer-in' targets for a product's selling price, profit, quantity, reliability, schedule, and life cycle costs concurrently with the planning and design of the product's features and its build process."
- Since 80-90% of a product's potential costs are engineered in during its design, target costing provides huge leverage for value creation during the pre-production phase itself.
- Before looking at a product's design and developing methods, in a Target costing approach, the product planning teams develop integrated evaluation of:
  (i) customer preferences identified through customer 'wants' research,
  (ii) customer value adding potentials of alternative design and build possibilities, and
  (iii) the associated product life cycle.

In this process, the strategic goal is to optimise concurrently a product's performance features, manufacturability, operating processes, and cycle times, along with its profits and cost targets.

Target Costing Methodology

Target Costing forces an organisation to 'manage upstream' during product planning and design stage and provides a framework of strategic targets to guide 'managing down stream' during production and later phases by employing a concurrent engineering analyses of (i) market forces, (ii) customer needs, (iii) relevant technology, (iv) competitors' models (v) product configuration and performance features, (iv) design alternatives, (vii) process capabilities, (viii) maintenance and service requirements etc., and (ix) life cycle costs.

The above analyses reveal innovative possibilities in several areas, especially for:

1. reducing cycle times for design, devel6pment, manufacturing and service;
2. reducing costs for design, development, manufacturing and service;
3. reducing the number of total parts;
4. reducing the number of unique parts per model; and
5. reducing the rate of redesign, rework, and repair.

The end result is a product design that builds in competitive barriers and 'guarantees' a target profit and a target cost against a planned selling price. A new product or a derivative is approved for production only after all concerned managers are satisfied that the targets are aggressive enough and can be achieved.

Target Costing-Steps

A firm's business plan and product-market strategies provide the framework and basic guidelines for applying the target costing methodology. Steps involved in target costings may be summarised as follows:

(i) Determining customer wants precisely.
(ii) Translating them into desired product performance features.
(iii) Estimating the proportion of value added by each feature and component.
(iv) Choosing a product design that assures a targeted profit and cost targets for each component and in total.
(v) Choosing manufacturing designs that assure targeted costs.
(vi) Choosing suppliers that assure buying at targeted costs.
(vii) After each cost review, conducting value engineering to reduce target costs.
(viii) Monitoring initial production to ensure that all product performance/cost/profit targets are met.

Implementing Target Costing

Exhibit 1 (given below) provides a blue print of reengineered product development and target costing methods. The first two columns list the pre-production phases and detailed steps beginning with business plan and ending with initial production.

Companies planning to adopt target costing must address four broad organizational issues: (1) aligning culture and incentives; (2) removing functional fixations; (3) empowering cross functional teams; and (4) providing information support. Target costing succeeds when the organizational culture and incentives motivate managers and employees to be sincerely committed to adding value to customers and shareholders. This is clearly a challenge to be addressed by senior management with the help of middle management and employee participation. The objective is to make every employee driven by a two-fold passion, namely, "How can I add value to the customer?" and "How can I add value to the shareholder?"

Functional fixations are a major impediment to successful target costing. Target costing demands a profound understanding of customer needs and of the processes used to design, produce, deliver, and service the products that satisfy those customer needs. Anchored on such knowledge, targets are set for customer value increments in each process that make up the product's value chain. To facilitate such process oriented analysis, target costing in companies embraces process-based organizational reengineering.

Cross functional teams play a critical role in managing customer value creation in all phases, from product concept to phase out or recycling. For instance, design and; manufacturing engineers, market research staff, customer support engineers, buyers, and cost accountants collaborate on translating customer preferences to optimal product features, components, structure, and manufacturability. Team members must develop a shared understanding of the perspectives, language, and tools used by each member. For this reason, target costing in

firms empowers cross functional teams as process owners, with the functional managers providing functional support. These firms also invest heavily in cross functional training of team members.
Critical to the success of target costing is the company's willingness to maintain an information system that has libraries of design alternatives for parts, components, and build processes along with associated cost tables. To create such libraries, cost accountants and engineers venture beyond verifiable historical data to develop best estimates of future cost and value increments. By making such expert data readily available, the information system serves as a major source of competitive advantages.
Note: In the face of increasing global competition and shrinking product lives, the relevant question is not whether or not to adopt target costing, but how soon and in what manner to adopt it. Successful implementation requires clear managerial vision and commitment, process based organizational reengineering, data development, and -incentives, and considerable methodological innovation. While these are difficult challenges, the rewards in terms of competitive gains and shareholder value creation can be immense.

Activity Based Costing (ABC): The impertive solution to active competitive advantage lies in aligning the firm's resources with strategic opportunities. According to porter, one of the strategies for maintaining sustainable competitive advantage is cost leadership through economies of scale, learning curve effects and cost control. Ail these means of Cost leadership fall within the territory of a cost reduction programme. Accomplishment of this programme requires several managerial interventions and these are possible only if the managers are equipped with relevant and accurate cost related information. Activity Based Costing (ABC) and its management can provide such information necessary to achieve cost leadership.
The underlying philosophy of ABC is that the cost responsibility should be shared by all functions of an organisation. ABC technique gives visibility to costs by detailing the organisation's activities, their interrelationship and their respective costs. It categories all inputs by the way in which they are consumed and that leads to an analysis focusing on cost reduction opportunities.

ABC Proper: Activity Based Costing is a technique which breaks down the work process into various activities and tries to work out cost of each of these activities. Further, each of these activities is broken down into two components:
(i) Value-added components (VA), and (ii) Non-Value-added components (NVA).
The non-value-added (NVA) components represent typically the activities that the firm's customers would rather not pay for. Unnecessary copying and filing, checking, chasing and correcting, overtime working, etc. are the common NVA activities., By collecting the total NVA cost by process, it is possible to priorities and bring in improvements in the activities done in the organistion. To make the ABC technique effective, performance targets are set for both of VA and NVA components and all-out efforts are made to continually improve upon the VA components, and to reduce and ultimately eliminate the NVA components.

ABC Objectives
The basic objectives of ABC are two-fold:
1. Validating the success of quality drive with it, and
2. Optimising the costs in response to price resistance in market.
The above objectives are achieved as follows:
(i) Gauging the efficiency of different activity; (ii) Determining non-value added activities; (iii) Attacking the area of cost redundancy; (iv) Pinning down the hidden costs; and(v) Determining focal point for continuous improvement.
So, ABC is a special technique to reengineer the existing costing system through identification of various activities at functional level and to capture the costs involved in delivering the desired products and/or services, and it helps in finding out costs to a greater accuracy.

ABC System Procedure
The system procedures to design the ABC consist of
1. Development of Linear Model of Cost Flow, which requires consideration of:
(i) Both direct and indirect costs; (ii) Indirect costs accumulation at various cost pool; (iii) Cost drivers at various activity levels; and (iv) Cost assignment to product.
2. Identification of Steps for Implementation, which requires consideration of Variables as outlined in eight boxes under 'Input Level'.
3. Design of Cost Pool according to organisation Tree Structure, duly classified in major heads like—
(i) Division : Cost Pool 1 : consisting of one or more departments;
(ii) Department: Cost Pool 2 : consisting of one or more sections;
(iii) Section : Cost Pool 3 : consisting of one or more units; and
(iv) Unit: Cost Pool 4 : the lowest activity level.
4. Identification of Functional Areas and relative Activities involved in each functional area.
5. Allocation of Common Expenditure to various Activities.
6. Preparation of Statements of Expenditure—Functionwise/Activity-wise/Account head-wise.
7. Identification of the most suitable Cost Driver in each Activity
8. Preparation of Activity-wise Cost Matrix, which requires consideration of costs and cost driver volume rates.
9. ABC Framework tracing costs to specific activities; and
10. Cost Flow and Incurrence, showing both upward movement of cost for accumulation in General Ledger and downward movement of cost to Activity Level,

ABC and Cost Reduction Programme

The activity-based analytical approaches to a cost reduction programme include:
(1) activity mapping, (2) value-chain analysis, and (3) analysis of core/support/diversionary activities. The successful implementation of these approaches needs micro cost information. The traditional cost systems based on over simplistic cost model fail to provide micro-level relevant cost information. ABC system can provide relevant cost information for implementation of the above analytical approaches through: (i) resourced focussed concept, (ii) management-oriented logic and (iii) rational assumption.
These are discussed below in brief:

1. Activity Mapping: The activities are analysed in terms of their flow of work by location and duration this enables the firm to focus on three aspects of process development –

- Cause of the activity: What is causing the activity to take place, so frequently?
- Resource consumption: Why does the activity consume so much resources every time?
- Activity linkage: How does the activity affect or is affected by other activities with which it is connected as a part of business process.

Analysis of the above three factors brings opportunity for process redesign with a view to reducing the cost of the process. And the process redesign scheme tries to avoid complexity of the activities and duplication of activities and thereby minimises the resource consumption by reconfiguration.

2. Value-Chain Analysis:

The value chain concept being broader in scope than the traditional value-added concept highlights four profit improvement areas –

- linkage with suppliers,
- linkage with customers,
- linkage with processes, and
- linkages across unit value chains within the firm.
- The analysis with a cost reduction perspective involves three steps :
- Identification of industry's value chain and assigning costs, revenues and assets to value activities;
- Diagnosing the cost drivers regulating each value activity (both structural cost drivers and operational cost drivers); and
- Developing sustainable competitive advantage either through controlling cost drivers better than the competitors or by reconfigurating the value chain.

Activity Based Costing, by analysing the activities and their cost drivers, addresses to the following key questions from a strategic view-point:
(i) Can the firm reduce costs in a particular activity, holding the value constant?
(ii) Can the firm increase the value in this activity, holding the costs constant?
(iii) Can the firm reduce assets in this activity, holding the costs and revenues constant?
(iv) Is there any surplus facility (spent but unutilised resources) that creates value?

3. Analysis of Core/Support/Diversionary Activities:

This three-tier classification of activities facilitates analysis that helps the firm to meet divergent competitive situations. ABC system helps identification of such activities and determination of costs associated with them. When micro-activities are analysed with regard to their cost effectiveness, managers can get insights into the areas where unnecessary activities can be dropped or their costs can be reduced.

4. Resource Focused Concept:

ABC system gives stress on indirect resources demanded by the product. It emphasises the need to obtain a better understanding of cost behaviour and thus ascertains what causes he overhead costs. The system examines the demands made by a particular product on the indirect resources along three lines.
(i) Focus on expensive resources;
(ii) Emphasis on resources whose consumption varies significantly by product or product type; and
(iii) Focus on resources whose demand patterns are not correlated with traditional location measures like direct materials, direct labour and processing time, etc.
The logic behind the above is that it is the activity which causes costs, not the products, and it is the product which consumes activities in turn. In fact, analysis of resource consumption by products with the help of cost driver is the essence of ABC.

5. Management-oriented Logic:

Managers do not manage costs, they manage the activities that cause costs. They basically decide and control the activities demanded by the products. Hence accounting information is needed to be provided to them for facilitating the management of activities. When the focus is on costs, it is a typical and conventional budgetary control system and the managers find difficulty to understand the cause and effect relationship between the costs and resources. Under ABC system, the focus of the management is taken care of by providing information regarding cost of resources supplied and cost of resources used i.e., capacity created and capacity used. ABC system brings in activity measures as a bridge in between the product costs and resources. A micro-level understanding of intermediary transformations has a lot of strategic managerial significance particularly in efficient and effective resource utilisation through creative value adding process.

6. Rational Assumptions:
Costs revealed by ABC system are considered superior to that of conventional volume-based system because of two assumptions underlying the ABC:
(i) The costs in each cost pool are driven by homogeneous activities; and (ii) The costs in each cost pool are strictly proportional to the activity.
Based on the above resource focused concept, management-oriented logic and assumptions, activity based total cost of production is computed as the sum of the cost of all activities performed. These costs vary with the activities performed at different levels of production organisation.

Cost Reduction through ABC
The scheme of cost reduction through ABC, to sum up, requires the following: (i) Resources to be classified in volume-based and value-based resources; (ii) Cost reduction opportunity to be developed; (iii) No-value activity to be minimised as far as possible; (iv) Process and procedure to be changed/redesigned, if required; (v) Areas where cost reduction is possible to be identified; and (vi) Outcome of cost reduction project to be matched with what premium buyers to pay in the market.

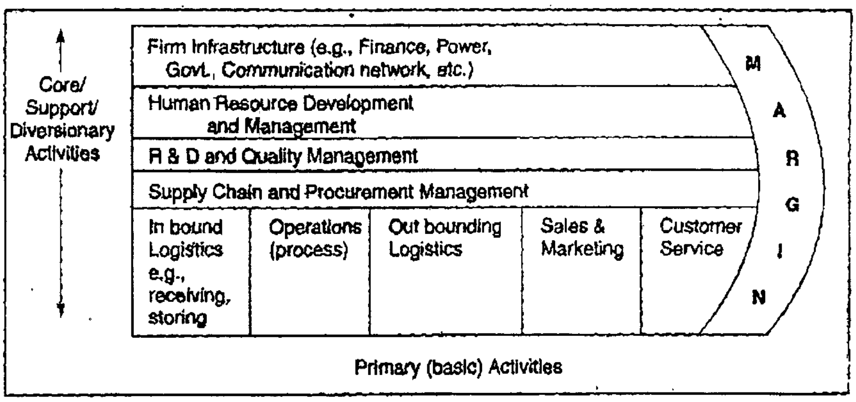
ABC and Management
In today's environment of competition and globalization, when each organisation has to continuously benchmark its activities with the most efficient in the world, one cannot do without ABC. The very survival of a firm today depends on proper management of the value chain at each stage. Unless one knows the value added at each stage as compared to its costs for that value addition, one cannot decide about cutting the unimportant activities or adding the new ones. Most of the recent approaches being followed for improving overall competitiveness and productivity of the business such as target costing, TQM, BPR and others depend heavily upon accurate cost information for various activities and comparison of these with the value the stakeholders attribute to them. Without exact cost information such exercises are meaningless.
The main benefits of ABC arise from the quality of managerial decisions based on more accurate information. This is the most promising aspect of ABC which is now being called activity Based Management (ABM). ABM views the activities in a dynamic sense rather than just a step for cost allocation to the end products. It uses the cost information generated by ABC about an activity for controlling the activity itself rather than using the cost of the final products only. The cost drivers that trigger the activity are also identified and monitored. These cost drivers may be different from the resource or activity drivers. In addition performance measures are developed and monitored to judge the efficiency at which the activity is being performed. These measures may be financial or non-financial variables such as cost per unit of activity driver, defects per million items produced or time taken per unit of item produced. These measures then provide a sound basis to control the performance of the activity with accurate information about the costs involved.

How ABC help ABM
The technique involves:
(i) Volume based resources to be analysed, (ii) Cost re-engineering to be made, (iii) Cost to be segregated –
(a) Product wise, (b)Customer wise, (c) Market wise.
(iv) Aforesaid information may be considered as input for –
(a)Targeted cost, (b) Business Process Reengineering,(c) Further detailed Cost Driver.

Implementation Steps of Activity Based Management (ABM)
John Miller suggests a four step approach to implementation of ABM. These steps of Planning, Activity Analysis, Activity/Product Costing, Documentation of Results and their related activities can act as a good checklist in an implementation plan. The steps and the activities involved are listed below:

Planning	Activity Analysis	Activity/Product Costing	Document Results
Purpose	Specific activities	Select or develop	Prepare report
Objectives	and business	software	Make
Scope	processes	Specify resource	recommendations
Time	Output and output	drivers	Assign action
Resources	measures	Specify activity	Identify next steps
Expectations	Value added analysis	drivers	data
Team development	Identify cost drivers	Trace costs	Refine
	Activity performance	Develop costing models	Trace improvement results

Industrial Value Chain: The technological environment is fast changing all over the world due to competition. There is, thus, a need to find improved solutions to problems. These changes demand increased emphasis on activities like quality, material utilisation, machine availability and use in manufacturing, and indigenous research and development Against this background, a systematic and in-depth analysis of an 'industrial value chain' is considered a strategic move for a firm. The concept of industrial value chain can be better understood through the model below:



Through the performance of the above kind and nature of activities, the firms create 'values' for their customers. So, it is useful to think of the end-use of a product or service as delivering value to the customers and the business unit as a collection of 'value' generating activities.

The value chain is about the creation of value, not just the addition of cost and margin. It is considered strategically important as it helps in identifying and measuring the value-creating activities. The value chain framework is broader in scope and highlights four profit improvement areas:

(i) linkage- with suppliers; (ii) linkage with customers; (iii) linkage with processes and operations; and (iv) linkages across business unit value chains (as shown in the above model) within the firm.

Careful management of linkages is the decisive source of competitive edge. The value chain analysis with a cost reduction perspective (to create and sustain a competitive advantage) involves the steps as follows:

(i) Identification of industry's value chain and assigning costs, revenues, and assets to value activities.

(ii) Diagnosing the cost drivers regulating each value activity (both structural cost drivers and operational cost drivers).

(iii) Developing sustainable competitive advantage either through controlling cost drivers better than the competitors or by re-configurating the value chain.

The value chain identifies the distinct strategic activities, analyses them and their respective cost drivers and addresses to the following key questions from strategic view point:

(i) Can a firm reduce costs in particular activity, holding the value (arising from external/internal customers) constant? (ii) Can a firm increase the value in this activity, holding the costs constant? (iii) Can a firm reduce assets in this activity, holding costs and revenues constant?

(iv) Is there any surplus facility (spent but unutilised resources) that can create value? The value chain analysis enables a firm to understand and focus on the aspects like (i) cause of the activity; (ii) resource consumption by the activity; and (iii) activity linkage. Knowledge and analysis of the above three factors brings opportunities for process redesign with a view to reducing the cost of the process.

This analysis points out— (i) if there is any complexity of the activity, (ii) if there is any duplication of the activity, (iii) if there is any alternative way of doing the activity so that it will consume lesser resource, (iv) if there any activity which is performed with no contribution to the process objective (i.e., no 'value' adding), (v) if there is any activity, when added in between two activities, that will increase the overall process value.

Again, the three-tier classification of activities into core/support/diversionary categories facilitates analysis that helps a firm to meet different competitive situations. When the micro-activities are identified and analysed with regard to their cost effectiveness, the management gets insights into the areas where unnecessary activities can be dropped or their costs can be reduced.

The benefits of 'Value Chain Analysis' are immense.

These are as follows— (i) It highlights the cost of activity, e.g., Does the employee at the time of causing an activity know its cost? Does the salesman know the cost of each order processing? Does the scheduling manager know the cost per batch? (ii) It encourages new thinking towards process improvement, e.g. How can the activities be carried out to improve efficiency? (iii) It links to Total Quality Management programmes as the activity cost can be related to the service level achieved. (iv) It facilitates cost cutting by taking activity levels into consideration, and thus making cost targets more realistic to achieve. (v) If enables trend analysis and 'benchmarking' of costs to take place.

Supply chain management

Supply Chain Management (SCM) is fast emerging as an innovative customer focused business solution. In the present competitive environment, corporates have to synchronise their business plans with their customers to stay in the business. SCM attempts to build a cost effective chain beginning with the ultimate customer and links all the previous suppliers under one platform.

The Concept: SCM requires an integrated approach towards managing the flow of physical goods, right from

sourcing of raw material to delivery of finished goods. Starting from the ultimate customer, every previous supplier is automatically treated as an internal customer. The main objective of SCM is 'Customer Satisfaction' and to achieve this, all road blocks are eliminated in between ultimate customer and the raw material supplier. This process improves delivery time, eliminates all non-value adding activities and improves quality and after-sales service.
Towards achieving this, strategic alliances between various entities in between the customer and raw material supplier become critical. The necessary requirements are (i) Information Access (ii) Training and (in) Confidence building.

Information Access: The recent developments in information and communication technology has enabled everyone in the business world for obtaining global information instantaneously for products and services. Once a customer's order is entered into the info-network of an enterprise, relevant information is transferred to all the concerned members of the supply chain through Electronic Data Interchange (EDI). A good Information and Communication infrastructure consisting of Enterprise Resource Planning (ERP) with internet and intranet facilities has facilitated the same with ease. There is a global trend to modify the present ERP packages into 'Customer Synchronised Resources Planning' packages.
In a typical environment, an ancillary supplier logs into the customer's ERP and delivers components directly to the concerned shop-floor user on just-in-time basis.
Training: Training both internal and external players in the supply chain is a very important ingredient. Each functionary has to be taught his role very clearly and empowerment is very essential for an effective supply chain management. External suppliers and service providers are also trained in such a way that the ultimate customer's satisfaction is the focus of all the players in the chain. Every individual is a strategic partner in the supply chain and the consequences of failure at every stage is imparted through simulated models. Hence every individual associated in the supply chain network is trained in correct practices for delivering best quality products and services at the quickest possible time and at the least cost.
Confidence Building: Everybody involved in the supply chain is taken into complete confidence through both transparency of operations as well as long-term relationship. Developing alternate supply sources is not encouraged and the existing supplier is continuously motivated to improve his quality, product/process technologies and cycle-time on a continued basis. It savings accrued are shared by all the players throughout the life cycle of the product, Internally also continuous organisational growth results in better promotional opportunities for human resources.

Salient Features of a typical SCM are:

1. Customer is the focus of all operations.
2. Retaining existing customers and adding values to them on a continuous basis through closer interaction and understanding their problems.
3. All the operations are streamlined and all bottlenecks removed between the raw material suppliers and ultimate customers.
4. Most of the non-core activities are outsourced and hence the fixed costs are kept minimum.
5. Implementing SCM in an ERP environment eliminates paper work.
6. Reduces inventory and facilitates JIT Gust-in-time) practices.
7. Ensures transparency at all levels and so the entire organisation operates as a angle integrated unit instead of different blocks.
8. Avoids developing multiple supply source for a single ensures long-term contracts with the suppliers with a resultant benefit of confidence building.
9. Close interaction between the corporate R & D and the suppliers facilitates continuous improvements in product design, process methodologies, etc. resulting in customer value enhancement and cost optimisation.

Business Process Reengineering (BPR)
Michael Hammer and James champy defined BPR as "the FUNDAMENTAL rethinking and RADICAL redesign of the business PROCESS to achieve DRAMATIC improvement in the critical contemporary measures of performance such as costs, quality, service, and speed." This definition contains the four key words:

FUNDAMENTAL	:	Why do we do what we do? Why do we do it that way?
RADICAL	:	Signifies getting to the root of the things, not making superficial changes in the branches or leaves of the organisation structure.
DRAMATIC	:	Signifies not incremental but quantum leaps in performance.
PROCESS	:	Signifies that the focus should be on process in addition to the task, job, people, and structure.

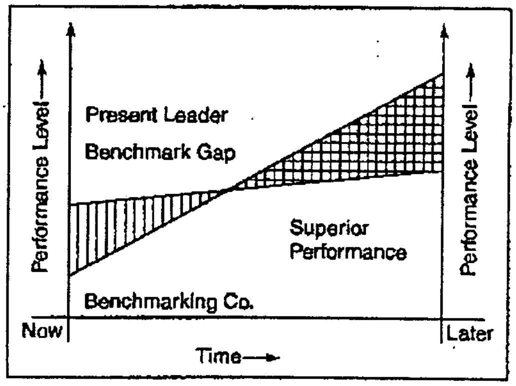
The word combination 'business process' is a collection of activities that take one or more kind of inputs and create an output that is of value to the customers. And the focus of regineering is: what a company must do? (and) how to do it?
BPR is the process of rethinking and redesigning in the way we work. It is characterised by totally transforming the way in which a company is organised, bringing revolutionary changes in perspective and redesigning structures and focus. BPR seeks the reduction of unnecessary work. More often than not, it requires the total demolition of the existing process. It is a move from functional stagnation to process-orientation action. Thus, BPR promises not just incremental but dramatic levels of improvement. The chart below high-lights the process:
Here, 'continuous improvement' means and requires relentless and on-going search for ways to improve

business performance. Through BPR, a business system is redesigned drastically to bring in improvements in the performance measures like cost and quality, and service and speed.
This is achieved through the maxim: old order changed yielding place to new.
Following the original definition and the ideas contained in it, it can be said that while going in for BPR the organisation has to take harsh measures, devoid of human face, to ensure radical changes in the existing system of working. The ground rules for the same are:

(1) Radical changes can only occur when old ways or thinking are fully replaced with new ways.
(2) Concrete results of BPR must be realised quickly.
(3) Information technology (IT) plays a key role in any organisational change effort
(4) Any change affects all parts of the organisation. A successful change effort, *thus* must address and integrate people, technology, and structure with management philosophy An Indian firm, engaged in large scale projects throughout the country, has chalked out its phased programme to introduce BRR combining it with IT (Information Technology)

BPR is sometimes referred to as Business Process Redesign in a complete sense) achieve a new and much higher standard of performance. BPR has three basic elements: Process simulation, quality management and cost simulation:
(i) Process simulation – involves the running of trials of 'as-is' and 'to-be' models to test 'what-if' assumptions about process improvement and reengineering;
(ii) Quality management – requires an approach to process control and improvement that focuses on meeting customer expectations, reducing process variation, and continuous improvement; and
(iii) Cost simulation – that is, simulation of cost reduction opportunities that help build commitments for improvement actions. This action includes evaluation of costs a benefits of alternative approaches to process re-engineering for all functions work units.
Since any process can be reengineered in various ways depending on the levels of ambition, BPR initiatives can be categorised into: (i) process improvement, (ii) process redesign, and (iii) business transformation. While process improvement is the lowest degree of BPR, process redesign is a major degree of BPR. But, business transformation is the highest degree of BPR as it aims at reinventing the business through a top-down appraisal and redesigning of the business.

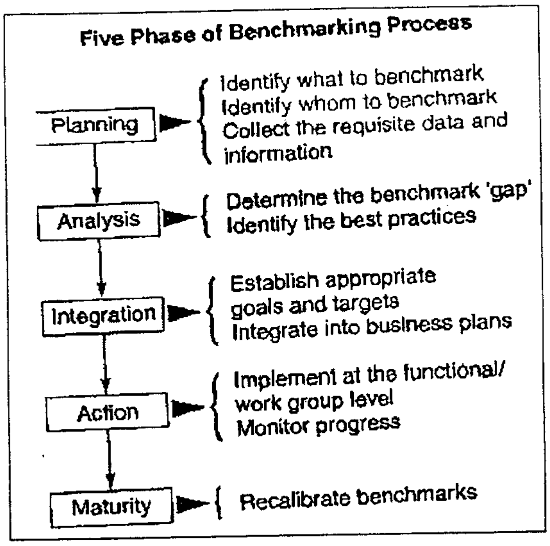
Benchmarking: The concept of benchmarking was pioneered in USA by Xerox Corporation in 1979.
Benchmarking is defined as the continuous process of measuring the products, services, and business practices of a company against the toughest competitors or those companies recognised as industry leaders.
Benchmarking is the search for industry's best practices that lead to superior performance. It is a systematic way of comparing and improving the activities carried out and services provided by a company. The chart below shows the achievement of benchmarking of a company.



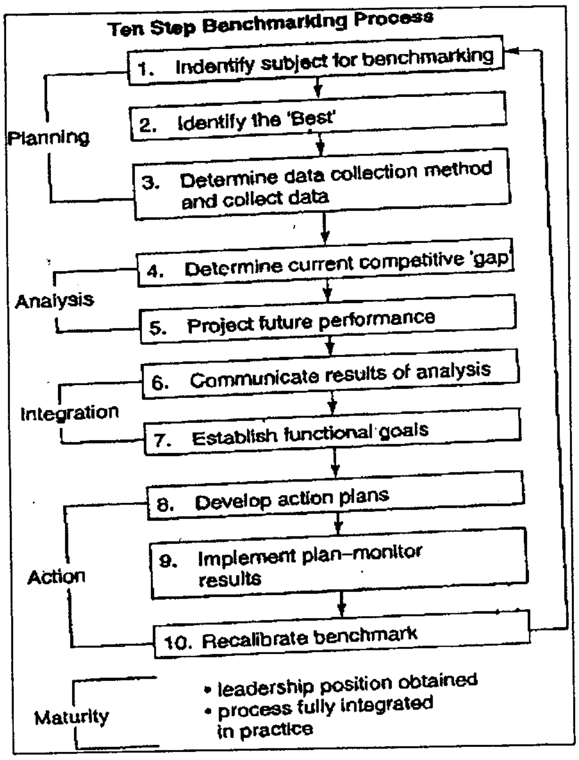
Benchmarking is not merely the comparison of time, cost and quality. It looks at the processes behind those results. It is extended to the learning of processes, standards, policies, attitudes and culture of organisation which are best in class. Further, benchmarking applies not only to manufacturing activities but has an application in other activities also.

Conceptual Framework
1.Benchmark is a standard or excellence or achievement against which other similar things must be measured or judged.
2. Benchmarking is a process of comparing results, outputs, methods, processes and practices in a systematic way. It is the process of:
(i) figuring out what to benchmark?, (ii) finding out what the benchmark is, which is the standard of excellence? (iii) determining how it is achieved. What methods or processes produce results?, (iv) deciding to make changes or improvements in one's own business practices to meet or exceed the benchmark. Are we capable of changing the practices or methods? Will they result in better services for customers?

Benchmarking Process
1. There are five phases of benchmarking process, as illustrated below.



2. There are ten steps for the above process. These steps are charted below.



Benchmarking is conceived of as a 'target' in which the information gathered during activity analysis stage is not only used to make the activities more efficient and productive but also to provide scope for value analysis and value engineering. Here, value analysis and value engineering refer to exhaustive analysis that categorises activities according to whether they add value to the output of an activity or process. Value added activities transform work-in-process in ways that customers perceive as beneficial. Non-value added activities are either reduced or eliminated. The value added activities are subjected to improvement for the purpose of benchmarking.

Michael. E. Porter's Views on Competitive Strategy and Competitive Advantage

Porter has identified, from the broader point of view, three internally consistent general (generic) strategies that a firm can adopt either singly or in combination for creating a sustainable competitive position in the long run and out performing the competitors in the industry. These are:

Cost leadership – Differentiation – Focus

Cost focus | Differentiation Focus

1. **Cost Leadership:** It implies that the firm will outstrip its competition by being the low-cost producer. It will build efficient-scale facilities, pursue cost control policies, avoid marginal customers and generally be cost conscious in all areas of the business. In other words, the firm will emphasize efficiency and productivity. With lower costs, the firm can offer lower prices and with lower prices, generate larger sales volume.
2. **Differentiation:** It involves the firm in creating products that consumers perceive to be unique. The perception of uniqueness (differentiation) can be based upon a variety of factors, such as brand image, product features, customer service, and dealer network. To be effective, differentiation requires creativity, basic research skill, strong marketing, and a reputation for quality. Differentiation strategy does not imply that cost control is ignored; only that it is not the primary strategic consideration. The emphasis on differentiation requires flexible response to changing customer preferences and perceptions.
3. **Focus:** It involves achieving either cost leadership or differentiation or both in a particular segment of the market. Rather than compete throughout the market, the firm focuses on one segment. While in cost focus the firm seeks cost advantage in its target segment, in differentiation focus the firm seeks differentiation in its target segment. Comments :

It is interesting to note that Porter's prescription of three generic strategies is in no way different conceptually from what has been mentioned under 'Market Share', an approach in creating and sustaining a competitive advantage of a firm. The conceptual similarities between the two approaches are expressed as follows:

According to Porter's views	According to 'Market share' approaches
1. Cost leadership	Cost advantage is achieved through : (i) economies of scale via specialisation, automation and vertical integration (ii) experience via employee learning and process improvement.
2, Differentiation	Differentiation advantage is obtained through : Experience via employee learning, process improvement and product improvement
3. Focus	Focus advantage is achieved through: Market power over suppliers, competitors and customers.

In relation to the topic, A.D. Little's- 'Life Cycle Portfolio Matrix' is of great significance. His matrix is useful in establishing the appropriateness of a specific strategy from the consideration of two dimensions : (a) stage of life cycle a business is in and (b) competitive situation with respect to eight external factors as under: (i) Market growth rate (ii) Growth Potential (iii) Depth and width of product line (iv) Number of competitors (v) Market share held by different competitors (vi) Customer loyalty to brands (vii) Barriers to entry (viii) Technology
The corporate life cycle is determined by assigning each factor a weight depending on its perceived importance and position.

	Embryonic	Growth	Mature	Ageing
Dominant	Fast growth, Start up	Fast growth, Attain cost leadership, renew, Defend position.	Defend position, Attain cost leadership, renew, Fast growth	Defend position, Focus, Renew growth with Industry
Strong competitive position	Start up, Differentiate, Fast growth	Fast growth, Renew, Focus differentiation	Attain cost leadership, Renew focus, Differentiate growth with Industry	Find niche, hold niche, hang on, Growth with industry, Harvest
Favourable	Start up, Differentiate, Focus fast growth	Differentiate Focus, Catch up Grow with Industry	Harvest, Hang on, Find Niche, hold niche, Renew, turn around, differentiate, focus growth with Industry	Retrench, Turn around
Tenable	Start up, grow with Industry focus	Harvest, Catch up, Hold niche, hang on, Find Niche, turnaround, Focus growth with Industry	Harvest, Turn-around, Find niche, Retrench	Divest, Retrench
Weak	Find niche, Catch up, Grow with Industry	Turn-around Retrench	Withdraw, divest	Withdraw

Note: The lines across the Figure indicate the growth history of different products of the company during life cycle.

Business Process Management:

Business process management (BPM) is a management approach focused on aligning all aspects of an organization with the wants and needs of clients. It is a holistic management approach that promotes business effectiveness and efficiency while striving for innovation, flexibility, and integration with technology. Business process management attempts to improve processes continuously. It could therefore be described as a "process optimization process." It is argued that BPM enables organizations to be more efficient, more effective and more capable of change than a functionally focused, traditional hierarchical management approach.

A business process is "a collection of related, structured activities that produce a service or product that meet the needs of a client." These processes are critical to any organization as they generate revenue and often represent a significant proportion of costs. As a managerial approach, BPM considers processes to be strategic assets of an organization that must be understood, managed, and improved to deliver value added products and services to clients. This foundation is very similar to other Total Quality Management or Continuous Improvement Process methodologies or approaches. BPM goes a step further by stating that this approach can be supported, or enabled, through technology to ensure the viability of the managerial approach in times of stress and change. In fact, BPM is an approach to integrate a "change capability" to an organization - both human and technological. As such, many BPM articles and pundits often discuss BPM from one of two viewpoints: people and/or technology.

Roughly speaking, the idea of (business) process is as traditional as concepts of tasks, department, production, outputs. The current management and improvement approach, with formal definitions and technical modeling, has been around since the early 1990s. Although the initial focus of BPM was on the automation of mechanistic business processes, it has since been extended to integrate human-driven processes in which human interaction takes place in series or parallel with the mechanistic processes. For example (in workflow systems), when individual steps in the business process require human intuition or judgment to be performed, these steps are assigned to appropriate members within the organization.

More advanced forms such as human interaction management are in the complex interaction between human workers in performing a workgroup task. In this case, many people and systems interact in structured, ad-hoc, and sometimes completely dynamic ways to complete one to many transactions.

BPM can be used to understand organizations through expanded views that would not otherwise be available to organize and present. These views include the relationships of processes to each other which, when included in the process model, provide for advanced reporting and analysis that would not otherwise be available. BPM is regarded by some as the backbone of enterprise content management.

BPM allows organizations to abstract business process from technology infrastructure; it goes far beyond automating business processes (software) or solving business problems (suite). BPM enables business to respond to changing consumer, market, and regulatory demands faster than competitors - creating competitive advantage.

BPM life-cycle: Business process management activities can be grouped into five categories: design, modeling, execution, monitoring, and optimization.

Design: Process Design encompasses both the identification of existing processes and the design of "to-be" processes. Areas of focus include representation of the process flow, the actors within it, alerts & notifications, escalations, Standard Operating Procedures, Service Level Agreements, and task hand-over mechanisms.

Good design reduces the number of problems over the lifetime of the process. Whether or not existing processes are considered, the aim of this step is to ensure that a correct and efficient theoretical design is prepared.

The proposed improvement could be in human-to-human, human-to-system, and system-to-system workflows, and might target regulatory, market, or competitive challenges

Modeling: Modeling takes the theoretical design and introduces combinations of variables (e.g., changes in rent or materials costs, which determine how the process might operate under different circumstances).

It also involves running "what-if analysis" on the processes: "What if I have 75% of resources to do the same task?" "What if I want to do the same job for 80% of the current cost?"

Execution: One of the ways to automate processes is to develop or purchase an application that executes the required steps of the process; however, in practice, these applications rarely execute all the steps of the process accurately or completely. Another approach is to use a combination of software and human intervention; however this approach is more complex, making the documentation process difficult.

As a response to these problems, software has been developed that enables the full business process (as developed in the process design activity) to be defined in a computer language which can be directly executed by the computer. The system will either use services in connected applications to perform business operations (e.g. calculating a repayment plan for a loan) or, when a step is too complex to automate, will ask for human input.

Monitoring: Monitoring encompasses the tracking of individual processes, so that information on their state can be easily seen, and statistics on the performance of one or more processes can be provided. An example of the tracking is being able to determine the state of a customer order (e.g. ordered arrived, awaiting delivery, invoice paid) so that problems in its operation can be identified and corrected.

Optimization: Process optimization includes retrieving process performance information from modeling or monitoring phase; identifying the potential or actual bottlenecks and the potential opportunities for cost savings or other improvements; and then, applying those enhancements in the design of the process. Overall, this creates greater business value.

Business process reengineering (BPR): Business process reengineering (BPR) is, in computer science and management, an approach aiming at improvements by means of elevating efficiency and effectiveness of the business process that exist within and across organizations. The key to BPR is for organizations to look at their business processes from a "clean slate" perspective and determine how they can best construct these processes to improve how they conduct business.

Business process reengineering is also known as BPR, Business Process Redesign, Business Transformation, or Business Process Change Management. Reengineering is a fundamental rethinking and radical redesign of business processes to achieve dramatic improvements in cost, quality, speed, and service. BPR combines a strategy of promoting business innovation with a strategy of making major improvements to business processes so that a company can become a much stronger and more successful competitor in the marketplace.

Re-engineering is the basis for many recent developments in management. The cross-functional team, for example, has become popular because of the desire to re-engineer separate functional tasks into complete cross-functional processes. Also, many recent management information systems developments aim to integrate a wide number of business functions. Enterprise resource planning, supply chain management, knowledge management systems, groupware and collaborative systems, Human Resource Management Systems and customer relationship management systems all owe a debt to re-engineering theory.

Business process reengineering (BPR) began as a private sector technique to help organizations fundamentally rethink how they do their work in order to dramatically improve customer service, cut operational costs, and become world-class competitors. A key stimulus for reengineering has been the continuing development and deployment of sophisticated information systems and networks. Leading organizations are becoming bolder in using this technology to support innovative business processes, rather than refining current ways of doing work.

Business process reengineering is one approach for redesigning the way work is done to better support the organization's mission and reduce costs. Reengineering starts with a high-level assessment of the organization's mission, strategic goals, and customer needs. Basic questions are asked, such as "Does our mission need to be redefined? Are our strategic goals aligned with our mission? Who are our customers?" An organization may find that it is operating on questionable assumptions, particularly in terms of the wants and needs of its customers. Only after the organization rethinks what it should be doing, does it go on to decide how best to do it.

Within the framework of this basic assessment of mission and goals, reengineering focuses on the organization's business processes--the steps and procedures that govern how resources are used to create products and services that meet the needs of particular customers or markets. As a structured ordering of work steps across time and place, a business process can be decomposed into specific activities, measured, modeled, and improved. It can also be completely redesigned or eliminated altogether. Reengineering identifies, analyzes, and redesigns an organization's core business processes with the aim of achieving dramatic improvements in critical performance measures, such as cost, quality, service, and speed.

Reengineering recognizes that an organization's business processes are usually fragmented into sub-processes and tasks that are carried out by several specialized functional areas within the organization. Often, no one is responsible for the overall performance of the entire process. Reengineering maintains that optimizing the performance of sub processes can result in some benefits, but cannot yield dramatic improvements if the process itself is fundamentally inefficient and outmoded. For that reason, reengineering focuses on redesigning the process as a whole in order to achieve the greatest possible benefits to the organization and their customers.

Balance score Cards & perspectives of Balance Score card: A Scorekeeper, the management accountant designs reports to help managers track progress in implementing strategy. Many organisations have introduced a balanced score card approach to manage the implementation of their strategies.

The Balanced Scorecard: The balanced scorecard translates an organisation mission and strategy into a set of performance measures that provides the framework for implementing the strategy. The balanced scorecard does not focus solely on achieving financial objectives. It also highlights the non-financial objectives that an' organisation must achieve to meet its financial objectives. The Scorecard measures an organisation performance from four perspectives:

- Financial
- Customer
- Internal business processes and
- Learning and growth

A Company's strategy influences the measures it uses to track performance in each of this perspective.

It's called the balanced scorecard because it balances the use of financial and nonfinancial performance measures to evaluate short-run and long-run performance in a single report. The balanced scorecard reduces managers emphasis on short-run financial performance such as quarterly earnings. That's because the nonfinancial and operational indicators, such as product quality and customer satisfaction measure changes that a company is making for the long run. The financial benefits of these long-run changes may not appear immediately in short- run earnings, but strong improvement in non financial measures is an indicator of economic value creation in the future. For example an increase in customer satisfaction, as measured by customer surveys and repeat purchases, is a signal of higher sales and income in the future. By balancing the mix of financial and non financial measures, the balanced scorecard broadness management's attention to short-run and long-run performance.

The four Perspectives of the Balanced Scorecard

1. **Financial Perspective:** This perspective evaluates the Profitability of the strategy. Because cost reduction relative to competitors, costs and sales growth are chipset's key strategic initiatives, the financial perspectives focuses on how much of operating income and return on capital results from reducing costs and selling more units of CX1 monitors.
2. **Customers Perspective:** This perspective identifies the targeted market segments and measures the company's success in these segments. To monitor its growth objectives, number of new. customers and customers satisfaction.
3. **Internal business process Perspective:** This perspective focuses on internal operation that further the customers perspective by creating value for customers and further the financial perspective by increasing shareholder value. Chipset determines internal business process improvement targets after benchmarking against its main competitors.

The internal business process perspective comprises three sub processes:

1. **The innovation process:** Creating products, services and processes that will meet the needs of customers, Chipset is aiming at lowering costs and promote growth by improving the technology of its manufacturing.
2. **The operations process:** Producing and delivering existing products and services that will meet the needs of customers. Chipset's strategic initiatives are (a) improving manufacturing quality Reducing delivery time to customers and (c) Meeting specified delivery dates.
3. **Post sales Service** Providing service and support to the customer after the sale of a product of service. Although customers do not require much post sales service. CX1 monitors how quickly and accurately CX1 monitors is responding to customers service requests.

Learning and Growth Perspectives This perspective identifies the capabilities the organisation must excel at to achieve superior internal processes that create value for customers and shareholders. Chipset's -learning and growth perspectives emphasizes three capabilities

1. Employee Capabilities measured using employee education and skill levels.
2. Information system capabilities, measured by percentage of manufacturing processes with real-time feedback
3. Motivation measured by employee satisfaction and percentage of manufacturing and sales employees (line employees) empowered to mange processes.

Features of Good Balanced Scorecard –

A good balanced scorecard design has several features:

1. It tells the story of a company's strategy by articulating a sequence of cause-and-effect relationships.
2. It helps to communicate the strategy to all members of the organization by translating the strategy into a coherent and linked set of understandable and measurable operational targets.
3. It places strong emphasis on financial objectives and measures in for-profit companies.
4. Nonfinancial measures are regarded as part of a Program to achieve future financial performance.
5. It limits the number of measures to only those that are critical to the implementation of strategy.
6. It highlights sub optimal tradeoffs that managers may make when they fail to consider operational and financial measures together.

Value Engineering

1. Value engineering aims to reduce non value - added costs by reducing the quantity of cost drivers of non value added activities. For example to reduce rework costs. The Company must reduce rework-hours.
2. Value engineering also seeks to reduce value - added costs by achieving greater efficiency in value- added activities. For example to reduce direct manufacturing labor costs.
3. A Value added cost is a cost that if eliminated would reduce the actual or perceived value or utility (usefulness) customers obtain from using the product or service.
4. A Non value added cost is a cost that, if eliminated would not reduce the actual or perceived value or utility (usefulness) customers obtain from using the product or service. It is a cost that the customer is unwilling to pay for Examples of non value- added costs are costs of reworking and repairing products.
5. Value engineering is a systematic evaluation of all aspects of the cost structure of a product or service, including research and development, design of products and processes; production, marketing, distribution and customer service with the objective of reducing costs while satisfying customer needs.
6. It differs from traditional approaches to cost reduction and cost control in that its focus is on the elimination of non value- added activities (e.g. waste) from the process.
7. Value engineering focuses on improving those qualities that the customer desires while reducing or eliminating unnecessary moves, setup and other activities that the customer will not pay for.
8. The process is re-engineered to eliminate non-value added work and thereby enhance the value of the process to the customer.

Economic Value Added: Economic Value Added, popularly known as EVA, has become an increasingly popular concept for a large number of businesses. Proponents of EVA, which include the bluest of the blue chip companies like Coca Cola, AT&T, Philip Morris, etc. consider that EVA is the miracle that rejuvenates a company from top to bottom. EVA is said to be the panacea that improves corporate governance, makes managers think, act and get paid like owners and re-engineers the financial management system to measure and reward value-creating activities.

Currently the most popular Value based measure is Economic Value- Added. It measures the value creation to shareholders by a company or business unit. The concept measures a company's or business unit's ability to earn more than its total cost of capital. It is the after-tax cash flow generated by a business minus the cost of the capital it has deployed to generate that cash flow. It is a method for measuring managerial performance regarding creation of shareholder value. It also measures whether the operating profit is enough compared to the total costs of capital employed.

The idea behind EVA is that shareholders must earn a return that compensates the risk taken. In other words equity capital has to earn at least same return as similarly risky investments at equity markets. If that is not the case, then there is no real profit made and actually the company operates at a loss from the viewpoint of shareholders. On the other hand if EVA is zero, this should be treated as a sufficient achievement because the shareholders have earned a return that compensates the risk.

EVA is also considered to be a useful measure of measuring corporate and divisional performance. It is a more specific version of residual income. It represents the business unit's true economic profit primarily because a charge for the cost of equity capital is implicit in the cost of capital. The cost of equity is an opportunity cost, that is, the return that could have been obtained on the best alternative investment of similar risk. So, EVA measures the marginal benefit obtained by using resources in a particular way. It is useful for determining whether a segment of a business is increasing shareholder value or not. It is a measure of surplus value created on an Investment.

Economic Value- Added (EVA) is a model based on a company's accounting and accordingly it can be expressed in an accounting form as under:

EVA= Sales- Operating Expenses-Tax = Operating Profit- Financial Requirement.

Where, Financial Requirement = Capital as per the Balance Sheet of a particular year x Weighted Average Cost of Capital%.

Calculation of EVA:

EVA= Net Operating Profits After Taxes – Cost of Capital.

Where, Net Operating Profits After Taxes means, Operating Profits less taxes but before financing costs and non-cash items (other than depreciation). Net Operating Profits after Taxes is the residual income that can be generated on the capital invested in the business.

Cost of Capital, means the charge for use of capital. It includes interest on the debt capital and a charge for the equity capital based on cash equivalent equity x cost of equity rate.

Economic Value -Added Analysis consists of three different steps:

- Determination of the income generated by a business: As a first step, a manager must first determine how much value is being created by a company or business unit or will be created by a potential investment.
- Estimation of the return required by investors: This is done, firstly identifying the money invested in the company or business unit and then calculating the cost of capital.
- Computation of the Economic Value-Added: It is done by subtracting the expected return to shareholders from the value created by the company or the business unit.

Once calculated, EVA is an indicator of how much value is created or destroyed by the management. If EVA is positive, value is added, and if it is negative, it means, value is destroyed.

EVA is considered to be a more powerful tool for measuring performance of a company or a business unit as compared to ROI (Return on Investment) as the standard performance measure.

Management can increase the EVA of the Company as a whole or of a business unit by the following ways:

- Investing Capital in projects that earn a return higher than the cost of capital.

- Increasing returns i.e., by increasing the Net Operating Profit After Taxes through better efficiencies, strict control over cost and also by higher productivity, etc.
- Improving the management of assets by selling-off non-performing assets and by increasing assets efficiency.

Merits of EVA: Conceptually, EVA is superior to accounting profits as a measure of value creation because it recognizes the cost of capital and, hence, the riskiness of a firm's operations. Furthermore EVA is constructed so that maximizing it can be set as a target. Traditional measures do not work that way. Maximizing any accounting profit or accounting rate of return leads to an undesired outcome.

Applications of EVA:

- For Correct evaluation of the true performance of business units and the overall organisation.
- Proper evaluation of capital projects by using economic value-added concept as opposed to cash flows.
- By understanding the fundamental drivers of value in each business, management can test assumptions used in the business plans. This provides a common framework to discuss the soundness of each plan.
- Establishing budgeted EVA levels for strategic areas of the business.

Limitations of the EVA Measure: EVA is usually computed on the basis of historical concept. Without forward-looking assessment of long-term investment decisions, EVA analysis can provide incorrect answers. It is important to understand the unique aspects of a business and to account for all the strategic and long-term benefits of investments in order to correctly perform EVA analysis. Sometimes, this makes the EVA analysis impractical. A critical requirement for EVA analysis is to recognize all of the resources being used in a particular business activity, a task that requires a good understanding of the business.

Conclusion: Finally, implementation of EVA-based management is not just a technical matter. For successful implementation of EVA program, it requires commitment and leadership of top management and co-ordination of the entire organisation toward this effort. Outside consultants can provide fresh insights and technical assistance but ultimate success requires work from within the organization.

Some Other Important Terms:

- **Capital Charge**: Capital employed multiplied by the cost of capital
- **Capital Invested or Capital Employed:** Debt plus Equity invested or Assets minus Non-interest Bearing Liabilities
- **Cost of Capital:** Weighted average return expected by both equity and debt investors
- **Shareholder value**: Shareholder value is being used as an overall term covering various aspects in thinking that promotes the interests of shareholders. Normally the term also means a company's value to its shareholders i.e. market capitalization.

Major Strategy Options: Central Strategy Alternatives

Glueck has identified the following types of strategies:

- Stable Growth Strategy;
- Growth Strategy;
- Retrenchment Strategy;
- Combination Strategy.

Broadly speaking, the major options in strategy formation may be divided into four categories:
(a) Stability strategy;
(b) Growth strategy;
(c) Retrenchment strategy; and
(d) Combination strategy.

These alternatives are sometimes called grand strategy alternatives. Within each category, again, the strategic planners may consider several sub-options or sub-strategies.

Stability Strategy: A stability strategy arises out of a basic recognition by management that the firm should concentrate on utilising its present resources so as to develop its competitive strength within a restricted product-market configuration. In other words, stability strategy implies that the company will continue in the same or a similar business as it now pursues, and with the same or similar objectives. This is not to be misunderstood as a 'do-nothing' strategy. For, stability strategy also implies focusing on improvements of functional performance and maintaining the level of achievements as in the immediate past. If the company had sales revenue or net earnings increasing at a certain rate per annum, it is required that the same performance should be evidenced in the years to come.

A stability strategy may be justified on the following grounds:

(a) The firm has succeeded in achieving its objectives and the level of performance is considered to be satisfactory. In such a situation management may be inclined to continue with the same activities, may, be, more zealously.

(b) The management does not visualise any major change in the environment; neither any serious threat appears to be there, nor any opportunity worth exploring.

(c) Potentially the threats are not so serious and opportunities not so attractive as to justify the risk that is involved in changing the product market posture.

(d) Introducing new products, entering new markets, or undertaking new functions which must be accompanied by organisational changes are not easily accepted by the key personnel of the firm. Resistance to change is a common phenomenon.

(e) Internal resource constraint or change of environment prevents further growth or change. A particular enterprise having achieved a high rate of growth in the past may actually find further growth impracticable due to the limitations of managerial capabilities, or government restrictions on growth beyond a certain limit.

Growth or Expansion Strategy: When a firm increases the level of objectives higher than what it has achieved in the immediate past, in terms of (say) market share, sales revenue, etc., or strategic decisions centre round increased functional performance in major respects, we have typical cases of growth strategy. Another kind of growth strategy is typically found when new products are added to the existing line, or dissimilar products are taken up for production and sale, or business activities are expanded through acquisition, merger, or amalgamation of firms. In a sense, growth strategy differs from stability strategy in that the former implies exponential growth while the latter implies an extrapolation of growth based on past performance.

The basic reasons underlying growth strategies may be outlined as follows:

(i) Growth is often a cherished cultural value. A company that is not expanding is said be falling behind; a stigma is associated with the failure to grow. On the other hand, a growth company is better known and attracts better management. It is a source of strength.

(ii) In industries which are subject to frequent changes in technology and other external conditions, growth is necessary for survival. Opportunities must be availed of and threats must be overcome so as to survive. In volatile industries, a firm which does not keep pace with the changing conditions is bound to be left high and dry sooner or later.

(iii) Growth strategy is associated with strong managerial motivation in its favour. Expansion is a rewarding phenomenon in several ways. Larger size means higher executive compensation. It satisfies power and recognition needs. To seize market share from competitors or to enter challenging new fields is not only exciting and satisfying but also leads to a sense of achievement. Besides, growth is often perceived as an index of effectiveness which has greater news value than stability.

(iv) The widely accepted 'experience curve' theory suggests that there are significant performance rewards over time as a firm grows in size and experience.

Growth Strategy: Different Types

Growth or expansion in the volume of business of a company may be achieved by different approaches. Accordingly, the strategists may consider different ways and means of expansion or growth. The variants of growth strategy (its sub-strategies) are differentiated as follows:

1. Intensive growth strategy (internal growth), and
2. Diversification strategy.

Types of diversification strategy which may be considered as alternatives are:

(i) Horizontal Diversification—
   (a) Concentric Diversification
   (b) Conglomerate Diversification.

(ii)Vertical Diversification (Vertical Integration)—
   (a) Forward Integration.
   (b) Backward Integration.

Intensive Growth Strategy (Internal Growth): Internal growth which consists of increasing the sales revenue, profits and market share of the existing product line or services is generally known as intensive growth strategy. It involves concentration of resources in a high-growth product or market segment. If the product is not in the maturity stage of the life-cycle, this is a particularly attractive strategy. It is often suited to firms with a small market share irrespective of whether the product is in the high-growth stage or maturity stage of its life-cycle. There are several ways of going about it, e.g.,

1. Increasing the volume of sales of existing products in unexplored sectors of the economy. The strategy adopted by a company to increase the sale of the popular brands of portable, transistorised radio sets in the rural sector is an example.
2. Increasing sales by encouraging new uses of the existing product in the same market, or increasing the primary demand for the product 'at the same price and with the existing organisational set-up. Typical examples of this approach may be found in case of companies promoting the sale of instant coffee, instant tea, tea-bags.
3. Increasing sales volume by introducing minor modifications in the product and entering new market segments, e.g., TV sets with indoor antennae or remote control devices; refrigerators with automatic defreezing, built-in voltage stabilisers, etc.
4. Increasing sales in new geographic areas within the country or in markets abroad. Transport Corporation of India has gradually expanded its services in different States.
5. Increasing sales volume on the basis of a new pricing policy, for instance, by offering economy packs of detergents (washing soap), exchanging old pressure cookers for new ones at a discount, discriminatory pricing in urban and rural markets.

Internal Growth by Increasing Sales of the Single Product Service Line: In this strategy, the firm increases its level of objective achievement rather than what is extrapolated against past performance by increasing the sales and profit of its present product or service line. By doing so, the firm increases its market-share profit at a much faster pace than it experienced in the past. It is a most successful strategy for a firm which is striving for rapid growth. This may be achieved in the following ways:

➢ By expanding sales through increasing primary demand and encouraging new uses for its present product or service;
➢ Expanding sales of product/service to different income groups;
➢ Expanding sales of product/service by adopting a differential pricing strategy;
➢ Expanding sales to different market segments by producing goods/services which cater to different purposes, purses and personalities.

A few examples of the firms which have profitably used the internal growth strategy are:

✓ Bakeman's home products have expanded the sales of its products by geographically expanding its area of operations.
✓ The Oberoi group of hotels has grown by establishing hotels not only in India but abroad as well and thereby earning the title of ownership of a worldwide chain of hotels.

Incremental Growth Strategy: An enterprise adopting the incremental growth strategy sets itself those objectives which are more or less similar to those which were accomplished earlier. These objectives usually represent the industry average, though the incremental growth strategy is less profitable than the other growth strategies, but it is adopted because of the following reasons:

(a) When a firm has smooth sailing or perceives itself to be a successful one. In this case, the management knows the factors which are responsible for the present state of affairs. That is why it sticks to the present strategy.
(b) It has been observed that risky ventures, stemming from new product and new investment decisions, often fail. Therefore, the management prefers to shun these strategies and tries to stick to less risky strategies. As a result, the incremental strategy is adopted.
(c) It is both convenient and comfortable to follow this type of strategy because there is no disruption in the routine activities of the organization.

The firms following this strategy usually concentrate on one product or service line, and grow slowly and incrementally by entering new territories, taking up new product lines, etc. Many companies have profitably employed this strategy. A few instances are given' here

➢ Lakme has concentrated on cosmetics and is doing well.

- Amul has concentrated its business on milk and allied products, and is doing well.
- Hindustan motors is competing well in the automobile) market.

Profit Strategies: When the objective of a firm is to generate cash immediately for itself or the stockholder, profit (or harvesting) strategies are followed. Herein, if necessary, the firm forgoes its market share to generate the cash. It has been noted that a harvesting strategy will work if many or most of these conditions exist:

- The unit's product is in a stable or declining market;
- The unit does not promote the sales stability or prestige of the firm;
- The unit's market share is small, and it would be very costly to increase it;
- The unit does not contribute a large percentage to total sales;
- The corporation has better use for its funds;
- Sales will decline less rapidly than the reduction in corporate support.

Harrigan and Porter describe profit strategy as the end-game strategy. They have noted that some firms have successfully profited from careful management by the sale of products which most firms felt were obsolete. For instance, two sick mills (namely, Mahalaxmi Mills and Edward Mills of Rajasthan after being taken over by N.T.C.) are now progressing well.
Harrigan and Porter have referred to the functional strategies used by the successful endgame players. These are:

- Dominate market share;
- Hold market share;
- Shrink selectively;
- Milk the investment;
- Divest now.

Internal Growth by Diversification

A diversification strategy is one by which the firm attains a growth level with the addition of new products/services internally to the existing product/service line. The diversification is of two types:
(i) Synergistic diversification (ii) Conglomerate diversification

Synergistic Diversification: In the synergistic diversification, new products/services are sold in new markets, when the resources required for producing or marketing the new line are highly compatible with the existing resources. The synergy may result from the commonalities in production facilities, R & D facilities, sales force skill or in particular management skill (such as ability to handle a large advertising budget).

Diversification Strategy: At some point of time in the process of intensive growth, it is no longer possible for a firm to expand in the basic product market. It is not able to grow any more through market penetration. Then it must consider adding new products or markets to its existing business line. This approach toward growth is known as diversification. Diversification strategy is thus defined as a strategy in which the growth objective is sought to be achieved by adding new products or services to the existing product or service line.

There are different ways in which a firm could possibly diversify its product or service line. The types of diversification commonly envisaged are as follows:

Horizontal diversification: This is a broad category in which are included strategies involving addition of parallel new products or services to the existing product/service line. Analytically, horizontal diversification may be grouped under two sub-categories: (1) Internal diversification, and (2) External diversification.

Internal diversification: When new products or services are developed by a firm on its own, or a firm decides to enter a parallel product market creating production facilities in addition to the existing product line, it is known as internal diversification

Examples of internal diversification are plenty e.g., Raymond Woollen Mills now produce cement and engineers' steel files in addition to woollen textiles; Godrej, manufacturers of steel safes and locks added refrigerators, washing machines, and, later on, detergents (washing soap) to its original product lines.

External diversification: If new products or services are added to the existing like of business through acquisition (purchase) of or merger with other firms, there is what may be called external diversification. The takeover of J.G. Glass Ltd (Pune) by Ballarpur Industries Ltd., the merger of Ceat Tyres Ltd. with Deccan Fibre Glass Ltd., acquisition of Tata Oil Mills Co. by Hindustran Lever, are instances of external diversification.

Concentric diversification: Concentric diversification is a type of diversification strategy which involves either (a) introduction of new products or services to serve similar customers in similar markets, or (b) introduction of new products or services using technologies similar to the present product or service line. The former is known as market-related concentric diversification, and the latter as technology-related concentric diversification. In recent years, lease financing has been added to the existing hire purchase business of a number of companies. These are obviously cases of market-related concentric diversification. An instance of technology-related concentric diversification is the addition of 'tomato ketchup' and 'sauce' to the existing 'Maggi' brand processed items of Nestle.

Concentric diversification takes place when the products or service added are in different industry but are similar to the existing product or service line with respect to technology or production or marketing channels or customers. Such diversification may be possible in two ways: internal development of new products or services by the firm on its own, or through acquisition (purchase) or merger of two or more firms.

Several reasons may underlie a company's preference for concentric diversification, e.g.,

(a) To counteract cyclical trend. If the company in one industry is subject to cyclical fluctuations, it may be necessary to diversify its business to smoothen its earnings flow.
(b) Excess cash flow. Where the existing product line has produced a high degree of liquidity through positive cash flows and opportunities exist with favourable rates of return, a company may consider concentric diversification very attractive.
(c) Saturation of product market. Another compelling reason for concentric diversification may be saturation of demand in the industry or product market.
(d) Managerial expertise. Concentric diversification may also be prompted by the top management's inclination to gain managerial expertise in a new field, or new technology, or entry into new markets, or new products.

Studies of corporate experience have shown that concentric diversification is very often related to eventual success and growth of companies.

Conglomerate diversification: Addition of dissimilar products or services to the existing line of business is known as conglomerate diversification. It involves diversification into business fields which are not significantly related or similar to the primary business mission. Thus, it differs from concentric diversification which also involves adding new product or service lines but in a related field. Conglomerate diversification in the case of DCM Limited led to the addition of a wide range of products in its business line of textiles. The products included engineering goods (castings), fertilizers, chemicals, rayon tyre cord, sugar, and data product.

The growth of ICICI, a development bank, into a financial conglomerate is recent history. Over the years, the corporation spun off other companies specialising in investment banking (I-Sec), commercial banking (ICICI Bank), Shipping Finance (SCCI), Mutual Fund (ICICI-AMC), and by mid-1990s it had strategic business divisions for infrastructure and oil and gas, and other specialised divisions like business consultancy and leasing.

In the United States, the International Telephones and Telegraphs (ITT) followed a conglomerate diversification strategy leading to the control and management of as many as 265 different companies in a number of industries like Sheraton (hotel), telephone, house-building, insurance, car rental, canteens, etc.

Norman Berg has defined a conglomerate as a firm which has at least five or six divisions selling different products principally to external markets rather than to each other. On this basis, Berg also suggests that management of conglomerate firms is different from that of diversified firms in the following respects:

- The central (corporate) office is much smaller in conglomerate firms;
- Decision-making authority is decentralised at the divisional level;
- Operating decisions are made at lower levels of management, hence performance evaluation is possible without any direct involvement of higher-level managers in day-to-day affairs; and
- The divisional managers have full autonomy as long as their contribution to corporate earnings is satisfactory.

The reasons underlying the use of conglomerate diversification strategy may be :

(i) To achieve a growth rate higher than what can be realised through expansion;
(ii) To make better use of financial resources with retained profits exceeding immediate investment needs;
(iii) To avail of potential opportunities of profitable investments;
(iv) To achieve distinct competitive advantage and broader stability;
(v) To spread the risk or gain increased stability; and
(vi) To improve the price-earnings ratio and bring about a higher market price of shares.

Many of these objectives of conglomerate diversification can be and are actually realised by external development through acquisition and merger. According to Norman Berg, conglomerates in the United States have diversified rapidly, primarily through mergers and acquisitions, into products unrelated to their prior business. Often, acquisition or merger leads to synergistic effects in marketing, production, finance and/or management.

However, conglomerate diversification has taken place also through internal development in the United States and other countries. In India, for instance, the growth of Godrej, Reliance Industries, DCM, and Hindustan Machine Tools (HMT) is the result of conglomerate diversification mainly through internal development.

Vertical diversification (vertical integration): Vertical diversification, commonly described as vertical integration, is a type of growth strategy wherein new products or services are added which are complementary to the existing product or service line. It is characterized by the extention of the firm's business definition in two possible directions from the present—backward or forward. In other words, vertical integration is a growth strategy that involves the expansion of business by moving backward or forward from the present products or services establishing linkages of products, processes or distribution system. Thus, vertical integration may be of two types: Backward Vertical Integration or Forward Vertical Integration.

Backward vertical integration: Also known as upstream development, backward integration strategy involves addition of activities to ensure the supply of a firm's present inputs. It is aimed at moving lower on the production process scale so that the firm is able to supply its own raw materials or basic components. Many sugar mills in India have developed sugarcane farming. TV manufacturers may produce picture tubes and other components. Steel plants have set up their own coke ovens and acquired mining rights to secure the supply of coal and coke. All these are instances of backward vertical integration.

Why is backward vertical integration used as a strategy? The use of backward vertical integration is generally found to be advantageous in several ways. Firms may adopt it for one or more of the following reasons:

(i) To secure a regular supply of materials or components particularly where the market is dominated by monopolistic or oligopolistic firms.
(ii) To improve or ensure quality control over major components for the final product.
(iii) To achieve a higher return on investment for the enterprise as a whole through better use of overhead facilities.
(iv) To improve the power of negotiation with suppliers on the basis of known costs.
(v) To save indirect taxes payable on the purchase of inputs.

Backward vertical integration may not always be a desirable strategy for the following disadvantages that go with it:

(a) Technological upgrading of units producing inputs may be difficult due to resource constraint. Purchasing from technically more efficient suppliers is ruled out. On the other hand, heavy investment in the process of backward diversification may hamper the development of the final product and advancement of later stages in the manufacturing process, which may lead to undue pressure on pricing and sales effort.
(b) Opportunities of purchasing at a lower cost which may emerge cannot be availed of.
(c) The problem of transfer pricing may be acute particularly if the divisions using the input do not have the freedom of comparing market condition of supply.
(d) Changing economic conditions affecting the main product market may cause a magnified impact on the production of inputs.

Collaboration with other firms by way of joint venture may be helpful in reducing the risks of backward vertical integration to some extent. The capacity of production may be planned in keeping with the requirements of co-partners. Similarly, the disadvantage of economic fluctuations producing a magnified effect could be taken care of by backward integration with a lower capacity so that, in case of need, outside purchases may be cut down and internal capacity fully used.

Forward vertical integration:

It involves entering into the business of finishing, distributing or selling some of the firm's present output. A few instances of this type of integration are:

- A few years ago, a number of textile manufacturers entered into this type of integration by selling their goods through chain stores.

- The Indian Oil Corporation can integrate forwardly if it decides to sell all its petrol output through its own service station.

It is sometimes described as 'downstream' expansion and refers to moving higher up in the production/distribution process towards the end consumer. Many a firm in India which started business with a spinning mill has later added loom sheds to produce fabrics. Large textile mills (DCM, Mafatlal, Binny, National Textile Corporation, and others) have set up their own retail distribution systems. These are examples of forward integration. Printing establishments entering the book publishing business, timber merchants extending business as furniture makers, producers of automobile engine parts setting up auto-assembly works, are other examples of forward vertical integration. Forward vertical integration offers certain advantages for which it is deemed to be a suitable strategy. It enables a firm to gain greater control over sales and prices of its existing output. This is particularly worthwhile in an oligopolistic market. Even otherwise, firms may improve their competitive position by increasing the scope of business and thereby reducing overall costs. Secondly, forward vertical integration improves the scope of quality control at different stages in the production process and distribution system. Retailing units owned by manufacturers not only ensure reliability of products but also prove to be a better source of customer feedback. Forward vertical integration may involve a firm competing with its own customers. Thus, a conflicting situation may arise when a producer of TV components enters the business of making TV sets. The problem can be avoided if the whole output of components can be used for making TV sets or if the markets are differentiated geographically or by brand names. Another disadvantage of forward vertical integration relates to the difficulty of coping with changes in technology, character and size or number of the additional units of production or distribution. Thus, it is advisable that forward vertical integration should be attempted on a sufficiently large scale.

Every business is involved in one or more types of the vertical integration strategy. A few firms hold a shallow position by performing limited economic functions: others take a quite comprehensive view by embracing the whole chain of sequential occurrences, including the processing of raw materials and production, and subsequent operations which cover the marketing of goods and services as well. Efforts have been made to establish why firms follow a vertical integration strategy. It has been noted that not only mere technical complexity but the volume of business, too, tempts an industry to go in for vertical integration. Thompson has noted that firms with long-linked technology are more effective if they grow through vertical integration. So if a firm feels that it can derive advantages from a vertical integration, it adopts this policy after a proper scanning of the environmental variables and the availability of resources.

Retrenchment Strategy: A retrenchment strategy involves the pruning or curtailment of the operations of the business so as to achieve a higher level of efficiency. However, this sort of strategy is used by undertakings only in exceptional cases. The following situations warrant the deployment of this strategy:

- The current level of performance is far below its past achievements;
- The management aims to wipe out the previous deficit;
- It seeks to serve the public by offering some products/services but finds it necessary to slice out certain products/services.

The important ingredients of this grand strategy include the following sub-strategies:

A strategic option which involves reduction of any existing product or service line along with the level of objectives set below the past achievement is known as retrenchment strategy. It is essentially a defensive strategy adopted as a reaction to operating problems stemming from either internal mismanagement, unanticipated actions by competitors, or changes in market conditions. It is often used as a short-run business policy to weather a storm and survive in the face of economic recession, financial stringency or poor performance. It is adopted out of necessity, not by deliberate choice. With a retrenchment strategy the endeavour of management is to raise the level of enterprise achievements focusing on improvements in the functional performance and cutting down operations with negative cash flows.

Reasons for using the retrenchment strategy are the following:

- Poor performance. When a firm suffers from poor performance in terms of lower earnings and profits, and is unable to recover its position by any other means, it may be required to shut down units of activity or segments of business which continue to be a drag on total performance.
- Threat to survival. When the survival of a firm is threatened by unanticipated problems in the product market, the management may be under pressure from shareholders and employees to improve performance by all means including cutback of operations.
- Redeployment of resources. When alternative investment opportunities promise higher returns, some of the existing business units or segments of activity may be shed and resources thus released utilised for increased profitability and growth.
- Insufficiency of resource. To sustain and develop satisfactory earning position in a product-market, it may be necessary to deploy large financial resources. If the firm is not in a position to provide adequate funds for that purpose, the best thing to do may be divestment of the particular product- market for better use of the finances released thereby.
- To secure better management and improved efficiency. It may be necessary to cut down some of the existing operations to simplify the range of enterprise activities and thus secure high efficiency of operations.

Retrenchment Strategy: Various Types

There are different ways in which a company may defend its existence and survive, or best serve the interest of owners in the face of internal or external crises. The variants or sub-strategies of retrenchment strategy are:

1. Turnaround strategy,
2. Divestment strategy, and
3. Liquidation strategy.

Conglomerate Diversification: In the conglomerate diversification strategy products/services are added to the existing line which is not significantly related to the present product/service in technology production process and R & D facilities. Godrej and DCM groups follow this strategy. How a company can grow may be best explained by the example of the T.T.K. group. It started its business in 1958 as the manufacturer of Woodward's gripe water. Later on, it shifted to ethical products in association with Kalichemie A.G. of West Germany and then to packaging materials. The Fryum (ready-to-fry food) has won a good market. The group has already entered on the production of capsule machinery and capsules.

Turnaround strategy: The turnaround strategy is often necessitated during recessionary conditions in an industry or in the economy as a whole. More generally speaking, the; turnaround strategy is called for when there is a substantial and sustained downtrend in the indicators of business performance which may be caused by external factors and the absence of properly timed, fresh management input. Turnaround strategy is aimed at halting the present declining trend in performance while improving the long-run efficiency of operations. Thus its focus is on : (a) cost reduction, (b) revenue increase, and (c) reduction of assets, alone with reduction of products or services, etc.

Divestment Strategy: A divestment strategy calls for the sale or liquidation of a sub-unit or a major part of undertaking to tide over a crisis. The divestment generally takes place for the following reasons:

An unfavorable market environment;

Declining market share and negative sales growth;

Unprofitable mergers;

The divestment may also be brought about in the following ways:

- If the sub-unit is viable, it may be segregated from the parent unit, and the latter one sold;
- The sub-unit may be sold to an independent buyer;
- The sub-unit may be liquidated and its assets be sold.
- The divestment decision is a very crucial one for the management. Therefore, it should be taken after giving due consideration to the many complex issues involved in it; otherwise the very existence of the company may be jeopardised.

Divestment strategy (also known as Divestiture Strategy) involves selling off or shedding business units or product divisions, or segments of business operations to redeploy the resources so released for other purposes. While selling off a business segment or product division is one of the common forms of divestment, it may also include selling off or giving up the control over a subsidiary, or a demerger whereby the wholly-owned subsidiaries may be floated off as independently quoted companies. An example of divestment strategy is the sale of Samrat Hotel by the Indian Tourism Development Corporation. Closing down of two out of the five textile units under Delhi Cloth Mills may be cited as another example.

Although divestment of a business unit or subsidiary by one company may be linked with the acquisition of a unit by another firm, it would not be correct to suppose that divestment and acquisition are opposite numerical sides of the same coin. In a study of divestments in U.K. industry, Hayes found that during the period 1969-84, purchase of independent companies figured in acquisitions to a much larger extent than acquisition of other firms' divestments. By number as well as value divestment represented an average of around 25 per cent of all acquisitions.

Liquidation Strategies: A liquidation strategy involves the winding up of the business by selling it off or closing down its operations. It is the least popular strategy and is adopted in exceptionally rare circumstances, such as:

(i) When bankruptcy is inevitable.

(ii) The various instrumentals will be better off with the liquidated results than by continuing the firm at a loss,

Captive Company Strategy: The company is said to follow a captive strategy when more than 75 per cent of the production/services are sold to a single customer. A company normally follows this captive strategy:

(i) When it is unable or unwilling to strengthen its marketing or other functions;

(ii) When the company can maximise its profit by using this strategy.

The best example of captive strategy is that of the marketing policies of ordnance factories which sell out their entire production to the government. ,

When these policies are adopted, the captive dictates the terms pertaining to product design, production control, and quality control. Moreover, it negotiates the price of goods.

Here, as the success of the business is intimately limited with one single customer, the management has to develop a long-term relationship with it so that it may prosper and be hedged against probable losses.

External Growth by Merger and Joint Ventures: An external growth strategy is one by which a firm increases its level of objective achievement through mergers and joint ventures.

A merger is that process by which two or more firms acquire the assets and liabilities of the other in exchange of stock, or cash, or both. It can be two types, namely, concentric and conglomerate.

- ✓ Concentric Merger: A concentric merger is one in which two or more firms which are related by the production process, technology and markets, combine.
- ✓ Conglomerate Merger: A conglomerate merger involves the combination of two or more firms not closely related by technology, production process or markets.

Factors Affecting Merger

Many reasons tempt a firm to go in for a merger. A few important reasons have been listed below:

1. To attain a high degree of efficiency and profitability, especially when there is synergy between two firms.
2. To increase the growth rate of the firm more rapidly than can be brought about by an internal growth strategy;
3. To stabilise the firm's earnings by acquiring another firm whose sales and earnings are at its peak;
4. To diversify the product line when it has attained the growth stage,
5. To acquire additional resources quickly, such as advanced technology, machinery, and expertise;
6. To minimise competition by buying out the competitors;

Joint Venture: It can take any shape, and can take place between two or more firms of the same country or between the firms operating in different countries. As they are formed with a different purpose and have a different rate of success, they have been discussed here independently.

Joint Ventures within National Boundaries: This type of venture takes place between two or more firms operating in the same country. That is, there can be a participation between the private sector and Government or between two or more private undertakings. Such types of ventures are usually created to:

- ❖ Minimize the risk of the new venture;
- ❖ Introduce new technology;
- ❖ Mobilise techno-managerial resources;
- ❖ Accelerate economic growth.

For instance, the Government of India has entered into collaboration with the private sector in many spheres. A few notable examples are the Cochin Refineries, Madras Refineries, and Gujarat State Fertiliser Company.

Joint Ventures across National Borders: When two or more different enterprises of different companies agree to create a new organisational entity, the joint venture across national borders comes into being.

According to Freiken, the following factors account for these agreements:

- ➢ Joint ventures save financial outlays for both parties, thus lowering cost;
- ➢ Joint ventures increase sales, thus allowing for important production cost savings;
- ➢ Joint ventures provide speedy channel acceptance, and this reduces marketing costs;

- Joint ventures ensure the independence of both companies;
- Joint ventures provide the foreign country with a "front row seat" in the new country. This means that the locals interpret the industrial language and the customers of the country.

It also reduces the fear of the nationalistic concerns of "foreign takeover".

In our country, ever since independence, to speed up the tempo of industrialisation, foreign collaborations were accepted in varying degrees under different regimes. With the recent liberalization of economic policies, a spate of joint agreements have been signed. Consequently, the emphasis is now on multilateralism. In the recent past, important agreements have been entered in the field of electronics, automobiles, drugs and Pharmaceuticals, textile and farm machinery, and engineering industry.

A few of foreign joint ventures include:

- Hindustan Motors has entered into collaboration with Caterpillar Company of U.S.A. for the production of its entire range of earth-moving machines and tractor engines.
- The Standard Motors Products of India Ltd. has entered into collaboration with the Austin Rover group for the production of the luxury motor car, Standard 2000.
- A few other notable collaborations in the automobile industry includes Mahindra & Mahindra with Peugeot Automobiles, France, Bajaj Tempo Ltd. with Daimler Benz A.G. of West Germany, TELCO with Mercedes Benz, DCM with Toyota, Premier with Nissan Motor Co., and Maruti with Suzuki.

Combination Strategy: As the name implies, a combination strategy is one in which there is conscious use of different strategies for different units or divisions at the same time, or sequential use of different strategies over time. In other words, a mixed or combination strategy involves using elements of two or more basic strategies at the same time in different segments of the organisation or using different basic strategies for the same segment at different stages. This type of strategy involves the blending of different types of strategies for the company or its sub-units. Normally, the deployment of this strategy is based on the premise that a company should have "different strategies for different environmental situations."

Where a combination strategy is followed, the management uses different strategies for different sub-units or for different phases in time. The possible combinations may be as follows:

- Stable growth in some sub-units while retrenchment in others;
- Stable growth in some sub-units while growth in others;
- Retrenchment in some sub-units and growth in others.

As a result of resource constrains and lack of managerial expertise, it is not possible for a small undertaking to enjoy this privilege. It has been noted that multi-branch, multi-product enterprises can reap the benefit of this policy.

Thus a combination strategy may be useful where a firm is operating in several markets subject to different rates of change in demand or where a firm deals in multiple products which are in different stages of the product life cycle.

Over a period of time, there may be various sequentially combined strategies, e.g., stability strategy followed by growth strategy or vice versa, retrenchment strategy followed by stability strategy or vice versa, and so on. The combination strategy is most frequently used in multi-product, divisionalised companies. The main purpose of such a strategy is optimisation of the enterprise profitability and/or minimising its losses. The basic reason underlying its use is that a single strategy does not fit all products or all markets. Hence, the purpose of a mixed strategy is to allocate resources to the high growth and high potential areas of business while reducing investments in or selling off the less profitable endeavours.

A company may pursue the combination strategy for one or more of the following reasons:

1. Different products in different stages of life cycle. Obviously a strategy suited to a product at the initial growth stage must be different from that of a product at the mature declining stage.
2. Industrial recession. When recessionary condition prevails in a product market, the strategy more suited to it is retrenchment strategy, while growth strategy may be suited to other product markets not so affected.
3. Size of the firm. It may be undesirable or impracticable to pursue growth strategy in all segments of activity at the same time; particularly when there are several opportunities and resources are not adequate to avail of all of them.

Combination strategies are most likely to be effective (a) for large, multi-industry firms in periods of economic transition or in periods of product/service transition in the life cyclic, and (b) in the case of firms of which the product or market divisions have uneven performance or uneven future potentials.

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ICWAI Group III Final December 2009 Examination

Subject: Strategic Management [redacted]

Topic: The Nature of Business Strategy

1. What is strategy about?

Some initial definitions

1. Strategy: 'A course of action, including the specification of resources required, to achieve a specific objective.'
2. Strategic plan: 'A statement of long-term goals along with a definition of the strategies and policies which will ensure achievement of these goals.'
3. 'The basic characteristics of the match an organisation achieves with its environment is called its strategy.'
4. 'Strategy is the direction and scope of an organisation over the long term: which achieves advantage for the organisation through its configuration of resources within a changing environment, to meet the needs of markets and to fulfill stakeholder expectations.'
5. 'Corporate strategy is the pattern of major objectives, purposes and goals and essential policies or plans for achieving those goals, stated in such a way as to define what business the company is in or is to be in and the kind of company it is or is to be.'
6. 'Corporate strategy is concerned with an organisation's basic direction for the future: its purpose, its ambitions, its resources and how it interacts with the world in which it operates.'

Common themes in strategy

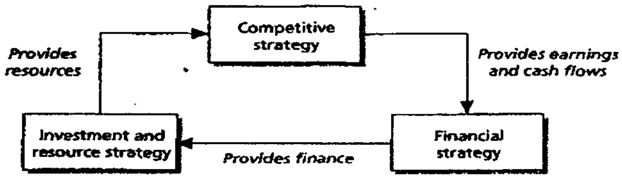
Strategy involves the following issues:

- It is about the purpose and long-term objectives of the business
- It is concerned with meeting the challenges from the firm's business environment such as competitors and the changing needs of customers.
- It involves using the firm's resources effectively and building on its strengths to meet environmental challenges
- It is ultimately about delivering value to the people who depend on the firm, its stakeholders, such as customers and shareholders.

Three elements to strategy

It is possible to perceive of a firm's strategy as consisting of several different elements in Figure 1

Figure 1 The elements of strategy



Competitive strategy

This deals with how the firm competes for business and where its earnings come from. It will involve considerations such as:

- how it attracts customers;
- what it decides to produce or sell;
- which markets and countries it operates in;
- how it will win-out against rivals.

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Levels of strategy

Strategy exists at several levels in the organisation. A simplified model of the business organisation is given in Figure 2.

Figure 2 Organisation chart showing corporate, SBU and functional strategies

Corporate strategy:

The corporate centre is at the apex of the organisation. It is the head office of the firm and will contain the corporate board. A textbook written twenty years ago would have assumed that all competitive strategy was formulated at corporate level and then implemented in a 'top-down' manner by instructions to the business divisions. During the 1980s, high-profile corporate planners like IBM, General Motors and Ford ran into difficulties against newer and smaller 'upstart' competitors who seemed to be more flexible and entrepreneurial.

One consequence was the devolution of responsibility for competitive strategy to business units. Corporate strategy today typically restricts itself to determining the overall purpose and scope of the organisation. Common issues at this level include:

- decisions on acquisitions, mergers and sell-offs or closure of business units;
- conduct of relations with key external stakeholders such as investors, the government and regulatory bodies;
- decisions to enter new markets or embrace new technologies (sometimes termed diversification strategies);
- development of corporate policies on issues such as public image, employment practices or information systems.

Business strategy

A strategic business unit (SBU) is defined as

'A section, within a larger organisation, responsible for planning, developing, producing and marketing its own products or services.'

Management of the SBU will be responsible for winning customers and beating rivals in its particular market. Consequently it is at this level that competitive strategy is usually formulated. The considerations at this level will include:

- marketing issues such as product development, pricing, promotion and distribution;
- decisions on production technology;
- staffing decisions.

A business strategy should be formulated within the broad framework of objectives laid down by the corporate centre to ensure that each SBU plays its part. The extent to which the management of the SBU is free to make competitive strategy decisions varies from corporation to corporation and reflects the degree of centralisation in the management culture of the firm.

Functional strategies

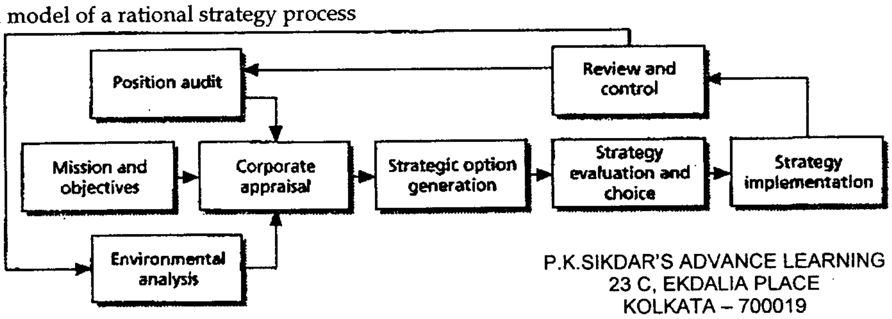
The functional (or sometimes called operational) level of the organisation refers to main business functions such as sales, production, purchasing, human resources and finance.

Functional strategies are the long-term management policies of these functional areas. They are intended to ensure that the functional area plays its part in helping the SBU achieve the goals of its business strategy.

A model of the rational strategy process

Figure 3 shows a model of the steps which management may take to develop a strategy for their business.

Figure 3: A model of a rational strategy process



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Mission and objectives

These set the purposes of the organisation to be satisfied by the strategy.

A mission is a broad statement of the purposes of the business. It will be open-ended and reflect the core values of the business. A mission will often define the industry that the firm competes in and make comments about its general way of doing business. For example:

- British Airways seek to be 'the world's favourite airline'.
- Nokia speak of 'connecting people'.
- DHL 'delivers your promises'.

Objectives differ from mission because they generally specify quantitative measures of the performance to be achieved and the time frame in which it is to be achieved. For a mobile phone operator these might include goals such as profit and growth but also non-financial targets such as customer service or geographical coverage.

Corporate appraisal

During this stage, management assess the ability of the business, following its present strategy, to reach the objectives they have set. They will draw on two sets of information:

a. Information on the current performance and resources position of the business. This will have been gathered in a separate position audit exercise.
b. Information on the present business environment and how this is likely to change over the period of the strategy. This will have been collected by a process of environmental analysis and will include information on:
    - competitors;
    - tastes of customers;
    - state of the economy.

This stage is also termed a SWOT analysis, standing for strengths, weaknesses, opportunities and threats.

Strategic option generation

Management seeks to identify alternative courses of action to ensure that the business reaches the objectives they have set. This will be largely a creative process of generating alternatives building on the strengths of the business and allowing it to tackle new products or markets to improve its competitive position.

Strategy evaluation and choice

At this point, management have a number of ideas to improve the competitive position of the business. The evaluation stage considers each strategic option in detail for its feasibility and fit with the mission and circumstances of the business. By the end of this process management will have decided on a shortlist of options that will be carried forward to the strategy implementation stage.

Strategy implementation

The strategy sets the broad direction and methods for the business to reach its objectives. However, none of it will happen without more detailed implementation.

The strategy implementation stage involves drawing up the detailed plans, policies and programmes necessary to make the strategy happen. It will also involve obtaining the necessary resources and committing them to the strategy.

These are commonly called tactical and operational decisions:

- Tactical programmes and decisions are medium-term policies designed to implement some of the key elements of the strategy such as developing new products, recruitment or downsizing of staff or investing in new production capacity. Project appraisal and project management techniques are valuable at this level.
- Operational programmes and decisions cover routine day-to-day matters such as meeting particular production, cost and revenue targets. Conventional budgetary control is an important factor in controlling these matters.

Review and control

This is a continuous process of reviewing both the implementation and the overall continuing suitability of the strategy. It will consider two aspects:

- Does performance of the strategy still put the business on course for reaching its strategic objectives?
- Are the forecasts of the environment on which the strategy was based still accurate, or have unforeseen threats or opportunities arisen subsequently that might necessitate a reconsideration of the strategy?

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ICWAI Group III Final December 2009 Examination

Subject: Strategic Management

SHEET-2

Topic: Setting the Goals of the Organisation

Nature and origins of corporate mission

Elements of a mission statement

Although there is no standard format for mission statements, most seem to contain the following four key elements. (The following mission statements were taken from the British Airways website in late 1999. It refers to the mission it established in 1997. It will be used here to illustrate the elements in mission statements.)

British Airways mission statement

The new mission

- To be the undisputed leader in world travel

The new values

- Safe and Secure
- Honest and Responsible
- Innovative and Team-spirited
- Global and Caring
- A Good Neighbour

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The new goals

- Customers' Choice - Airline of first choice in key markets
- Strong Profitability - Meeting investors' expectations and securing the future
- Truly Global - Global network, global outlook: recognised everywhere for superior value in world travel
- Inspired People - Building on success and delighting customers

➔ A statement of the purpose of the business. According to conventional economic theories of the firm, this will be to make profit (or shareholder value). For British Airways it is the second of its three goals. The appearance of customers, community and environment in mission statements raises the question of whether satisfying the shareholder is (or indeed should be) still the principal goal of strategic management.

➔ A statement of its scope or industrial domain. This is conventionally described as its products and markets. British Airways alludes to creating a global travel network of which airlines seem to be only a part.

➔ A statement of its competitive strategy or positioning. British Airways emphasises the way they are viewed by their customers, in particular its superior value and truly global nature.

➔ A statement of its principles, ways of doing business and social responsibilities. British Airways communicates this under its values.

Roles of mission statements

The following purposes of mission statements:

To provide a basis for consistent planning decisions.

1. To assist in translating purposes and direction into objectives suitable for assessment and control.
2. To provide a consistent purpose between different interest groups connected to the organisation.
3. To establish organisational goals and ethics.
4. To improve understanding and support from key groups outside the organisation.

Mission statements help at four places in the rational model of strategy:

1. Mission and objectives. The mission sets the long-term framework and trajectory for the business. It is the job of the strategy to progress the firm towards this mission over the coming few years covered by the strategy. For example, whatever British Airways decides to do, it must be concerned with delivering customer and financial value in the global travel business. Discussing opportunities for opening a chain of burger bars in London would not be appropriate because it is not BA's business.
2. Corporate appraisal. Assessing the firm's opportunities and threats, its strengths and its weaknesses must be related to its ability to compete in its chosen business domain. Factors are relevant only in so far as they affect its ability to follow its mission.
3. Strategic evaluation. When deciding between alternative strategic options, management can use the mission as a touchstone or benchmark against which to judge their suitability. The crucial question will be, 'does the strategy help us along the road to being the kind of business we want to be?'
4. Review and control. The key targets of the divisions and functions should be related to the mission, otherwise the mission will not be accomplished.

Setting strategic objectives

The link between mission and objectives

A mission is an open-ended statement of the firm's purposes and strategies. Strategic objectives translate the mission into strategic milestones for the business strategy to reach.

A strategic objective will possess four characteristics which set it apart from a mission statement:

- a precise formulation of the attribute sought;
- an index or measure for progress towards the attribute;

- a target to be achieved;
- a time-frame in which it is to be achieved.

Another way of putting this is to say that objectives must be SMART, i.e.

- Specific unambiguous in what is to be achieved;
- Measurable specified as a quantity;
- Attainable within reach;
- Relevant appropriate to the mission of the firm;
- Time-bound with a completion date.

Table 1 lists some strategic objectives.

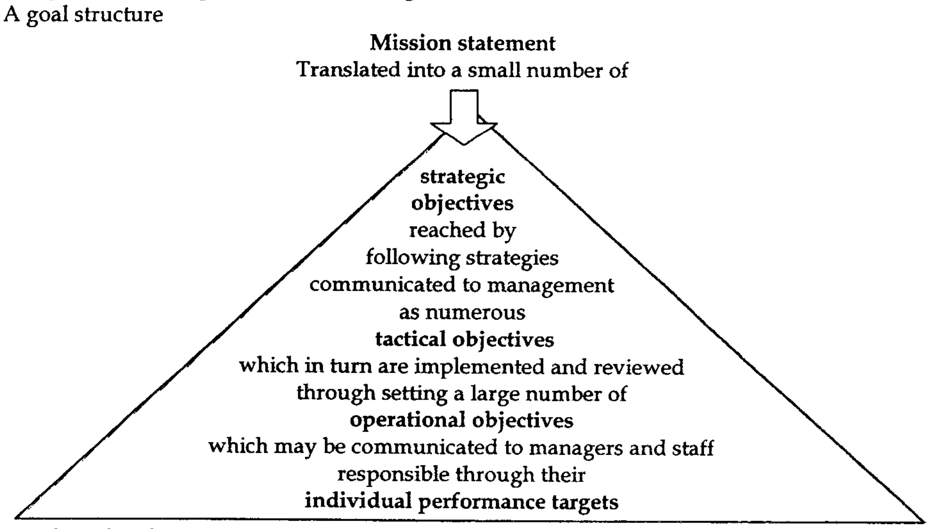
Table 1: Examples of strategic objectives

Mission	Attributes	Measure
Growth	Sales volume	'000s of units
	Share of market	% of total volume
	Asset base of firm	Net assets
Quality	Customer satisfaction	Repeat purchases
	Defects	No. per '000
	Consistency	Adoption of procedures
Innovation	Peer group respect	Industry awards received
	Speed to market	Development time
	Successful new products	% of sales from new products
Social responsibility	Non-discrimination	Workforce composition
	Environmental pollution	Cubic metres of waste
	Safety	Notified incidents

The goal structure. The goal structure is the hierarchy of objectives in the organisation. It can be visualised as the diagram in Figure1.

This pyramid parallels the organisation chart in Figure 2.

Figure 1: A goal structure



Objectives perform five functions:

1. Planning. Objectives provide the framework for planning. They are the targets which the plan is supposed to reach.
2. Responsibility. Objectives are given to the managers of divisions, departments and operations. This communicates to them:
   (a) the activities, projects or areas they are responsible for;
   (b) the sorts of output required;
   (c) the level of outputs required.
3. Integration. Objectives are how senior management co-ordinate the firm. Provided that the objectives handed down are internally consistent, this should ensure goal congruence between managers of the various divisions of the business.
4. Motivation. Management will be motivated to reach their objectives in order to impress their superiors and perhaps receive bonuses. This means that the objectives set must cover all areas of the mission. For example, if the objectives emphasise purely financial outcomes, then managers will not pay much heed to issues such as social responsibility or innovation.
5. Evaluation. Senior management control the business by evaluating the performance of the managers responsible for each of its divisions. For example by setting the manager a target return on investment (ROI) and monitoring it, senior management ensure that the business division makes a suitable return on its assets.

Critical success factors

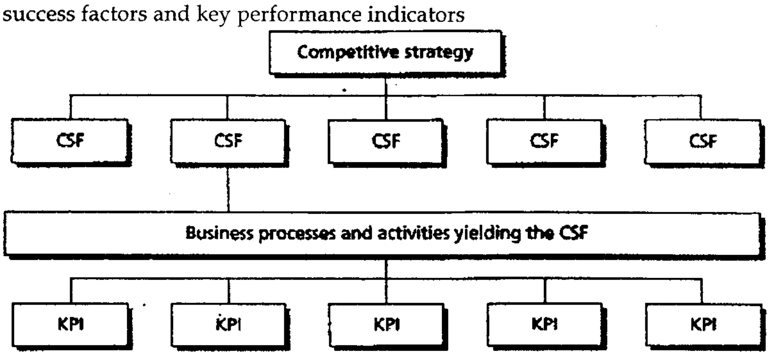
Defining critical success factors:

This approach first emerged as an approach for linking information systems strategy to broader commercial goals by first identifying the crucial elements of the firm's business strategy. More recently it has been appropriated by strategists in general as an alternative to the goal structure approach described above.

According to its originators, critical success factors (CSFs) are: 'The limited number of areas in which results, if they are satisfactory, will enable successful competitive performance' (Rockart and Hoffman, 1992). More recently Johnson and Scholes (1997) have defined CSFs as:

'... those components of strategy where the organisation must excel to outperform competition. These are underpinned by competences which ensure this success. A critical success factor analysis can be used as a basis for preparing resource plans.' The attraction of the approach lies in the fact that it provides a methodology for identifying strategic goals (or CSFs) by basing them on the strengths, or core competences, of the firm. These are implemented though the development of key performance indicators (KPIs) for milestones in the processes delivering the CSFs (Figure 2).

Figure 2 Critical success factors and key performance indicators



Methodology of CSF analysis

According to Johnson and Scholes, this is a six-step process. We have illustrated them here using the example of a chain of fashion clothing stores.

1. Identify the critical success factors for the specific strategy. They recommend keeping the list of CSFs to six or less. The store chain might decide that these are:
   - right store locations;
   - good brand image;
   - correct and fashionable lines of stock;
   - friendly fashionable store atmosphere.

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2. Identify the underpinning competences essential to gaining competitive advantage in each of the CSFs. This will involve a thorough investigation of the activities, skills and processes that deliver superior performance of each .Taking just one of the store's CSFs, the issue of correct stock, as an example:
   - recruit and retain buyers with acute fashion sense;
   - just-in-time purchasing arrangements with clothing manufacturers;
   - proprietary designs of fabrics and clothes;
   - close monitoring of shop sales by item to detect trends in which items are successful and which are not;
   - swift replenishment delivery service to minimise amount of stock in the system.
3. Ensure that the list of competences is sufficient to give competitive advantage. The store needs to consider whether improvement to the systems and processes underlying its CSFs will be sufficient to secure its place in the high street or whether more needs to be done. For example have they considered whether they need to develop a direct ordering facility to raise profile and gain loyalty?
4. Identify performance standards which need to be achieved to outperform rivals. These are sometimes termed key performance indicators and will form the basis of a performance measurement and control system to implement and review the strategy.
   KPIs that the clothing store chain might consider to match its key processes (listed above) include:
   - staff turnover among buyers and designers;
   - lead times on orders from suppliers;
   - percentage of successful stock lines designed in-house;
   - installation of a real-time store sales information system by the end of the year;
   - establishment of one-day order turnaround for store replenishment.
5. Ensure that competitors will not be able to imitate or better the firm's performance of each activity, otherwise it will not be the basis of a secure competitive strategy. Our store would compare its competences against Gap, Miss Selfridge, Next, River Island, etc. It would need to consider whether its present advantages are sustainable.
6. Monitor competitors and predict the likely impact of their moves in terms of their impact on these CSFs. This process is carried out principally by discussions between management, although there is a clear additional role for the special expertise of the chartered management accountant in mapping the key process, developing KPIs and monitoring them.

Meeting the objectives of shareholders

Maximisation of shareholder wealth as an objective

Traditional economic theory specifies that the objective of the firm is to maximise profit. However this assumption does not accurately reflect the goals of the shareholder for a number of reasons:

1. It is a single-period measure (typically annual). The shareholder wants financial returns across many years.
2. It ignores risk. Shareholders will require higher returns if risks are higher but will be satisfied with lower returns if risks are low.
3. It confuses profit with cashflows to the investor. The investor wants cash flows not a figure for profit on the income statement.

In Management Accounting - Financial Strategy, a more appropriate version of rational shareholder objectives is either (a) maximisation of the present value of the free cash flows of the business, or (b) maximisation of the share price.

Financial and non-financial objectives

Traditionally the shareholders' objectives have been translated into financial objectives such as profit or profitability (e.g. return on capital employed or earnings per share).

These accounting measures have several drawbacks when used as strategic targets:

- They are not useful for start-up businesses. During their first few years many firms do not make a profit or return a positive cash flow due to the high costs of set-up and getting established in the market. For example, at the time of writing Amazon.com, the on-line bookstore, has a market capitalisation of $15bn, yet so far has not made a profit. Profitability measures are better suited to mature businesses.
- They are inherently short-termist. Because profit is an annual measure it encourages management to focus on short-term returns at the expense of the long-term development of the business. Hence managers may decide to cut product development, promotion or staff development to improve profit performance at the expense of the long term.
- They provide no control over strategic behaviour. The profit figure is a financial summary of the effects of a year's economic activity. The competitive strategy of the firm will seek to do business in particular ways in order to make this profit. This strategy should also feature in the goal structure.
- They can be manipulated by creative accounting.

Consequently the strategic targets of firms usually contain a mixture of financial and non-financial measures of performance. These ensure that:

- managers follow courses of action consistent with the competitive strategy;
- shareholders and others can form an opinion of the success of the firm's strategy even when financial results are low;
- the strategic objectives can be more easily translated into tactical and operational objectives for divisions and processes without an immediately discernible impact on profits (e.g. human resources, marketing, etc.)

Stakeholders

The identity of stakeholders

Stakeholders are defined as 'Groups or individuals having a legitimate interest in the activities of an organisation.

- shareholders and other investors;
- management;
- staff and organised labour;
- customers;
- suppliers;
- local community;
- national governments.

The first three items are sometimes called internal stakeholders, while the remainder is external stakeholders.