



UNIVERSITY OF CALICUT

SCHOOL OF DISTANCE EDUCATION

MCom

II SEMESTER

**STRATEGIC
MANAGEMENT**

&

**CORPORATE
GOVERNANCE**

2030

Master of Commerce

Semester II

MC2C10: STRATEGIC MANAGEMENT AND CORPORATE GOVERNANCE



UNIVERSITY OF CALICUT

SCHOOL OF DISTANCE EDUCATION

Calicut University P.O., Malappuram, PIN - 673635

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***Study material
M Com II Semester***

MC2C10: STRATEGIC MANAGEMENT AND CORPORATE GOVERNANCE

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CHAPTER 1

STRATEGIC MANAGEMENT

INTRODUCTION

Strategic management can be is the art and science of formulating, implementing, and evaluating cross-functional decisions that enable an organization to achieve its objectives. Strategic management focuses on integrating management, marketing, finance, operations, research and development, and information systems to achieve organizational success. The purpose of strategic management is to exploit and create new and different opportunities for tomorrow. A strategic plan is, in essence, a company's game plan. Just as a cricket team needs a good game plan to have a chance for success, a company must have a good strategic plan to compete successfully. Profit margins among firms in most industries have been so reduced by the global economic crisis that there is little room for error in the overall strategic plan. A strategic plan results from tough managerial choices among numerous good alternatives, and it signals commitment to specific markets, policies, procedures, and operations.

STRATEGY

The word strategy is derived from the Greek word strategos, (meaning army) and ago (meaning leading /moving). Strategy is an action that managers take to attain one or more of the organisation's goals. A strategy is all about integrating organizational activities and utilizing and allocating the scarce resources within the organizational environment so as to meet the present objectives.

Where are the business trying to get to in the long-term (direction), which markets should a business competing in and what kind of activities is involved in such markets? (Markets; scope), How can the business perform better than the competition in those markets? (Advantage), what resources (skills, assets, finance, relationships, technical competence, and facilities) are required in order to be able to compete? (Resources), what external, environmental factors affect the businesses' ability to compete? (Environment), what are the values and expectations of those who have power in and around the business? (Stakeholders).

A few definitions stated below may clarify the concept of Business strategy

Kenneth Andrews "The pattern of objectives, purpose, goals and the major policies and plans for achieving these goals stated in such a way so as to define what business the company is in or is to be and the kind of company it is or is to be"

Igor Ansoff explained the concept of strategy as "the common thread among the organizations, activities and product markets that defines the essential nature of business that the organization was or planned to be in future".

A few aspects regarding the nature of strategy are as follows:

1. Strategy is concerned with pursuing those activities which move an organization - from its current position to a planned future position
2. It is concerned with the resources necessary for implementing a plan or a predetermined course of action.
3. It is a plan or course of action or a set of decision rules.
4. It is derived from its policies, objectives and goals.

THE CONCEPT OF STRATEGIC MANAGEMENT



The term "Strategic Management" is gaining importance in the era of privatisation, globalization and liberalisation. Strategic management is the process of specifying the organization's objectives, developing policies and plans to achieve these objectives, and allocating resources to implement the policies and plans to achieve the organization's objectives. Strategic management, therefore, combines the activities of the various functional areas of a business to achieve organizational objectives. It is the highest level of managerial activity, usually formulated by the Board of Directors and performed by the organization's Chief Executive Officer (CEO) and executive team. Strategic management provides overall direction to the enterprise and is closely related to the field of organization Studies.

Strategic management techniques can be viewed as bottom-up, top-down or collaborative processes. In the bottom-up approach, employees submit proposals to their managers who, in turn, funnel the best ideas further up the organization. This is often accomplished by a capital budgeting process. Proposals are assessed using financial criteria such as return on investment or cost benefit analysis. The proposals that are approved form the substance of a new strategy, all of which is done without a grand strategic design or a strategic architect. The top-down approach is the most common by far. In it, the CEO possibly with the assistance of a strategic planning team, decides on the overall direction the company should take. Some organizations are starting to experiment with collaborative strategic planning techniques that recognize the emergent nature of strategic decisions.

The twenty fifth National Business Conference sponsored by the Harvard Business School Association in 1955 made one of the earliest attempts to discuss the concept of strategy. In 1965, Ansoff published a book "Business Strategy" which was based on his experiences at the Lockheed Aircraft Corporation. Chandler's historical study of the development of some of the American enterprises proposed strategy as one of the most important variables in the study of organizations. From the literature on strategic management, it is evident that strategic planning refers to the management processes in organizations through which the future impact of change is determined and current decisions are made to reach a designed future. In business parlance, there is no definite meaning assigned to strategy.

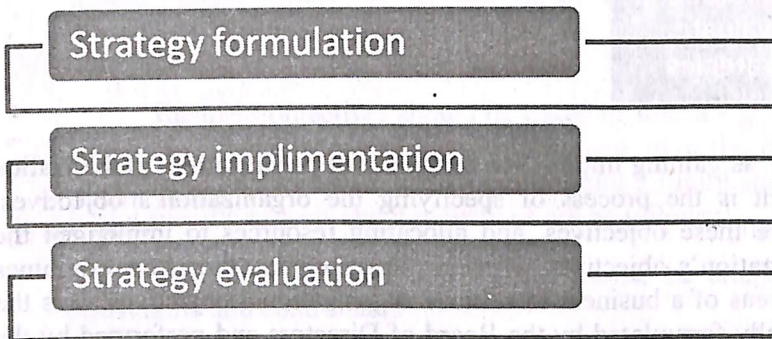
Alfred Chandler (1962) "The determination of the basic long-term goals and objectives for an enterprise and the adoption of action and the allocation of resources necessary for carrying out these goals".

FEATURES

1. Strategic Management is related mostly to external environment.
2. Strategic Management is being formulated at the higher level of management. At operational level, operational strategies are also formulated.
3. Strategic Management integrates three distinct and closely related activities in strategy making. The activities are strategic planning, strategic implementation and strategic evaluation and control.

4. Strategic Management is related to long term.
5. It requires systems and norms for its efficient adoption in any organization.
6. It provides overall frame work for guiding enterprise thinking and action.
7. It is concerned with a unified direction and efficient allocation of organization resources.
8. Strategic Management provides an integrated approach for the organization and aids in meeting the challenges posed by environment.

STRATEGIC MANAGEMENT PROCESS



The strategic management formulation and implementation methods vary with product profile, Company profile, environment within and outside the organization and various other factors. Large organizations which use sophisticated planning use detailed strategic management Models whereas smaller organizations where formality is low use simpler models. Small businesses concentrate on planning steps compared to larger companies in the same industry. Large firms have diverse products, operations, markets, and technologies and hence they have to essentially use complex systems. In spite of the fact that companies have different structures, systems, product profiles, etc, various components of models used for analysis of strategic management are quite similar. You must have observed that different thinkers have defined business strategy differently, yet there are some common elements in the way it is defined and understood. The strategic management consists of different phases, which are sequential in nature.

The strategic-management process consists of three stages:

1. Strategy formulation
2. Strategy implementation, and
3. Strategy evaluation.

Strategy formulation includes developing a vision and mission, identifying an organization's external opportunities and threats, determining internal strengths and weaknesses, establishing long-term objectives, generating alternative strategies, and choosing particular strategies to pursue. Strategy-formulation issues include deciding what new businesses to enter, what businesses to pursue, how to allocate resources, whether to expand operations or diversify, whether to enter international markets, whether to merge or form a joint venture, and how to avoid a hostile takeover. Because no organization has unlimited resources, strategists must decide which alternative strategies will benefit the firm most. Strategy-formulation decisions commit an organization to specific products, markets, resources, and technologies over an extended period of time. Strategies determine long-term competitive advantages. For better or worse, strategic decisions have major multifunctional consequences and enduring effects on an organization. Top managers have the best perspective to understand fully the ramifications of strategy-formulation decisions; they have the authority to commit the resources necessary for implementation. Strategy implementation requires a firm to establish annual objectives, devise policies, motivate

employees, and allocate resources so that formulated strategies can be executed. Strategy implementation includes developing a strategy-supportive culture, creating an effective organizational structure, redirecting marketing efforts, preparing budgets, developing and utilizing information systems, and linking employee compensation to organizational performance.

Strategy implementation often is called the “action stage” of strategic management. Implementing strategy means mobilizing employees and managers to put formulated strategies into action. Often considered to be the most difficult stage in strategic management, strategy implementation requires personal discipline, commitment, and sacrifice. Successful strategy implementation hinges upon managers’ ability to motivate employees, which is more an art than a science. Strategies formulated but not implemented serve no useful purpose. Interpersonal skills are especially critical for successful strategy implementation. Strategy-implementation activities affect all employees and managers in an organization. Every division and department must decide on answers to questions, such as “What must we do to implement our part of the organization’s strategy?” and “How best can we get the job done?” The challenge of implementation is to stimulate managers and employees throughout an organization to work with pride and enthusiasm toward achieving stated objectives. Strategy evaluation is the final stage in strategic management. Managers desperately need to know when particular strategies are not working well; strategy evaluation is the primary means for obtaining this information. All strategies are subject to future modification because external and internal factors are constantly changing.

Three fundamental strategy-evaluation activities are

- reviewing external and internal factors that are the bases for current strategies,
- measuring performance, and
- taking corrective actions.

Strategy evaluation is needed because success today is no guarantee of success tomorrow! Success always creates new and different problems; complacent organizations experience demise. Strategy formulation, implementation, and evaluation activities occur at three hierarchical levels in a large organization: corporate, divisional or strategic business unit, and functional. By fostering communication and interaction among managers and employees across hierarchical levels, strategic management helps a firm function as a competitive team. Most small businesses and some large businesses do not have divisions or strategic business units; they have only the corporate and functional levels. Nevertheless, managers and employees at these two levels should be actively involved in strategic-management activities. Peter Drucker says the prime task of strategic management is thinking through the overall mission of a business

The process takes place in the following stages:

1. The Strategic Planner has to define what is intended to be accomplished (not just desired). This will help in defining the objectives, strategies and policies.
2. In the light of stage I, the results of the current performance of the organization are documented.
3. The Board of Directors and the top management will have to review the current performance of the documented.
4. In view of the review, the organization will have to scan the internal environment for strengths and weaknesses and the external environment for opportunities and threats.
5. The internal and external scan helps in selecting the strategic factors.
6. These have to be reviewed and redefined in relation to the Mission and Objectives.
7. At this stage a set of strategic alternatives and generated.
8. The best strategic alternative is selected and implemented through programmed budgets and procedures.

9. Monitoring, evaluation and review of the strategic alternative chosen is undertaken in this mode. This can provide a feedback on the changes in the implementation if required.

COMPONENTS OF STRATEGIC MANAGEMENT

The major components of Business strategy are purpose and objectives, competitive advantage, synergy, personal aspirations and social obligations. AP Soff has used the term "common thread" for the purpose. According to him, the common thread is a statement of relationship between present and future product market postures. In this section, the different components of Business strategy are discussed.

Objectives:

Business objectives should be stated in such a way so that they may provide a clear idea about the scope of the enterprise's business. Objectives give the direction for which action plan is formulated. Objectives are open-ended attributes denoting a future state. Objectives translate the purpose into goals. A few specific aspects about objectives are as follows:

The objectives must have time frame, be attainable, be challenging, be Understandable, be measurable and controllable

For having clarity in objectives, the business domain is defined specifically in terms of a product class, technology, customer group, market need or some other combination.

Competitive Advantage:

Business strategy is relative by nature. In the formulation of Business strategy, the management should isolate unique features of the organization. The steps to be taken must be competitively superior. While making plans, competitors may be ignored. However, when we formulate Business strategies, we cannot ignore competitors. If all organization does not look at competitive advantage, it cannot survive in a dynamic environment. Tills aspect builds internal strength of the organization and enhances the quality of Business strategy.

Synergy

Synergy means measurement of the firm's capability to take advantage of a new product market move. If decisions are made in the same direction to accomplish the objectives there will be synergic impacts. The Business strategy will give the synergy benefit.

Personal aspirations

Personal aspirations are the goals people want to achieve or the things people would like to have in the life. Aspirations of the people in the organizations play a significant role in the process of strategic management.

Social obligations

It is the informal need to give back to the society. It is based on the prescribed social etiquette. These are established over time based on social norms. Some of the ways in which companies meet social obligations include donating to local charities, participating in community events and being transparent with the public.

FUNCTIONS OF STRATEGIC MANAGEMENT

Strategic Management performs the following functions:

1. It provides a dual approach to problem solving. Firstly, it exploits the most effective means to overcome difficulties and face competition. Secondly, it assists in the deployment of scarce resources among critical activities.
2. It focuses attention upon changes in the organizational set up, administration of organizational process affecting behavior and the development of effective leadership.
3. It offers a technique to manage changes. The management is totally prepared to anticipate and influence to look at changes. It also offers a different way of thinking.
4. It furnishes the management with a perspective whereby, the latter gives equal importance to present and future opportunities.
5. It provides the management with a mechanism to cope with highly complex environment characterized by diversity of cultural, social, political and competitive forces.

APPROACHES TO STRATEGIC MANAGEMENT

There are two approaches.

I-The Industrial Organizational Approach

This approach is based on economic theory. It focuses mainly on the profit maximization objective of a business entity. It deals with issues like competitive rivalry, resource allocation, economies of scale etc. Assumptions include rationality, self discipline and profit maximization. An example of a company that currently operates this way is General Motors.

II-The Sociological Approach

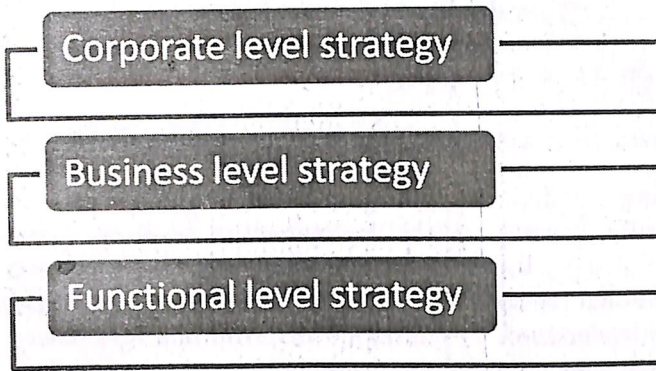
The approach deals primarily with human interactions. Human element of every organization is considered in this approach. Assumptions include bounded rationality, satisfying behaviour, profit sub-optimality. An example of a company that currently operates this way is Google.

Benefits of strategic management

1. Enhanced Communication through dialogue and participation
2. Deeper/Improved Understanding of others' views and of what the firm is doing/planning and why
3. Greater Commitment
 - to achieve objectives
 - to implement strategies
 - to work hard

LEVELS OF STRATEGY

Strategy may operate at different levels of an organisation-corporate level, business level, and functional level. The strategy may change based on the levels of strategy.



1. Corporate level strategy (Group level)

This strategy occupies the highest level of strategic decision making and covers actions dealing with the objective of the firm, acquisition and allocation of resources and coordination of strategies of various SBU's for optimal performance. Top management of the organization makes such decision.

2. Business level strategy (Company level)

Applicable in those organizations which have different businesses and each business is treated as separate strategic business unit. Reliance industries limited operates in textile fabrics, yarns, fibers, petrochemical products etc. For each product groups the nature of market in terms of customers, competition, and marketing channel differs.

3. Functional level strategy (Department level)

As suggested by title relates to a single functional operation and the activities involved therein. These decisions are often referred as tactics. It deals with relatively restricted plan providing objectives for specific action, allocation of resources among different operations within the functional area and coordination between them for the optimal contribution towards the achievement of business level and corporate level strategies. Marketing strategy is an example of a functional strategy

THE STRATEGISTS

Strategists are the individuals who are most responsible for the success or failure of an organization. Strategists have various job titles, such as chief executive officer, president, and owner, chair of the board, executive director, chancellor, dean, or entrepreneur. Jay Conger, professor of organizational behavior at the London Business School and author of Building Leaders says, "All strategists have to be chief learning officers. We are in an extended period of change. If our leaders aren't highly adaptive and great models during this period, then our companies won't adapt either, because ultimately leadership is about being a role model." Strategists help an organization gather, analyze, and organize information. They track industry and competitive trends, develop forecasting models and scenario analyses, evaluate corporate and divisional performance, spot emerging market opportunities, identify business threats, and develop creative action plans. Strategic planners usually serve in a support or staff role. Usually found in higher levels of management, they typically have considerable authority for decision making in the firm. The CEO is the most visible and critical strategic manager. Any manager who has responsibility for a unit or division, responsibility for profit and loss outcomes, or direct authority over a major piece of the business is a strategic manager (strategist). In the last five years, the position of chief strategy officer (CSO) has emerged as a new addition to the top management ranks of many organizations, including ITC, Lenovo, IBM, Alphabet, Tata Tea, Bajaj Finserv etc.

Strategists differ in their attitudes, values, ethics, willingness to take risks, concern for social responsibility, concern for profitability, concern for short-run versus long-run aims, and management style. The founder of Hershey Foods, Milton Hershey, built the company to manage an orphanage. From corporate profits, Hershey Foods today cares for over a thousand boys and girls in its School for Orphans.

CHAPTER II

BUSINESS VISION AND MISSION

BUSINESS VISION

We can perhaps best understand vision and mission by focusing on a business when it is first started. In the beginning, a new business is simply a collection of ideas. Starting a new business rests on a set of beliefs that the new organization can offer some product or service to some customers, in some geographic area, using some type of technology, at a profitable price. A new business owner typically believes that the management philosophy of the new enterprise will result in a favorable public image and that this concept of the business can be communicated to, and will be adopted by, important constituencies. When the set of beliefs about a business at its inception is put into writing, the resulting document mirrors the same basic ideas that underlie the vision and mission statements. As a business grows, owners or managers find it necessary to revise the founding set of beliefs, but those original ideas usually are reflected in the revised statements of vision and mission. Vision and mission statements often can be found in the front of annual reports. They often are displayed throughout a firm's premises and are distributed with company information sent to constituencies.

What Do We Want to Become? It is especially important for managers and executives in any organization to agree on the basic vision that the firm strives to achieve in the long term. A vision statement should answer the basic question, "What do we want to become?" A clear vision provides the foundation for developing a comprehensive mission statement. Many organizations have both a vision and mission statement, but the vision statement should be established first and foremost. The vision statement should be short, preferably one sentence, and as many managers as possible should have input into developing the statement.

Vision is a descriptive image of what a company wants to be or want to be known for. Vision reminds us of what the goals are. Without vision performance of the business are likely to be affected. A vision is a statement for where the organization is heading over the next five to ten years. It is the statement that indicates mission to be accomplished by the management distant future.

Warren Bennis and Burt Nanus described the role of vision as follows "To choose a direction, a leader must first have developed a mental image of a possible and desirable future state of the organization which we call a vision. With a vision, the leader provides the all important bridge from the present to the future of the organization".

Examples:

Tyson Foods' vision is to be the world's first choice for protein solutions while maximizing shareholder value. (Good statement, unless Tyson provides non protein products)

General Motors' vision is to be the world leader in transportation products and related services. (Good statement)

PepsiCo's responsibility is to continually improve all aspects of the world in which we operate— environment, social, economic— creating a better tomorrow than today (Statement is too vague; it should reveal beverage and food business)

Dell's vision is to create a company culture where environmental excellence is second nature (Statement is too vague; it should reveal computer business in some manner; the word environmental is generally used to refer to natural environment so is unclear in its use here)

Samsonite's vision is to provide innovative solutions for the traveling world. (Statement needs to be more specific, perhaps mention luggage; statement as is could refer to air carriers or cruise lines, which is not good)

BUSINESS MISSION

A Business organization cannot set objectives without mission statement. Therefore, it is of utmost importance to frame a mission statement. Many organizations define the basic reason for their existence in terms of a mission statement. An organization's mission includes both a statement of organizational philosophy and purpose. The mission can be seen as a link between performing some social function and attaining objectives of the organization. In military circles, the word "Mission" is used instead of objectives. It also denotes an end point of the activities which doer wants to fulfill. In business management terminology, a mission is an objective that has been psychologically accepted by the doer. A mission explains the reason for the existence and operation of an enterprise. It is a key statement that provides guidelines for the company's business objectives. Mission indicates what is the company's business and what should it be. It reflects the company's philosophy and values.

Organizations often commit their major goals and corporate philosophy to writing in a Mission Statement or a statement of purpose. Though varied in its structure and form, the statement typically describes the company's reasons for existing. It also sometimes outlines the "core values" on which the organization is based and to which it expects corporate behaviour to conform.

A good mission statement outlines customer needs and utilities. It places emphasis on public need rather than the company product e.g. Oil and Natural Gas Commission and the Indian Oil Company may stress that they are meeting the energy need of the people rather than producing and selling oil or gas. Similarly, the Bharat Sanchar Nigam Ltd. (BSNL) may emphasize that it is helping better and faster communications and not merely selling or operating telephones.

Some firms use mission statement to develop core principles or norms which guide decision making or behaviour. These principles serve as guidelines for a company's course of business as well as strategic decision making or behaviour. Business definition statement is a part of the mission statement. It means a description of products, services, functions, activities and markets of the firm. In any good strategy formulation, mission must be imbibed in the management and the staff. Clarity of a mission statement and publicity given to it on the right lines would get the conveying of mission in a convincing manner to the staff.

A clear mission statement is essential for effectively establishing objectives and formulating strategies. Sometimes called a creed statement, a statement of purpose, a statement of philosophy, a statement of beliefs, a statement of business principles, or a statement "defining our business, a mission statement reveals what an organization wants to be and whom it wants to serve. All organizations have a reason for being, even if strategists have not consciously transformed this reason into writing. Statements of mission and vision are widely recognized by both practitioners and academicians as the first step in strategic management.

One has the following to say about mission statements: A business mission is the foundation for policies, strategies, plans, and work assignments. It is the starting point for the design of managerial jobs and, above all, for the design of managerial structures. Nothing may seem simpler or more obvious than to know what a company's business is. A steel mill makes steel, a railroad runs trains to carry freight and passengers, an insurance company underwrites fire risks, and a bank lends money. Actually, "What is our business?" is almost always a difficult question and the right answer is usually anything but obvious. The answer to this question is the first responsibility of strategists. Only strategists can make sure that this question receives the attention it deserves and that the answer makes sense and enables the business to plot its course and set its objectives.

Mission Statement Components:

Mission statements can and do vary in length, content, format, and specificity. Most practitioners and academicians of strategic management feel that an effective statement should include nine components. Because a mission statement is often the most visible and public part of the strategic-management process, it is important that it includes the nine characteristics

1. Customers—who are the firm’s customers?
2. Products or services—what are the firm’s major products or services?
3. Markets—geographically, where does the firm compete?
4. Technology—is the firm technologically current?
5. Concern for survival, growth, and profitability—is the firm committed to growth and financial soundness?
6. Philosophy—what are the basic beliefs, values, aspirations, and ethical priorities of the firm?
7. Self-concept—what is the firm’s distinctive competence or major competitive advantage?
8. Concern for public image—Is the firm responsive to social, community, and environmental concerns?
9. Concern for employees—Are employees a valuable asset of the firm?

Examples:

1. Fleetwood Enterprises will lead the recreational vehicle and manufactured housing industries in providing quality products, with a passion for customer-driven innovation. We will emphasize training, embrace diversity and provide growth opportunities for our associates and our dealers. We will lead our industries in the application of appropriate technologies. We will operate at the highest levels of ethics and compliance with a focus on exemplary corporate governance. We will deliver value to our shareholders, positive operating results and industry-leading earnings. (Statement lacks two components: Markets and Concern for Public Image)
2. PepsiCo the world’s premier consumer Products Company, focused on convenient foods and beverages. We seek to produce healthy financial rewards for investors as we provide opportunities for growth and enrichment to our employees, our business partners and the communities in which we operate. And in everything we do, we strive to act with honesty, openness, fairness and integrity. (Comment: Statement lacks three components: Customers, Technology, and Self-Concept)
3. Dell’s mission is to be the most successful computer company in the world at delivering the best customer experience in markets we serve. In doing so, Dell will meet customer expectations of highest quality; leading technology; competitive pricing; individual and company accountability; best-in-class service and support; flexible customization capability; superior corporate citizenship; financial stability. (Statement lacks only one component: Concern for Employees)
4. Procter & Gamble will provide branded products and services of superior quality and value that improve the lives of the world’s consumers. As a result, consumers will reward us with industry leadership in sales, profit, and value creation, allowing our people, our shareholders, and the communities in which we live and work to prosper.

Benefits of having a clear mission and vision

1. Achieve clarity of purpose among all managers and employees.
2. Provide a basis for all other strategic planning activities,
3. Provide direction.
4. Provide a focal point for all stakeholders of the firm.
5. Resolve divergent views among managers.

6. Promote a sense of shared expectations among all managers and employees.
7. Project a sense of worth and intent to all stakeholders.
8. Project an organized, motivated organization worthy of support.
9. Achieve higher organizational performance.
10. Achieve synergy among all managers and employees.

BUSINESS OBJECTIVES

An objective is something aimed at or something sought for. It is nothing but the goal or destination of the organization. Objectives should be very clearly spelt out, as clearer the objectives the more the strength one derives to achieve them. The organization should see to it that while fixing business objectives interest of all groups should be considered and under no circumstance should it be sacrificed for others.

According to George Terry- "A Managerial objectives is the intended goal which prescribes definite scope and suggests direction to efforts of a manager".

According to D. E. McFarland- "Objectives are the goals, aims or purposes that organizations wish to achieve over varying period of time".

FEATURES OF BUSINESS OBJECTIVES

1. **Ultimate goals:** Objectives are the aims; goals and the destination where the organization wants to go. Objectives differentiate one company from others. Every organization must have a clearly defined objective, e.g. a marketing objective of an organization may be to increase its profits by 5% or increase its market share by 3%.
2. **Future Oriented:** Objectives are future destinations which the organization wants to reach. However these objectives are finalized after considering the past trends and the past performance of the organization. This is necessary in order to formulate realistic objectives.
3. **Guides principles:** Whether economic, social or human objectives guide the organization in taking relevant and quick decisions. Objectives guide in formulating the policies, the programmes and the plans which in turn guide the employees while implementing the plans in order to achieve the objectives.
4. **Complex:** Business environment is very complex. Change in one environment may have different impacts on the other environmental factors. Moreover these environmental factors are uncontrollable. Objectives have to be modified continuously in order to suit the changed environment. Thus dynamic environment makes setting of objectives difficult.
5. **Qualitative/Quantitative:** There are certain objectives which are of qualitative nature, especially advertising objectives. Advertising objectives can be creating awareness, changing attitudes, perceptions, enabling recognition of the brand etc. Qualitative objectives are therefore difficult to measure. Quantitative objectives are those which can be measured in volume or value terms. Marketing objectives are generally of quantitative in nature. Some of the common marketing objectives are increasing sales, increasing market share, increasing profits etc.
7. **Hierarchical:** All objectives may not be equally important at a given moment of time, for instance if the organization is new, its objective generally is survival, rather than growth or achieving prestige and recognition. However since many groups are involved like shareholders, creditors, employees etc. identifying proper hierarchy is difficult.

IMPORTANCE OF BUSINESS OBJECTIVES

1. **Identity to the organization:** Every organization must have an objective. In fact it is the objectives that justify an organization's existence. Outwardly all organizations may be similar but what differentiate one organization from another are its objectives.
2. **Facilitates co-ordination:** There are various departments in an organization. Success of any organization depends upon the achievements of each department, which in turn depends upon the proper co-ordination between people and functions of different departments. This would enable the different department to work as a cohesive unit.
3. **Guides decision-making:** The top management has to take number of decisions in different areas every day. Decisions can be relating to extending the product line or changing the pricing structure or the place of sale. Decisions depend entirely upon the objectives of the organization. So, it is the objectives that guide individual as well as group decision making.
4. **Motivation:** Motivation is the simulation to work with zeal and enthusiasm. When objectives are clear, the employees know what is expected of them and the reward which they would earn on achieving those objectives. Clear definition of business objectives motivates employees to put in their best efforts as they are aware as to what to achieve.
5. **Ensures planning:** It is said that most people don't succeed in life because they don't know what they want to achieve. One can plan properly only when one knows what one wants to achieve. Moreover implementation would be effective only if it is planned properly. Therefore objectives ensure proper planning.
6. **Reduces wastage:** Objectives facilitate preparing programmes and schedules for achieving the predetermined goals. Men, money, materials etc. are scarce. Success of a business organization depends upon the effective utilization of the resources. So to the extent possible wastage of resources should be avoided.

GOALS

Goals are used to help a business grow and achieve its objectives. They can be used to foster teamwork and help the business describe what it wants to accomplish. Setting goals is an important part of any business plan.

Business Goals

Part of the planning process, business goals describe what a company expects to accomplish over a specific period of time. Businesses usually outline their goals and objectives in their business plans. Goals might pertain to the company as a whole, departments, employees, customers, or any other area of the business.

The Importance of Business Goals

Businesses should not fear setting goals because there is absolutely no downside to the process. Goals give a business direction and help measure results. There are four detailed and important reasons why a business should have goals.

1. **Measure success** - Good organizations should always be trying to improve, grow, and become more efficient. Setting goals provides the clearest way to measure the success of the company.
2. **Leadership cohesion** - Setting goals ensures that everyone understands what the organization is trying to achieve. When the leadership team clearly understands what the business is trying to accomplish, it provides greater rationale for the decisions management might make regarding hiring, acquisitions, incentives, sales programs, etc.
3. **Knowledge is power** - If an employee knows and understands the goals, it becomes easier for him or her to make daily decisions based on the long- and short-term goals that were established.

4. **Reassess goals** - When goals are set, they can be monitored on a regular basis to verify the business is headed in the right direction. If the business is not achieving or moving towards accomplishing its goals, then changes or adjustments need to be made.

Pitfalls of Developing Business Goals

Setting business goals can go wrong if not done correctly. Seasoned business managers put a great deal of time and energy into developing and implementing business goals. There are two big pitfalls a business manager should try to avoid.

1. **Setting unrealistically high goals** - When a goal is perceived to be unreachable, no effort will be made by the employees to achieve them. A businessperson needs to set realistic goals so that the employees can come together as a team to achieve them.
2. **Setting vague and ambiguous goals** - Goals that are not specific enough do not lead to action and are useless. If achievements cannot be measured against the businesses expectations, then a manager cannot observe any progress towards the goal.

Measuring the Success of Business Goals

Establishing goals is only half the work in a business plan. Once the goals have been explained to the employees and a plan has been developed to achieve those goals, it is important to review those goals at certain times during the year. A business manager needs to take a 'time-out' every so often and ask him or herself the following questions:

- Is the business on target to achieve our goals?
- Is a course direction needed to get the business closer to achieving the goals?
- Are the goals still relevant with the ever-changing business world we live in?
- Are the employees still focused on helping the business achieve its goals?

The answers to these questions will help management decide if corrective action is needed. For example, if a business is not headed in the right direction, the manager might want to get all the employees together to review what is happening and make changes to help achieve the goals. Whether the management is good or bad, it still needs to keep the employees informed about how the business is performing and how the employees are doing with respect to the goals.

CHAPTER III

ENVIRONMENT ANALYSIS

Business Environment consists of all those forces both internal and external that affect the working of a business. It refers to the conditions, forces, events and situations within which business enterprises have to operate. Business and its environment are closely related and the effectiveness of interaction of the two determines the success or failure of a business.

According to Wheeler -“Business Environment is the total of all things external to firms and individuals, which affect their organization and operations”.

COMPONENTS OF BUSINESS ENVIRONMENT

The business environment can be broadly divided into two groups

A. Internal Environment B. External Environment

A. Internal Environment: internal environment includes all those factors and forces which exists within the business organization. These factors are controllable. These include factors such as

1. **Management Philosophy:** The management philosophy greatly influences the working of business firm. The management may adopt a traditional philosophy or a professional philosophy. Nowadays business firm needs to adopt professional approach. A proper analysis of internal environment will reveal the weaknesses of the traditional approach and force the management to adopt a professional approach.

2. **Mission and Objectives:** It is always advisable to frame a mission statement and then to list out the various objectives. An analysis of internal environment will enable the firm to find out whether the objectives are in line with the mission statement and whether the objectives are accomplished or not.

3. **Human Resources:** The survival and success of the firm largely depends on the quality of human resources. An analysis of internal environment in respect of human resources would reveal the shortcomings of human resources and as such measures can be taken to correct such weaknesses.

4. **Physical Resources:** Physical resources include machines, equipments, building, furniture etc. A firm needs adequate and quality physical resources. An analysis of the internal environment may reveal the weaknesses of the physical resources and company can take appropriate measures to correct such weaknesses.

5. **Financial Resources:** A firm needs adequate working capital as well a fixed capital. There is a need to have proper management of working capital and fixed capital. An analysis of the internal environment will help to make optimum use of available funds as well as to raise additional funds.

6. **Corporate Image:** A firm should develop, maintain and enhance a good image in the minds of the employees, investors, customers and others. Poor corporate image is a weakness. An analysis of the internal environment enables the firm to build good public image.

7. **Research and Development facilities:** If the organization has adequate research and development facilities, it is in a position to innovate, introduce new products and services continuously. This enables the firm to remain ahead of the competition

8. **Internal Relationship:** There should be a proper flow of vertical and horizontal communication i.e. between superiors and subordinates and between colleagues at the same level. A free flow of ideas enables a healthy relationship between colleagues.

B. **External Environment:** External environment includes all those factors and forces which are external to the business organization. These include factors such as economic, socio-cultural, legal, demographic etc. These factors are beyond the control of the company.

1. **Demographic Environment:** Demographic environment studies human population with reference to its size, density, literacy rate, sex-ratio, age composition etc. These factors affect the demand for goods and services, quantity and quality of production, distribution etc. e.g. a rapidly growing population indicates growing demand for many products.

2. **Natural Environment:** Business firms use natural resources like water, land, iron, crude oil etc. All business units are directly or indirectly dependent upon natural environment. Business firms are responsible for ecological imbalance. So they should take necessary measures to control pollution. Business operations have caused considerable changes in ecological balance and natural environment of the country. The applications of modern technology in industry leads to rapid economic growth at a huge social cost as measured by the deterioration of physical environment i.e. air pollution, water pollution, noise pollution etc. So a business enterprise has to calculate net social cost of its venture.

3. **Economic Environment:** A business firm closely interacts with its economic environment. Economic environment is generally related to those external forces, which have direct economic effect upon business. Economic environment is a sum total of

a. Economic conditions in the market

b. Economic policies of the government

c. Economic system of the country.

a. **Economic conditions:** It includes nature of economy, the stage in economic development, national income, per capita income etc. These operate in the market and influence the demand and supply of goods and services.

b. **Economic policies:** Economic policies mean policies formulated by the government to shape the economy of the country. These include monetary and fiscal policies, export-import policy, industrial policy, licensing policy, budgetary policy etc. The economic policies of the Government affect the business. This impact may be positive or negative e.g. liberalization of the economy has adversely affected the small scale industry in India.

c. **Economic systems:** Economic systems means the classification of economies on the basis of role of the government in the functioning of the economy. Economic system can be classified as

Capitalist Economy – There exist least government control in regulating the working of a market. E.g: United States of America.

Socialist Economy– The government has major control over all activities E.g: China.

Mixed Economy– It combines the features of both capitalist and socialist economy where both private and public sector play an equally important role E.g: India.

4. **Legal Environment / Regulatory Environment:** Legal environment includes laws, which define and protect the fundamental rights individuals and organizations. It creates a framework of rules and regulations within which business units have to operate. Business firm must have up to date and complete knowledge of the laws governing production and distribution of goods and services. Some of the important laws are

Indian Companies Act, 2013

The Consumer Protection Act, 1986
The Competition Act, 2002
The Essential commodities Act, 1955
Foreign Exchange Management Act, 2000 etc...

5. **Political Environment:** It refers to the influence exerted by three political institutions namely the legislature, the executive and the judiciary in developing and controlling business activities. Business decisions are greatly influenced by the developments in the political environment. A change in the government brings about a change in attitude, preference, objectives etc. Business firms need to keep a track of all political events, anticipate changes in government policies and frame production and marketing strategies accordingly. Factors include attitude towards foreign companies, laws on hiring and promotion, Stability of the government, political ideology of the ruling party etc

6. **Cultural Environment:** Every society has a culture of its own. Culture includes knowledge, belief, art, morals, laws, customs and other capabilities and habits acquired by an individual as a member of society. Cultural values are passed on from one generation to another. Culture thus determines the types of goods and services a business should produce. Business should realize the cultural differences and bring out products accordingly. Cultural factors consists of life style changes, career expectations, consumer activism, rate of family formation, growth rate of population, regional shifts in population, life expectancies, birth rates etc.

Failure of Wal-Mart in Latin American countries relates to the cultural differences in that part of the world. Wal-Mart failed to understand that on time.

7. **Technological Environment:** Technology is the systematic application of scientific or other organized knowledge to practical tasks. Technological advancement makes it possible to improve the quality of products, increase the output and decrease the cost of product. Technological changes are rapid and to keep pace with it, businessmen need to be alert and flexible in order to quickly incorporate them in their business organization so as to survive and succeed in the competitive business world. Technological factors include Government spending for R&D, Technological efforts, Patent protection, New products, Technology transfer, Automation, Internet availability, Infrastructure

8. **International Environment:** The international environment is an outcome of political and economic conditions in the international market. Business firms engaged in the foreign trade are more affected by the changes in the international environment factors like war, civil disturbances, political instability, changes in trade policies in other countries with which India has trading links do affect Indian exporters and importers. Therefore, business firms, which cater to foreign trade, must constantly monitor implications of international environment on their business. The components of international environment are

- Foreign trade policy
- Rules and regulations lay down by International Institutions like IMF, World Bank etc.
- The policies of trading blocs like European Union, Latin American Free Trade Area, and Association of South East Asian Nations etc...
- Foreign exchange regulations like tariffs and non tariff barriers.
- Trade cycle like boom, recession at world level

The interaction of these four environmental dimensions creates further sub- dimensions such as political and economic environments that act as a filter between the internal and external environment and profoundly affect the performance of the corporation

ENVIRONMENT ANALYSIS

Environmental Analysis is the process by which corporate planners monitor the economic, governmental, supplier technological and market settings to determine the opportunities for and threats to their enterprise. The importance of Environmental Analysis lies in its usefulness for evaluating the present strategy, setting strategic objectives and formulating strategies. Environmental Analysis gives the strategic manager time to anticipate opportunities and to plan alternative responses to those opportunities. It also helps them to develop an early warning system to present threats or develop strategies, which can turn a threat to the organizations advantage. Here we will take examples of some American firms. In the last few decades almost half of the 100 largest American firms became significantly less important to the society due to their failure in anticipating environmental changes. Standard chartered Bank is the oldest foreign bank operating in India missed the bus in exploiting the opportunities that suddenly opened for MNC Banks in India in the eighties. In an interview to "Business India" the Chief Officer of the bank stated that, "a lack of direction, a lack of focus and the absence of a clear perception of business opportunities available in the environment has left the bank behind".

Scanning of environment is necessary before the planning exercise is carried out. Also the behaviour of the environment has to be understood as the response depends upon these behaviour situations. Environmental scanning is understood in simple words by an example where a boy has to cross a busy road in a metro city in reaching a goal and he tries to have a visual scan, looks for an opportunity, which he may be able to use or not, analysis possible threats due to police, traffic speed or the risk situation in the middle of the road and only then makes a strategy to cross. An environmental analysis plays an essential role in business management by providing possible opportunities or threats outside the company in its external environment. The purpose of an environmental analysis is to help to develop a plan by keeping decision-makers within an organization. The changes can be including exchanging of executive parties, increasing guidelines to decrease pollution, technological developments, and fluctuating demographics. An environment analysis helps the industries to improve the outline of their environment to find more opportunities or threats.

CHAPTER IV

ENVIRONMENTAL SCANNING

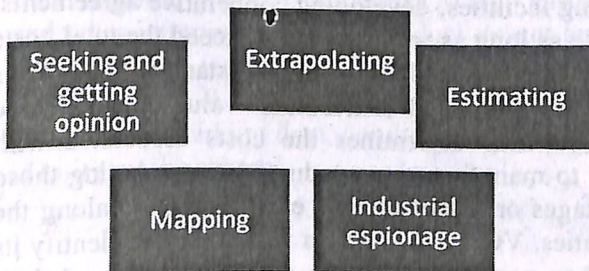
Environmental Scanning means an examination and study of the environment of a business unit in order to identify its survival and prosperity chances. It means observing the business environment both external and internal and understanding its implications for business opportunities. It also involves knowing beforehand the risks and uncertainties as well as threats to the business unit. As business environment is dynamic in nature, it is always changing environmental scanning has to be quick and regular. It should not be one time act to scan the environment. It is the constant telescoping of external environment and micro scoping of internal environment. Environmental Scanning provides broader prospective to corporate planners in formulating plans and strategies. Environmental scanning is the monitoring, evaluating, and disseminating of information from the external and internal environment to key people within the corporation. In short, the process by which organizations monitor their relevant environment to identify opportunities and threats affecting their business is known as environmental scanning.

NEED FOR ENVIRONMENTAL SCANNING

Environmental Scanning is essential because of following reasons:

- 1) **Prime Influence** – Environment is a prime influence on the effectiveness of business strategies. If strategic planning is done without considering environment, it is likely to be defective. Besides, the success of the implementation of the strategy depends on the environmental factors.
- 2) **A tool to anticipate Changes** – Environmental scanning is a very useful tool not only to understand business surroundings, but also as a good instrument to anticipate the changes and be prepared to face the challenges of such changes.
- 3) **Time for adjustment** – A business unit cannot change the business activities overnight. It needs time to adjust with the changing environment. If it has to face the changed environment suddenly, it may be possible to make immediate changes according to the demand of the changed environment. Environmental scanning gives time to the company to get adjust to the changed environment.
- 4) **Early Warning system** - Environmental Scanning gives advance warning or danger signals of the adverse changes in environment. It helps the company to design defense mechanism to avoid future adverse effects of environment on the business activities e.g. with the changing marketing environment, many companies are adopting on-line marketing to survive in this competitive environment.

TECHNIQUES /APPROACHES OF ENVIRONMENTAL SCANNING



Environmental Scanning can be effectively done following different techniques or approaches as follows:

- 1) **Seeking and getting opinion** – Opinions of experts or knowledge people can be got by talking to them. Depending upon the nature of industry, and type of markets, these experts would differ, but they would

be the people who are good at reading the current trends as well as future trends e.g. a businessman who wishes to establish a holiday resort may talk to an expert in Tourism or expert person in the hotel business in order to know the prospects of the resort. Opinions can be sought even from non-experts or laymen who are involved in the relevant business. This can be done through surveys or informal chats or meetings with the concerned people. The opinions of experts and non-experts should be integrated to have a clear picture of environment and future trends.

2) **Extrapolating** – To extrapolate means to calculate or estimate unknown factors or future trends by inference or logic after knowing the facts or present trends. It involves estimating or forecasting an unknown present trend. It helps a businessman to read future with the help of the present. It is not guesswork. It is a calculation that peeps into the future or in the unknown with the help of proper reading of the present.

3) **Estimate** – An estimate is a technique of designing the worst case scenario and the best case scenario. It estimates the best opportunities and the worst threats that are likely to emerge from the analysis of the environment. It thereafter weights the possibilities and probabilities of the opportunities and threats and preparing a balanced, realistic environment.

4) **Mapping** – It is an analytical tool that tries to read the process of transformation of factors in environment. The whole of the environment does not change suddenly, certain factors change, while others remain the same over a period of time. Mapping is a technique that tries to track the environmental factors to find out how many of them, and which of them is changing. It tries also to find out the direction and the speed of the change. It locates and plots the changes, their routes and their magnitude or extent.

5) **Industrial espionage** – It is used mainly for two purposes

To gather vital information from government department

To collect clues from the competitors

A spy can be a government employee or an employee of a competitor, a competitor's supplier or customer. E.g. Japanese visitors to American factories, plants and facilities gather information. Research students working in laboratories may take up vacation jobs with companies as a part of spying assignments.

VALUE CHAIN ANALYSIS

According to Porter, the business of a firm can best be described as a value chain, in which total revenues minus total costs of all activities undertaken to develop and market a product or service yields value. All firms in a given industry have a similar value chain, which includes activities such as obtaining raw materials, designing products, building manufacturing facilities, developing cooperative agreements, and providing customer service. A firm will be profitable as long as total revenues exceed the total costs incurred in creating and delivering the product or service. Firms should strive to understand not only their own value chain operations but also their competitors, suppliers, and distributors' value chains. Value chain analysis (VCA) refers to the process whereby a firm determines the costs associated with organizational activities from purchasing raw materials to manufacturing product(s) to marketing those products. VCA aims to identify where low-cost advantages or disadvantages exist anywhere along the value chain from raw material to customer service activities. VCA can enable a firm to better identify its own strengths and weaknesses, especially as compared to competitors' value chain analyses and their own data examined over time. Substantial judgment may be required in performing a VCA because different items along the value chain may impact other items positively or negatively, so there exist complex interrelationships. For example, exceptional customer service may be especially expensive yet may reduce the costs of returns and increase revenues. Cost and price differences among rival firms can have their origins in activities performed by suppliers, distributors, creditors, or even shareholders.

Despite the complexity of VCA, the initial step in implementing this procedure is to divide a firm's operations into specific activities or business processes. Then the analyst attempts to attach a cost to each discrete activity, and the costs could be in terms of both time and money. Finally, the analyst converts the cost data into information by looking for competitive cost strengths and weaknesses that may yield competitive advantage or disadvantage. When a major competitor or new market entrant offers products or services at very low prices, this may be because that firm has substantially lower value chain costs or perhaps the rival firm is just waging a desperate attempt to gain sales or market share. Thus value chain analysis can be critically important for a firm in monitoring whether its prices and costs are competitive. There can be more than a hundred particular value-creating activities associated with the business of producing and marketing a product or service, and each one of the activities can represent a competitive advantage or disadvantage for the firm. The combined costs of all the various activities in a company's value chain define the firm's cost of doing business. Firms should determine where cost advantages and disadvantages in their value chain occur relative to the value chain of rival firms. Value chains differ immensely across industries and firms. A Computer Company such as Hewlett-Packard would include programming, peripherals, software, hardware, and laptops. A coffee shop like star bucks would include food, housekeeping, check-in and check-out operations, Web site, reservations system, and so on. However all firms should use value chain analysis to develop and nurture a core competence and convert this competence into a distinctive competence. A core competence is a value chain activity that a firm performs especially well. When a core competence evolves into a major competitive advantage, then it is called a distinctive competence. More and more companies are using VCA to gain and sustain competitive advantage by being especially efficient and effective along various parts of the value chain. For example, Tesco has built powerful value advantages by focusing on exceptionally tight inventory control, volume purchasing of products, and offering exemplary customer service. Computer companies in contrast compete aggressively along the distribution end of the value chain. Of course, price competitiveness is a key component of effectiveness among both mass retailers and computer firms.

BENCHMARKING:

Benchmarking is an analytical tool used to determine whether a firm's value chain activities are competitive compared to rivals and thus conducive to winning in the marketplace. Benchmarking entails measuring costs of value chain activities across an industry to determine "best practices" among competing firms for the purpose of duplicating or improving upon those best practices. Benchmarking enables a firm to take action to improve its competitiveness by identifying (and improving upon) value chain activities where rival firms have comparative advantages in cost, service, reputation, or operation. The hardest part of benchmarking can be gaining access to other firms' value chain activities with associated costs. Typical sources of benchmarking information include published reports, trade publications, suppliers, distributors, customers, partners, creditors, shareholders, lobbyists, and willing rival firms. Some rival firms share benchmarking data. However, the International Benchmarking Clearinghouse provides guidelines to help ensure that restraint of trade, price fixing, bid rigging, bribery, and other improper business conduct do not arise between participating firms. Due to the popularity of benchmarking today, numerous consulting firms such as Accenture, AT Kearney, Best Practices Benchmarking & Consulting, as well as the Strategic Planning Institute's Council on Benchmarking, gather benchmarking data, conduct benchmarking studies, and distribute benchmark information without identifying the sources.

CHAPTER V

SWOT (Strength, weakness, opportunity, threat) analysis

In order to survive and grow in this competitive environment, it is essential for every business organization to undertake SWOT analysis. The process by which the enterprises monitor their relevant environment to identify their strength, weakness, business opportunities and threats affecting their business is known as SWOT analysis. In other words analyzing the surrounding environment before framing policies and taking business decisions is called as SWOT analysis. Any organization before they begin the work of strategy formulations must scan the external environment to identify possible opportunities and threats and its internal environment for strengths and weaknesses.

Strengths and weaknesses are derived from internal environment. Strength is something a company is good at doing or a characteristic that gives it an important capability. Strength is an inherent capacity which an organization can use to gain strategic advantage over its competitors e.g. Marketing of Hindustan Leaver Limited, they have around 15 lakhs retail outlets for distributing their various products in India. Possible strengths are: Name recognition, Proprietary technology, Cost advantages, skilled employees, loyal customers etc.

A Weakness is something a company lacks or does poorly (in comparison to others) or a condition that places it at a disadvantage. A weakness is an inherent limitation, which creates a strategic disadvantage for the organization e.g. limited finance. Possible weaknesses are: Poor market image, obsolete facilities, Internal operating problems, Poor marketing skills etc.

Opportunities and threats arise from external environment. SWOT analysis helps the business unit to know its positive points as well as negative points. An opportunity is a favourable condition in the organization's environment which enables it to strengthen its position. Possible opportunities are

- Consumers expect green operations and products,
- Marketing has moving rapidly to the Internet,
- Consumers must see value in all that they consume,
- Global markets offer the highest growth in revenues.

A threat is an unfavourable condition in the organization's environment that creates a rise for or cause damage to the organization. Possible threats include

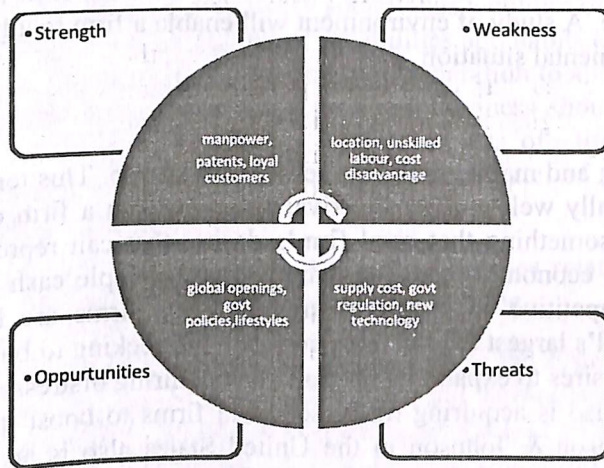
- Layoffs are rampant among many firms as revenues and profits fall and credit sources dry up.
- Dramatic slowdowns in consumer spending are apparent in virtually all sectors, except some discount retailers and restaurants
- Borrowers are faced with much bigger collateral requirements than in years past.
- Discretionary spending has fallen dramatically; consumers buy only essential items; this has crippled many luxury and recreational businesses such as boating and cycling.
- The double whammy of falling demand and intense price competition is plaguing most firms, especially those with high fixed costs.
- Many companies in many industries face the severe external threat of online sales capturing increasing market share in their industry.

Other opportunities and threats may include the passage of a law, the introduction of a new product by a competitor, a national catastrophe, or the declining value of the dollar.

A basic tenet of strategic management is that firms need to formulate strategies to take advantage of external opportunities and to avoid or reduce the impact of external threats. For this reason, identifying,

monitoring, and evaluating external opportunities and threats are essential for success. This process of conducting research and gathering and assimilating external information is sometimes called environmental scanning or industry analysis. Lobbying is one activity that some organizations utilize to influence external opportunities and threats.

Internal strengths and internal weaknesses are an organization's controllable activities that are performed especially well or poorly. They arise in the management, marketing, finance, operations, research and development, and management information systems activities of a business. Identifying and evaluating organizational strengths and weaknesses in the functional areas of a business is an essential strategic management activity. Organizations strive to pursue strategies that capitalize on internal strengths and eliminate internal weaknesses. Strengths and weaknesses are determined relative to competitors.



ROLE AND IMPORTANCE OF SWOT ANALYSIS

1. **Identify strengths** – The analysis of the internal environment help to identify the strengths of the firm. The internal environment refers to plans and policies of the firm, its resources-physical, financial and human resources e.g. If company has good relations with workers, the strength of the company can be identified through the workers loyalty and dedication on the part of workers.
2. **Identify weaknesses** – A firm may be strong in certain areas, whereas it may be weak in some other areas. The firm should identify such weaknesses through SWOT analysis so as to correct them as early as possible e.g. Lack of capital may be a weakness of the company, but company should try to raise additional funds to correct the weaknesses.
3. **Identify Opportunities** – An analysis of the external environment helps the business firms to identify the opportunities in the market. The business firm should make every possible effort to grab the opportunities, as and when they come e.g. increasing role of internet in marketing and sales of products.
4. **Identify threats** – Business may be subject to threats from competitors and others. Identification of threats at an earlier date is always beneficial to the firm as it helps to defuse the same. For instance, a competitor may come up with innovative product. This not only affects the firm's business but also endanger its survival, so business firm should take necessary steps to counter the strategy of the competitors. e.g. declining value of rupee is a serious threat to an import dependant company
5. **Effective Planning** – A proper study of environment helps a business firm to plan its activities properly. Before planning, it is very much necessary to analysis the internal as well as external

environment. After SWOT analysis, the firm can list out well-defined and time-bound objectives, which in turn help to frame proper plans.

6. **Facilitates Organizing Resources** – Environment analysis not only helps in organizing the resources of right type and quantity. A proper analysis of environment enables a firm to know the demand potential in the market. Accordingly, the firm can plan and organize the right amount of resources to handle the activities of the organization.

7. **Face Competition** – A study of business environment enable a firm to analyse the competitor's strengths and weaknesses. This would enable the firm to incorporate the competitor's strengths in its working. The firm may also try to exploit the competitor's weaknesses in its favour.

8. **Flexibility in Operations** – The environmental factors are uncontrollable and a business firm finds it difficult to influence the surrounding of its choice. A study of environment will enable a firm to adjust its operations depending upon the changing environmental situation

COMPETITIVE ADVANTAGE

Strategic management is all about gaining and maintaining competitive advantage. This term can be defined as “anything that a firm does especially well compare to rival firms.” When a firm can do something that rival firms cannot do, or owns something that rival firm's desire, that can represent a competitive advantage. For example, in a global economic recession, simply having ample cash on the firm's balance sheet can provide a major competitive advantage. Some cash-rich firms are buying distressed rivals. For example, Alibaba, the world's largest e commerce company, is seeking to buy rival firms in many parts of the world. Lenovo also desires to expand its portfolio by acquiring distressed rival companies. Indian drug company Sun Pharma also is acquiring distressed rival firms to boost its drug development and diversification. Cash-rich Johnson & Johnson in the United States also is acquiring distressed rival firms. This can be an excellent strategy in a global economic recession. Having less fixed assets than rival firms also can provide major competitive advantages in a global recession. For example, Apple has no manufacturing facilities of its own, and rival Sony has 57 electronics factories. Apple relies exclusively on contract manufacturers for production of all of its products, whereas Sony owns its own plants. Less fixed assets has enabled Apple to remain financially lean with virtually no long-term debt. Sony, in contrast, has built up massive debt on its balance sheet.

A competitive advantage enables the firm to create superior value for its customers and superior profits for itself. Cost and differentiation advantages are known as positional advantages since they describe the firm's position in the industry as a leader in either cost or differentiation.

A resource-based view emphasizes that a firm utilizes its resources and capabilities to create a competitive advantage that ultimately results in superior value creation. According to the resource-based view, in order to develop a competitive advantage the firm must have resources and capabilities that are superior to those of its competitors. Without this superiority, the competitors simply could replicate what the firm was doing and any advantage quickly would disappear. Resources are the firm-specific assets useful for creating a cost or differentiation advantage and that few competitors can acquire easily. The following are some examples of such resources:

- Patents and trademarks
- Proprietary know-how
- Installed customer base
- Reputation of the firm
- Brand equity

Capabilities refer to the firm's ability to utilize its resources effectively. An example of a capability is the ability to bring a product to market faster than competitors. Such capabilities are embedded in the

routines of the organization and are not easily documented as procedures and thus are difficult for competitors to replicate. The firm's resources and capabilities together form its distinctive competencies. These competencies enable innovation, efficiency, quality, and customer responsiveness, all of which can be leveraged to create a cost advantage or a differentiation advantage. Competitive advantage is created by using resources and capabilities to achieve either a lower cost structure or a differentiated product. A firm positions itself in its industry through its choice of low cost or differentiation. This decision is a central component of the firm's competitive strategy.

Another important decision is how broad or narrow a market segment to target. Porter formed a matrix using cost advantage, differentiation advantage, and a broad or narrow focus to identify a set of generic strategies that the firm can pursue to create and sustain a competitive advantage. The firm creates value by performing a series of activities that Porter identified as the value chain. In addition to the firm's own value-creating activities, the firm operates in a value system of vertical activities including those of upstream suppliers and downstream channel members.

To achieve a competitive advantage, the firm must perform one or more value creating activities in a way that creates more overall value than do competitors. Superior value is created through lower costs or superior benefits to the consumer (differentiation).

CHAPTER VI

STRATEGY FORMULATION

Strategy formulation refers to the process of choosing the most appropriate course of action for the realization of organizational goals and objectives and thereby achieving the organizational vision. Every organization whether small or big has certain objectives to be achieved. Each of them has to prepare a broad plan for achieving those objectives. Strategy is a plan of action prepared to achieve the organizational goals. It is a broad long term plan formulated to direct the business activities. Strategy formulation means defining the strategy in very clear and simple words. Strategy formulation means stating the outline and the features of a strategy. It simply means preparing the action plan.

Strategy is a pattern or plan that integrates an organization's values, major goals, policies and action sequences into a cohesive whole. A well formulated strategy helps to marshal and allocate an organization's resources into a unique and viable posture based on its relative internal competencies and shortcomings, anticipated changes in the environment, and contingent moves by intelligent opponents. Formulation strategy that is an effective guide to actions both an art that individual managers must develop and a process that a well managed firm must implement.

Once the analysis of current and projected performance of the company based on existing strategies and the assessment of desired performance is done, the strategic gap is identified. Strategic alternatives are then generated to bridge the gap if the projected performance in future falls short of the expected or desired performance. A number of alternatives may be possible but only one or a few of them may finally be accepted as a strategy or strategies for future. "Strategic choice is the decision to select from among the alternative strategies considered, the strategy that will meet the enterprise's objectives. The decision involves focussing on few alternatives, considering the selection factors, evaluating the alternatives against these criteria, and making the actual choice".

The process of narrowing down a large number of possible strategic alternatives starts with the consideration of strategic gap. Strategic gap is the perceived difference between the targeted performance and projected performance following the present strategies. Strategic gap could be very narrow or quite large. If the perceived gap is narrow or the projected performance is likely to be better than targeted, one would expect that the stability strategy would be followed. A large gap could be caused by increase in targeted level of performance or the adverse changes in the environment which would lead to poor performance in future from the present strategies. In the former case the strategic gap may be said to be positive while in the latter it is negative. One would expect the growth strategy to be followed in case of large positive strategic gap and retrenchment strategy in case the strategic gap is negative and large. A large positive gap is likely to occur due to environmental opportunities and a large negative gap due to environmental threats. It must be noted that the importance of leadership in any situation cannot be underestimated. The same environment may be viewed by one as threatening and by another as providing an opportunity. Thus a large positive strategic gap is more likely to be associated with dynamic leadership which may have substantially higher aspiration levels of performance. The transformational type of leaders will, in all probability, have a large positive strategic gap.

Like environmental conditions, the strengths and weakness of the organization also determine the strategic alternatives to be considered. If the internal analysis shows strength, the growth strategies are more likely to be considered. Organizational weaknesses may push for retrenchment strategies.

The vehicle for affecting the strategy is likely to be internal if the gap is small or large positive. It is likely to be external if the gap is very large as the organization may find it difficult to cope with the demands of implementation following internal approach. Same is the case with relatedness of strategies. It is to be noted that while in small organizations and in some medium size organizations, only one of the

strategies may be followed. In large, complex, multi-product / business organisations a combination of strategies is most likely.

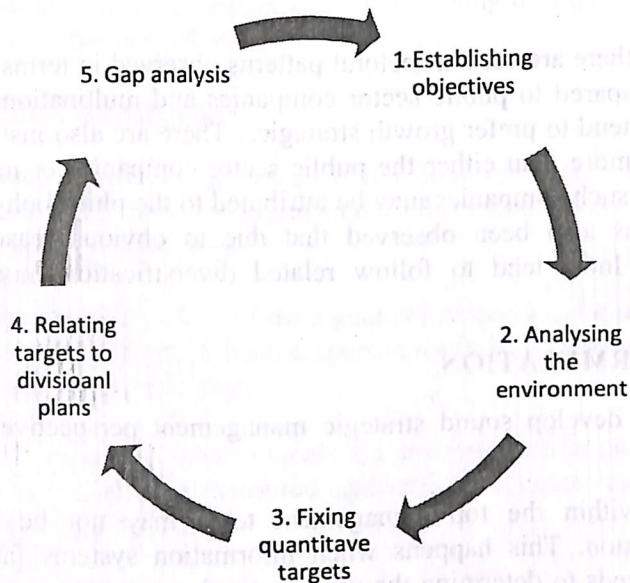
It is worth mentioning that there are certain sectoral patterns observed in terms of strategies. In a recent study it was found that compared to public sector companies and multinationals in India, large domestic private sector companies tend to prefer growth strategies. There are also instances of domestic private sector companies growing more than either the public sector companies or multinationals. The high growth strategies followed by such companies may be attributed to the philosophy of encashing the environmental opportunities. It has also been observed that due to obvious reasons public sector enterprises and multinationals in India tend to follow related diversification more than unrelated diversification.

PROBLEMS IN STRATEGY FORMULATION

Organizations often fail to develop sound strategic management perspective for a variety of reasons. Some of these reasons are:

1. **Lack of awareness:** People within the top management team may not be aware about the organization's real operating situation. This happens when information systems fail to provide the information the top management needs to determine the organization's position relative to competitors, consumption trends, relative costs, etc.
2. **Kidding themselves syndrome:** This happens when senior managers are collectively deluding themselves about the organizations conditions. Usually this occurs when the senior management team acts as a tightly knit group. As there is no flow of either fresh information or new perspectives, the top managers tend to hold the same stereotyped views of the business environment.
3. **Vested interests of the managers:** It also plays havoc with strategic planning. Managers prefer to maintain their exiting position and power. This personal interest results in continuation of the same strategies even in a changed business environment.
4. **Excessive involvement in everyday operational problem:** this also leads to inefficient strategic plans. This over-emphasis on regular activities leaves no time to study emerging trends and to think about future plans. Proper delegation of routine tasks will help to overcome this problem.
5. **Resistance to change:** A change in direction is often misinterpreted as an admission that what was done in the past was a mistake. These managers who were closely associated with decision taken in the past may be reluctant to see the organization move in a new direction.
7. **Inability on the part of the top management:** Some top level people lack the ability to become a strategists. Due to that they may not be able to locate its competitive edge may also lead to its ignoring strategy and strategic planning.

STEPS OF STRATEGY FORMULATION



The process of strategy formulation broadly involves the following steps.

1. **Establishing objectives:** The main element of corporate strategy is the objectives of the firm. Objectives of the firm act as a foundation or base on the strategy is based. Hence objectives should be properly defined. But objectives should be realistic in nature and achievable. E.g. if the firm's aim is to expand the business, firm has to pursue a growth strategy.

2. **Analysing the Environment:** In this stage general environment is analyzed from different angles. This involves assessment of internal and external business environment. This will help the firm to appraise its strengths and weaknesses and identify the major strengths and weaknesses of their competitors.

3. **Fixing quantitative targets:** In this state a firm may set quantitative target for some of its objectives. At this stage, the purpose is not to set targets for comparison with future outcomes, but to set global targets for the firm as a whole, so as to assess the contribution that may be made by different product areas or operating divisions.

4. **Relating targets to divisional plans:** This step of strategy formulation identifies the contribution that can be made by each division or product group within the corporation and for this purpose, a provisional strategic plan must be developed for each sub-unit. These plans should be based upon the analysis of macroeconomic trends and the competitive environment specific to the sub-unit. Corporate targets when related to divisional plans ensure better chance of their attainment.

5. **Gap Analysis:** Gap Analysis is the identification and analysis of a gap between planned or desired performance. The organization must analyze critically its previous performance, its present condition and the desired future conditions. Such an analysis helps to reveal the extent of gap that exists between the present reality and future aspirations of the organizations. The organization also tries to estimate its likely future state if the present trends and activities continue.

CULTURAL ASPECTS OF STRATEGIC FORMULATION

There is an often told story of a person new to a company asking an experienced co-worker what an employee should do when a customer calls. The old-timer responded: "There are three ways to do any work. Do the job - the right way, the wrong way, and the company way. Around here, we always do

things the company way." In most organizations, the "company way" is derived from the corporation's culture. Corporate culture is the collection of beliefs, expectations, and values learned and shared by a corporation's members and transmitted from one generation of employees to another. The corporate culture generally reflects the values of the founder(s) and the mission of the firm. It gives a company a sense of identity: This is who we are. This is what we do. This is what we stand for. The culture includes the dominant orientation of the company, such as research and development at Apple inc, customer service at Tata consultancy services, or product quality at Bajaj Group. It often includes a number of informal work rules (forming the "company way") that employees follow without question. These work practices over time become part of a company's unquestioned tradition. Corporate culture has two distinct attributes, intensity and integration. Cultural intensity is the degree to which members of a unit accept the norms, values, or other culture content associated with the unit. This shows the culture's depth. Organizations with strong norms promoting a particular value, such as quality at TVS, have intensive cultures, whereas new firms (or those in transition) have weaker, less intensive cultures. Employees in an intensive culture tend to exhibit consistent behavior, that is, they tend to act similarly over time. Cultural integration is the extent to which units throughout an organization share a common culture. This is the culture's breadth. Organizations with a pervasive dominant culture may be hierarchically controlled and power oriented, such as a military unit, and has highly integrated cultures. All employees tend to hold the same cultural values and norms. In contrast, a company that is structured into diverse units by functions or divisions usually exhibits some strong subcultures (for example, marketing versus operations) and a less integrated corporate culture.

Corporate culture fulfills several important functions in an organization:

1. Conveys a sense of identity for employees
2. Helps generate employee commitment to something greater than themselves
3. Adds to the stability of the organization as a social system
4. Serves as a frame of reference for employees to use to make sense out of organizational activities and to use as a guide for appropriate behavior

Corporate culture shapes the behavior of people in the corporation. Because these cultures have a powerful influence on the behavior of people at all levels, they can strongly affect a corporation's ability to shift its strategic direction. A strong culture should not only promote -survival, but it should also create the basis for a superior competitive position. For example, a culture emphasizing constant renewal may help a company adapt to a changing, hypercompetitive environment. To the extent that a corporation's distinctive competence is embedded in an organizations culture, it will be a form of tacit knowledge and very difficult for a competitor to imitate.

A change in mission, objectives, strategies, or policies is not likely to be successful if it is in opposition to the accepted culture of the firm. Foot-dragging and even sabotage may result as employees fight to resist a radical change in corporate philosophy. Like structure, if an organization's culture is compatible with a new strategy, it is an internal strength. But if the corporate culture is not compatible with the proposed strategy, it is a serious weakness.

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CHAPTER VII

STRATEGIC ALTERNATIVES

Apple-doing best even in times of slowdown

When most firms were struggling in 2008, Apple increased its revenues from \$24.0 billion in 2007 to \$32.4 billion in 2008. Apple's net income was \$4.4 billion in 2008, up from \$3.5 billion the prior year—wonderfully impressive in a global slump. Fortune magazine in 2009 rated Apple as their number-one “Most Admired Company in the World” in terms of their management and performance. That's right, number one out of millions of companies around the world. In the global recession, technology purchases were deemed disposable or discretionary for most businesses and individuals. New orders for both business and consumer tech products plummeted, and technology firms shed workers rapidly. This led to massive layoffs in the computer industry and related industries. The meltdown permeated all the way down the supply chain to chip makers, hard drive makers, peripheral makers, software vendors, and other segments. Hewlett-Packard recently cut 24,600 employees and Dell laid off 8,900. Microsoft recently cut its travel budget 20 percent and laid off 5,000 employees. Amid recession and faltering rivals, Apple is doing great. Brisk sales of iPods, iPhones, and laptops are yielding higher and higher revenues and profits every quarter. Legendary CEO Steve Jobs and his colleagues are implementing a great strategic plan. Apple has no manufacturing plants but does have retail stores. Apple continues to amaze the world with its new, innovative products, being one of the best examples of a “first mover” firm in developing new products. Apple has very loyal customers and has about \$25.6 billion in cash on their balance sheet to go along with zero long-term debt. Based in Cupertino, California, Apple has not cut prices of computers much at all during the recession, even as competitors have slashed prices dramatically. On June 9, 2009, Apple did however lower the price of its entry-level iPhone by 50 percent to \$99 and rolled out a next-generation model named iPhone 3GS which is faster than existing models and can capture videos. Apple by mid-2009 had sold over 20 million iPhones and reported in July 2009 that the company was unable to supply enough iPhones and Macintosh computers to meet demand. Apple sold 5.2 million iPhones in the quarter ending that month, more than 7 times what it sold the same quarter the prior year. Shipments of Macintosh computers that quarter were up 4 percent to 2.6 million. For the first 7 months of 2009, Apple's stock rose 80 percent compared to the Nasdaq Composite being up 25 percent. Apple has aggressive new plans to design its own computer chips in order (1) obtain better chips for its unique products, and (2) share fewer details about its technology with external chip manufacturers.

Strategic alternatives refer to different courses of action which an organization may pursue at a point in time. These alternatives are crucial to the success of the organization. More often than not, these are influenced by factors external to the organization and over which the organization has limited control. For example consider a situation where a firm is experiencing increased competition of its products. How should the organization respond? Should it reduce price. Should it improve the quality of the product? Should it improve the distribution network? Should it improve promotional effort? Is there a set of guidelines which could be followed by the organization? Alternatives external to the organization such as mergers, acquisitions and joint ventures may also be considered. The list of alternatives will be incomplete without the alternative of disinvestment. There are situations when withdrawal from an existing business is the most suitable course of action. In fact, it may be wrong to consider that continuing to produce a particular product or service is a must.

A firm may consider withdrawal from a business if the present value of the anticipated stream of earnings from that business is less than its present worth. Thus, if the present value of the stream is of earnings from the textile unit of a corporate group is less than the net worth of the textile business, the organization should withdraw from the textile business. Sometimes there may be obstacles if the organization wishes to withdraw. The most serious opposition may come from the Government in its anxiety to protect workers likely to be rendered unemployed. This kind of a situation is being faced by

many public sector undertakings in India. Any organization contemplating to withdraw from a particular business should attempt to foresee the constraints and evolve ways to overcome them.

Some obvious alternatives include:

- i) Offering alternative jobs to workers in other units;
- ii) Providing attractive retrenchment terms to workers so that they would not easily turn down the offer (the golden handshake).

In a small organization all decisions are made by the owner himself or by the chief executive. These decisions deal with what an organization should do under alternative situations. What new businesses should be added or what existing businesses should be done away with the success or failure of the organization depends upon the experience and technical competence of the chief executive. Thus, in small organizations strategic alternatives are identified by the owner-manager. Of course his decision may be influenced by some bureaucrats, industrialists, etc. with whom he interacts. The procedure used for identifying alternatives may be intuitive rather than based on a well-defined procedure. The process of implementing alternatives in small business is however reasonably fast. In organizations of medium to large size, the following mechanisms may be employed for identifying strategic alternatives.

- Brain-storming sessions;
- Special meetings for the purpose;
- Services of outside consultant;
- Joint meetings of the consultant and the senior employees of the organization.

1. Brain Storming Session

In most organizations strategic alternatives are identified during the brain-storming sessions. In such meetings participants are encouraged to come out with any course of action which they feel is possible. At this stage no importance is attached to relative merits and demerits of the alternatives. In the next stage each alternative is reviewed and subjected to a close scrutiny. The alternatives which are considered fairly appealing are further examined and analysed for final selection of one or more alternatives. Consider the case of power shortage in an organization which produces energy intensive product such as aluminum. What should the organization do? Since the decision is, bound to affect the organization crucially, the alternatives are of critical, importance. These may include: i) buy a generator, ii) start producing those products which are not very energy intensive, iii) have a stand-by generator for meeting part of the, requirements; iv) introduce a change in, the product-mix, with an emphasis on; those products which, have a higher contribution per unit of investment.

The few alternatives listed above have their own: implications in, terms of financial, physical facilities, manpower requirements, etc. The chief executive has to select the alternative which is, the most appropriate in his opinion. The current resource position of the organization with be a major influencing factor in this decision.

2. Special Meetings

Large organizations, recognizing the significant of generating strategic alternatives, hold special meetings away from the place of their work in a hotel or a holiday resort. This is to ensure that the process of thinking, is, not disturbed by interruptions during the course of deliberations. The participants present alternative scenarios along with their recommended courses of action. Alternative scenarios- may be based upon: assumptions regarding rate of growth of the economy, position regarding foreign exchange, rate of inflation, rate of unemployment, ideology of the political party in power, rate of change in technology, socio-cultural factor having a bearing on the profitability of the organization

Depending on the assumptions, regarding the values and future trends of the above parameters, alternative courses of action, are often recommended. An attempt is made through the discussions to arrive at a consensus. The turnaround, strategy of a leading pharmaceutical company Pfizer come was conceived in a series of meetings the Chief Executive had with his senior managers.

3. Outside Consultants

This procedure of identifying strategic alternatives is based on the premise that an outsider can observe the phenomenon in an objective manner. It is recognised that the executive's who have been actively associated with, a particular project, are often so involved with it that they tend to, be subjective and over look its shortcomings. Others, from within the organization may also be unable to see its limitations. Under such conditions, engaging outside consultant may be a more effective way to generate, strategic alternatives on an objective basis. The outside viewpoint is expected to, be new and fresh, and thus, can show, up many new opportunities, to the organization.

4. Joint Meeting

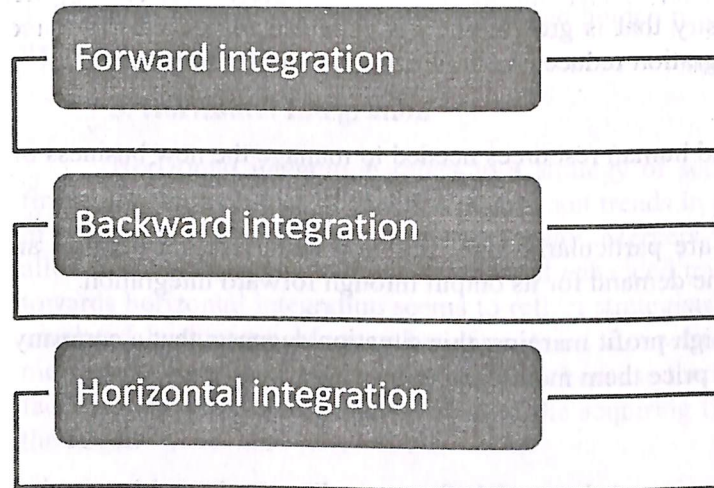
Another desired way of generating alternatives is to hire the services of a, consultant but also associate some internal members in the process. This method is able to combine the advantages of the new ideas contributed by outsiders being blended with workable solutions from within the organisation. In, any case, an, outside consultant may like to seek the opinion of the internal members on his proposals.

CHAPTER VIII

STARETGIC OPTIONS

Organisations are complex entities. A company can use a number of business strategies, depending on its situation. For example, new companies may face different challenges than companies that are established. Therefore, the business strategies they implement may be different from those of key competitors. Various authors have described these strategies differently but the essential issues can be addressed using the below mentioned four types of strategies.

1. INTEGRATION STRATEGIES



Forward integration, backward integration, and horizontal integration are sometimes collectively referred to as vertical integration strategies. Vertical integration strategies allow a firm to gain control over distributors, suppliers, and/or competitors.

1. Forward Integration

Forward integration involves gaining ownership or increased control over distributors or retailers. Increasing numbers of manufacturers (suppliers) today are pursuing a forward integration strategy by establishing web sites to directly sell products to consumers. This strategy is causing turmoil in some industries. For example, Samsung is opening its own retail stores, a forward integration strategy similar to rival Apple Inc., which currently has more than 500 stores around the world. Samsung wants to learn firsthand about what consumers want and how they buy. Some Microsoft shareholders are concerned that the company's plans to open stores will affect existing retail partners such as Best Buy. Automobile dealers have for many years pursued forward integration, perhaps too much. Ford has almost 6,000 dealers compared to Toyota, which has fewer than 3,000 U.S. dealers. That means the average Toyota dealer sold, for example, 1,628 vehicles in 2007 compared to 236 vehicles for Ford dealers. GM, Ford, and Chrysler are all reducing their number of dealers dramatically. The Canadian company Research in Motion (RIM) opened its first online store for BlackBerry applications in April 2009. RIM is looking to tap a market for software made popular by Apple and its I Phone. BlackBerry users can download the new RIM storefront from the main RIM Web site, but then they need to buy applications using PayPal. An effective means of implementing forward integration is franchising. Approximately 2,000 companies in about 50 different industries in the United States use franchising to distribute their products or services. Businesses can expand rapidly by franchising because costs and opportunities are spread among many individuals. Total sales by franchises in the United States are annually about \$2 trillion. McDonald's today owns less than 20 percent of its 32,000 restaurants, down from 23 percent in 2013. Restaurant chains are increasingly being pressured to own fewer of their locations. McDonald's sold

1,600 of its Latin America and Caribbean restaurants to Woods Staton, a former McDonald's executive. Companies such as McDonald's are using proceeds from the sale of company stores/restaurants to franchisees to buy back company stock, pay higher dividends, and make other investments to benefit shareholders. These six guidelines indicate when forward integration may be an especially effective strategy:

1. When an organisation's present distributors are expensive or unreliable or incapable of meeting the firm's distribution needs.
2. When the availability of quality distributors is so limited as to offer a competitive advantage to those firms that integrate forward.
3. When an organization competes in an industry that is growing and is expected to continue to grow markedly; this is a factor because forward integration reduces an organization's ability to diversify into basic industry falters.
4. When an organisation has both the capital and human resources needed to manage the new business of distributing its own products.
5. When the advantages of stable production are particularly high; this is a consideration because an organization can increase the predictability of the demand for its output through forward integration.
6. When present distributors or retailers have high profit margins; this situation suggests that a company profitably could distribute its own products and price them more competitively by integrating forward.

2. Backward Integration

Both manufacturers and retailers purchase needed materials from suppliers backward integration is a strategy of seeking ownership or increased control of a firm's suppliers. This strategy can be especially appropriate when a firm's current suppliers are unreliable, too costly, or cannot meet the firm's needs. When you buy a box of Pampers diapers at Pantaloon retail, a scanner at the store's checkout counter instantly zaps an order to Procter & Gamble Company. In contrast, in most hospitals, reordering supplies is a logistical nightmare. Inefficiency caused by lack of control of suppliers in the health-care industry, however, is rapidly changing as many giant health-care purchasers, such as the Indian Defense Department and DM Healthcare Corporation, move to require electronic bar codes on every supply item purchased. This allows instant tracking and recording without invoices and paperwork. Of the estimated \$83 billion spent annually on hospital supplies, industry reports indicate that \$11 billion can be eliminated through more effective backward integration. In a major strategic shift to design its own computer chips, Apple Inc. in 2009 began a backward integration strategy to shield Apple technology from rival firms. Apple envisions soon producing its own internally developed chips for its iPhone and iPod Touch devices. Online job postings from Apple describe dozens of chip-related positions. Apple's new strategy also is aimed at sharing fewer details about Apple technology plans with external chip suppliers. This new backward integration strategy marks a break from a long-term trend among most big electronics companies to outsource the development of chips and other components to external suppliers. Some industries in the United States, such as the automotive and aluminum industries, are reducing their historical pursuit of backward integration. Instead of owning their suppliers, companies negotiate with several outside suppliers. Ford and GM buy over half of their component parts from outside suppliers such as TRW, Eaton, General Electric, and Johnson Controls. De-integration makes sense in industries that have global sources of supply. Companies today shop around, play one seller against another, and go with the best deal. Global competition is also spurring firms to reduce their number of suppliers and to demand higher levels of service and quality from those they keep. Although traditionally relying on many suppliers to ensure uninterrupted supplies and low prices, American firms now are following the lead of Japanese firms, which have far fewer suppliers and closer, long-term relationships with those few.

“Keeping track of so many suppliers is onerous”. Seven guidelines for when backward integration may be an especially effective strategy are

1. When an organization’s present suppliers are especially expensive, or unreliable, or incapable of meeting the firm’s needs for parts, components, assemblies, or raw materials.
2. When the number of suppliers is small and the number of competitors is large.
3. When an organization competes in an industry that is growing rapidly; this is a factor because integrative-type strategies (forward, backward, and horizontal) reduce an organization’s ability to diversify in a declining industry.
4. When an organization has both capital and human resources to manage the new business of supplying its own raw materials.

3. Horizontal Integration

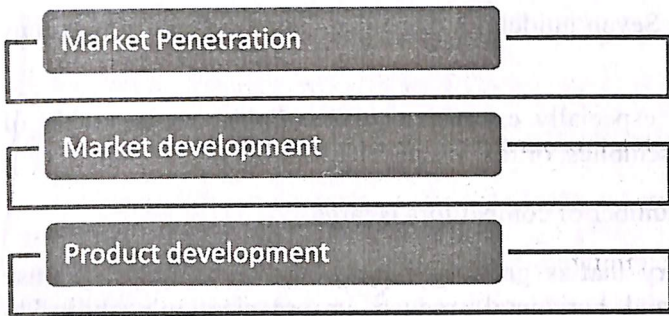
Horizontal integration refers to a strategy of seeking ownership of or increased control over a firm’s competitors. One of the most significant trends in strategic management today is the increased use of horizontal integration as a growth strategy. Mergers, acquisitions, and takeovers among competitors allow for increased economies of scale and enhanced transfer of resources and competencies. The trend towards horizontal integration seems to reflect strategists’ misgivings about their ability to operate many unrelated businesses. Mergers between direct competitors are more likely to create efficiencies than mergers between unrelated businesses, both because there is a greater potential for eliminating duplicate facilities and because the management of the acquiring firm is more likely to understand the business of the target.

These five guidelines indicate when horizontal integration may be an especially effective strategy:

1. When an organization can gain monopolistic characteristics in a particular area or region without being challenged by the government for tending substantially to reduce competition.
2. When the organization competes in a growing industry.
3. When increased economies of scale provide major competitive advantages.
4. When an organization has both the capital and human talents needed to successfully manage an expanded organization.
5. When competitors are faltering due to a lack of managerial expertise or a need for particular resources that an organization possesses, note that horizontal integration would not be appropriate if competitors are doing poorly, because in that case overall industry sales are declining.

II. INTENSIVE STRATEGIES

Market penetration, market development, and product development are sometimes referred to as intensive strategies because they require intensive efforts if a firm’s competitive position with existing products is to improve.



1. Market Penetration

A market penetration strategy seeks to increase market share for present products or services in present markets through greater marketing efforts. This strategy is widely used alone and in combination with other strategies. Market penetration includes increasing the number of salespersons, increasing advertising expenditures, offering extensive sales promotion items, or increasing publicity efforts. Vodafone in 2015/2016 spent billions on its new advertising slogan. These five guidelines indicate when market penetration may be an especially effective strategy

1. When current markets are not saturated with a particular product or service. • When the usage rate of present customers could be increased significantly.
2. When the market shares of major competitors have been declining while total industry sales have been increasing.
3. When the correlation between dollar sales and dollar marketing expenditures historically has been high.
4. When increased economies of scale provide major competitive advantages.

2. Market Development

Market development involves introducing present products or services into new geographic areas. For example, information technology companies such as Wipro, Tata consultancy services, Infosys are expanding further into China in 2013/2014 even in a world of slumping sales. Tesco is opening fewer stores in Britain to divert capital expenditures to China. French hypermarket chain Carrefour is opening stores in India in 2015. All of these market development strategies come in the face of a slowing global economy and faltering consumer confidence among the international consumers. Air Asia in 2015 began serving Indian domestic destinations as part of a strategy by the Asia based carrier to derive more traffic from Indian routes. This market development strategy is being implemented largely by deploying its recently acquired Airlines big jets from unprofitable domestic routes to global routes, especially into Asia, where the company previously had only a few routes. Amazon Inc. is spending \$1 billion in China from 2012 to 2015 to build more plants, specifically in western and southern areas of India. Also in China, PepsiCo is developing products tailored to Chinese consumers, building a larger sales force, and expanding research and development efforts. China is Pepsi's second-largest beverage market by volume, behind the United States. Pepsi owns Lays potato chips and in China sells the chips with Beijing duck flavor. Pepsi has 41 percent share of the potato chip market in China. Pepsi's new market development strategy is aimed primarily at rival Coke, which dominates Pepsi in the carbonated-soft-drink sector in China; Coke has a 51.9 percent share of the market to Pepsi's 32.6 percent. The company's new strategic plan includes selling many if not most of its stores worldwide to existing franchisees or new investors. These six guidelines indicate when market development may be an especially effective strategy:

1. When new channels of distribution are available that are reliable, inexpensive, and of good quality.

2. When an organization is very successful at what it does.
3. When new untapped or unsaturated markets exist.
4. When an organization has the needed capital and human resources to manage expanded operations.
5. When an organization has excess production capacity.
6. When an organization's basic industry is rapidly becoming global in scope.

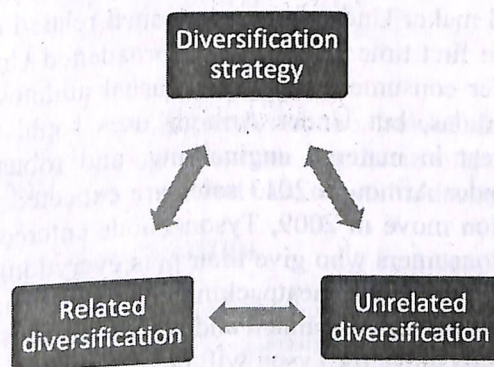
3. Product Development

Product development is a strategy that seeks increased sales by improving or modifying present products or services. Product development usually entails large research and development expenditures. Apple's new I phone 6 S illuminates years of monies spent on product development. Maruti Suzuki's timely introduction of Alto brand made the company an international one. Activa scooter introduced by Honda helped the company to become a better company in many parts of the world by parting away from locally based joint venture companies like Hero in India.

These five guidelines indicate when product development may be an especially effective strategy to pursue:

1. When an organization has successful products that are in the maturity stage of the product life cycle; the idea here is to attract satisfied customers to try new (improved) products as a result of their positive experience with the organization's present products or services.
2. When an organization competes in an industry that is characterized by rapid technological developments.
3. When major competitors offer better-quality products at comparable prices.
4. When an organization competes in a high-growth industry.
5. When an organization has especially strong research and development capabilities.

III. DIVERSIFICATION STRATEGIES



There are two general types of diversification strategies: related and unrelated. Businesses are said to be related when their value chains possess competitively valuable cross-business strategic fits; businesses are said to be unrelated when their value chains are so dissimilar that no competitively valuable cross-business relationships exist. Most companies favor related diversification strategies in order to capitalize on synergies as follows:

1. Transferring competitively valuable expertise, technological know-how, or other capabilities from one business to another.

2. Combining the related activities of separate businesses into a single operation to achieve lower costs.
3. Exploiting common use of a well-known brand name.
4. Cross-business collaboration to create competitively valuable resource strengths and capabilities.

Diversification strategies are becoming less popular as organizations are finding it more difficult to manage diverse business activities. In the 1960s and 1970s, the trend was to diversify so as not to be dependent on any single industry, but the 1980s saw a general reversal of that thinking. Diversification is now on the retreat. Michael Porter, of the Harvard Business School, says, "Management found it couldn't manage the beast." Hence businesses are selling, or closing, less profitable divisions to focus on core businesses. The greatest risk of being in a single industry is having all of the firm's eggs in one basket. Although many firms are successful operating in a single industry, new technologies, new products, or fast-shifting buyer preferences can decimate a particular business. For example, digital cameras are decimating the film and film processing industry, and cell phones have permanently altered the long-distance telephone calling industry. Diversification must do more than simply spread business risk across different industries, however, because shareholders could accomplish this by simply purchasing equity in different firms across different industries or by investing in mutual funds. Diversification makes sense only to the extent the strategy adds more to shareholder value than what shareholders could accomplish acting individually. Thus, the chosen industry for diversification must be attractive enough to yield consistently high returns on investment and offer potential across the operating divisions for synergies greater than those entities could achieve alone. Conglomerates prove that focus and diversity are not always mutually exclusive. Many strategists contend that firms should "stick to the knitting" and not stray too far from the firms basic areas of competence. However, diversification is still sometimes an appropriate strategy, especially when the company is competing in an unattractive industry. For example, United Technologies is diversifying away from its core aviation business due to the slumping airline industry. United Technologies now owns British electronic-security Company Chubb PLC, as well as Otis Elevator Company and Carrier air conditioning to reduce its dependence on the volatile airline industry.

1. Related Diversification

Alphabet's (parent company of Google) stated strategy is to organize the entire world's information into searchable form, diversifying the firm beyond its roots as a Web search engine that sells advertising. Based in Baltimore, the sports apparel maker Under Armour pursued related diversification when it introduced athletic "running" shoes for the first time. This strategy broadened Under Armour's appeal from boys and young men to women, older consumers, and more casual athletes. The athletic footwear business is dominated by Nike and Adidas, but Under Armour uses sophisticated design software, new manufacturing techniques, the latest in material engineering, and robust information technology systems to produce all its products. Under Armour's 2013 sales are expected to increase 20 percent to \$2900 million. In a related diversification move in 2009, Tyson Foods entered the dog food business, selling refrigerated pet food targeted to consumers who give their pets everything from clothes and car seats to cemetery graves. Prior to this move by Tyson, meatpacking companies has been content to sell scraps such as chicken fat and by-products to makers of canned and dry pet food. Scott Morris of Freshpet Company in Secaucus, New Jersey, says this move by Tyson will change the fact that "pet food today looks the same as it did 30 years ago. Six guidelines for when related diversification may be an effective strategy are as follows.

1. When an organization competes in a no-growth or a slow-growth industry.
2. When adding new, but related, products would significantly enhance the sales of current products.
3. When new, but related, products could be offered at highly competitive prices.

4. When new, but related, products have seasonal sales levels that counterbalance an organization's existing peaks and valleys.
5. When an organization's products are currently in the declining stage of the product's life cycle.
6. When an organization has a strong management team.

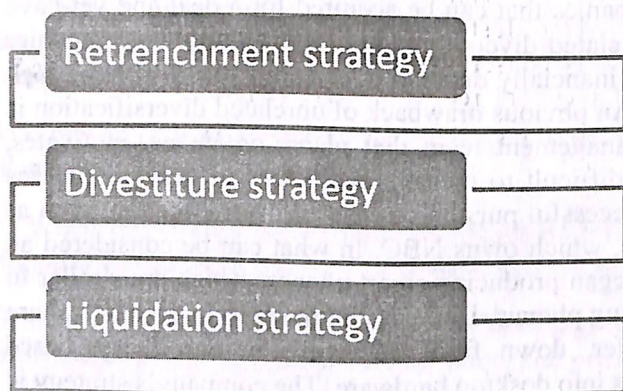
2. Unrelated Diversification

An unrelated diversification strategy favors capitalizing on a portfolio of businesses that are capable of delivering excellent financial performance in their respective industries, rather than striving to capitalize on value chain strategic fits among the businesses. Firms that employ unrelated diversification continually search across different industries for companies that can be acquired for a deal and yet have potential to provide a high return on investment. Unrelated diversification entails to acquire companies whose assets are undervalued, or companies that are financially distressed, or companies that have high growth prospects but are short on investment capital. An obvious drawback of unrelated diversification is that the parent firm must have an excellent top management team that plans, organizes, motivates, delegates, and controls effectively. It is much more difficult to manage businesses in many industries than in a single industry. However, some firms are successful pursuing unrelated diversification, such as Walt Disney, which owns ABC, and General Electric, which owns NBC. In what can be considered an unrelated diversification strategy, Dell Inc. recently began producing smart phones, which are similar to Apple's iPhone and Research in Motion's Web browsing phones. Dell has continued to lose market share with a 13.7 percent share of the personal computer, down from 14.6 percent. San Diego-based Qualcomm Inc. recently diversified beyond cell phones into desktop hardware. The company's strategy is to bring Web access to places in the world that have cell phone networks but do not have Internet access because it is impractical or unaffordable. Qualcomm is test marketing its new device called Kayak. The company expects Intel to be its main competitor in this new product area. IBM entered the water management business with the creation of new desalination-membrane technology that removes arsenic and boron salts from contaminated groundwater. The company expects to license the technology rather than build desalination plants itself. But IBM has begun installing systems of water sensors and software to monitor water pipes, reservoirs, rivers, and harbors. It is all part of IBM's 2009 Big Green Innovations Initiative. The firm has always been known as Big Blue. Cisco Systems diversified by entering into the fiercely competitive computer server market, placing it in direct competition for the first time with its longtime partners Hewlett-Packard and IBM. Before this strategic move, Cisco was primarily in the router and switch business, which directs Internet traffic. This new Cisco strategy highlights the fact that data centers are becoming a new battleground as large customers manage Internet traffic and energy costs escalate. Michael Corrado at IBM says it is not unusual for tech companies to be both partners and competitors. However, HP's Jim Ganthier says, "HP is delivering today what Cisco is promising tomorrow. French aerospace manufacturer Safran SA recently diversified further away from jet propulsion into maintenance and service operations by buying 81 percent of General Electric Company's Homeland Protection division for \$580 million in cash. This new division of Safran focuses on explosive and narcotics detection. GE and Safran have worked together for more than 30 years, including a joint venture that produces the CFM commercial-jet engine. Guidelines for unrelated diversification to be effective strategy are:

1. When revenues derived from an organization's current products or services would increase significantly by adding the new, unrelated products.
2. When an organization competes in a highly competitive and/or a no-growth industry, as indicated by low industry profit margins and returns.
3. When an organization's present channels of distribution can be used to market the new products to current customers.

4. When the new products have countercyclical sales patterns compared to an organization's present products.
5. When an organization's basic industry is experiencing declining annual sales and profits.
6. When an organization has the capital and managerial talent needed to compete successfully in a new industry.
7. When an organization has the opportunity to purchase an unrelated business that is an attractive investment opportunity.

IV. DEFENSIVE STRATEGIES



In addition to integrative, intensive, and diversification strategies, organizations also could pursue retrenchment, divestiture, or liquidation.

1. Retrenchment

Retrenchment occurs when an organization regroups through cost and asset reduction to reverse declining sales and profits. Sometimes called a turnaround or reorganizational strategy, retrenchment is designed to fortify an organization's basic distinctive competence. During retrenchment, strategists work with limited resources and face pressure from shareholders, employees, and the media. Retrenchment can entail selling off land and buildings to raise needed cash, pruning product lines, closing marginal businesses, closing obsolete factories, automating processes, reducing the number of employees, and instituting expense control systems. Smithfield Foods, the world's largest pork processor, is closing 6 of its 40 plants, laying off 1,800 employees, and cutting production by 10 percent in 2013 in efforts to stop the liquidity drain on the firm. Pork is the world's most consumed meat by volume. Starbucks has launched a massive retrenchment strategy in efforts to save the company. Starbucks will soon close 300 underperforming, company-operated stores worldwide, including 200 in the United States. These closing are on top of 600 recent Starbucks closings in the United States and 40 closings in Australia. However, the firm plans to open 140 stores in the United States and open 170 stores outside the United States. Starbucks plans to cut 700 corporate and nonretail positions globally. In addition, as part of Starbucks's strategy to survive the global recession, the company will enter the value-meal race to combat McDonald's new McCafe coffee bars, which are spreading nationally and likely soon globally. Pursuing a heavy retrenchment strategy to survive, Citigroup recently announced that it is cutting 25,000 more jobs. This is one of the largest corporate layoff announcements. Citigroup had already cut 23,000 jobs in 2012 as its stock price fell 70 percent in that year alone. Tokyo-based Sony Corp. is cutting 8,000 jobs and closing 6 of its 57 factories by March 2015 as prices of televisions fall and consumer spending in general declines. Sony has also been hurt by falling demand for digital cameras and the sharp rise in the yen against major currencies, which has cut into profits by reducing its overseas revenue when converted back into the Japanese currency.

2. Divestiture

Selling a division or part of an organization is called divestiture. Divestiture often is used to raise capital for further strategic acquisitions or investments. Divestiture can be part of an overall retrenchment strategy to rid an organization of businesses that are unprofitable, that require too much capital, or that do not fit well with the firm's other activities. Divestiture has also become a popular strategy for firms to focus on their core businesses and become less diversified. For example, to raise cash, Motorola in 2009 divested its Good Technology mobile e-mail division to Visto Corporation. Both Good Technology and Visto Corp. lag behind market leader Research In Motion Ltd. maker of BlackBerry devices. Motorola has fallen from being the number two maker of cell phones to number five. Ailing Lehman Brothers Holdings divested its venture-capital division in 2009 as the firm shed assets to raise cash and pay creditors. Cadbury PLC sold its Australian drinks business to Asahi Breweries Ltd. of Japan for \$811.9 million. Asahi is Japan's largest beer brewer by market share. Just prior to this divestiture, Cadbury had divested its Dr Pepper Snapple business to a private-equity consortium. Historically firms have divested their unwanted or poorly performing divisions, but the global recession has witnessed firms simply closing such operations. Six guidelines for when divestiture may be an especially effective strategy to pursue follow:

1. When an organization has pursued a retrenchment strategy and failed to accomplish needed improvements.
2. When a division needs more resources to be competitive than the company can provide.
3. When a division is responsible for an organization's overall poor performance.
4. When a division is a misfit with the rest of an organization; this can result from radically different markets, customers, managers, employees, values, or needs.
5. When a large amount of cash is needed quickly and cannot be obtained reasonably from other sources.
6. When government antitrust action threatens an organization.

3. Liquidation

Selling all of a company's assets, in parts, for their tangible worth is called liquidation. Liquidation is recognition of defeat and consequently can be an emotionally difficult strategy. However, it may be better to cease operating than to continue losing large sums of money. For example, despite four years in development and two years in construction, the Hard Rock Park in Myrtle Beach, South Carolina, liquidated in 2009 just nine months after it opened. The park had been called the world's first rock 'n' roll theme park and the single largest tourism investment in South Carolina history. From its opening in April 2008 to its closing six months later, the park generated only \$20 million in ticket sales, way below its \$24 million in annual interest payments due. The park drew far fewer than the projected 30,000 people a day. Bad planning and being too highly leveraged crushed this business very quickly. Based in Knoxville, Tennessee, Goody's Family Clothing liquidated all its 282 stores in 2009 and all 10,000 of its employees lost their jobs. The moderately priced clothing retailer had been operating under bankruptcy but was unable to restructure terms with its creditors. Intense price competition among rival firms coupled with falling consumer demand and being highly leveraged combined to crush this well-known firm. Woolworths Group PLC recently launched a liquidation sale at all its stores that virtually ended its 99-year-old British retail icon. This British company is not related to the U.S. and Australian companies with similar names. Woolworths Group PLC has 815 stores and about 30,000 employees. Woolies, as the British call this company, began in Britain in 1909 when Frank Woolworth opened the first store in Liverpool, England.

FUNCTIONAL STRATEGIES

Strategic management process involves determining appropriate courses of action for achieving objectives. In the process of formulation it is necessary to gear the organization in such a way that all the functional areas are synchronized viz, finance, marketing, human resources and operations. Off late logistics is also included as a key functional area. Further the functional strategies must cover all the three levels of management top, middle and lower. It is in this context that we need to study functional strategies in detail. Functional experts like R&D, operations, finance, marketing and human resources devise functional strategies. The characteristics of functional strategies are as follows.

➤ **Short term**

They provide short term operational details for achieving long term objectives systematically

➤ **Limited scope**

Functional strategy deals with a relatively restricted plan, which provides the objectives for a specific function, for the allocation of resources among different operations within that functional area and for enabling coordination between them for an optimal contribution to the achievement of the business and corporate level objectives.

➤ **Derivative**

Functional strategies are derived from business and corporate strategies. Functional strategies specify the grand plans in different functional areas in time horizons and help operationalise the strategies. They cascade down the hierarchy and percolate from corporate strategies to divisional strategies and further down to departmental strategies.

1.R & D Strategy

New technologies may make the business obsolete like the way Photostat technology rooted out the carbon paper technology. Software and pharma companies need good R & D strategies for survival itself. Motorola recently announced that it had figured out how to combine silicon and gallium arsenide in one semiconductor chip. The company said this discovery will greatly reduce manufacturing process costs and result in smaller, faster products. The discovery is expected to yield products by the end of 2016 and may lead to cell phones as small as shirt buttons. Intel and Microsoft are continuing to increase their expenditures on research and development. Intel spent nearly 25 percent of sales, while Microsoft spent 37 percent of sales. Both companies expect to increase R&D spending. Intel is developing more powerful and smaller chips to power computers, while Microsoft is improving its Windows XP operating system. In India we can take the example of companies like Dr. Reddy's Laboratories who are spending huge amounts for developing new drugs and vaccine. Linked to this R & D strategy they are bringing back outstanding Indian scientists from countries like USA and UK but paying them heavily in dollars a HR strategy they proudly claim as 'reverse brain drain'. But the disadvantage of R & D strategy is the high costs and time involved, also the risk associated with. According to a finding an average of 30 to 35 percent of new products fails after being put on the market, so innovation strategies those that focus heavily on developing new products can be very risky. For this reason, many organizations use imitation strategies, that is, they rapidly copy new competitive products that are doing well. A number of Japanese electronics companies were quite successful in copying American technology and, by avoiding many R&D costs, improved their competitive positions significantly. Today Chinese manufactures are considered to be good at imitation strategies. A Hero Honda Motor Cycle manufactured in Japan is costlier by 50% in Japan compared to India and Chinese can make it at half the price with the same features but a different brand name. Even within Japan we can give legendary examples like that of Kodak who are pioneers in photo film making but lost their market to Fuji, an imitator when Kodak had to leave Japan during second world war for a few years.

iii) Operations strategy

This strategy adds value to the raw materials to create a product or service. This value addition should be cost effective, fast and without quality rejects or reworks. The emphasis should be on cost reduction while enhancing quality. Areas like safety, breakdown, downtime, inventory control scheduling etc. should be adequately covered with policies and strategies at functional level. India is known for high cost of inventories. Companies spend huge amounts on storage and warehousing in this country unlike countries like Japan which follow 'Just in time (JIT) in production and operations. Raw materials arrive eight hours before they are put in process for making finished goods in Japan. This is true with M/S Toshiba of Japan, where they can get the required plates from just across the waters from M/S Nippon steels unlike many companies in India who have to order thick plates at least eight to ten months in advance. Many Japanese manufacturers have also provided extensive training and cross training of their workers so that they will have multiskilled workers. This versatile work force, coupled with plant arrangements and equipment that can easily be changed over from one product to another, provides greater flexibility without a significant increase in cost. Regarding procurement of materials, strategies on right qualities of material, at the right time and price, the number of sources, their reliability and price patterns analysis and decision, vendor relationships, forward buying etc. must be chalked down to enable managers to work according to them. Industries like Bharat Heavy Plates and Vessels which are strategically located closer to steel plant in Visakapatnam in Andhra Pradesh have the advantage to get raw materials like steel and coke with less carrying cost and storage cost. Industries located closer to ports like Chennai, Mumbai and Calcutta have also strategic advantage of location not only for getting raw material but also for shipping finished products. The product, or output, desired from the operations system will certainly affect the type of inputs needed and the capabilities that must be available to transform the inputs into the desired goods or services. As the product is designed, a cost benefit evaluation should be performed, taking into account the kind and amount of materials, labour and processing equipment that each alternative design will require. The company must also recognize that the potential consumer will also perform some sort of cost benefit evaluation before deciding whether to purchase the product. Some processes and materials are more expensive and should be used only if the functions of the product make them necessary or the aesthetic appeal of the results justifies the expense. Myriad alternative designs for a product are usually possible, and alternative production methods may be possible even after the product is designed. Production engineers often serve as advisers to designers, helping them develop product designs that are reasonably economical to produce. Here is an example of retail firm design of products and operations for consumer acceptance. The Loft, the first of its kind multi brand footwear store in India, is based in Mumbai. The Loft is a one stop shop for anyone who is looking for a good pair of footwear. It has found favour with much first time visitors, thanks to its unique services, intensely trained sales men who understand shoes and customer preferences intimately and all that it takes to give the right footwear to the discerning customer. Spread over 18,000 sq.ft of space, The Loft stocks almost 100 plus brands, has facilities like pedicure, cobbler, and jogging track. It also boasts of the biggest socks shop which houses a staggering 15,000 pairs of socks from over ten brands and all price points. The Loft also stocks numerous footwear accessories like, shoe polishes, shoe trees, brushes, shoe cleaners, shoe shiners, insoles, laces, shoe norms, shoe bags etc. In short, The Loft is the destination if one is looking for anything in footwear or foot care.

iv) Information systems strategy

Corporations are increasingly adopting information system strategies in that they are turning to information systems technology to provide business units with competitive advantage. Multinational corporations are finding that the use of a sophisticated intranet for the use of its employees allows them to practice follow the sun management, in which project team members living in one country can pass their work to team members in another country in which the work day is just beginning. Thus, night shifts are no longer needed. The development of instant translation software is also enabling workers to have online communication with coworkers in other countries who use a different language.

v) **Logistics and supply chain strategy**

In an age where the cash on delivery sales by e-tailors are increasing the role of logistics strategy is quite important. One of the recent surveys pointed the cash working capital requirement of logistics companies which require a thorough revision in the way logistics companies have been running. Logistics/supply chain strategy deals with the flow of products into and out of the manufacturing process. Three trends are evident.

- Centralization,
- Outsourcing, and
- Use of the Internet.

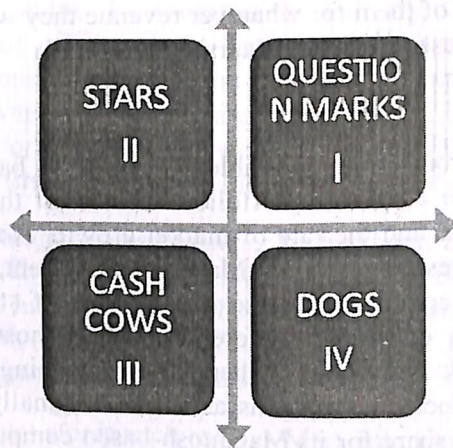
To gain logistical synergies a cross business unit, corporations began centralizing logistics in the headquarters group. This centralized logistics group usually contains specialists with expertise in different transportation modes such as rail or trucking. They work to aggregate shipping volumes across the entire corporation to gain better contracts with shippers. Companies like Amoco Chemical, Georgia Pacific, Marriott, and Union Carbide view the logistics function as an important way to differentiate themselves from the competition, to add value, and to reduce costs. Many companies have found that outsourcing of logistics reduces costs and improves delivery time? Many companies are using the Internet to simplify their logistical system. For example, Ace Hardware created an online system for its retailers and suppliers.

The functional strategies can be effective only when they are aligned with corporate strategies and integrated with one another. Functional strategies give more clarity to corporate and business level strategies and operate at third level. They provide specific plans for achieving objectives with optimal contribution for organizational advancement. Operational strategies take into account production system, operations planning and control and R & D. R & D strategies aim at innovation and new product development. Logistics minimize transportation and delay costs. Information systems provide effective communication and knowledge sharing opportunities. One must understand that strategies must be coordinated to have a vertical fit which aligns the functional areas. Simultaneously horizontal fit leads to alignment of activities. Operational implementation adopted by a firm achieves more effectiveness and perform value creating opportunities

CHAPTER IX

BCG MODEL OF PORTFOLIO ANALYSIS

This technique is particularly useful for multi-divisional or multi-product companies. The divisions or products comprise the organisations "business portfolio". The composition of the portfolio can be critical to the growth and success of the company. The BCG growth/share matrix is divided into four cells or quadrants, each of which represents a particular type of business. Divisions or products are represented by circles. The size of the circle reflects the relative significance of the division/product to group sales. A development of the matrix is to reflect the relative profit contribution of each division and this is shown as a pie-segment within the circle. The BCG is simple and useful technique for strategic analysis. It is convenient for multi-product or multi-divisional companies. It focuses on cash flow and is useful for investment and marketing decisions.



The BCG matrix considers two variables, namely,

Market Growth Rate and Relative Market Share

I-Question Mark (Market growth is high and Market share is low)

Products and their respective strategies fall into one of four quadrants. The typical starting point for a new business is as a question mark. If the product is new, it has no market share, but the predicted growth rate is good. What typically happens in an organization is that management is faced with a number of these types of products but with too few resources to develop all of them. Thus, the strategic decision-maker must determine which of the products to attempt to develop into commercially viable products and which ones to drop from consideration. Question marks are cash users in the organization. Early in their life, they contribute no revenues and require expenditures for market research, test marketing, and advertising to build consumer awareness.

Note: Market Penetration • Market Development • Product Development • Divestiture

II-Stars (Market growth is high and Market share is high)

If the correct decision is made and the product selected achieves a high market share, it becomes a BCG matrix star. Stars have high market share in high-growth markets. Stars generate large cash flows for the business, but also require large infusions of money to sustain their growth. Stars are often the targets of large expenditures for advertising and research and development to improve the product and to enable it to establish a dominant position in the industry.

Note: Backward, Forward, or Horizontal Integration • Market Penetration • Market Development • Product Development

III-Cash Cows (Market growth rate is low and market share is low)

Cash cows are business units that have high market share in a low-growth market. These are often products in the maturity stage of the product life cycle. They are usually well-established products with wide consumer acceptance, so sales revenues are usually high. The strategy for such products is to invest little money into maintaining the product and divert the large profits generated into products with more long-term earnings potential, i.e., question marks and stars.

Note: Product Development • Diversification • Retrenchment • Divestiture

IV-Dogs (Market growth rate is low and Market share is low)

Dogs are businesses with low market share in low-growth markets. These are often cash cows that have lost their market share or question marks the company has elected not to develop. The recommended strategy for these businesses is to dispose of them for whatever revenue they will generate and reinvest the money in more attractive businesses (question marks or stars).

Note: Retrenchment • Divestiture • Liquidation

Despite its simplicity, the BCG matrix suffers from limited variables on which to base resource allocation decisions among the business making up the corporate portfolio. Notice that the only two variables composing the matrix are relative market share and the rate of market growth. Now consider how many other factors contribute to business success or failure. Management talent, employee commitment, industry forces such as buyer and supplier power and the introduction of strategically-equivalent substitute products or services, changes in consumer preferences, and a host of others determine ultimate business viability. The BCG matrix is best used, then, as a beginning point, but certainly not as the final determination for resource allocation decisions as it was originally intended. Consider, for instance, Apple Computer. With a market share for its Macintosh-based computers below ten percent in a market notoriously saturated with a number of low-cost competitors and growth rates well-below that of other technology pursuits such as biotechnology and medical device products, the BCG matrix would suggest Apple divest its computer business and focus instead on the rapidly growing iPod business (its music download business). Clearly, though, there are both technological and market synergies between Apple's Macintosh computers and its fast-growing iPod business. Divesting the computer business would likely be tantamount to destroying the iPod business.

PORTER'S GENERIC STRATEGIES

If the primary determinant of a firm's profitability is the attractiveness of the industry in which it operates, an important secondary determinant is its position within that industry. Even though an industry may have below-average profitability, a firm that is optimally positioned can generate superior returns. A firm positions itself by leveraging its strengths. Michael Porter has argued that a firm's strengths ultimately fall into one of two headings: cost advantage and differentiation. By applying these strengths in either a broad or narrow scope, three generic strategies result: cost leadership, differentiation, and focus. These strategies are applied at the business unit level. They are called generic strategies because they are not firm or industry dependent.

Three of the most widely read books on competitive analysis in the 1980s were Michael Porter's *Competitive Strategy*, *Competitive Advantage*, and *Competitive Advantage of Nations*. In his various books, Porter developed three generic strategies that, he argues, can be used singly or in combination to create a defensible position and to outperform competitors, whether they are within an industry or across nations. Porter states that the strategies are generic because they are applicable to a large variety of situations and contexts. The generic strategies provide direction for firms in designing incentive systems, control procedures, and organizational arrangements. Following is a description of this work.

The strategies are

- (1) Overall cost leadership strategy
- (2) Differentiation strategy
- (3) Focus strategy
- (4) Combination strategy

1. Overall Cost Leadership Strategy

Overall cost leadership requires firms to develop policies aimed at becoming and remaining the lowest-cost producer and/or distributor in the industry. Company strategies aimed at controlling costs include construction of efficient-scale facilities, tight control of costs and overhead, avoidance of marginal customer accounts, minimization of operating expenses, reduction of input costs, tight control of labor costs, and lower distribution costs. The low-cost leader gains competitive advantage by getting its costs of production or distribution lower than those of the other firms in its market. The strategy is especially important for firms selling unbranded commodities such as beef or steel.

Department stores and other high-margin firms often leave their selling price as SP, the original selling price. This allows the low-cost leader to obtain a higher profit margin than they received before the reduction in costs. Since the competition was unable to lower their costs, they are receiving the original, smaller profit margin. The cost leader gains competitive advantage over the competition by earning more profit for each unit sold.

Discount stores such as Wal-Mart are more likely to pass the savings from the lower costs on to customers in the form of lower prices. These discounters retain the original profit margin, which is the same margin as their competitors. However, they are able to lower their selling price due to their lower costs. They gain competitive advantage by being able to under-price the competition while maintaining the same profit margin.

Overall cost leadership is not without potential problems. Two or more firms competing for cost leadership may engage in price wars that drive profits to very low levels. Ideally, a firm using a cost leader strategy will develop an advantage that is not easily copied by others. Cost leaders also must maintain their investment in state-of-the-art equipment or face the possible entry of more cost-effective competitors. Major changes in technology may drastically change production processes so that previous investments in production technology are no longer advantageous. Finally, firms may become so concerned with maintaining low costs that needed changes in production or marketing are overlooked. The strategy may be more difficult in a dynamic environment because some of the expenses that firms may seek to minimize are research and development costs or marketing research costs, yet these are expenses the firm may need to incur in order to remain competitive.

2. Differentiation Strategy

The second generic strategy, differentiating the product or service, requires a firm to create something about its product or service that is perceived as unique throughout the industry. Whether the features are real or just in the mind of the customer, customers must perceive the product as having desirable features not commonly found in competing products. The customers also must be relatively price-insensitive. Adding product features means that the production or distribution costs of a differentiated product may be somewhat higher than the price of a generic, non-differentiated product. Customers must be willing to pay more than the marginal cost of adding the differentiating feature if a differentiation strategy is to succeed.

Differentiation may be attained through many features that make the product or service appear unique. Possible strategies for achieving differentiation may include:

- Warranties (E.g.: Dell corporation)
- Brand Image (E.g.: Coach Handbags, Tommy Hilfiger Sportswear)
- Technology (E.g.: Hewlett-Packard Laser Printers)
- Features (E.g.: Apple phones, Whirlpool Appliances)
- Service (E.g.: Maruti Suzuki cars)
- Quality/Value (E.g.: Walt Disney Company)
- Dealer Network (E.g.: Caterpillar Construction Equipment)

Differentiation does not allow a firm to ignore costs; it makes a firm's products less susceptible to cost pressures from competitors because customers see the product as unique and are willing to pay extra to have the product with the desirable features. Differentiation can be achieved through real product features or through advertising that causes the customer to perceive that the product is unique.

Differentiation may lead to customer brand loyalty and result in reduced price elasticity. Differentiation may also lead to higher profit margins and reduce the need to be a low-cost producer. Since customers see the product as different from competing products and they like the product features, customers are willing to pay a premium for these features. As long as the firm can increase the selling price by more than the marginal cost of adding the features, the profit margin is increased. Firms must be able to charge more for their differentiated product than it costs them to make it distinct, or else they may be better off making generic, undifferentiated products. Firms must remain sensitive to cost differences. They must carefully monitor the incremental costs of differentiating their product and make certain the difference is reflected in the price.

Firms pursuing a differentiation strategy are vulnerable to different competitive threats than firms pursuing a cost leader strategy. Customers may sacrifice features, service, or image for cost savings. Customers who are price sensitive may be willing to forgo desirable features in favor of a less costly alternative. This can be seen in the growth in popularity of store brands and private labels. Often, the same firms that produce name-brand products produce the private label products. The two products may be physically identical, but stores are able to sell the private label products for a lower price because very little money was put into advertising in an effort to differentiate the private label product.

Imitation may also reduce the perceived differences between products when competitors copy product features. Thus, for firms to be able to recover the cost of marketing research or R&D, they may need to add a product feature that is not easily copied by a competitor. A final risk for firms pursuing a differentiation strategy is changing consumer tastes. The feature that customers like and find attractive about a product this year may not make the product popular next year. Changes in customer tastes are especially obvious in the apparel industry. Polo Ralph Lauren has been a very successful brand in the fashion industry. However, some younger consumers have shifted to Tommy Hilfiger and other youth-oriented brands.

Ralph Lauren, founder and CEO, has been the guiding light behind his company's success. Part of the firm's success has been the public's association of Lauren with the brand. Ralph Lauren leads a high-profile lifestyle of preppy elegance. His appearance in his own commercials, his Manhattan duplex, his Colorado ranch, his vintage car collection, and private jet have all contributed to the public's fascination with the man and his brand name. This image has allowed the firm to market everything from suits and

ties to golf balls. Through licensing of the name, the Lauren name also appears on sofas, soccer balls, towels, table-ware, and much more.

3. Focus Strategy

The generic strategies of cost leadership and differentiation are oriented toward industry-wide recognition. The final generic strategy, focusing (also called niche or segmentation strategy), involves concentrating on a particular customer, product line, geographical area, channel of distribution, stage in the production process, or market niche. The underlying premise of the focus strategy is that a firm is better able to serve a limited segment more efficiently than competitors can serve a broader range of customers. Firms using a focus strategy simply apply a cost leader or differentiation strategy to a segment of the larger market. Firms may thus be able to differentiate themselves based on meeting customer needs, or they may be able to achieve lower costs within limited markets. Focus strategies are most effective when customers have distinctive preferences or specialized needs.

A focus strategy is often appropriate for small, aggressive businesses that do not have the ability or resources to engage in a nationwide marketing effort. Such a strategy may also be appropriate if the target market is too small to support a large-scale operation. Many firms start small and expand into a national organization. For instance, Wal-Mart started in small towns in the South and Midwest. As the firm gained in market knowledge and acceptance, it expanded through-out the South, then nationally, and now internationally. Wal-Mart started with a focused cost leader strategy in its limited market, and later was able to expand beyond its initial market segment.

A firm following the focus strategy concentrates on meeting the specialized needs of its customers. Products and services can be designed to meet the needs of buyers. One approach to focusing is to service either industrial buyers or consumers, but not both. Martin-Brower, the third-largest food distributor in the United States, serves only the eight leading fast-food chains. With its limited customer list, Martin-Brower need only stock a limited product line; its ordering procedures are adjusted to match those of its customers; and its warehouses are located so as to be convenient to customers.

Firms utilizing a focus strategy may also be better able to tailor advertising and promotional efforts to a particular market niche. Many automobile dealers advertise that they are the largest volume dealer for a specific geographic area. Other car dealers advertise that they have the highest customer satisfaction scores within their defined market or the most awards for their service department.

Firms may be able to design products specifically for a customer. Customization may range from individually designing a product for a customer to allowing customer input into the finished product. Tailor-made clothing and custom-built houses include the customer in all aspects of production, from product design to final acceptance. Key decisions are made with customer input. However, providing such individualized attention to customers may not be feasible for firms with an industry-wide orientation.

Other forms of customization simply allow the customer to select from a menu of predetermined options. Burger King advertises that its burgers are made "your way," meaning that the customer gets to select from the predetermined options of pickles, lettuce, and so on. Similarly, customers are allowed to design their own automobiles within the constraints of predetermined colors, engine sizes, interior options, and so forth.

Potential difficulties associated with a focus strategy include a narrowing of differences between the limited market and the entire industry. National firms routinely monitor the strategies of competing firms in their various submarkets. They may then copy the strategies that appear particularly successful. The national firm, in effect, allows the focused firm to develop the concept, then the national firm may emulate the strategy of the smaller firm or acquire it as a means of gaining access to its technology or

processes. Emulation increases the ability of other firms to enter the market niche while reducing the cost advantages of serving the narrower market.

Market size is always a problem for firms pursuing a focus strategy. The targeted market segment must be large enough to provide an acceptable return so that the business can survive. For instance, ethnic restaurants are often unsuccessful in small U.S. towns, since the population base that enjoys Japanese or Greek cuisine is too small to allow the restaurant operator to make a profit. Likewise, the demand for an expensive, upscale restaurant is usually not sufficient in a small town to make its operation economically feasible.

3:Combination Strategies

Can forms of competitive advantage be combined? Porter asserts that a successful strategy requires a firm to aggressively stake out a market position, and that different strategies involve distinctly different approaches to competing and operating the business. An organization pursuing a differentiation strategy seeks competitive advantage by offering products or services that are unique from those offered by rivals, either through design, brand image, technology, features, or customer service. Alternatively, an organization pursuing a cost leadership strategy attempts to gain competitive advantage based on being the overall low-cost provider of a product or service. To be "all things to all people" can mean becoming "stuck in the middle" with no distinct competitive advantage. The difference between being "stuck in the middle" and successfully pursuing combination strategies merits discussion. Although Porter describes the dangers of not being successful in either cost control or differentiation, some firms have been able to succeed using combination strategies.

Research suggests that, in some cases, it is possible to be a cost leader while maintaining a differentiated product. Southwest Airlines has combined cost cutting measures with differentiation. The company has been able to reduce costs by not assigning seating and by eliminating meals on its planes. It has then been able to promote in its advertising that one does not get tasteless airline food on its flights. Its fares have been low enough to attract a significant number of passengers, allowing the airline to succeed.

Another firm that has pursued an effective combination strategy is Nike. When customer preferences moved to wide-legged jeans and cargo pants, Nike's market share slipped. Competitors such as Adidas offered less expensive shoes and undercut Nike's price. Nike's stock price dropped in 1998 to half its 1997 high. However, Nike reported a 70 percent increase in earnings for the first quarter of 1999 and saw a significant rebound in its stock price. Nike achieved the turn-around by cutting costs and developing new, distinctive products. Nike reduced costs by cutting some of its endorsements. Company research suggested the endorsement by the Italian soccer team, for example, was not achieving the desired results. Michael Jordan and a few other "big name" endorsers were retained while others, such as the Italian soccer team, were eliminated, resulting in savings estimated at over \$100 million. Firing 7 percent of its 22,000 employees allowed the company to lower costs by another \$200 million, and inventory was reduced to save additional money. While cutting costs, the firm also introduced new products designed to differentiate Nike's products from those of the competition.

Some industry environments may actually call for combination strategies. Trends suggest that executives operating in highly complex environments such as health care do not have the luxury of choosing exclusively one strategy over the other. The hospital industry may represent such an environment, as hospitals must compete on a variety of fronts. Combination (i.e., more complicated) strategies are both feasible and necessary to compete successfully. For instance, DRG-based reimbursement (diagnosis related groups) and the continual lowering of reimbursement ceilings have forced hospitals to compete on the basis of cost. At the same time, many of them jockey for position with differentiation based on such features as technology and birthing rooms. Thus, many hospitals may need to adopt some form of hybrid strategy in order to compete successfully, according to Walters

GENERIC STRATEGIES AND THE INTERNET

Porter asserts that these generic competitive strategies were not only relevant for the old economy, but are just as vital today. Indeed, he goes on to say that terms such as “old economy” and “new economy” may be misguided, and the concept of a firm’s Internet operation as a stand-alone entity preclude the firm from garnering important synergies. Furthermore, the Internet may enhance a firm’s opportunities for achieving or strengthening a distinctive strategic positioning. Therefore, effective strategy formulation at the business level should pay off, not in spite of the Internet, but in concert with it.

Porter describes how companies can set themselves apart in at least two ways: operational effectiveness (doing the same activities as competitors but doing them better) and strategic positioning (doing things differently and delivering unique value for customers). “The Internet affects operational effectiveness and strategic positioning in very different ways. It makes it harder for companies to sustain operational advantages, but it opens new opportunities for achieving or strengthening a distinctive strategic positioning.” Although the Internet is a powerful tool for enhancing operational effectiveness, these enhancements alone are not likely to be sustained because of copying by rivals. This state of affairs elevates the importance of defining for the firm a unique value proposition. Internet technology can be a complement to successful strategy, but it is not sufficient. “Frequently, in fact, Internet applications address activities that, while necessary, are not decisive in competition, such as informing customers, processing transactions, and procuring inputs. Critical corporate assets—skilled personnel, proprietary product technology, efficient logistical systems—remain intact, and they are often strong enough to preserve existing competitive advantages.”

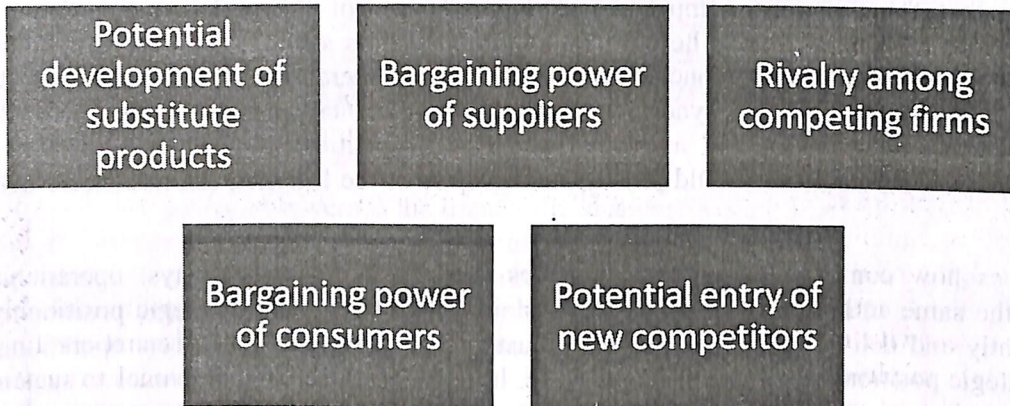
Porter’s generic business strategies provide a set of methods that can be used singly or in combination to create a defensible business strategy. They also allow firms that use them successfully to gain a competitive advantage over other firms in the industry. Firms either strive to obtain lower costs than their competitors or to create a perceived difference between their product and the products of competitors. Firms can pursue their strategy on a national level or on a more focused, regional basis.

Clearly, Michael Porter’s work has had a remarkable impact on strategy research and practice. The annual Porter Prize, akin to the Deming Prize, was established in 2001 in Japan to recognize that nation’s leading companies in terms of strategy. Porter’s ideas have stood the test of time and appear to be relevant both for profit-seeking enterprises and not-for-profit institutes in a variety of international settings. When a firm sustains profits that exceed the average for its industry, the firm is said to possess a competitive advantage over its rivals. The goal of much of business strategy is to achieve a sustainable competitive advantage.

MICHAEL PORTER FIVE FORCES MODEL

Model for industry analysis

Michael Porter provided a framework that models an industry as being influenced by five forces. The strategic business manager seeking to develop an edge over rival firms can use this model to better understand the industry context in which the firm operates. The model of pure competition implies that risk-adjusted rates of return should be constant across firms and industries. However, numerous economic studies have affirmed that different industries can sustain different levels of profitability; part of this difference is explained by industry structure.



I. Rivalry among competing firms

In the traditional economic model, competition among rival firms drives profits to zero. But competition is not perfect and firms are not unsophisticated passive price takers. Rather, firms strive for a competitive advantage over their rivals. The intensity of rivalry among firms varies across industries, and strategic analysts are interested in these differences. Economists measure rivalry by indicators of industry concentration. With only a few firms holding a large market share, the competitive landscape is less competitive (closer to a monopoly). A low concentration ratio indicates that the industry is characterized by many rivals, none of which has a significant market share. These fragmented markets are said to be competitive. The concentration ratio is not the only available measure; the trend is to define industries in terms that convey more information than distribution of market share.

If rivalry among firms in an industry is low, the industry is considered to be disciplined. This discipline may result from the industry's history of competition, the role of a leading firm, or informal compliance with a generally understood code of conduct. Explicit collusion generally is illegal and not an option; in low-rivalry industries competitive moves must be constrained informally. However, a maverick firm seeking a competitive advantage can displace the otherwise disciplined market.

The intensity of rivalry is influenced by the following industry characteristics:

A larger number of firms increase rivalry because more firms must compete for the same customers and resources. The rivalry intensifies if the firms have similar market share, leading to a struggle for market leadership. Slow market growth causes firms to fight for market share. In a growing market, firms are able to improve revenues simply because of the expanding market. High fixed costs result in an economy of scale effect that increases rivalry. When total costs are mostly fixed costs, the firm must produce near capacity to attain the lowest unit costs. Since the firm must sell this large quantity of product, high levels of production lead to a fight for market share and results in increased rivalry. High storage costs or highly perishable products cause a producer to sell goods as soon as possible. If other producers are attempting to unload at the same time, competition for customers intensifies. Low switching costs increases rivalry. When a customer can freely switch from one product to another there is a greater struggle to capture customers. Low levels of product differentiation are associated with higher levels of rivalry. Brand identification, on the other hand, tends to constrain rivalry. Strategic stakes are high when a firm is losing market position or has potential for great gains. This intensifies rivalry. High exit barriers place a high cost on abandoning the product. The firm must compete.

High exit barriers cause a firm to remain in an industry, even when the venture is not profitable. A common exit barrier is asset specificity. When the plant and equipment required for manufacturing a product is highly specialized, these assets cannot easily be sold to other buyers in another industry. Litton Industries' acquisition of Ingalls Shipbuilding facilities illustrates this concept. Litton was successful in the 1960's with its contracts to build Navy ships. But when the Vietnam war ended, defense spending declined and Litton saw a sudden decline in its earnings. As the firm restructured, divesting from the shipbuilding plant was not feasible since such a large and highly specialized investment could not be sold easily, and Litton was forced to stay in a declining shipbuilding market. A diversity of rivals with different cultures, histories, and philosophies make an industry unstable. There is greater possibility for mavericks and for misjudging rival's moves. Rivalry is volatile and can be intense. The hospital industry, for example, is populated by hospitals that historically are community or charitable institutions, by hospitals that are associated with religious organizations or universities, and by hospitals that are for-profit enterprises. This mix of philosophies about mission has lead occasionally to fierce local struggles by hospitals over who will get expensive diagnostic and therapeutic services. At other times, local hospitals are highly cooperative with one another on issues such as community disaster planning.

When a rival acts in a way that elicits a counter-response by other firms, rivalry intensifies. The intensity of rivalry commonly is referred to as being cutthroat, intense, moderate, or weak, based on the firms' aggressiveness in attempting to gain an advantage.

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

- Changing prices - raising or lowering prices to gain a temporary advantage.
- Improving product differentiation - improving features, implementing innovations in the manufacturing process and in the product itself.
- Creatively using channels of distribution - using vertical integration or using a distribution channel that is novel to the industry. For example, with high-end jewelry stores reluctant to carry its watches, Timex moved into drugstores and other non- traditional outlets and cornered the low to mid-price watch market.
- Exploiting relationships with suppliers - for example, from the 1950's to the 1970's Sears, Roebuck and Co. dominated the retail household appliance market. Sears set high quality standards and required suppliers to meet its demands for product specifications and price.

II. Threat of Substitutes

In Porter's model, substitute products refer to products in other industries. To the economist, a threat of substitutes exists when a product's demand is affected by the price change of a substitute product. A product's price elasticity is affected by substitute products - as more substitutes become available, the demand becomes more elastic since customers have more alternatives. A close substitute product constrains the ability of firms in an industry to raise prices.

The competition engendered by a Threat of Substitute comes from products outside the industry. The price of aluminum beverage cans is constrained by the price of glass bottles, steel cans, and plastic containers. These containers are substitutes, yet they are not rivals in the aluminum can industry. To the manufacturer of automobile tires, tire retreads are a substitute. Today, new tires are not so expensive that car owners give much consideration to retreating old tires. But in the trucking industry new tires are expensive and tires must be replaced often. In the truck tire market, retreating remains a viable substitute industry. In the disposable diaper industry, cloth diapers are a substitute and their prices constrain the price of disposables.

While the treat of substitutes typically impacts an industry through price competition, there can be other concerns in assessing the threat of substitutes. Consider the substitutability of different types of TV

transmission: local station transmission to home TV antennas via the airways versus transmission via cable, satellite, and telephone lines. The new technologies available and the changing structure of the entertainment media are contributing to competition among these substitute means of connecting the home to entertainment. Except in remote areas it is unlikely that cable TV could compete with free TV from an aerial without the greater diversity of entertainment that it affords the customer.

III. Bargaining Power of consumers

The power of buyers is the impact that customers have on a producing industry. In general, when buyer power is strong, the relationship to the producing industry is near to what an economist terms a monopsony - a market in which there are many suppliers and one buyer. Under such market conditions, the buyer sets the price. In reality few pure monopsonies exist, but frequently there is some asymmetry between a producing industry and buyers.

IV. Bargaining Power of suppliers

A producing industry requires raw materials - labor, components, and other supplies. This requirement leads to buyer-supplier relationships between the industry and the firms that provide it the raw materials used to create products. Suppliers, if powerful, can exert an influence on the producing industry, such as selling raw materials at a high price to capture some of the industry's profits.

V. Barriers to Entry / Threat of Entry

It is not only incumbent rivals that pose a threat to firms in an industry; the possibility that new firms may enter the industry also affects competition. In theory, any firm should be able to enter and exit a market, and if free entry and exit exists, then profits always should be nominal. In reality, however, industries possess characteristics that protect the high profit levels of firms in the market and inhibit additional rivals from entering the market. These are barriers to entry.

Barriers to entry are more than the normal equilibrium adjustments that markets typically make. For example, when industry profits increase, we would expect additional firms to enter the market to take advantage of the high profit levels, over time driving down profits for all firms in the industry. When profits decrease, we would expect some firms to exit the market thus restoring a market equilibrium. Falling prices, or the expectation that future prices will fall, deters rivals from entering a market. Firms also may be reluctant to enter markets that are extremely uncertain, especially if entering involves expensive start-up costs. These are normal accommodations to market conditions. But if firms individually (collective action would be illegal collusion) keep prices artificially low as a strategy to prevent potential entrants from entering the market, such entry-detering pricing establishes a barrier.

Barriers to entry are unique industry characteristics that define the industry. Barriers reduce the rate of entry of new firms, thus maintaining a level of profits for those already in the industry. From a strategic perspective, barriers can be created or exploited to enhance a firm's competitive advantage. Barriers to entry arise from several sources:

Government creates barriers. Although the principal role of the government in a market is to preserve competition through anti-trust actions, government also restricts competition through the granting of monopolies and through regulation. Industries such as utilities are considered natural monopolies because it has been more efficient to have one electric company provide power to a locality than to permit many electric companies to compete in a local market. To restrain utilities from exploiting this advantage, government permits a monopoly, but regulates the industry. Illustrative of this kind of barrier to entry is the local cable company. The franchise to a cable provider may be granted by competitive bidding, but once the franchise is awarded by a community a monopoly is created. Local governments were not effective in monitoring price gouging by cable operators, so the federal government has enacted legislation to review and restrict prices.

CHAPTER X

STRATEGIC BUSINESS UNIT (SBU)

Strategic Business Unit is any part of a business organization which is treated separately for strategic management purpose. The SBU structure groups similar divisions into strategic business units and delegates authority and responsibility for each unit to a senior executive who reports directly to the chief executive officer. This change in strategy can facilitate strategy implementation by improving coordination between similar divisions and channeling accountability to distinct business units.

An SBU has three characteristics:

- It is a single business or collection of related business that can be planned separately from the rest of the company.
- It has its own set of competition.
- It has a manager who is responsible for strategic planning and profit performance and who controls most of the factors affecting profit.

The purpose of identifying the company's strategic business units is to assign to these units strategic planning goals and appropriate tending. These units send their plans to company headquarters which approves them and sends them back for revision. The head office reviews these plans in order to decide which of its SBU to Build, Maintain, Harvest and Divest. When companies face difficulty due to its high complexity of operations size, different areas of operation etc. the top management cannot control the whole company. Here the concept of SBU is helpful in creating an SBU organizational structure.

The advantages of SBU are:

- Establishes co-ordination between divisions having common strategic interests.
- Facilitates strategic management and control of large, diverse organizations.
- Fixes accountability at very distinct business units.

The Disadvantages are:

- There are too many different SBU's to handle effectively in large diverse organizations.
- Difficulty in assigning responsibility and defining autonomy for SBU heads.
- By adding another layer of management it means it takes longer to take a corporate decision.

MERGERS AND ACQUISITIONS

Merger and acquisition are two commonly used ways to pursue strategies. A merger occurs when two organizations of about equal size unite to form one enterprise. An acquisition occurs when a large organization purchases (acquires) a smaller firm, or vice versa. When a merger or acquisition is not desired by both parties, it can be called a takeover or hostile takeover. In contrast, if the acquisition is desired by both firms, it is termed a friendly merger. Most mergers are friendly

In merger, a firm may acquire another firm or two or more firm may combine together to improve their competitive strength or to gain control over additional facilities. Merger may be of two types: A firm merges with other firms in the same industry having similar or related products, using similar processes and distributing through similar channels. Such a merger creates problems of co-ordination between the merged units. The latter type of merger, firms merging together are engaged in altogether different lines of business and have little common in their products, processes and distribution channel. They are known as conglomerate merger.

Acquisition or take-over: Acquisition generally refers to buying another firm, either its assets or as an operating company. In a takeover, or acquisition, one company gets control over the acquired company. Takeover involves a change in ownership and management of the acquired company. In pre 1991 India, the MRTP Act, Industrial Licensing Policy and the companies Act, 1956 etc. made takeovers difficult to accomplish. The post 1991 scenario is of course, very different. There are several instances of takeovers; both friendly and hostile are reported since 1992.

Merger is contained in sections 394 to 396 of the Companies Act. But these sections have to be interpreted in conjunction with section 94 (Power of limited companies to alter share capital) 95, 97 (dealing with special resolution for reduction of capital), 101, 102, 104 and 107. Some of the important provisions of the Companies Act deal with the power of the court, with whom an application for amalgamation has been pending, to make any alternation or modification in the scheme for amalgamation. The most important aspect is the protection of the interests of the dissenting shareholders. Any scheme for transfer of whole or any part of an undertaking requires the approval of the three-fourths in value and three-fourths in number of share holders of the company. Probably the most important section is 396 dealing with the power of the Central Government to provide for amalgamation of companies in public interest. The sick units are being amalgamated with other companies or are being taken over by the Government.

In actual practice it is difficult to draw a distinction between mergers and acquisitions. Strictly speaking, in case of mergers, the existing companies lose their identity and a new company is formed, while in the case of acquisitions it is the purchase of a company by another company. Madura Coats is a company born out of the merger of Madura Mills and Coats India Limited in early seventies.

At times it is profitable to diversify through mergers. The process of mergers gives the advantage of not having to start from scratch. Amalgamations enable the companies to have advantage of fast changing technologies: the underlying assumption in this case is that one of the merged companies enjoys distinct strength in the area of R&D. Mergers may also enable reduction in administrative costs. Given the indivisibility of certain expenditure on personnel, the merger will result in better utilisation of their time. Further, the merger may facilitate the process of linking the products and may amount to vertical integration. This could be undertaken where for various reasons the merging companies individually would not have been able to implement vertical integration. The process often results in providing a complete product line. It goes without saying that some companies undertake merger as a means to plan their tax liability. (The most amusing example is provided by an advertisement which appeared in a reputed newspaper stating 'wanted companies which may have incurred a loss upto a specified amount).

Here is a detailed procedure for screening projects for diversification based on merger. The sequential steps are:

- (i) Define the objective of merger (to reflect how better utilisation of resources is to be achieved and the manner in which the adaptability to the changing environment is going to take place)
- (ii) Review the strengths and weaknesses,
- (iii) Develop criteria to identify the most advantageous merger prospects,
- (iv) Find out the financial resources available, and
- (v) Develop strategies for choosing among the industries.

Desirably, the management of the buying company should be aware of the extent of its need for the other company because the price payable (or the exchange ratio) depends upon the bargaining power of the two managements. Management of the buying company has to convince the management of the selling company that the sale is in the latter's interests. One has to look to the alternative offers the selling

company may be having. If the forecasts of resources generated after merger show a brighter picture, a generous price offer can be made. The factors to be considered for a successful merger or acquisition include

- 1) Study of relevant information and forecasts to identify the maximum price and the mode of payment.
- 2) Incorporation of non-price terms in the final contract.
- 3) Formulation of alternative course of actions and their implications with contingency provisions.
- 4) Awareness of company's stand on ethics, integrity and honesty.
- 5) Review of the related factors like timing of the negotiations, the person to negotiate.
- 6) Identify the alternatives that may be open to this company regarding price and the mode of payment.
- 7) Substantiate or cross-check the information.
- 8) Review the assumptions by approaching the problem from the seller's point of view.
- 9) Identify the factors that could be important to the other company.

Reasons for failure of Mergers and Acquisitions:

- Integration difficulties
- Inadequate evaluation of target
- Large or extraordinary debt
- Inability to achieve synergy
- Too much diversification
- Managers overly focused on acquisitions
- Difficult to integrate different organizational cultures
- Reduced employee morale due to layoffs and relocation

JOINT VENTURE/PARTNERING

Joint venture is a popular strategy that occurs when two or more companies form a temporary partnership or consortium for the purpose of capitalizing on some opportunity. Often, the two or more sponsoring firms form a separate organization and have shared equity ownership in the new entity. Other types of cooperative arrangements include research and development partnerships, cross-distribution agreements, cross-licensing agreements, cross-manufacturing agreements, and joint-bidding consortia. Once bitter rivals, Nokia Corp. and Qualcomm recently formed a cooperative agreement to develop next-generation cell phones for North America to hit the market in mid-2010. Based in Finland, Nokia has roughly 40 percent of the global cell phone market but has lagged behind in North America. Joint ventures and cooperative arrangements are being used increasingly because they allow companies to improve communications and networking, to globalize operations, and to minimize risk. Joint ventures and partnerships are often used to pursue an opportunity that is too complex, uneconomical, or risky for a single firm to pursue alone. Such business creations also are used when achieving and sustaining competitive advantage when an industry requires a broader range of competencies and know-how than any one firm can marshal.

In today's global business environment of scarce resources, rapid rates of technological change, and rising capital requirements, the important question is no longer "Shall we form a joint venture?" Now the question is "Which joint ventures and cooperative arrangements are most appropriate for our needs and expectations?" followed by "How do we manage these ventures most effectively?"

In a global market tied together by the Internet, joint ventures, and partnerships, alliances are proving to be a more effective way to enhance corporate growth than mergers and acquisitions. Strategic partnering takes many forms, including outsourcing, information sharing, joint marketing, and joint research and development. Many companies, such as Eli Lilly, now host partnership training classes for their managers and partners. There are today more than 50,000 joint ventures formed annually, more than all mergers and acquisitions. There are countless examples of successful strategic alliances, such as Internet coverage. A major reason why firms are using partnering as a means to achieve strategies is globalization. Wal-Mart's successful joint venture with Mexico's Cifra is indicative of how a domestic

firm can benefit immensely by partnering with a foreign company to gain substantial presence in that new country. Technology also is a major reason behind the need to form strategic alliances, with the Internet linking widely dispersed partners. The Internet paved the way and legitimized the need for alliances to serve as the primary means for corporate growth. Evidence is mounting that firms should use partnering as a means for achieving strategies. However, the sad fact is that most Indian firms in many industries—such as financial services, forest products, metals, and retailing—still operate in a merger or acquire mode to obtain growth. Partnering is not yet taught at most business schools and is often viewed within companies as a financial issue rather than a strategic issue. However, partnering has become a core competency, a strategic issue of such importance that top management involvement initially and throughout the life of an alliance is vital.

Joint ventures among once rival firms are commonly being used to pursue strategies ranging from retrenchment to market development. Although ventures and partnerships are preferred over mergers as a means for achieving strategies, certainly they are not all successful. The good news is that joint ventures and partnerships are less risky for companies than mergers, but the bad news is that many alliances fail. Forbes has reported that about 30 percent of all joint ventures and partnership alliances are outright failures, while another 17 percent have limited success and then dissipate due to problems. There are countless examples of failed joint ventures. A few common problems that cause joint ventures to fail are as follows:

- Managers who must collaborate daily in operating the venture are not involved in forming or shaping the venture.
- The venture may benefit the partnering companies but may not benefit customers, who then complain about poorer service or criticize the companies in other ways.
- The venture may not be supported equally by both partners. If supported unequally, problems arise.
- The venture may begin to compete more with one of the partners than the other.
- Some guidelines for when a joint venture may be an especially effective means for pursuing strategies are:
 - When a domestic organization is forming a joint venture with a foreign company; a joint venture can provide a domestic company with the opportunity for obtaining local management in a foreign country, thereby reducing risks such as expropriation and harassment by host country officials.
 - When the distinct competencies of two or more firms complement each other especially well.
 - When some project is potentially very profitable but requires overwhelming resources and risks.
 - When two or more smaller firms have trouble competing with a large firm.
 - When there exists a need to quickly introduce a new technology.

CHAPTER XI

STRATEGIC IMPLEMENTATION

Google-doing best even in times of economic slowdown

When most firms were struggling in, Google increased its revenues and profits such that Fortune magazine rated Google as their fourth "Most Admired Company in the World" in terms of their management and performance. These results widened Google's lead in overall searches and online advertising market share. Google owns both YouTube and Double Click. Google in 2009 began selling books online. This related diversification strategy led Google to digitize close to 10 million books by year's end. Google cofounder Sergey Brin recently said, "Call me weird, but I think there are a lot of advantages to reading books online. Today's monitors have great resolution and you don't have to wait on the book to arrive once ordered." Google does not charge people to use its search engine. Instead of charging what the market will bear as most firms do, Google charges as little as they can bear. Thus Google obtains networks of people, millions of people, which strengthens its competitive position. Google's founders, Larry Page and Sergey Brin, each have nearly 30 percent voting control of the firm and have established a golden rule that permeates Google's internal culture. The rule is to "Don't be evil," and this operating policy encourages all employees to challenge all managers on decisions to make sure the decisions are true to the firm's mission. Another internal rule at Google is to "Give up control," which means giving up control to outsiders to reap the benefits of their input. This latter rule is done through beta launches of any new software, product, or service they do. Google's strategic plan is to attack Microsoft in nearly all of its businesses, including browsers, where Google has 1.8 percent market share versus Microsoft's 66 percent, smart phone operating systems (Google 1.6% versus Microsoft 10%), office suites (Google 0.04% versus Microsoft 94%), and Web searches (Google 65% versus Microsoft 8%). Google's Chrome OS operating system will require users to be connected to the Internet, unlike Microsoft's operating systems. CEO Eric Schmidt at Google has been on a mission for the last several years, according to analysts, to capture Microsoft's market share. The Google strategy is accelerating a shift in the personal computer (PC) industry to become more like the cell phone industry whereby customers pay monthly service fees for use of hardware and software. Google's Chrome will be free to all computer makers such as Hewlett-Packard who historically have pre-installed Microsoft's operating system for a fee to consumers. Microsoft released its new Microsoft Windows 2010 in the fall 2009 and believes that the learning curve for any consumer to switch away to Google's operating system will not be worth the effort. Google.com is the most visited Web site in the world and even in 2009 offered its own online word processing, spreadsheet, and presentation programs free – called Google Docs. The Google strategy is a huge bet that online programs can eventually overtake and crush desktop software. Due to its dominance in the Internet search and advertising business, Google is coming under increasing scrutiny from the U.S. Justice Department regarding possible antitrust infringement. The pending Microsoft/ Yahoo merger may negate that Google vulnerability. Google obtains about 95 percent of its revenues from online advertising.

Successful strategy formulation does not guarantee successful strategy implementation. It is always more difficult to do something (strategy implementation) than to say you are going to do it (strategy formulation)! Although inextricably linked, strategy implementation is fundamentally different from strategy formulation. The strategic-management process does not end when the firm decides what strategy or strategies to pursue. There must be a translation of strategic thought into strategic action. This translation is much easier if managers and employees of the firm understand the business, feel a part of the company, and through involvement in strategy-formulation activities have become committed to helping the organization succeed. Without understanding and commitment, strategy-implementation efforts face major problems. Implementing strategy affects an organization from top to bottom; it affects all the functional and divisional areas of a business. It is beyond the purpose and scope of this text to examine all of the business administration concepts and tools important in strategy implementation.

Even the most technically perfect strategic plan will serve little purpose if it is not implemented. Many organizations tend to spend an inordinate amount of time, money, and effort on developing the strategic plan, treating the means and circumstances under which it will be implemented as afterthoughts! Change comes through implementation and evaluation, not through the plan. A technically imperfect plan that is implemented well will achieve more than the perfect plan that never gets off the paper on which it is typed.

Strategy formulation and implementation can be differentiated in the following ways:

Strategy formulation	Strategy implementation
Strategy formulation is positioning forces before the action	Strategy implementation is managing forces during the action
Strategy formulation focuses on effectiveness	Strategy implementation focuses on efficiency
Strategy formulation is primarily an intellectual process	Strategy implementation is primarily an operational process
Strategy formulation requires good intuitive and analytical skills	Strategy implementation requires special motivation and leadership skills
Strategy formulation requires coordination among a few individuals	Strategy implementation requires coordination among many individuals
Strategy formulation concepts and tools do not differ greatly for small, large, for-profit, or nonprofit organizations.	Strategy implementation varies substantially among different types and sizes of organizations

Strategy implementation directly affects the lives of plant managers, division managers, department managers, sales managers, product managers, project managers, personnel managers, staff managers, supervisors, and all employees. In some situations, individuals may not have participated in the strategy-formulation process at all and may not appreciate, understand, or even accept the work and thought that went into strategy formulation. There may even be foot dragging or resistance on their part. Managers and employees who do not understand the business and are not committed to the business may attempt to sabotage strategy-implementation efforts in hopes that the organization will return to its old ways.

Implementing strategies requires such actions as altering sales territories, adding new departments, closing facilities, hiring new employees, changing an organization's pricing strategy, developing financial budgets, developing new employee benefits, establishing cost-control procedures, changing advertising strategies, building new facilities, training new employees, transferring managers among the different divisions etc.

In all but the smallest organizations, the transition from strategy formulation to strategy implementation requires a shift in responsibility from strategists to divisional and functional managers. Implementation problems can arise because of this shift in responsibility, especially if strategy-

formulation decisions come as a surprise to middle- and lower-level managers. Managers and employees are motivated more by perceived self-interests than by organizational interests, unless the two coincide. Therefore, it is essential that divisional and functional managers be involved as much as possible in strategy-formulation activities. Of equal importance, strategists should be involved as much as possible in strategy-implementation activities. Management issues central to strategy implementation include establishing annual objectives, devising policies, allocating resources, altering an existing organizational structure, restructuring and reengineering, revising reward and incentive plans, minimizing resistance to change, matching managers with strategy, developing a strategy-supportive culture, adapting production/operations processes, developing an effective human

Management changes are necessarily more extensive when strategies to be implemented move a firm in a major new direction. Managers and employees throughout an organization should participate early and directly in strategy-implementation decisions. Their role in strategy implementation should build upon prior involvement in strategy-formulation activities. Strategists' genuine personal commitment to implementation is a necessary and powerful motivational force for managers and employees. Too often, strategists are too busy to actively support strategy-implementation efforts, and their lack of interest can be detrimental to organizational success. The rationale for objectives and strategies should be understood and clearly communicated throughout an organization. Major competitors' accomplishments, products, plans, actions, and performance should be apparent to all organizational members. Major external opportunities and threats should be clear, and managers' and employees' questions should be answered. Top-down flow of communication is essential for developing bottom-up support. Firms need to develop a competitor focus at all hierarchical levels by gathering and widely distributing competitive intelligence; every employee should be able to benchmark her or his efforts against best-in-class competitors so that the challenge becomes personal. For example, Starbucks Corp. in 2013–2014 is instituting "lean production/operations" at its 11,000 U.S. stores. This system eliminates idle employee time and unnecessary employee motions, such as walking, reaching, and bending. Starbucks says 30 percent of employees' time is motion and the company wants to reduce that.

APPROACHES TO STRATEGY IMPLEMENTATION

1. Commander approach
2. Organizational change approach
3. Collaborative approach
4. Cultural approach
5. Crescive approach

1. *Commander approach*

The manager will determine the "best" strategy either alone or with the help of a group of experts. Once the desired strategy is formulated, the manager passes it along to subordinates who are instructed to execute the strategy. In this scenario, the manager does not take an active role in implementing the strategy, but rather uses explicit or implied power to see that the strategy is implemented. There are three conditions that must be met in order for the new strategy to be implemented. First, the manager must have enough power to command the implementation of the strategy. It should be recognized that implementation under this approach is resisted if the new strategy threatens the position of employees. Second, accurate and timely information regarding the strategy must be available, and the environment in which the company operates should be reasonably stable. If the environment is changing so that information becomes dated before it can be assimilated, effective implementation under the approach is unlikely. Finally, the manager formulating the strategy should be insulated from personal biases and political influences that might affect the outcome of the strategy.

One drawback to this approach is that it can reduce employee motivation and employees who feel that they have no say in strategy formulation are unlikely to be very innovative. However the approach can work in smaller companies within stable industries. Advocates of this approach say that managers who utilize it can gain a valuable perspective from the company and the approach allows these managers to focus their energies on strategy formulation. Second, young managers in particular seem to prefer this approach since it allows them to focus on the quantitative, objective aspects of a situation rather than on the qualitative, subjective elements of behavioral interactions. Many young managers are better trained to deal with the objective rather than the subjective. Finally, such an approach may make some ambitious managers feel powerful in that their thinking and decision making affects the activities of the workforce (people).

2. Organizational change approach

The Organizational Change approach focuses on how to get an organization to implement a strategy. Managers who implement this approach assume that a good strategy has been formulated and view their task as getting the company moving toward new goals. The tools used to accomplish this approach are largely behavioral and include such things as changing the organizational structure and staffing to focus attention on the organization's new priorities, revising planning and control systems, and invoking other organizational change techniques. Because these behavioral tools are used, this approach is often more effective than the Commander Approach and can be used to implement more difficult strategies. However, it does have several limitations that may limit its use to smaller companies in stable industries. It doesn't help managers stay abreast of rapid changes in the environment. It doesn't deal with situations where politics and personal agendas discourage objectivity among strategists. And since it imposes strategy in a top down fashion, it is subject to the same motivational problems as the Commander approach. Finally, it can backfire in rapidly changing industries since the manager sacrifices strategic flexibility by manipulating organizational systems and structures that may take a long time to implement.

3. Collaborative approach

The manager in charge of the strategy calls in the rest of the management team to brainstorm strategy formulation and implementation. The role of the manager is that of a coordinator. Other members of the organization's management team are encouraged to contribute their points of view in order to extract whatever group wisdom may be present. This approach overcomes two key limitations present in the previous two approaches. First, by capturing information contributed by managers close to operations, it can increase the quality and timeliness of the information incorporated in the strategy. Also, it improves the chances of efficient implementation to the degree that participation enhances strategy commitment.

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However, it may result in a poorer strategy since the strategy is negotiated among managers with different points of view and possibly different goals. This may reduce the chances of management's ability to formulate and implement the "best" strategy. Furthermore, it is not really collective decision making from an organizational viewpoint since management retains centralized control over the strategy. This can lead to political problems within the organization that may impede rapid and efficient strategy

formulation and implementation

4. Cultural approach

This approach enlarges the Collaborative Approach by including lower levels of the company. It partially breaks down the barriers between management and workers since each member of the organization can be involved to some degree in both the formulation and implementation of the strategy. It seems to work best in organizations that have sufficient resources to absorb the cost of building and maintaining a supportive value system. Often these are high-growth firms in high-technology industries. It has the advantage of more enthusiastic implementation of strategies by all members of the company. Limitations include:

1. It seems to only work in organizations composed primarily of informed, intelligent people;
2. It consumes enormous amounts of time;
3. It can promote such a strong sense of organizational identity that it becomes a handicap (for example, bringing in managers from outside the organization can be difficult because they aren't accepted by the other members of the organization since they didn't "grow up" with the organization);
4. It can promote a strong organizational culture to an extent that change and innovation becomes difficult.

5. Crescive approach

This approach addresses strategy formulation and implementation simultaneously (crescive means "increasing" or "growing"). The manager does not focus on performing the formulation and implementation tasks himself, but encourages subordinates to develop, champion, and implement sound strategies on their own. This approach is a "bottom-up" approach rather than a "top-down" approach since it moves upward from the workforce to management. Second, the strategy becomes the sum of all the individual proposals that are "successfully" proposed throughout the planning period. Third, the manager in charge of the strategy shapes the employees' notions of what are acceptable strategies and acts as a judge evaluating the proposals rather than a master strategist.

RESOURCE ALLOCATION

Resource allocation is a central management activity that allows for strategy execution. In organizations that do not use a strategic-management approach to decision making, resource allocation is often based on political or personal factors. Strategic management enables resources to be allocated according to priorities established by annual objectives. Nothing could be more detrimental to strategic management and to organizational success than for resources to be allocated in ways not consistent with priorities indicated by approved annual objectives. All organizations have at least four types of resources that can be used to achieve desired objectives: financial resources, physical resources, human resources, and technological resources. Allocating resources to particular divisions and departments does not mean that strategies will be successfully implemented. A number of factors commonly prohibit effective resource allocation, including an overprotection of resources, too great an emphasis on short-run financial criteria, organizational politics, vague strategy targets, a reluctance to take risks, and a lack of sufficient

knowledge. Below the corporate level, there often exists an absence of systematic thinking about resources allocated and strategies of the firm.

Managers normally have many more tasks than they can do. Managers must allocate time and resources among these tasks. Pressure builds up. Expenses are too high. The Chief Executive Officer wants a good financial report for the third quarter. Strategy formulation and implementation activities often get deferred. Today's problems soak up available energies and resources. Scrambled accounts and budgets fail to reveal the shift in allocation away from strategic needs to currently squeaking wheels. The real value of any resource allocation program lies in the resulting accomplishment of an organization's objectives. Effective resource allocation does not guarantee successful strategy implementation because programs, personnel, controls, and commitment must breathe life into the resources provided. Strategic management itself is sometimes referred to as resource allocation.

CHAPTER XII

STRATEGY AND ORGANIZATION STRUCTURE

It refers to established pattern of relationship among the components or parts of an organization. It is through the structure that the various parts of an organization are interrelated or interlinked. Organization structure involves issues such as division of work among various units or departments, and the coordination of activities to accomplish organizational objectives.

The organization has to be designed according to the needs of the strategy implementation. Any changes in corporate strategy may require some changes in the organization structure and in the skills required in certain positions. Managers must, therefore closely examine the way their company is structured in order to decide what changes should be made in the way work is accomplished. Although it is agreed that the organizational structure must change with environment conditions, which in turn, affect an organizational strategy, there is no agreement about an optimal structural design. What was appropriate for Raymonds and General Motors in the 1920s might not be appropriate today. Firms in the same industry do, however, tend to organize themselves likewise. For instance, automobile firms tend to emulate General Motor's divisional concept, whereas consumer good firms tend to adopt the brand-management concept introduced by Proctor & Gamble. The general conclusion seems to be that following similar strategies in similar industries tend to adopt similar structures.

FORMATION OF STRUCTURE

The implementation of strategy requires performance of tasks. To perform tasks, there should be various structural mechanisms. The structural mechanism help to undertake the various activities required to implement the strategy. In order to implement strategy, an organization must

Identify the major tasks required to implement strategy

Group the tasks into departments or units

Make arrangement of necessary resources to undertake tasks

Assign the duties to employees

Define and delegate the authority and responsibility

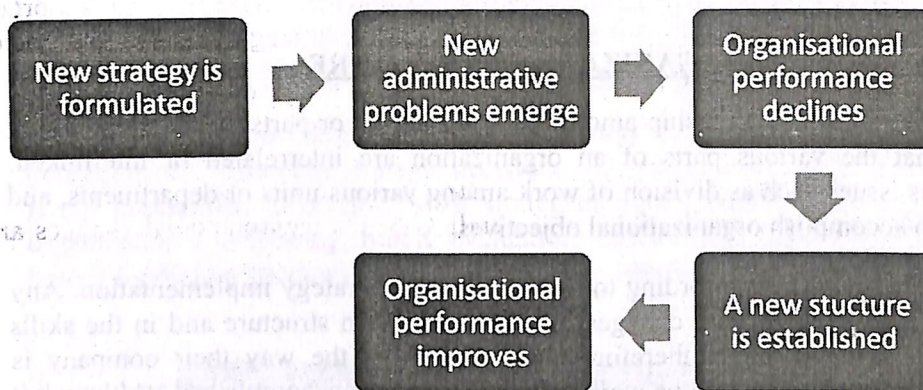
Establish superior-subordinate relationship

Provide a system of coordination of interlink the various tasks

The above process would lead to creation of a structure. A firm must design a suitable structure to undertake activities required to implement strategy. The structure may range from simple organization structure to a major complex one – matrix or network structure. The type of structure depends upon the size of the organization, the number of product lines, the number of plants or factories, the number of markets – local, national or international etc...

A simple organization structure, i.e., line organization structure is suitable for small organization having concentrating on one or few products and is restricted to local market. A functional organizational structure is suitable to organization that grows in size from the original entrepreneurial firm. As the business expands in diverse produce lines, the organization may adopt the strategic business unit structure, where each division is functionally independent to manage its performance. Some complex organization with multi plans and multi products may adopt the matrix organization or the network organization.

Chandler's Strategy Structure Relationship:



ORGANIZATIONAL STRUCTURE & BUSINESS STRATEGY

Changes in strategy often require changes in the way an organization is structured for two major reasons. First, structure largely dictates how objectives and policies will be established. For example, objectives and policies established under a geographical organizational structure are couched in geographic terms. Objectives and policies are stated largely in terms of products in an organization whose structure is based on product groups. The structural format for developing objectives and policies can significantly impact all other strategy-implementation activities. The second major reason why changes in strategy often require changes in structure is that structure dictates how resources will be allocated. If an organization's structure is based on customer groups, then resources will be allocated in that manner. Similarly, if an organization's structure is set up along functional business lines, then resources are allocated for functional areas. Unless new or revised strategies place emphasis in the same areas as old strategies, structural reorientation commonly becomes a part of strategy implementation.

Changes in strategy lead to changes in organizational structure. Structure should be designed to facilitate the strategic pursuit of a firm and therefore, follows strategy. Without a strategy or reasons for being (mission), companies find it difficult to design an effective structure. There is no optimal organizational design or structure for a given strategy or type of organization. What is appropriate for an organization may not be appropriate for a similar firm, although successful firm in a given industry do tend to organize themselves in a similar way. For example, consumer goods companies tend to emulate the divisional structure by product form of organization. Small firms tend to functionally structured (centralized) Medium sized firms tend to be divisionally structured (decentralized). Large firms tend to use a SBU (Strategic business unit) or Matrix structure. As organization grow, their structures generally change from simple to complex as a result of concatenation, or the linking together of several basic strategies. Numerous external and internal forces affect an organization; no firm could change its structure in response to every one of these forces, because to do so would lead to chaos.

TYPES OF ORGANIZATIONAL STRUCTURE

Successful companies tend to follow a pattern of structural development as they grow and expand. Beginning with the simple structure used by entrepreneurial firm characterized by decision making and moves on to divisional structure to manage different product lines. The following are the different stages in organizational development and strategy structure:

I. SIMPLE STRUCTURE

Firms are small enterprises managed by the founder. The entrepreneur makes all the important decisions and is involved in every detail and phase of the organization. The strategies adopted may be of expansion type.

Advantages of this structure include:

- Since there is only one decision maker, the decisions are taken faster.
- Quick and timely on the spot decisions are taken depending on the environmental changes and competition.
- These firms are very simple in nature.
- These firms are very informal in nature.

Disadvantages of this structure include:

- Since the owner has to do nearly everything including taking decisions has time can be demanded by almost everyone. He concentrates so much on day to day activities that major expansion decisions are left pending.
- When the owner is on holiday or such the firms operations usually fall due to lack of supervision.
- Excessive reliance on the owner.
- Future expansion only depends on the owner's ability to invest money.

II. FUNCTIONAL STRUCTURE

The most widely used structure is the functional type because this structure is the simplest and least expensive of the seven alternatives. A functional structure groups tasks and activities by business function, such as production/operations, marketing, finance/accounting, research and development, and management information systems. A university may structure its activities by major functions that include academic affairs, student services, alumni relations, athletics, maintenance, and accounting. Besides being simple and inexpensive, a functional structure also promotes specialization of labor, encourages efficient use of managerial and technical talent, minimizes the need for an elaborate control system, and allows rapid decision making. Some disadvantages of a functional structure are that it forces accountability to the top, minimizes career development opportunities, and is sometimes characterized by low employee morale, line/staff conflicts, poor delegation of authority, and inadequate planning for products and markets. A functional structure often leads to short-term and narrow thinking that may undermine what is best for the firm as a whole. For example, the research and development department may strive to overdesign products and components to achieve technical elegance, while manufacturing may argue for low-frills products that can be mass produced more easily. Thus, communication is often not as good in a functional structure. Schein gives an example of a communication problem in a functional structure: The word "marketing" will mean product development to the engineer, studying customers through market research to the product manager, merchandising to the salesperson, and constant change in design to the manufacturing manager. Then when these managers try to work together, they often attribute disagreements to personalities and fail to notice the deeper, shared assumptions that vary and dictate how each function thinks. Most large companies have abandoned the functional structure in favor of decentralization and improved accountability.

This is the point when a team of managers who have functional specializations replaces the entrepreneur. The transition to this stage requires a substantial managerial style change for the chief executive, especially if he was the Stage I entrepreneur. He must learn to delegate, otherwise having a team of managers bring no benefit.

Advantages of this structure include:

- The day to routine work is delegated to people thus the owner/chief executive can concentrate on strategic business decisions.
- Efficient distribution of work through specialization. Hence work is done faster.

Disadvantages of this structure include:

- Co-ordination between different departments is difficult. Everyone wants to work in watertight compartments.
- Line and staff departments usually conflicts.
- This creates specialists which results in narrow specialisation.

III. THE DIVISIONAL STRUCTURE

As a small organization grows, it has more difficulty managing different products and services in different markets. Some form of divisional structure generally becomes necessary to motivate employees, control operations and compete successfully in diverse locations. The divisional or decentralized structure is the second most common type used by businesses. The functional structure may not work well for large firms with diverse product lines. Managers managing diversified product lines need more decision making powers than the top management is willing to provide to them. The company needs to move to a different structure, i.e. divisional structure. Each division is semi-autonomous and linked to the headquarters but functionally independent.

The divisional structure can be organized in one of 4 ways:

- By Geographic Area By Customer By Product or Service By Process

a. **Geographic area based structure:** This type of structure is appropriate of organizations whose strategies need to be tailored to fit the particular needs and characteristics of customers of different geographic area. This type of structure can be most appropriate for organizations that have similar branch facilities located in widely dispersed areas. It allows local participation in decision making and improved coordination within a region.

b. **Customer-based Structure:** In some organization, divisions are made according to the customers serviced. The reason behind dividing according to customers so that exclusive and more priority attention can be given to top customers.

c. **Product – based structure:** The activities are grouped according to the product lines followed by the organization. Such a requirement is essential when the strategy adopted requires exclusive attention to a particular product (may be a new one) or one is the declining stage. Expansion and diversification strategies may require a product based structure as it facilitates the addition of deletion of product divisions.

d. **Process based structure:** Here the activities are organized according to the way work is actually performed. An example of a divisional structure by process is a manufacturing business organized into six divisions: electrical work, glass cutting, welding , grinding, painting and foundry work. In this case, all operations related to these specific processes would be grouped under the separate divisions.

Divisional Structure is the result of grouping of jobs, processes and resources into logical units to perform some organizational task. Large organizations divide its organizational structure into units and sub-units so as to effectively and efficiently plan, organize, direct and control its activities to achieve desired objectives. It becomes necessary to motivate employees, control operations, and compete successfully in diverse locations. With a divisional structure, functional activities are performed both centrally and in each separate division.

A divisional structure has some clear advantages. First and perhaps foremost, accountability is clear. That is, divisional managers can be held responsible for sales and profit levels. Because a divisional structure is based on extensive delegation of authority, managers and employees can easily see the results of their good or bad performances. As a result, employee morale is generally higher in a divisional structure than it is in a centralized structure. Other advantages of the divisional design are that it creates career development opportunities for managers, allows local control of situations, leads to a competitive climate within an organization, and allows new businesses and products to be added easily. The divisional design is not without some limitations, however. Perhaps the most important limitation is that a divisional structure is costly, for a number of reasons. First, each division requires functional specialists who must be paid. Second, there exists some duplication of staff services, facilities, and personnel; for instance, functional specialists are also needed centrally (at headquarters) to coordinate divisional activities. Third, managers must be well qualified because the divisional design forces delegation of authority; better-qualified individuals require higher salaries. A divisional structure can also be costly because it requires an elaborate, headquarters-driven control system. Fourth, competition between divisions may become so intense that it is dysfunctional and leads to limited sharing of ideas and resources for the common good of the firm. A divisional structure by geographic area is appropriate for organizations whose strategies need to be tailored to fit the particular needs and characteristics of customers in different geographic areas. This type of structure can be most appropriate for organizations that have similar branch facilities located in widely dispersed areas. A divisional structure by geographic area allows local participation in decision making and improved coordination within a region. The divisional structure by product (or services) is most effective for implementing strategies when specific products or services need special emphasis. Also, this type of structure is widely used when an organization offers only a few products or services or when an organization's products or services differ substantially. The divisional structure allows strict control over and attention to product lines, but it may also require a more skilled management force and reduced top management control. General Motors, DuPont, and Procter & Gamble use a divisional structure by product to implement strategies. Huffy, the largest bicycle company in the world, is another firm that is highly decentralized based on a divisional-by-product structure.

Advantages of this structure includes

- Accountability is clear
- Allows local control of local situations
- Creates career development chances
- Promotes delegation of authority
- Leads to competitive climate internally
- Allows easy adding of new products or regions
- Allows strict control and attention to products, customers, and/or regions

Disadvantages of this structure includes

- Can be costly
- Duplication of functional activities
- Requires a skilled management force
- Requires an elaborate control system
- Competition among divisions can become as intense as to be dysfunctional
- Can lead to limited sharing of ideas and resources
- Some regions/products/customers may receive special treatment

IV. THE STRATEGIC BUSINESS UNIT (SBU) STRUCTURE

As the number, size, and diversity of divisions in an organization increase, controlling and evaluating divisional operations become increasingly difficult for strategists. Increases in sales often are

not accompanied by similar increases in profitability. The span of control becomes too large at top levels of the firm. For example, in a large conglomerate organization composed of 90 divisions, such as TATA, the chief executive officer could have difficulty even remembering the first names of divisional presidents. In multidivisional organizations, an SBU structure can greatly facilitate strategy-implementation efforts. The SBU structure groups similar divisions into strategic business units and delegates authority and responsibility for each unit to a senior executive who reports directly to the chief executive officer. This change in structure can facilitate strategy implementation by improving coordination between similar divisions and channeling accountability to distinct business units. In a 100-division conglomerate, the divisions could perhaps be regrouped into 10 SBUs according to certain common characteristics, such as competing in the same industry, being located in the same area, or having the same customers. Two disadvantages of an SBU structure are that it requires an additional layer of management, which increases salary expenses. Also, the role of the group vice president is often ambiguous. However, these limitations often do not outweigh the advantages of improved coordination and accountability. Another advantage of the SBU structure is that it makes the tasks of planning and control by the corporate office more manageable. Citigroup reorganized the whole company into two SBUs: (1) Citigroup, which includes the retail bank, the corporate and investment bank, the private bank, and global transaction services; and (2) Citi Holdings, which includes Citi's asset management and consumer finance segments, Citi Mortgage, Citi Financial, and the joint brokerage operations with Morgan Stanley.

In 1970s and 1980s divisions of large organizations have been developed into Strategic Business Units (SBU) to better reflect product market considerations. Each SBU may look after the production and marketing of a particular product / brand or a group of products / brands. The units are not tightly controlled but are held responsible for their own performance.

The advantages of this structure are

- This structure encourages the grouping of various functions which are required for the performance of activities with respect to a particular division.
- Here the top management can concentrate on strategic business policies and decisions while the day to day operations are conducted by those in the lower rung of the ladder.
- This structure generates quick response to environmental changes affecting the businesses of different divisions.

The Disadvantages of this structure are

- Company overheads increase duplication of work in each unit is also there.
- Policy inconsistencies between the different divisions.

V. THE MATRIX STRUCTURE

This type of organization structure was first developed in the United States in the early 1960s to solve management problems emerging in the aerospace industry. It uses two or more co-existing structures. It can combine project organization with functional organization structure. In such a structure the project managers work in close and co-operation with functional or departmental heads. Authority of departmental heads flows downwards, and the authority of the project manager flows across, thereby forming a grid or rectangular array and is called Matrix Structure.

A matrix structure is the most complex of all designs because it depends upon both vertical and horizontal flows of authority and communication (hence the term matrix). In contrast, functional and divisional structures depend primarily on vertical flows of authority and communication. A matrix structure can result in higher overhead because it creates more management positions. Other disadvantages of a matrix structure that contribute to overall complexity include dual lines of budget

authority (a violation of the unity-of-command principle), dual sources of reward and punishment, shared authority, dual reporting channels, and a need for an extensive and effective communication system. Despite its complexity, the matrix structure is widely used in many industries, including construction, health care, research, and defense. Some advantages of a matrix structure are that project objectives are clear, there are many channels of communication, workers can see the visible results of their work, and shutting down a project can be accomplished relatively easily. Another advantage of a matrix structure is that it facilitates the use of specialized personnel, equipment, and facilities. Functional resources are shared in a matrix structure, rather than duplicated as in a divisional structure. Individuals with a high degree of expertise can divide their time as needed among projects, and they in turn develop their own skills and competencies more than in other structures. Walt Disney Corp. relies on a matrix structure.

Matrix Management is also known as product management/ market management organization. Companies that produce many products flowing into many markets face a dilemma. They could use a product management system which requires product managers to be familiar with highly divergent markets. A matrix organization would seem desirable in a multi-product, multi-Market Company. Such a type of structure is created by assigning functional specialists, who normally work in a department in their area of specialization to work on a special project or a new product or service. For the duration of the project, the specialists from different areas form a group or team to report to the team leader. Simultaneously they also work in their respective parent departments. Once the project is completed, the team members fully revert to their parent departments. Advantages of this structure are

- Individual specialists are assigned where their talent is needed most.
- Fosters creativity because of pooling of diverse talents.
- Provides good exposure to specialists in general management

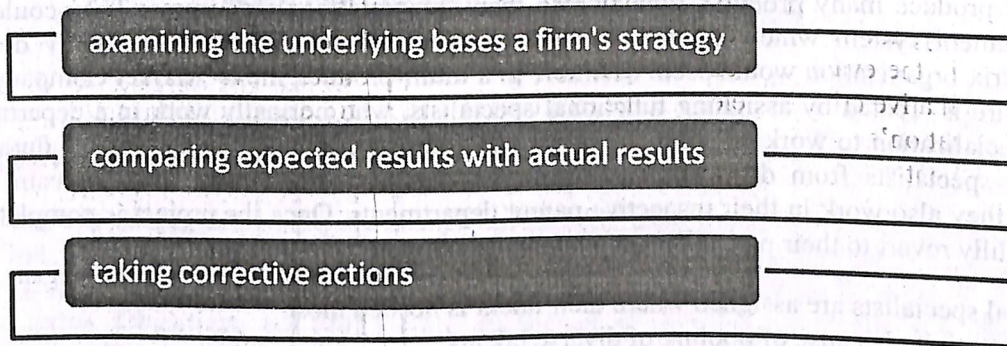
Disadvantage of this structure are

- Dual accountability creates confusion and thus difficulty to individual team members
- This system is costly and conflictual
- There are questions about where authority and responsibility should reside.
- Shared authority creates communication problem
- Requires a high level of vertical and horizontal co-ordination.

CHAPTER XIII

STRATEGY EVALUATION

The strategic-management process results in decisions that can have significant, long-lasting consequences. Erroneous strategic decisions can inflict severe penalties and can be exceedingly difficult, if not impossible, to reverse. Most strategists agree, therefore, that strategy evaluation is vital to an organization's well-being; timely evaluations can alert management to problems or potential problems before a situation becomes critical. Strategy evaluation includes three basic activities:



1. Examining the underlying bases of a firm's strategy:

Adequate and timely feedback is the cornerstone of effective strategy evaluation. Strategy evaluation can be no better than the information on which it is based. Too much pressure from top managers may result in lower managers contriving numbers they think will be satisfactory. Strategy evaluation can be a complex and sensitive undertaking. Too much emphasis on evaluating strategies may be expensive and counterproductive. No one likes to be evaluated too closely! The more managers attempt to evaluate the behavior of others, the less control they have. Yet too little or no evaluation can create even worse problems. Strategy evaluation is essential to ensure that stated objectives are being achieved. In many organizations, strategy evaluation is simply an appraisal of how well an organization has performed. Have the firm's assets increased? Has there been an increase in profitability? Have sales increased? Have productivity levels increased? Have profit margin, return on investment, and earnings-per-share ratios increased? Some firms argue that their strategy must have been correct if the answers to these types of questions are affirmative. Well, the strategy or strategies may have been correct, but this type of reasoning can be misleading because strategy evaluation must have both a long-run and short-run focus. Strategies often do not affect short-term operating results until it is too late to make needed changes. Strategy evaluation is becoming increasingly difficult with the passage of time, for many reasons. Domestic and world economies were more stable in years past, product life cycles were longer, less frequently, there were fewer competitors, foreign companies were weak, and there were more regulated industries.

Challenges to strategic evaluation

- A dramatic increase in the environment's complexity
- The increasing difficulty of predicting the future with accuracy

- The increasing number of variables
- The rapid rate of obsolescence of even the best plans
- The increase in the number of both domestic and world events affecting organizations
- The decreasing time span for which planning can be done with any degree of certainty.

2. Measuring organization performance

Failure to make satisfactory progress toward accomplishing long-term or annual objectives signals a need for corrective actions. Many factors, such as unreasonable policies, unexpected turns in the economy, unreliable suppliers or distributors, or ineffective strategies, can result in unsatisfactory progress toward meeting objectives. Problems can result from ineffectiveness (not doing the right things) or inefficiency (poorly doing the right things). Many variables can and should be included in measuring organizational performance. Typically a favorable or unfavorable variance is recorded monthly, quarterly, and annually, and resultant actions needed are then determined. Determining which objectives are most important in the evaluation of strategies can be difficult. Strategy evaluation is based on both quantitative and qualitative criteria. Selecting the exact set of criteria for evaluating strategies depends on a particular organization's size, industry, strategies, and management philosophy. An organization pursuing a retrenchment strategy, for example, could have an entirely different set of evaluative criteria from an organization pursuing a market-development strategy.

Quantitative criteria commonly used to evaluate strategies are financial ratios, which strategists use to make three critical comparisons:

- Comparing the firm's performance over different time periods,
- Comparing the firm's performance to competitors', and
- Comparing the firm's performance to industry averages.

Some key financial ratios that are particularly useful as criteria for strategy evaluation are as follows:

- Return on investment (ROI)
- Return on equity (ROE)
- Profit margin
- Market share
- Debt to equity
- Earnings per share
- Sales growth
- Asset growth

3. Taking Corrective Actions

The final strategy-evaluation activity, taking corrective actions, requires making changes to competitively reposition a firm for the future. Examples of changes that may be needed are altering an organization's structure, replacing one or more key individuals, selling a division, or revising a business mission. Other changes could include establishing or revising objectives, devising new policies, issuing stock to raise capital, adding additional salespersons, differently allocating resources, or developing new performance incentives. Taking corrective actions does not necessarily mean that existing strategies will be abandoned or even that new strategies must be formulated.

The probabilities and possibilities for incorrect or inappropriate actions increase geometrically with an arithmetic increase in personnel. Any person directing an overall undertaking must check on the actions of the participants as well as the results that they have achieved. If either the actions or results do not comply with preconceived or planned achievements, then corrective actions are needed.

The popular corrective actions include

- Alter the firm's structure
- Replace one or more key individuals
- Divest a division
- Alter the firm's vision and/or mission
- Revise objectives
- Alter strategies
- Devise new policies
- Install new performance incentives
- Raise capital with stock or debt
- Add or terminate salespersons, employees, or managers
- Allocate resources differently
- Outsource (or rein in) business functions

Corrective actions should place an organization in a better position to capitalize upon internal strengths; to take advantage of key external opportunities; to avoid, reduce, or mitigate external threats; and to improve internal weaknesses. Corrective actions should have a proper time horizon and an appropriate amount of risk. They should be internally consistent and socially responsible. Perhaps most important, corrective actions strengthen an organization's competitive position in its basic industry. Continuous strategy evaluation keeps strategists close to the pulse of an organization and provides information needed for an effective strategic-management system.

The benefits of strategy evaluation as follows:

Evaluation activities may renew confidence in the current business strategy or point to the need for actions to correct some weaknesses, such as erosion of product superiority or technological edge. In many cases, the benefits of strategy evaluation are much more far-reaching, for the outcome of the process may be a fundamentally new strategy that will lead, even in a business that is already turning a respectable profit, to substantially increased earnings. It is this possibility that justifies strategy evaluation, for the payoff can be very large.

Strategic audit

Strategic audits refer to the examination and evaluations of the strategic management processes of an organisation. It could also include measuring corporate performance against the corporate strategy to identify any deficiency. As and when a deficiency is noted or performance of an organisation is sub-par, the organisation may choose to carry out a strategic audit. The audit may be carried out by in-house auditors or by employing a firm of external auditors. Auditors against the current corporate strategy evaluate the organisation's performance. The intention of such an audit is to try to find out probable issues with the existing strategy, which could be directly or indirectly related to the ineffective performance of the organization. Once the audit process is over, the audit report is prepared by incorporating all the findings of the audit committee, which is then submitted to the top management with its remedial recommendations. The organisation may then implement the proposed remedies as recommended by the audit committee with a hope of improving organisational effectiveness and efficiency and thereby its overall performance.

Importance of Strategic Audit

Strategic audit is one of the methods for evaluating the performance of the chosen strategy, by pinpointing the problem areas and highlighting the organisational strengths and weaknesses for corporate planning. It provides a checklist of questions, by area or issues, which enables a systematic analysis of various organisational functions or activities³⁶. However, the main objective of the strategic audit is to develop benchmarks³⁷. The process involves the following steps:

- i. Identification of functions or processes, usually an activity that can give a business unit a competitive advantage, which has to be audited.
- ii. Determination of measures of performance of the functions or processes.

Advantages of Strategic Audit³⁸

Strategic Audit helps to:

1. Assess the performance result and review corporate governance
2. Assess the external environment Scan and assess the internal environment Scan using SWOT
3. Generate and evaluate strategic alternatives to implement strategies
4. Evaluate and control.

Balanced Scorecard

The balanced scorecard is a strategic planning and management system that is used extensively in business and industry, government, and nonprofit organizations worldwide to align business activities to the vision and strategy of the organization, improve internal and external communications, and monitor organization performance against strategic goals. It was originated by Drs. Robert Kaplan (Harvard Business School) and David Norton as a performance measurement framework that added strategic non-financial performance measures to traditional financial metrics to give managers and executives a more 'balanced' view of organizational performance. While the phrase *balanced scorecard* was coined in the early 1990s, the roots of this type of approach are deep, and include the pioneering work of General Electric on performance measurement reporting in the 1950's and the work of French process engineers (who created the *Tableau de Bord* – literally, a "dashboard" of performance measures) in the early part of the 20th century.

Gartner Group suggests that over 50% of large US firms have adopted the BSC. More than half of major companies in the US, Europe and Asia are using balanced scorecard approaches, with use growing in those areas as well as in the Middle East and Africa. A recent global study by Bain & Co listed balanced scorecard fifth on its top ten most widely used management tools around the world, a list that includes closely-related strategic planning at number one. Balanced scorecard has also been selected by the editors of Harvard Business Review as one of the most influential business ideas of the past 75 years. The balanced scorecard has evolved from its early use as a simple performance measurement framework to a full strategic planning and management system. The "new" balanced scorecard transforms an organization's strategic plan from an attractive but passive document into the "marching orders" for the organization on a daily basis. It provides a framework that not only provides performance measurements, but helps planners identify what should be done and measured. It enables executives to truly execute their strategies.

This new approach to strategic management was first detailed in a series of articles and books by Drs. Kaplan and Norton. Recognizing some of the weaknesses and vagueness of previous management approaches, the balanced scorecard approach provides a clear prescription as to what companies should measure in order to 'balance' the financial perspective. The balanced scorecard is a management system (not only a measurement system) that enables organizations to clarify their vision and strategy and translate them into action. It provides feedback around both the internal business processes and external outcomes in order to continuously improve strategic performance and results. When fully deployed, the balanced scorecard transforms strategic planning from an academic exercise into the nerve center of an enterprises. Kaplan and Norton describe the innovation of the balanced score card as follows: "The balanced scorecard retains traditional financial measures. But financial measures tell the story of past events, an adequate story for industrial age companies for which investments in long-term capabilities and customer relationships were not critical for success. These financial measures are inadequate, however, for guiding and evaluating the journey that information age companies must make to create

future value through investment in customers, suppliers, employees, processes, technology, and innovation."

Perspectives

The balanced scorecard suggests that we view the organization from four perspectives, and to develop metrics, collect data and analyze it relative to each of these perspectives:

The Learning & Growth Perspective

This perspective includes employee training and corporate cultural attitudes related to both individual and corporate self-improvement. In a knowledge-worker organization, people -- the only repository of knowledge -- are the main resource. In the current climate of rapid technological change, it is becoming necessary for knowledge workers to be in a continuous learning mode. Metrics can be put into place to guide managers in focusing training funds where they can help the most. In any case, learning and growth constitute the essential foundation for success of any knowledge-worker organization.

Kaplan and Norton emphasize that 'learning' is more than 'training'; it also includes things like mentors and tutors within the organization, as well as that ease of communication among workers that allows them to readily get help on a problem when it is needed. It also includes technological tools; what the Baldrige criteria call "high performance work systems."

The Business Process Perspective

This perspective refers to internal business processes. Metrics based on this perspective allow the managers to know how well their business is running, and whether its products and services conform to customer requirements (the mission). These metrics have to be carefully designed by those who know these processes most intimately; with our unique missions these are not something that can be developed by outside consultants.

The Customer Perspective

Recent management philosophy has shown an increasing realization of the importance of customer focus and customer satisfaction in any business. These are leading indicators : if customers are not satisfied, they will eventually find other suppliers that will meet their needs. Poor performance from this perspective is thus a leading indicator of future decline, even though the current financial picture may look good.

In developing metrics for satisfaction, customers should be analyzed in terms of kinds of customers and the kinds of processes for which we are providing a product or service to those customer groups.

The Financial Perspective

Kaplan and Norton do not disregard the traditional need for financial data. Timely and accurate funding data will always be a priority, and managers will do whatever necessary to provide it. In fact, often there is more than enough handling and processing of financial data. With the implementation of a corporate database, it is hoped that more of the processing can be centralized and automated. But the point is that the current emphasis on financials leads to the "unbalanced" situation with regard to other perspectives. There is perhaps a need to include additional financial-related data, such as risk assessment and cost-benefit data, in this category.

CHAPTER XIV

STRATEGIC CONTROL

Strategic control is a term used to describe the process used by organizations to **control** the formation and execution of **strategic** plans; it is a specialised form of management **control**, and differs from other forms of management **control** (in particular from operational **control**) in respects of its need to handle ...Strategic control involves tracking a strategy as it's being implemented. It's also concerned with detecting problems or changes in the strategy and making necessary adjustments. As a manager, you tend to ask yourself questions, such as whether the company is moving in the right direction, or whether your assumptions about major trends and changes in the company's environment are correct. Such questions necessitate the establishment of strategic controls.

Premise Control

Every strategy is based on certain planning premises or predictions. Premise control is designed to check methodically and constantly whether the premises on which a strategy is grounded on are still valid. If you discover that an important premise is no longer valid, the strategy may have to be changed. The sooner you recognize and reject an invalid premise, the better. This is because the strategy can be adjusted to reflect the reality.

Special Alert Control

A special alert control is the rigorous and rapid reassessment of an organization's strategy because of the occurrence of an immediate, unforeseen event. An example of such event is the acquisition of your competitor by an outsider. Such an event will trigger an immediate and intense reassessment of the firm's strategy. Form crisis teams to handle your company's initial response to the unforeseen events.

Implementation Control

Implementing a strategy takes place as a series of steps, activities, investments and acts that occur over a lengthy period. As a manager, you'll mobilize resources, carry out special projects and employ or reassign staff. Implementation control is the type of strategic control that must be carried out as events unfold. There are two types of implementation controls: strategic thrusts or projects, and milestone reviews. Strategic thrusts provide you with information that helps you determine whether the overall strategy is shaping up as planned. With milestone reviews, you monitor the progress of the strategy at various intervals or milestones.

Strategic Surveillance

Strategic surveillance is designed to observe a wide range of events within and outside your organization that are likely to affect the track of your organization's strategy. It's based on the idea that you can uncover important yet unanticipated information by monitoring multiple information sources. Such sources include trade magazines, journals such as The Wall Street Journal, trade conferences, conversations and observations.

Essentials of effective Control Strategies

It is crucial to measure performance to take corrective action. Lack of quantifiable objectives or performance standards and the inability of the information system to provide timely, valid information are two obvious control problems. In designing a control system, top management should remember that controls should follow strategy. Unless controls ensure the use of a proper strategy to achieve objectives, dysfunctional side effects may completely undermine the implementation of the objectives. The following guidelines should be borne in mind while developing a control system for any organization.

- The control system should help monitor only meaningful activities.
- The control system should involve a minimum amount of inputs required to give a reliable and realistic picture of events. Too many controls create confusion and hence the 80/20 rule, which means 20% of the factors that determine 80% of the results, should be followed.
- The control system should be timely.
- The control system should have long -term and short-term perspective⁴⁹
- The control system should be able to pinpoint exceptions.
- The control system should be used to reward meeting or exceeding standards rather than to punish failure in meeting the standards that have been set.

CHAPTER XV

CORPORATE GOVERNANCE

Introduction

India has the largest number of listed companies in the world, and the efficiency and well being of the financial markets is critical for the economy in particular and the society as a whole. It is imperative to design and implement a dynamic mechanism of corporate governance, which protects the interests of relevant stakeholders without hindering the growth of enterprises.

Before delving further on the subject, it is important to define the concept of corporate governance. The vast amount of literature available on the subject ensures that there exist innumerable definitions of corporate governance. To get a fair view on the subject it would be prudent to give a narrow as well as a broad definition of corporate governance.

In a narrow sense, corporate governance involves a set of relationships amongst the company's management, its board of directors, its shareholders, its auditors and other stakeholders. These relationships, which involve various rules and incentives, provide the structure through which the objectives of the company are set, and the means of attaining these objectives as well as monitoring performance are determined. Thus, the key aspects of good corporate governance include transparency of corporate structures and operations; the accountability of managers and the boards to shareholders; and corporate responsibility towards stakeholders.

While corporate governance essentially lays down the framework for creating long-term trust between companies and the external providers of capital, it would be wrong to think that the importance of corporate governance lies solely in better access of finance. Companies around the world are realizing that better corporate governance adds considerable value to their operational performance:

- It improves strategic thinking at the top by inducting independent directors who bring a wealth of experience, and a host of new ideas
- It rationalizes the management and monitoring of risk that a firm faces globally
- It limits the liability of top management and directors, by carefully articulating the decision making process
- It assures the integrity of financial reports
- It has long term reputational effects among key stakeholders, both internally and externally

In a broader sense, however, good corporate governance- the extent to which companies is run in an open and honest manner- is important for overall market confidence, the efficiency of capital allocation, the growth and development of countries' industrial bases, and ultimately the nations' overall wealth and welfare.

It is important to note that in both the narrow as well as in the broad definitions, the concepts of disclosure and transparency occupy centre-stage. In the first instance, they create trust at the firm level among the suppliers of finance. In the second instance, they create overall confidence at the aggregate economy level. In both cases, they result in efficient allocation of capital.

Having committed to the above definitions, it is important to note that ever since the first writings on the subject appeared in the academic domain, there have been many debates on the true scope and nature of corporate governance mechanisms around the world. More specifically on the question 'Who should corporate governance really represent?' This issue of whether a company should be run solely in the interest of the shareholders or whether it should take account the interest of all constituents has been widely discussed and debated for a long time now. Two definitions of Corporate Governance highlight the variation in the points of view:

Corporate governance is concerned with ways of bringing the interests of investors and manager into line and ensuring that firms are run for the benefit of investors. The belief that the purpose of the modern corporation is to maximise shareholder value, along with typical capital market and ownership features, has been associated with the 'Anglo-Saxon' agency model of the corporation. This contrasts the 'German (and Japanese) conception of the company as a social institution'. In making this distinction, commentators have mostly focused on the extent and nature of the separation of ownership and control. The Anglo-Saxon model is said to be characterised by a clear separation between management control and shareholder ownership, and hence is described as an 'outsider' system of corporate governance. Shareholder primacy is embodied in the finance view of corporate.

In India, we have sought to resolve the "shareholder vs. stakeholder" debate by taking the view that since shareholders are residual claimants, in well performing capital and financial markets, whatever maximises shareholder value should maximise corporate prosperity and best satisfy the claims of creditors, employees, shareholders, and the State. Moreover, there exist well-defined laws to protect the interests of employees, and recently framed legislations have considerably strengthened the rights of the creditors. It is therefore appropriate that corporate governance regulations in India seek to promote the rights of shareholders, while at the same time ensuring that the interests of other stakeholders are not adversely impacted.

Corporate governance is the set of processes, customs, policies, laws and institutions affecting the way a corporation is directed, administered or controlled. Corporate governance also includes the relationship stakeholders among the many players involved (the stakeholders) and the goals for which the corporation is governed. The principal players are the shareholders, management and the board of directors. Other stakeholders include employees, suppliers, customers, banks and other lenders, regulators, the environment and the community at large.

Corporate governance is a multi-faceted subject. An important theme of corporate governance is to ensure the accountability of the impact of a corporate governance system in economic efficiency, with a strong emphasis on shareholders welfare. There are yet other aspects to the corporate governance subject, such as the stake holder view and certain individuals in an organization through mechanisms that try to reduce or eliminate the principal-agent problem. A related but separate thread of discussions focus on the corporate governance models around the world.

Definition of Corporate Governance

Gabrielle O'Donovan defines corporate governance as 'an internal system encompassing policies, processes and people, which serves the needs of shareholders and other stakeholders, by directing and controlling management activities with good business savvy, objectivity and integrity. Sound corporate governance is reliant on external marketplace commitment and legislation, plus a healthy board culture which safeguards policies and processes'.

Corporate Governance is a system of structuring, operating and controlling a company with a view to achieve long term strategic goals to satisfy shareholders, creditors, employees, customers and suppliers, and complying with the legal and regulatory requirements, apart from meeting environmental and local community needs.

Report of SEBI committee (India) on Corporate Governance defines corporate governance as the acceptance by management of the inalienable rights of shareholders as the true owners of the corporation and of their own role as trustees on behalf of the shareholders. It is about commitment to values, about ethical business conduct and about making a distinction between personal & corporate funds in the management of a company." The definition is drawn from Gandhian principle of Trusteeship and Directive Principle of constitution. Corporate Governance is viewed as ethics and a moral duty.

Features of corporate governance

- clear strategy
- Effective risk management
- Discipline
- Fairness
- Accountability
- Transparency
- Social responsibility
- Self evaluation

History of Corporate Governance

In the 19th century, state corporation law enhanced the rights of corporate boards to govern without unanimous consent of shareholders in exchange for statutory benefits like appraisal rights, to make corporate governance more efficient. Since that time, and because most large publicly traded corporations in the US are incorporated under corporate administration friendly Delaware law, and because the US's wealth has been increasingly securitized into various corporate entities and institutions, the rights of individual owners and shareholders have become increasingly derivative and dissipated. The concerns of shareholders over administration pay and stock losses periodically has led to more frequent calls for corporate governance reforms.

In the 20th century in the immediate aftermath of the Wall Street Crash of 1929 legal scholars such as Adolf Augustus Berle, Edwin Dodd, and Gardiner C. Means pondered on the changing role of the modern corporation in society. Berle and Means' monograph "The Modern Corporation and Private Property" (1932, Macmillan) continues to have a profound influence on the conception of corporate governance in scholarly debates today.

From the Chicago school of economics, Ronald Coase's "Nature of the Firm" (1937) introduced the notion of transaction costs into the understanding of why firms are founded and how they continue to behave. Fifty years later, Eugene Fama and Michael Jensen's "The Separation of Ownership and Control" (1983, Journal of Law and Economics) firmly established agency theory as a way of understanding corporate governance: the firm is seen as a series of contracts. Agency theory's dominance was highlighted in a 1989 article by Kathleen Eisenhardt (Academy of Management Review).

US expansion after World War II through the emergence of multinational corporations saw the establishment of the managerial class. Accordingly, the following Harvard Business School Management professors published influential monographs studying their prominence: Myles Mace (entrepreneurship), Alfred D Chandler, Jr (business history), Jay Lorsch (organizational behavior) and Elizabeth MacIver (organizational behavior). According to Lorsch and MacIver "many large corporations have dominant control over business affairs without sufficient accountability or monitoring by their board of directors."

Since the late 1970's, corporate governance has been the subject of significant debate around the globe. Bold, broad efforts to reform corporate governance have been driven, in part, by the needs and desires of shareowners to exercise their rights of corporate ownership and to increase the value of their shares and, therefore, wealth. Over the past three decades, corporate directors' duties have expanded greatly beyond their traditional legal responsibility of duty of loyalty to the corporation and its shareowners.

In the first half of the 1990s, the issue of corporate governance in the U.S. received considerable press attention due to the wave of CEO dismissals (e.g.: IBM, Kodak, Honey well) by their boards. In 1997, the East Asian Financial Crisis saw the economies of Thailand, Indonesia, South Korea, Malaysia and The Philippines severely affected by the exit of foreign capital after property assets collapsed. The lack of corporate governance mechanisms in these countries highlighted the weaknesses of the institutions in their economies.

In the early 2000s, the massive bankruptcies (and criminal malfeasance) of Enron and Worldcom, as well as lesser corporate debacles, such as Adelphia Communications, AOL and, more recently, Fannie Mae and Freddie Mac, led to increased shareholder and governmental interest in corporate governance. This culminated in the passage of the Sarbanes-Oxley Act of 2002.

Given the peculiar system of ownership, nature of the financial sector and business practices in each economy, it is imperative that the governance mechanisms are designed to suit their unique nature.

Corporate governance principles and codes have been developed in different countries and issued from stock exchanges, corporations, institutional investors, or associations (institutes) of directors and managers with the support of governments and international organizations. As a rule, compliance with these governance recommendations is not mandated by law, although the codes linked to stock exchange listing requirements may have a coercive effect.

For example, companies quoted on the London and Toronto Stock Exchanges formally need not follow the recommendations of their respective national codes. However, they must disclose whether they follow the recommendations in those documents and, where not, they should provide explanations concerning divergent practices. Such disclosure requirements exert a significant pressure on listed companies for compliance.

In the United States, companies are primarily regulated by the state in which they incorporate though they are also regulated by the federal government and, if they are public, by their stock exchange. The highest number of companies is incorporated in Delaware, including more than half of the Fortune 500.

One issue that has been raised since the Disney decision in 2005 is the degree to which companies manage their governance responsibilities; in other words, do they merely try to supersede the legal threshold, or should they create governance guidelines that ascend to the level of best practice. For example, the guidelines issued by associations of directors (see Section 3 above), corporate managers and individual companies tend to be wholly voluntary. For example, The GM Board Guidelines reflect the company's efforts to improve its own governance capacity. Such documents, however, may have a wider multiplying effect prompting other companies to adopt similar documents and standards of best practice.

The World Business Council for Sustainable Development WBCSD has also done substantial work on corporate governance, particularly on accountability and reporting, and in 2004 created an Issue Management Tool: Strategic challenges for business in the use of corporate responsibility codes, standards, and frame works. This document aims to provide general information, a "snap-shot" of the landscape and a perspective from a think-tank/professional association on a few key codes, standards and frameworks relevant to the sustainability agenda.

Since the mid-1990s, several corporate governance guidelines and regulations have been prepared in different parts of the world.

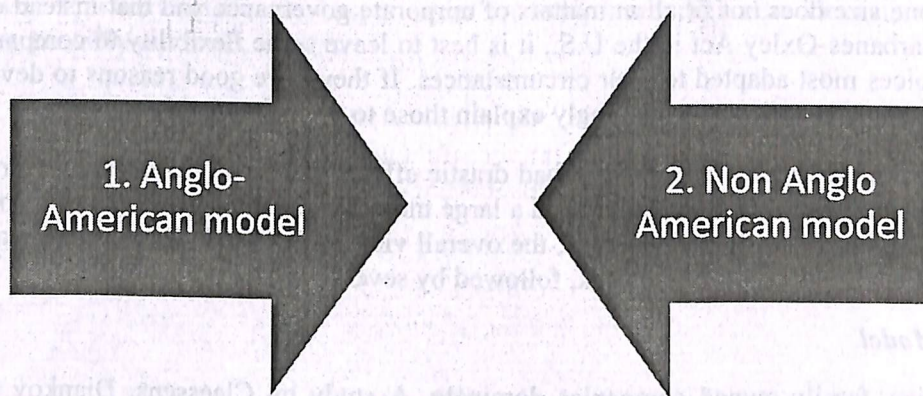
Some of these are:

- Cadbury Committee Report (1992)
- CalPERS- Global Corporate Governance Principles (1996)
- Market Specific Principles UK and France (1997)
- Market Specific Principles Japan and Germany (1997)
- Core Principles and Guidelines USA (April 1998)

- TIAACREF- Policy Statement on Corporate Governance (September 1997)
- Business Roundtable Statement on Corporate Governance (September 1997)
- Hampel Report on Corporate Governance UK (January 1998)
- The Sarbanes-Oxley Act – USA (August 2002)
- The Higgs Report UK (January 2003)

At the same time given the increasing interdependence and integration of financial markets around the world it is important that some degree of uniformity and coherence is established in laws of all countries. With this in mind the OECD Council, meeting at Ministerial level on 27-28 April 1998, called upon the OECD to develop, in conjunction with national governments, other relevant international organizations and the private sector, a set of corporate governance standards and guidelines.

CORPORATE GOVERNANCE MODELS AROUND THE WORLD



Although the US model of corporate governance is the most popular, there is a considerable variation in corporate governance models around the world. The intricate shareholding structures of keiretsus in Japan, the heavy presence of banks in the equity of German firms, the chaebols in South Korea and many others are examples of arrangements which try to respond to the same corporate governance challenges as in the US.

• *Anglo-American Model*

There are many different models of corporate governance around the world. These differ according to the variety of capitalism in which they are embedded. The liberal model that is common in Anglo-American countries tends to give priority to the interests of shareholders. The coordinated model that one finds in Continental Europe and Japan also recognizes the interests of workers, managers, suppliers, customers, and the community. Both models have distinct competitive advantages, but in different ways. The liberal model of corporate governance encourages radical innovation and cost competition, whereas the coordinated model of corporate governance facilitates incremental innovation and quality competition. However, there are important differences between the U.S. recent approach to governance issues and what has happened in the U.K.

In the United States, a corporation is governed by a board of directors, which has the power to choose an executive officer, usually known as the chief executive officer. The CEO has broad power to manage the corporation on a daily basis, but needs to get board approval for certain major actions, such as hiring his/her immediate subordinates, raising money, acquiring another company, major capital expansions, or other expensive projects. Other duties of the board may include policy setting, decision making, monitoring management's performance, or corporate control.

The board of directors is nominally selected by and responsible to the share holders, but the bylaws of many companies make it difficult for all but the largest shareholders to have any influence over the makeup of the board; normally, individual shareholders are not offered a choice of board nominees among which to choose, but are merely asked to rubberstamp the nominees of the sitting board. Perverse incentives have pervaded many corporate boards in the developed world, with board members beholden to the chief executive whose actions they are intended to oversee. Frequently, members of the boards of directors are CEOs of other corporations, which some see as a conflict of interest.

The U.K. has pioneered a flexible model of regulation of corporate governance, known as the "comply or explain" code of governance. This is a principle based code that lists a dozen of recommended practices, such as the separation of CEO and Chairman of the Board, the introduction of a time limit for CEOs' contracts, the introduction of a minimum number of non-executives Directors, of independent directors, the designation of a senior non executive director, the formation and composition of remuneration, audit and nomination committees. Publicly listed companies in the U.K. have to either apply those principles or, if they choose not to, to explain in a designated part of their annual reports why they decided not to do so. The monitoring of those explanations is left to shareholders themselves. The tenet of the Code is that one size does not fit all in matters of corporate governance and that instead of a statutory regime like the Sarbanes-Oxley Act in the U.S., it is best to leave some flexibility to companies so that they can make choices most adapted to their circumstances. If they have good reasons to deviate from the sound rule, they should be able to convincingly explain those to their shareholders.

The code has been in place since 1993 and has had drastic effects on the way firms are governed in the U.K. Many deviations are simply not explained and a large majority of explanations fail to identify specific circumstances justifying those deviations. Still, the overall view is that the U.K.'s system works fairly well and in fact is often branded as a benchmark, followed by several countries.

• *Non Anglo-American Model*

In East Asian countries, family-owned companies dominate. A study by Claessens, Djankov and Lang (2000) investigated the top 15 families in East Asian countries and found that they dominated listed corporate assets. In countries such as India, Pakistan, Indonesia and the Philippines, the top 15 families controlled over 50% of publicly owned corporations through a system of family cross-holdings, thus dominating the capital markets. Family-owned companies also dominate the Latin model of corporate governance that is companies in Mexico, Italy, Spain, France (to a certain extent), Brazil, Argentina, and other countries in South America.

- Shareholder and stakeholder
- a small number of listed companies,
- an illiquid capital market where ownership and control are not frequently traded
- High concentration of shareholding in the hands of corporations, institutions, families or government.
- The insider model uses a system of interlocking networks and committees.

At the same time that developing countries are undergoing a process of economic growth and transformation, they are also experiencing a revolution in the business and political relationships that characterize their private and public sectors. Establishing good corporate governance practices is essential to sustaining long-term development and growth as these countries move from closed, market-unfriendly, undemocratic systems towards open, market-friendly, democratic systems. Good corporate governance systems will allow organizations to realize their maximum productivity and efficiency minimize corruption and abuse of power, and provide a system of managerial accountability. These goals are equally important for both private corporations and government bodies.

Because of the implicit relationship between private interests and the larger government, good corporate governance practices are essential to establishing good governance at the national level in developing countries. A number of ties keep the public and private sectors closely linked. On one hand, judiciary and regulatory bodies as well as legislatures play a role in corporate management and oversight. At the same time cartels and large corporate interests use their size to exert not only economic, but also political power. These two sectors are so intertwined that a country cannot significantly change one without simultaneously instituting changes in the other.

According to Nicolas Meisel, there are four priorities which developing countries should concentrate on while experimenting with new forms of corporate and public governance. The first is to focus on improving the quality of information and increasing the speed at which it is created and distributed to the public. Good communication is important to the functioning of any organization. The second is to allow individual actors more autonomy while at the same time maintaining or increasing accountability. Thirdly, if a hierarchical organization used to orient private activities toward the general interest, new countervailing powers should be encouraged to fill this role. Finally, the part the state plays and how government officials are selected must be considered if a developing economy is to achieve sustainable growth. This may involve making it easier for newcomers with new ideas incumbents who may hold to older, possibly outdated, models.

CHAPTER XVI

CORPORATE GOVERNANCE IN INDIA

There have been several major corporate governance initiatives launched in India since the mid-1990s. The first was by the Confederation of Indian Industry (CII), India's largest industry and business association, which came up with the first voluntary code of corporate governance in 1998. The second was by SEBI, now enshrined as Clause 49 of the listing agreement. The third was the Naresh Chandra committee, which submitted its report in 2002. The fourth was again by SEBI — the Narayana Murthy committee, which also submitted its report in 2002. Based on some of the recommendations of this committee, SEBI revised Clause 49 of the listing agreement in August 2003. Subsequently, SEBI further revised Clause 49 in December 2003, and currently, the original Clause 49 is in force. A task force was formed in 2009 by Confederation of Indian Industries. Refinements are made from time to time and even in Companies Act 2013, we can see the influence of many corporate governance principles.

Code

More than a year before the onset of the Asian crisis, CII set up a committee to examine corporate governance issues, and recommend a voluntary code of best practices. The committee was driven by the belief that good corporate governance was essential for Indian companies to access domestic as well as foreign capital at competitive rates. The first draft of the code was prepared by April 1997, and the final *Desirable Corporate Governance: A Code*, was publicly released in April 1998. The code was comprehensive, contained detailed provisions, and focused on listed companies.

Mangalam Birla committee report and Clause 49

Since the CII code was well-received and some progressive companies adopted it, it was felt that in certain conditions a statutory rather than a voluntary code would be more purposeful, and

Subsequently, the second major corporate governance initiative in the country was undertaken by SEBI. In early 1999, it set up a committee under Kumar Mangalam Birla to promote and raise the standards of good corporate governance. In early 2000, the SEBI board had accepted and ratified key recommendations of this committee, and these were incorporated into Clause 49 of the Listing Agreement of the Stock Exchanges.

Naresh Chandra committee report on corporate governance

The Naresh Chandra committee was appointed in August 2002 by the Department of Company Administration (DCA) under the Ministry of Finance and Company Affairs to examine various corporate governance issues. The Committee submitted its report in December 2002. It made recommendations in various aspects of corporate governance: financial and non-financial disclosures; and independent directorship and board oversight of management. The major recommendations of the report are given in

Murthy committee report on corporate governance

The fourth initiative on corporate governance in India is in the form of the recommendations of the Narayana Murthy committee. The committee was set up by SEBI, under the chairmanship of Mr. N. Narayana Murthy, to review Clause 49, and suggest measures to improve corporate governance. Some of the major recommendations of the committee primarily related to audit committees,

audit reports, independent directors, related party transactions, risk management, directorships and director compensation, codes of conduct and financial disclosures

Naresh Chandra committee report

Formed in 2009 is the second national task force by CII. The Committee focuses on improving corporate governance standards and practices both in letter and spirit. The recommendations include

- Nomination committee
- Letter of appointment to directors
- Remuneration to independent directors
- Remuneration committee
- Audit committee
- Board meetings through teleconferencing
- Shareholder activism
- Media as a stakeholder

PARTIES TO CORPORATE GOVERNANCE

1. The Regulators(SEBI, RBI,SEC)
2. The Management (The Chief Executive Officer, the Board of Directors).
3. Share Holders
4. Suppliers,
5. Employees,
6. Creditors,
7. Customers,
8. The Community At Large.

In corporations, the shareholder delegates decision rights to the manager to act in the principal's best interests. This separation of ownership from control implies a loss of effective control by shareholders over managerial decisions. Partly as a result of this separation between the two parties, a system of corporate governance controls is implemented to assist in aligning the incentives of managers with those of shareholders. With the significant increase in equity holdings of investors, there has been an opportunity for a reversal of the separation of ownership and control problems because ownership is not so diffuse.

A board of directors often plays a key role in corporate governance. It is their responsibility to endorse the organisation's strategy, develop directional policy, appoint, supervise and remunerate senior executives and to ensure accountability of the organisation to its owners and authorities. The Company Secretary, known as a Corporate Secretary in the US and often referred to as a Chartered Secretary if qualified by the Institute of Chartered Secretaries and Administrators (ICSA), is a high ranking professional who is trained to uphold the highest standards of corporate governance, effective operations, compliance and administration.

All parties to corporate governance have an interest, whether direct or indirect, in the effective performance of the organisation. Directors, workers and management receive salaries, benefits and reputation, while shareholders receive capital return. Customers receive goods and services; suppliers receive compensation for their goods or services. In return these individuals provide value in the form of natural, human, social and other forms of capital.

A key factor in an individual's decision to participate in an organisation e.g. through providing financial capital and trust that they will receive a fair share of the organisational returns. If some parties are receiving more than their fair return then participants may choose to not continue participating leading to organizational collapse.

Issues involving corporate governance principles include:

- oversight of the preparation of the entity's financial statements
- internal controls and the independence of the entity's auditors
- review of the compensation arrangements for the chief executive officer and other senior executives
- the way in which individuals are nominated for positions on the board
- the resources made available to directors in carrying out their duties
- oversight and management of risk
- dividend policy

Corporate Governance-Future

The next few years will see a flurry of activity on the corporate governance front. While to a certain extent, this activity will be driven by more stringent regulations, to a greater extent, the momentum will come from the forces of competition, and demand for low-cost capital.

First, and most important, is the force of competition. With the dismantling of licenses and controls, reduction of import tariffs and quotas, virtual elimination of public sector reservations, and a much more liberalized regime for foreign direct and portfolio investments, Indian companies have faced more competition in the second half of the 1990s than they did since independence. Competition has forced companies to drastically restructure their ways of doing business. Underutilized assets are being sold, capital is being utilized like never before, and companies are focusing on the top and bottom line with a hitherto unknown degree of intensity. Moreover, while there have been losers in liberalization, competition has led to greater overall profits. Thus, the aggregate financial impact of competition has been positive — the more so for those who went through the pains of restructuring in the relatively early days of liberalization. And there is every indication that while many companies will fall by the wayside, many more will earn greater profits than before.

Second, there has been a great churning taking place in corporate India. Many companies and business groups that were on the top of the pecking order in 1991 have been relegated to much lower positions. Simultaneously, new aggressive companies have clawed their way to the top. By and large, these are firms managed by relatively modern, outward-oriented professionals who place a great deal of value on corporate governance and transparency — if not for themselves, then as instruments for facilitating access to international and domestic capital. Therefore, they are more than willing to have professional boards and voluntarily follow disclosure standards that measure up to the best in the world.

Third, despite high and low cycles of stock prices, there has been a phenomenal growth in market capitalization. This growth has triggered a fundamental change in mindset from the earlier one of appropriating larger slices of a small pie, to doing all that is needed to let the pie grow. Creating and distributing wealth has become a more popular maxim than ever before — more so when the maxim is seen to be validated by growing market cap.

Fourth, one cannot exaggerate the impact of well-focused, well-researched portfolio investors (both domestic and foreign). These investors have steadily raised their demands for better corporate governance, more transparency and greater disclosure. And given their clout in the secondary market — they account for over 50 per cent of the average daily volume of trade — portfolio investors have voted with their feet. Over the last two years, they have systematically increased their exposure in well-governed firms at the expense of poorly run ones.

Fifth, India has a strong financial press, which will get stronger with the years. In the last five years, the press and financial analysts have induced a level of disclosure that was inconceivable a decade ago. This will increase and force companies to become more transparent—not just in their financial statements but also in matters relating to internal governance.

Sixth, despite shortcomings in Indian bankruptcy provisions, neither banks nor financial institutions (FIs) will continue to support management irrespective of performance. Already, the more aggressive and market oriented FIs have started converting some of their outstanding debt to equity, and setting up mergers and acquisition subsidiaries to sell their shares in under-performing companies to more dynamic entrepreneurs and managerial groups. This will intensify over time, especially with the advent of universal banking.

Seventh, Indian corporations have appreciated the fact that good corporate governance and internationally accepted standards of accounting and disclosure can help them to access the US capital markets. Until 1998, this premise existed only in theory. It changed with Infosys making its highly successful Nasdaq issue in March 1998. This has been followed by 10 more US depository issues. This trend has had two major beneficial effects. First, it has shown that good governance pays off, and allows companies to access the world's largest capital market. Second, it has demonstrated that good corporate governance and disclosures are not difficult to implement- and that Indian companies can do all that is needed to satisfy US investors and the SEC. The message is now clear: it makes good business sense to be a transparent, well-governed company incorporating internationally acceptable accounting standards.

Finally, prospects of future policy changes towards capital account convertibility create its own challenges. With capital account convertibility an Indian investor may seriously consider putting his funds in an Indian company or a foreign mutual or pension fund. The choice before the investor is likely to further propel good corporate governance. Thankfully, many Indian companies have already seen the writing on the wall and are concentrating on good corporate governance practices.

The National Foundation for Corporate Governance

There is no doubt that once the government and the regulators establish an efficient and effective regulatory framework for corporations to function in, the market would push these corporations to raise the bar constantly. There is also no doubt that India is progressing towards the inevitability of market-driven corporate governance practices. The corporate governance ratings introduced by some rating agencies in India, and the willingness showed by many companies to volunteer for these is a case in point. In the midst of this transition, the NFCG will play an important role. The Foundation, on a continuous basis, would collaborate with the regulators and concerned authorities to develop regulations which are in line with the dynamics of the emerging business environment and at the same time help corporations implement these regulations in letter and spirit. This would, however, not be a two-pronged approach but a multi-pronged one and would include:

- Creating awareness on the importance of implementing good corporate governance practices both at the level of individual corporations and for the economy as a whole. The foundation would provide a platform for quality discussions and debates amongst academicians, policy makers, professionals and corporate leaders through workshops, conferences, meetings and seminars.
- Encouraging research capability in the area of corporate governance in the country and providing key inputs for developing laws and regulations which meet the twin objectives of maximizing wealth creation and fair distribution of this wealth.
- Working with the regulatory authorities at multiple levels to improve implementation and enforcement of various laws related to corporate governance
- In close coordination with the private sector, work to instil a commitment to corporate governance reforms and facilitate the development of a corporate governance culture
- Cultivating international linkages and maintaining the evolution towards convergence with international standards and practices for accounting, audit and non-financial disclosure.
- Setting up of 'National Centres for Corporate Governance' across the country, which would provide quality training to Directors and aim to have global recognition and acceptance
- Encourage Corporate Governance cooperation in South Asia particularly relating to SAARC countries;

- Hold seminars in collaboration with World Bank and Asian Development Bank on Corporate Governance Audit;
- Explore the desirability and possibility of including Whistle Blowers' Policy as an essential feature of Corporate Governance;
- Work out feasibility of Corporate Governance guidelines for large institutional investors;
- Institute an annual award for the best Centre for Corporate Governance
- Work out the modalities for setting up of a database of independent directors with wider interactions with eminent groups, persons and societies.

These initiatives will be carried out after extensive consultations with concerned stakeholders. All these initiatives will be totally non-mandatory in nature. It will be entirely up to individual companies and institutional investors to decide whether they want to adopt the model whistle blowers' policy or the model corporate governance policies suggested by the NFCG. Similarly, the participation in the corporate governance audit, too, will be optional. The NFCG would also like to play a role in promoting corporate governance throughout the world.

CHAPTER XVII

PRINCIPLES OF CORPORATE GOVERNANCE

Key elements of good corporate governance principles include honesty, trust and openness, performance orientation, responsibility and accountability, mutual respect, and com the organization. Commonly accepted principles of corporate governance include:

1• Rights and equitable treatment of shareholders:

Organizations should respect the rights of shareholders and help shareholders to exercise their rights. They can help shareholders exercise their rights by effectively communicating information understandable and accessible and encouraging shareholders to participate in general meetings.

2• Interests of other stakeholders:

Organizations should recognize that they have legal and other obligations to all stakeholders. The rights of stakeholders that are established by law or through mutual agreement include:

1. *The rights of creditors:*

Secured creditors such as banks, development financial institutions (DFIs) and companies offering long term debt, have the right to be represented on the board through representatives who, in India, are called 'nominee directors'. This right arises from the contract between the company and the creditor organisation, and is enforced through the covenants in the contract. Creditors also have the right to block dividend payments if their dues have not been paid. This involves all debt dues, including payment towards debentures or bonds; this right is exercised by petitioning the civil courts, the Company Law Board or High Courts.

2. *The rights of employees:*

All employees, workmen or otherwise, have the right to form trade unions. The Industrial Disputes Act, the Factories Act and the Contract Labour Act say that workmen cannot be fired, or laid-off without due cause and without following due process. If anything, these processes are in favour of workers. In bankruptcy restructuring, representatives of workers have the legal right to participate in the proceedings.

3. *The rights of creditors:*

Creditors can, and do, petition the Company Law Board, the Board for Industrial and Financial Reconstruction (BIFR, the special bankruptcy court under SICA), civil courts, High Courts and Recovery Tribunals for violation of their rights. This is routinely done in instances of violation of their rights.

4. *The rights of employees:*

Workers and employees can petition civil courts and High Courts. This is regularly done in cases of violation. However, workmen of a company are not allowed to file petition for winding up of the company. They may be allowed to appear and be heard in support or opposition of the winding up petition.

3• Role and responsibilities of the board:

According to the Clause 49 of the listing agreement, at least 50 per cent of the Board of Directors of a company should consist of non-executive directors. The number of independent directors on the Board should be at least 1/3rd of the total number of directors, whether the Chairman is executive or non-executive. In case of a non-executive Chairman, a

third of the board should comprise independent directors; if on the other hand the Chairman is executive at least half of the board should comprise independent directors.

The board needs a range of skills and understanding to be able to deal with various business issues and have the ability to review and challenge management performance. It needs to be of sufficient size and have an appropriate level of commitment to fulfill its responsibilities and duties. There are issues about the appropriate mix of executive and non-executive directors. The key roles of Chairperson and CEO should not be held by the same person. Board members should act on a fully informed basis, in good faith, with due diligence and care, and in the best interest of the company and the shareholders.

Where board decisions may affect different shareholder groups differently, the board should treat all shareholders fairly. The fiduciary duty of the directors obligates them to treat all shareholders equally and fairly. The board should apply high ethical standards. It should take into account the interests of stakeholders.

Functions of the Board:

- Reviewing and guiding corporate strategy, major plans of action, risk policy, annual budgets and business plans; setting performance objectives
- Monitoring implementation and corporate performance; and overseeing major capital expenditures, acquisitions and divestitures.
- Monitoring the effectiveness of the company's governance practices and making changes as needed
- Selecting, compensating, monitoring and, when necessary, replacing key executives and overseeing succession planning.
- Aligning key executive and board remuneration with the longer-term interests of the company and its shareholders.
- Ensuring a formal and transparent board nomination and election process.
- Monitoring and managing potential conflicts of interest of management, board members and shareholders, including misuse of corporate assets and abuse in related party transactions.
- Ensuring the integrity of the corporation's accounting and financial reporting systems, including the independent audit, and that appropriate systems of control are in place, in particular, systems for monitoring risk, financial control, and compliance with the law.
- Overseeing the process of disclosure and communications.

By law, the fiduciary duty of the directors obligates them not to exceed their authority and powers and to act with honesty and good faith. They should not engage in any activity which is ultra vires the company or illegal. Directors must not use unpublished or confidential information belonging to the company for their own purpose. Any knowledge or information that is generated by the company is its own property, and any gain on information should accrue to the company and not to the individual. A director has to take reasonable care in performance of his duties. He need not be an expert in any particular field or in the activities of the company and might not have any extraordinary skill or knowledge. However, he is expected to be not negligent in performing his duties.

Personal liabilities of the Board

- For ultra vires acts: The act on the part of the directors ultra vires the company may render liable to indemnify the company in respect of any consequent loss or damages sustained. If the directors use the company's money for purposes, which the company cannot sanction, they become personally liable to replace it, however, honestly they may have acted.
- For mala fide acts: If the directors act dishonestly and in breach of trust or misfeasance in that capacity, they are liable to account for and surrender profits to their company. Also, they should

make good the loss sustained by the company by reason of the mala fide exercise of any of the powers vested in them.

- For negligence: If directors are negligent in discharging their duties, they may be liable to their company for loss sustained due to their negligence.
- Liability to the third parties: In certain circumstances, directors may incur personal liability to third parties

Under the Companies Act, criminal proceedings against directors may be also being initiated, for actions such as:

- Filing of prospectus containing untrue statements
- Inviting deposits in contravention of rules or manner or conditions
- Issuing false advertisement inviting deposits
- Concealing name of the creditors
- Default in distributing dividends
- Failure to assist the Registrar or any officer authorized by central government in inspection of the books
- Failure to lay balance sheet in the Annual General Meeting (AGM)
- Failure in compliance with regard to matters being stated in the balance sheet
- Failure to attach to balance sheet a report of the board
- Improper issue of shares
- Failure to disclose shareholdings in the company
- False declaration of a company's solvency

4. Audit Committee:

Clause 49 has made it mandatory for all Indian listed companies to constitute an audit committee, consisting of non-executive directors, majority of whom are independent. The chairman of this committee has to be an independent director. The duties of the audit committee include oversight of the financial reporting process of the company and review of related party transactions. An annual audit should be conducted by an independent, competent, and qualified auditor in order to provide an external and objective assurance to the board and shareholders that the financial statements fairly represent the financial position and performance of the company in all material respects.

The company agrees that a qualified and independent audit committee shall be set up and that: The audit committee shall have minimum three members, all being non-executive directors, with the majority of them being independent, and with at least one director having financial and accounting knowledge; the chairman of the committee shall be an independent director; the chairman shall be present at Annual General Meeting to answer shareholder queries; the audit committee should invite such of the executives, as it considers appropriate (and particularly the head of the finance function) to be present at the meetings of the committee, but on occasions it may also meet without the presence of any executives of the company. The finance director, head of internal audit and when required, a representative of the external auditor shall be present as invitees for the meetings of the audit committee; the Company Secretary shall act as the secretary to the committee.

The audit committee shall meet at least thrice a year. One meeting shall be held before finalization of annual accounts and one every six months. The quorum shall be either two members or one third of the members of the audit committee, whichever is higher and minimum of two independent directors.

The audit committee shall have powers which should include the following:

- To investigate any activity within its terms of reference.
- To seek information from any employee.
- To obtain outside legal or other professional advice.

- To secure attendance of outsiders with relevant expertise, if it considers necessary.
- Oversight of the company's financial reporting process and the disclosure of its financial information to ensure that the financial statement is correct, sufficient and credible.
- Recommending the appointment and removal of external auditor, fixation of audit fee and also approval for payment for any other services.
- Reviewing with management the annual financial statements before submission to the board, focusing primarily on;
 - Any changes in accounting policies and practices.
 - Major accounting entries based on exercise of judgment by management.
 - Qualifications in draft audit report.
 - Significant adjustments arising out of audit.
 - The going concern assumption.
 - Compliance with accounting standards.
 - Compliance with stock exchange and legal requirements concerning financial statements
 - Any related party transactions i.e. transactions of the company of material nature, with promoters or the management, their subsidiaries or relatives etc. that may have potential conflict with the interests of company at large.
- Reviewing with the management, external and internal auditors, the adequacy of internal control systems.
- Reviewing the adequacy of internal audit function, including the structure of the internal audit department, staffing and seniority of the official heading the department, reporting structure coverage and frequency of internal audit.
- Discussion with internal auditors any significant findings and follow up there on.
- Reviewing the findings of any internal investigations by the internal auditors into matters where there is suspected fraud or irregularity or a failure of internal control systems of a material nature and reporting the matter to the board.
- Reviewing the company's financial and risk management policies.
- To look into the reasons for substantial defaults in the payment to the depositors, debenture holders, shareholders (in case of non payment of declared dividends) and creditors.

Annual audit is mandated by the Companies Act. The auditors are independent, and the following are not eligible for appointment as auditors:

- Body corporate
- Officer or employee of the company
- A person who is a partner or in employment of an officer or employee of the company
- A person indebted to the company for an amount exceeding Rs 1000; or which has given any guarantee or provided any security in connection with the indebtedness
- A person holding any security carrying voting rights if the company

Key information that must be reported to, and placed before, the Audit Committee of the board as well, must contain:

- Annual operating plans and budgets, together with up-dated long term plans.
- Capital budgets, manpower and overhead budgets.
- Quarterly results for the company as a whole and its operating divisions or business segments.
- Internal audit reports, including cases of theft and dishonesty of a material nature.
- Show cause, demand and prosecution notices received from revenue authorities which are considered to be materially important.
- Fatal or serious accidents, dangerous occurrences, and any effluent or pollution problems. Default in payment of interest or non-payment of the principal on any public deposit, and/or to any secured creditor or financial institution.

- Defaults such as non-payment of inter-corporate deposits by or to the company, or materially substantial non-payment for goods sold by the company.
- Any issue which involves possible public or product liability claims of a substantial nature, including any judgment or order which may have either passed strictures on the conduct of the company, or taken an adverse view regarding another enterprise that can have negative implications for the company.
- Details of any joint venture or collaboration agreement.
- Transactions that involve substantial payment towards goodwill, brand equity, or intellectual property.
- Recruitment and remuneration of senior officers just below the board level, including appointment or removal of the Chief Financial Officer and the Company Secretary.
- Labour problems and their proposed solutions.
- Quarterly details of foreign exchange exposure and the steps taken by management to limit the risks of adverse exchange rate movement, if material.

External auditors should be accountable to the shareholders and owe a duty to the company to exercise due professional care in the conduct of the audit. Clause 49 stipulates that the appointment and removal of external auditors is recommended by the audit committee of the board. Channels for disseminating information should provide for fair, timely and cost-efficient access to relevant information by users. The annual report of the company along with its audited accounts are sent to all shareholders, to SEBI, DCA, ROC, the stock exchanges, and posted on the company's website. In addition, key elements of the balance sheet and profit and loss account, segment accounts and cash flow statement along with notes is reported in national newspapers. Key elements of the audited half-yearly accounts, as defined by the SEBI, are published in national newspapers, submitted to SEBI, DCA, ROC, the stock exchanges and the company's website. Similarly, elements of the non-audited quarterly accounts, as defined by the SEBI, are published in national newspapers, submitted to SEBI, DCA, ROC, the stock exchanges and the company's website. Annual accounts have to be prepared within six months of the end of the financial year. The Companies (Amendment) Bill, 2003, proposes to reduce this period to three months. Half yearly accounts have to be prepared within two months of the end of the six-month period. Quarterly accounts have to be prepared within one month of the end of the quarter.

5• Integrity and ethical behaviour:

Organizations should develop a code of conduct for their directors and executives that promotes ethical and responsible decision making. It is important to understand, though, that systemic reliance on integrity and ethics is bound to eventual failure. Because of this, many organizations establish Compliance and Ethics Programs to minimize the risk that the firm steps outside of ethical and legal boundaries.

6• Disclosure and transparency:

Organizations should clarify and make publicly known the roles and responsibilities of board and management to provide shareholders with a level of accountability. They should also implement procedures to independently verify and safeguard the integrity of the company's financial reporting. Disclosure of material matters concerning the organization should be timely and balanced to ensure that all investors have access to clear, factual information.

The corporate governance framework should ensure that timely and accurate disclosure is made on all material matters regarding the corporation, including the financial situation, performance, ownership, and governance of the company. Disclosure should include

- The financial and operating results of the company.
- Company objectives.

- Major share ownership and voting rights.
- Remuneration policy for members of the board and key executives, and information about board members, including their qualifications, the selection process, other company directorships, and whether they are regarded as independent by the board
- Related party transactions
- Material foreseeable risk factors.
- Material issues regarding employees and other stakeholders.
- Governance structures and policies, in particular, the content of any corporate governance code or policy and the process by which it is implemented.

7. Provision of information

Schedule 1A of Clause 49 of the listing agreement mandates that the board of directors be provided (at least) the following information on a quarterly basis

- Annual operating plans and budgets and any updates.
- Capital budgets and any updates.
- Quarterly results for the company and its operating divisions or business segments.
- Minutes of meetings of audit committee and other committees of the board.
- The information on recruitment and remuneration of senior officers just below the board level, including appointment or removal of Chief Financial Officer and the Company Secretary.
- Show cause, demand, prosecution notices and penalty notices which are materially important.
- Fatal or serious accidents, dangerous occurrences, any material effluent or pollution problems.
- Any material default in financial obligations to and by the company, or substantial non-payment for goods sold by the company.
- Any issue, which involves possible public or product liability claims of substantial nature, including any judgement or order which, may have passed strictures on the conduct of the company or taken an adverse view regarding another enterprise that can have negative implications on the company.
- Details of any joint venture or collaboration agreement.
- Transactions that involve substantial payment towards goodwill, brand equity, or intellectual property.
- Significant labour problems and their proposed solutions. Any significant development in Human Resources/ Industrial Relations front like signing of wage agreement, implementation of Voluntary Retirement Scheme etc.
- Sale of material nature, of investments, subsidiaries, assets, which is not in normal course of business.
- Quarterly details of foreign exchange exposures and the steps taken by management to limit the risks of adverse exchange rate movement, if material.
- Non-compliance of any regulatory, statutory nature or listing requirements and shareholders service such as non-payment of dividend, delay in share transfer etc.

CHAPTER XVIII

BUSINESS ETHICS

INTRODUCTION

Ethics is a branch of social science. It deals with moral principles and social values. It helps us to classify, what is good and what is bad? It tells us to do good things and avoid doing bad things. So, ethics separate, good and bad, right and wrong, fair and unfair, moral and immoral and proper and improper human action. In short, ethics means a code of conduct. It is like the 10 commandments of holy Bible. It tells a person how to behave with another person.

So, the businessmen must give a regular supply of good quality goods and services at reasonable prices to their consumers. They must avoid indulging in unfair trade practices like adulteration, promoting misleading advertisements, cheating in weights and measures, black marketing, etc. They must give fair wages and provide good working conditions to their workers. They must not exploit the workers. They must encourage competition in the market. They must protect the interest of small businessmen. They must avoid unfair competition. They must avoid monopolies. They must pay all their taxes regularly to the government. In short, business ethics means to conduct business with a human touch in order to give welfare to the society.

FEATURES OF BUSINESS ETHICS

1. **Code of conduct:** Business ethics is a code of conduct. It tells what to do and what not to do for the welfare of the society. All businessmen must follow this code of conduct.
2. **Based on moral and social values:** Business ethics is based on moral and social values. It contains moral and social principles (rules) for doing business. This includes self-control, consumer protection and welfare, service to society, fair treatment to social groups, not to exploit others, etc.
3. **Gives protection to social groups:** Business ethics give protection to different social groups such as consumers, employees, small businessmen, government, shareholders, creditors, etc.
4. **Provides basic framework:** Business ethics provide a basic framework for doing business. It gives the social cultural, economic, legal and other limits of business. Business must be conducted within these limits.
5. **Voluntary:** Business ethics must be voluntary. The businessmen must accept business ethics on their own. Business ethics must be like self-discipline. It must not be enforced by law.
6. **Requires education and guidance:** Businessmen must be given proper education and guidance before introducing business ethics. The businessmen must be motivated to use business ethics. They must be informed about the advantages of using business ethics. Trade Associations and Chambers of Commerce must also play an active role in this matter.
7. **Relative Term:** Business ethics is a relative term. That is, it changes from one business to another. It also changes from one country to another. What is considered as good in one country may be taboo in another country.
8. **New concept:** Business ethics is a newer concept. It is strictly followed only in developed countries. It is not followed properly in poor and developing countries.

Determining how to conduct business appropriately can be challenging. Wrongdoing by businesses has focused public attention and government involvement to encourage more acceptable business conduct. Any business decision may be judged as right or wrong, ethical or unethical, legal or illegal. In

this chapter, we will take a look at the role of ethics and social responsibility in business decision making.

Business ethics are moral principles that guide the way a business behaves. Acting in an ethical way involves distinguishing between "right" and "wrong" and then making the "right" choice. Ethics is a branch of philosophy which seeks to find answers about the moral concepts like bad, good, evil, right, wrong, etc. Business ethics is the study of business situations, activities, and decisions where issues of right and wrong are addressed. Fairness in business dealings means being objective and having an interest in creating a win-win situation for both parties whether that is employer-employee or company-client. Honesty applies to every part of running a business while making a profit. Personal ethics are usually considered as the foundation for running ethical businesses. Ethical behaviour and corporate social responsibility can bring significant benefits to a business. For example: Attract customers to the firm's products, thereby boosting sales and profits. Make employees want to stay with the business, reduce labour turnover and therefore increase productivity. Attract more employees wanting to work for the business, reduce recruitment costs and enable the company to get the most talented employees. Attract investors and keep the company's share price high, thereby protecting the business from takeover. Due to increased emphasis on the business ethics over last three decades, this field is suffering and is troubled by the lack of proper directions and is struck in the issues like logic, reasons etc. The past conception of the companies about the ethical issues in business was related to the administration of rules, regulations in the organizations. Today, people from the top management level and the business owners have understood that this concept of ethical issues in business is far superior than handling the rules and regulations and their effective implementation.

There are wide ranges of issues related to the business ethics currently observed by the market analysts. In the current business environment, the issues like fairness, justice and honesty are the main issues that are posing complex dilemma to the businesses. Any wrong or biased decision can have a profound impact on the goodwill of the company as well as its market position. If they choose to use legality and profitability as their measurement in determining what is right from wrong then business ethics will surely become irrelevant..

ADVANTAGES OF BUSINESS ETHICS

Business ethics offer companies a competitive advantage.

Good will of the firm hikes depending on its responds towards it ethical issues
Productivity through rigid, firm and sincere workers as well as other business chain members. Through increasing morale and trust business can increase their market share,

Publicity due to well and ethical performance of the company. 'Words of mouth' is the fastest and best source to gain market. Thus a good performance will helps in publicity through words of mouth of general public.

Acceptance of product. For example: most of consumers prefer classmates notebook of ITC just because it is eco-friendly and also it contributes a part of its profit for social welfare.

DISADVANTAGES OF BUSINESS ETHICS

Business ethics reduce a company's freedom to maximize its profit.

Diversity in achievements. For example. A company may diverse from its achievements and turn towards any other directions.

Extra expenditure in some cases. For example, in some cases company may incur extra cost for solving certain ethical issues like accident compensation, solution for pollutions etc.

PRINCIPLES OF BUSINESS ETHICS

1. Be Trustworthy

Recognize that customers want to do business with a company they can trust; when trust is at the core of a company, it's easy to recognize. Trust defined, is assured reliance on the character, ability, strength, and truth of a business.

2. Keep an Open Mind

For continuous improvement of a company, the leader of an organization must be open to new ideas. Ask for opinions and feedback from both customers and team members and your company will continue to grow.

3. Meet Obligations

Regardless of the circumstances, do everything in your power to gain the trust of past customer's and clients, particularly if something has gone awry. Reclaim any lost business by honoring all commitments and obligations.

4. Have Clear Documents

Re-evaluate all print materials including small business advertising, brochures, and other business documents making sure they are clear, precise and professional. Most important, make sure they do not misrepresent or misinterpret.

5. Become Involved in the Community

Remain involved in community-related issues and activities, thereby demonstrating that your business is a responsible community contributor. In other words, stay involved.

6. Maintain Accounting Control

Take a hands-on approach to accounting and bookkeeping, not only as a means of gaining a better feel for the progress of your company, but as a resource for any "questionable" activities. Gaining control of accounting and record keeping allows you to end any dubious activities promptly.

7. Be Respectful

Treat others with the utmost of respect. Regardless of differences, positions, titles, ages, or other types of distinctions, always treat others with professional respect and courtesy.

Recognizing the significance of business ethics as a tool for achieving your desired outcome is only the beginning. A small business that instills a deep-seated theme of business ethics within its strategies and policies will be evident among customers. It's overall influence will lead to a profitable, successful company. By recognizing the value of practicing admirable business ethics, and following each of the 7 principles, your success will not be far off.

SOURCES OF BUSINESS ETHICS

Ethics in general refers to a system of good and bad, moral and immoral, fair and unfair. It is a code of conduct that is supposed to align behaviors within an organization and the social framework. But the question that remains is, where and when did business ethics come into being?

Primarily ethics in business is affected by three sources - culture, religion and laws of the state. It is for this reason we do not have uniform or completely similar standards across the globe. These three factors exert influences to varying degrees on humans which ultimately get reflected in the ethics of the organization. For example, ethics followed by Infosys are different than those followed by Reliance Industries or by Tata group for that matter. Again ethical procedures vary across geographic boundaries.

Religion

It is one of the oldest foundations of ethical standards. Religion wields varying influences across various sects of people. It is believed that ethics is a manifestation of the divine and so it draws a line between the good and the bad in the society. Depending upon the degree of religious influence we have different sects of people; we have sects, those who are referred to as orthodox or fundamentalists and those who are called as moderates. Needless to mention, religion exerts itself to a greater degree among the orthodox and to lesser extent in case of moderates. Fundamentally however all the religions operate on the principle of reciprocity towards ones fellow beings!

Culture

Culture is a pattern of behaviors and values that are transferred from one generation to another. Those that are considered as ideal or within the acceptable limits. No wonder therefore that it is the culture that predominantly determines what is wrong and what is right. It is the culture that defines certain behavior as acceptable and others as unacceptable.

Human civilization in fact has passed through various cultures, wherein the moral code was redrafted depending upon the epoch that was. What was immoral or unacceptable in certain culture became acceptable later on and vice versa.

During the early years of human development where ones who were the strongest were the ones who survived! Violence, hostility and ferocity were thus the acceptable. Approximately 10,000 year ago when human civilization entered the settlement phase, hard work, patience and peace were seen as virtues and the earlier ones were considered otherwise. These values are still in practice by the managers of today!

Still further, when human civilization witnessed the industrial revolution, the ethics of agrarian economy was replaced by the law pertaining to technology, property rights etc. Ever since a tussle has ensued between the values of the agrarian and the industrial economy!

Law

Laws are procedures and code of conduct that are laid down by the legal system of the state. They are meant to guide human behavior within the social fabric. The major problem with the law is that all the ethical expectations cannot be covered by the law and specially with ever changing outer environment the law keeps on changing but often fails to keep pace. In business, complying with the rule of law is taken as ethical behavior, but organizations often break laws by evading taxes, compromising on quality, service norms etc.

BUSINESS ETHICS AND SOCIAL RESPONSIBILITY

Business ethics is the principles and standards that determine acceptable conduct in business organizations. The acceptability of behaviour in business is determined by customers, competitors, government regulators, interest groups, and the public, as well as each individual's personal moral principles and values. Many consumers and social advocates believe that businesses should not only make a profit but also consider the social implications of their activities. Although many people use the terms social responsibility and ethics interchangeably, they do not mean the same thing. Business ethics relates to an individual's or a work group's decisions that society evaluates as right or wrong, whereas social responsibility is a broader concept that concerns the impact of the entire business's activities on society. From an ethical perspective, for example, we may be concerned about a health care organization or practitioner over charging the federal government for medical services. From a social responsibility

perspective, we might be concerned about the impact that this overcharging will have on the ability of the health care system to provide adequate services for all citizens. The most basic ethical and social responsibility concerns have been codified as laws and regulations that encourage businesses to conform to society's standards, values, and attitudes. At a minimum, managers are expected to obey these laws and regulations. Most legal issues arise as choices that society deems unethical, irresponsible, or otherwise unacceptable. However, all actions deemed unethical by society are not necessarily illegal, and both legal and ethical concerns change over time. Business law refers to the laws and regulations that govern the conduct of business. Many problems and conflicts in business can be avoided if owners, managers, and employees know more about business law and the legal system. Business ethics, social responsibility, and laws together acts as a compliance system requiring that business and employees act responsibly in society.

THE ROLE OF ETHICS IN BUSINESS

Learning how to recognize and resolve ethical issues is an important step in evaluating ethical decisions in business. Well-publicized incidents of unethical activity—ranging from health care fraud to using the Internet to gain personal information from young children to charges of deceptive advertising of food and diet products to unfair competitive practices in the computer software industry—strengthen the public's perception that ethical standards and the level of trust in business need to be raised.

It is not just altruism that motivates corporations to operate in a socially responsible manner, but also consideration of the "bottom line." There are good business reasons for a strong commitment to ethical values:

- Ethical companies have been shown to be more profitable.
- Making ethical choices results in lower stress for corporate managers and other employees.
- Our reputation, good or bad, endures.
- Ethical behaviour enhances leadership.
- Ethical conduct builds trust among individuals and in business relationships, which validates and promotes confidence in business relationships.

Learning to recognize ethical issues is the most important step in understanding business ethics. An ethical issue is an identifiable problem, situation, or opportunity that requires a person to choose from among several actions that may be evaluated as right or wrong, ethical or unethical. In business, such a choice often involves weighing monetary profit against what a person considers appropriate conduct. The best way to judge the ethics of a decision is to look at a situation from a customer's or competitor's viewpoint: Should liquid-diet manufacturers make unsubstantiated claims about their products? Should an engineer agree to divulge her former employer's trade secrets to ensure that she gets a better job with a competitor? Should a salesperson omit facts about a product's poor safety record in his presentation to a customer? Such questions require the decision maker to evaluate the ethics of his or her choice.

Now that we understand the idea of business ethics, it is important to practice good ethical behaviour. Leading by example; teaching by example; being a role model; these are all things that will come if you practice ethical behaviour and chose to make the right decisions. One of the most formidable challenges is avoiding immoral management, and transitioning from an amoral to a moral management mode of leadership, behavior, decision making, policies and practices. Moral management requires ethical leadership. It entails more than just "not doing wrong."

Moral management requires that managers search out those vulnerable situations in which amorality may reign if careful, thoughtful reflection is not given by management. Moral management requires that managers understand, and be sensitive to, all the stakeholders of the organization and their stakes. If the moral management model is to be achieved, managers need to integrate ethical wisdom with their managerial wisdom and to take steps to create and sustain an ethical climate in their organizations. If this is done, the desirable goals of moral management are achievable

CHAPTER XIX

ETHICAL ISSUES IN BUSINESS

In the complex global business environment of the 21st century, companies of every size face a multitude of ethical issues. Businesses have the responsibility to develop codes of conduct and ethics that every member of the organization must abide by and put into action. Fundamental ethical issues include concepts such as integrity and trust, but more complex issues include accommodating diversity, decision-making, compliance and governance.

Conflict of interest

A conflict of interest exists when a person must choose whether to advance his or her own personal interests or those of others. For example, a manager in a corporation is supposed to ensure that the company is profitable so that its stockholder-owners receive a return on their investment. In other words, the manager has a responsibility to investors. If she instead makes decisions that give her more power or money but do not help the company, then she has a conflict of interest—she is acting to benefit herself at the expense of her company and is not fulfilling her responsibilities. To avoid conflicts of interest, employees must be able to separate their personal financial interests from their business dealings.

Fairness and Honesty

Fairness and honesty are at the heart of business ethics and relate to the general values of decision makers. At a minimum, businesspersons are expected to follow all applicable laws and regulations. But beyond obeying the law, they are expected not to harm customers, employees, clients, or competitors knowingly through deception, misrepresentation, coercion, or discrimination. A recent survey showed that nearly one-fourth of workers have been asked to engage in an unethical act at work, and 41 percent carried out the act. One aspect of fairness relates to competition. Although numerous laws have been passed to foster competition and make monopolistic practices illegal, companies sometimes gain control over markets by using questionable practices that harm competition. Rivals of Microsoft, for example, have accused the software giant of using unfair and monopolistic practices to maintain market dominance with its Microsoft Network web browser. Competitors such as Netscape feel at a competitive disadvantage since the Microsoft Network is coupled with the Windows operating system and is readily available to 90 percent of the PC market.

Communications

Communications is another area in which ethical concerns may arise. False and misleading advertising, as well as deceptive personal-selling tactics, anger consumers and can lead to the failure of a business. Truthfulness about product safety and quality are also important to consumers. In the pharmaceutical industry, for example, dietary supplements, such as herbs, are sold with limited regulation and testing, and many supplements are sold by small, independent marketers.

Business Relationships

The behaviour of businesspersons toward customers, suppliers, and others in their workplace may also generate ethical concerns. Ethical behaviour within a business involves keeping company secrets, meeting obligations and responsibilities, and avoiding undue pressure that may force others to act unethically. Managers, in particular, because of the authority of their position, have the opportunity to influence employees' actions. For example, a manager can influence employees to use pirated computer software to save costs. The use of illegal software puts the employee and the company at legal risk, but employees may feel pressured to do so by their superior's authority. On the other hand, new network management programs enable managers to try to control when and where software programs can be

used. This could introduce an issue of personal privacy: Should your company be able to monitor your computer? Unauthorized copying of games and other programs has exposed companies to copyright-infringement suits, computer viruses, and system overload as well as the loss of productivity from employees spending time playing games.¹⁴ It is the responsibility of managers to create a work environment that helps the company achieve its objectives and fulfill its responsibilities. However, the methods that managers use to enforce these responsibilities should not compromise employee rights. Organizational pressures may encourage a person to engage in activities that he or she might otherwise view as unethical, such as invading others' privacy or stealing a competitor's secrets. Or the firm may provide only vague or lax supervision on ethical issues, providing the opportunity for misconduct. Managers who offer no ethical direction to employees create many opportunities for manipulation, dishonesty, and conflicts of interest.

Plagiarism

Taking someone else's work and presenting it as your own without mentioning the source—is another ethical issue. As a student, you may be familiar with plagiarism in school, for example, copying someone else's term paper or quoting from a published work without acknowledging it. In business, an ethical issue arises when an employee copies reports or takes the work or ideas of others and presents them as his or her own. A manager attempting to take credit for a subordinate's ideas is engaging in another type of plagiarism. Several well-known musicians, including Michael Jackson, George Harrison, and Michael Bolton, have been accused of taking credit for the work of others.

Fundamental Issues

The most fundamental or essential ethical issues that businesses must face are integrity and trust. A basic understanding of integrity includes the idea of conducting your business affairs with honesty and a commitment to treating every customer fairly. When customers perceive that a company is exhibiting an unwavering commitment to ethical business practices, a high level of trust can develop between the business and the people it seeks to serve. A relationship of trust between you and your customers may be a key determinate to your company's success.

Diversity Issues

According to the HSBC Group, "the world is a rich and diverse place full of interesting cultures and people, who should be treated with respect and from whom there is a great deal to learn." An ethical response to diversity begins with recruiting a diverse workforce, enforces equal opportunity in all training programs and is fulfilled when every employee is able to enjoy a respectful workplace environment that values their contributions. Maximizing the value of each employees' contribution is a key element in your business's success.

Decision-Making Issues

According to Santa Clara University, the following framework for ethical decision-making is a useful method for exploring ethical dilemmas and identifying ethical courses of action: "recognizes an ethical issue, gets the facts, evaluates alternative actions, makes a decision and tests it and reflects on the outcome." Ethical decision-making processes should center on protecting employee and customer rights, making sure all business operations are fair and just, protecting the common good and making sure individual values and beliefs of workers are protected.

Compliance and Governance Issues

Businesses are expected to fully comply with environmental laws, federal and state safety regulations, fiscal and monetary reporting statutes and all applicable civil rights laws. The Aluminum

Company of America's approach to compliance issues states, "no one may ask any employee to break the law, or go against company values, policies and procedures." ALCOA's commitment to compliance is underpinned by the company's approach to corporate governance; "we expect all directors, officers and other Alcoans to conduct business in compliance with our Business Conduct Policies."

SOCIAL RESPONSIBILITY OF BUSINESS

The social responsibility of business means various obligations or responsibilities or duties that a business-organization has towards the society within which it exists and operates from.

Generally, the social responsibility of business comprises of certain duties towards entities, which are depicted and listed below.

1. Shareholders or investors who contribute funds for business.
2. Employees and others that make up its personnel.
3. Consumers or customers who consume and/or use its outputs (products and/or services).
4. Government and local administrative bodies that regulate its commercial activities in their jurisdictions.
5. Members of a local community who are either directly or indirectly influenced by its activities in their area.
6. Surrounding environment of a location from it operates.
7. The general public that makes up a big part of society.

The social responsibility of business comprises of the following obligations:

1. A business must give a proper dividend to its shareholders or investors.
2. It must provide fair wages and salaries with good working conditions.
3. It must provide a regular supply of good quality goods and/or services to its consumers/customers at reasonable prices.
4. It must abide by all government rules and regulations, supports its business-related policies and should pay fair taxes without keeping any delays or dues.
5. It must also contribute in betterment of a local community by doing generous activities like building schools, colleges, hospitals, etc.
6. It must take immense care to see that its activities neither directly nor indirectly create havoc on the vitality of its surrounding environment.
7. It should maintain a stringent policy to curb or control pollution in regard to contamination of air, water, land, sound and radiation leakages. Here, to do so, it must hire experienced professional individuals who are experts in their respective fields.
8. It should also offer social-welfare services to the general public.

The core objectives of social responsibility of business are as follows:

1. It is a concept that implies a business must operate (function) with a firm mindset to protect and promote the interest and welfare of society.
2. Profit (made through any means) must not be its only highest objective else contributions made for betterment and progress of a society must also be given a prime importance.
3. It must honestly fulfill its social responsibilities in regard to the welfare of society in which it operates and whose resources & infrastructures it makes use of to earn huge profits.
4. It should never neglect (avoid) its responsibilities towards society in which it flourishes.

Now let's discuss how the survival, growth and success of business are linked and dependent on sincere execution of its social responsibilities.

1. Shareholders or investors

Social responsibility of business towards its shareholders or investors is most important of all other obligations.

If a business satisfies its funders, they are likely to invest more money in a project. As a result, more funds will flow in and the same can be utilized to modernize, expand and diversify the existing activities on a larger scale. Happy financiers can fulfill the rising demand of funds needed for its growth and expansion.

2. Personnel

Social responsibility of business towards its personnel is important because they are the wheels of an organization. Without their support, the commercial institution simply can't function or operate.

If a business takes care of the needs of its human resource (for e.g. of office staff, employees, workers, etc.) wisely, it will boost the motivation and working spirit within an organization. A happy employee usually gives his best to the organization in terms of quality labour and timely output than an unsatisfied one. A pleasant working environment helps in improving the efficiency and productivity of working people. A good remuneration policy attracts new talented professionals who can further contribute in its growth and expansion.

Thus, if personnel are satisfied, then they will work together very hard and aid in increasing the production, sales and profit.

3. Consumers or customers

Social responsibility of business towards its consumers or customers matters a lot from sales and profit point of view. Its success is directly depends on their level of satisfaction. Higher their rate of satisfaction greater is the chances to succeed.

If a business rolls out good-quality products and/or delivers better quality services that too at reasonable prices, then it is natural to attract lots of customers. If the quality-price ratio is maintained well and consumers get worth for their money spends, this will surely satisfy them. In a long run, customer loyalty and retention will grow, and this will ultimately lead to profitability.

4. Government

Social responsibility of business towards government's regulatory bodies or agencies is quite sensitive from the license's point of view. If permission is not granted or revoked abruptly, it can result in huge losses to an organization. Therefore, compliance in this regard is necessary. Furthermore, a business must also function within the demarcation of rules and policies as formulated from time to time by the government of state or nation. It should respect laws and abide by all established regulations while performing within the jurisdiction of state.

Some examples of activities a business can do in this regard:

- Licensing an organization,
- Seeking permissions wherever necessary,
- Paying fair taxes on time,
- Following labor, environmental and other laws, etc.

If laws are respected and followed, it creates a goodwill of business in eyes of authorities. Overall, if a government is satisfied it will make favorable commercial policies, which will ultimately open new opportunities and finally benefit the organization sooner or later. Therefore, satisfaction of government and local administrative bodies is equally important for legal continuation of business.

5. Local community

Social responsibility of business towards the local community of its established area is significant. This is essential for smooth functioning of its activities without any agitations or hindrances. A business has a responsibility towards the local community besides which it is established and operates from. Industrial activities carried out in a local-area affect the lives of many people who reside in and around it. So, as a compensation for their hardship, an organization must do something or other to alleviate the intensity of suffering.

As a service to the local community, a business can build:

- A trust-run hospital or health center for local patients,
- A primary and secondary school for local children,
- A diploma and degree college for local students,
- An employment center for recruiting skilled local people, etc.

Such activities to some-extend may satisfy the people that make local community and hence their changes of agitations against an establishment are greatly reduced. This will ensure the longevity of a business in a long run.

6. Environment

Social responsibility of business with respect to its surrounding environment can't be sidelined at any cost. It must show a keen interest to safeguard and not harm the vitality of the nature.

A business must take enough care to check that its activities don't create a negative impact on the environment. For example, dumping of industrial wastes without proper treatment must be strictly avoided. Guidelines as stipulated in the environmental laws must be sincerely followed. Lives of all living beings are impacted either positively or negatively depending on how well their surrounding environment is maintained (naturally or artificially). Humans also are no exception to this. In other words, health of an environment influences the health of our society. Hence, environmental safety must not be an option else a top priority of every business.

7. Public

Finally, social responsibility of business in general can also contribute to make the lives of people a little better.

Some examples of services towards public include:

- Building and maintaining devotional or spiritual places and gardens for people,
- Sponsoring the education of poor meritorious students,
- Organizing events for a social cause, etc.

Such philanthropic actions create a goodwill or fame for the business-organization in the psyche of general public, which though slowly but ultimately pay off in a due course of time.

The world is recognizing the importance of social responsibility of business

ENVIRONMENTAL RESPONSIBILITY OF BUSINESS

Going beyond environmental compliance can bring business benefits. Many businesses have realised that acting in a socially and environmentally responsible way is more than just a legal duty. It affects your bottom line and the long-term success of your business.

This guide outlines your main environmental responsibilities, including your obligations to recycle the waste your business produces. It also explains where you can find more detailed information and help on environmental issues.

1. Comply with environmental legislation

Comply with legislation regarding emissions into the air.

Store waste safely and securely, make sure it is treated appropriately, ensure it is collected by an authorised organisation (such as your local authority or a licensed private waste contractor) and complete a waste transfer note or consignment note when waste is handed over.

Manage your business waste for recycling by separating paper, card, plastic, metals and glass prior to collection. Most food businesses also need to separate food waste for recycling.

Ensure you do not cause a statutory nuisance which could affect someone's health or annoy your neighbours. This covers things like producing noise, smoke, fumes, gases, dust, odour, light pollution or accumulating rubbish.

Get permission from your water company before you allow trade effluent such as waste chemicals, detergents, cooling or cleaning water to enter the sewerage system.

Register with the National Packaging Waste Database, or join an approved compliance scheme if you handle more than 50 tonnes of packaging and have a turnover of more than £2 million. You must then provide evidence that you're recovering and recycling a set amount of packaging waste.

Make sure that you comply with restrictions on the storage and use of hazardous substances. Ensure that any hazardous waste your business produces is correctly classified and described, and is either disposed of or recovered at an appropriately authorised facility.

Notify the relevant enforcing authority and take steps to prevent the damage if your business activities pose an imminent threat to the environment. If your business activities cause actual environmental damage, you must take remedial action to repair the damage.

2. Hazardous substances covered by environmental legislation

Specific environmental rules cover potentially dangerous substances. Every business needs to think about the risks to people or the environment posed by chemicals or substances classified as hazardous to health.

Hazardous substances are tightly regulated. They include:

- animal by-products
- chemicals
- oil
- ozone-depleting substances (ODS)

- pesticides and biocides
- radioactive materials
- hazardous substances in electrical and electronic equipment
- solvents

You must consider the environmental risks for every hazardous substance you store, use, produce or dispose of at work. You must ensure you control any potential risks and comply with legislation when storing goods and materials.

If you work with equipment containing ODS or fluorinated gases - including air conditioning and refrigeration equipment - there are requirements that you must meet regarding:

- containment including prevention and repair of leaks, checking for leakages and record keeping
- recovery for the purpose of recycling, reclamation or destruction
- training and certification

3. Waste and recycling

Business must ensure that any waste you produce as a result of your business operations is stored safely and securely, treated appropriately and collected for disposal or recycling by an organisation authorised to do so (such as your local authority or a licensed private waste contractor).

In addition, all businesses to separate the following forms of commercial waste for recycling:

- paper
- card
- plastic
- metals
- glass

If your business processes, prepares or distributes food and produces over 50kg of food waste per week, you are also required to separate food waste unless your business operates in a designated rural area. Food businesses in non-rural areas producing over 5kg of food waste per week will have to comply with the regulations from 1 January 2016. Where collections of food waste are available, from 1 January 2016 it will be illegal to dispose of food waste directly or indirectly into a public drain or sewer.

4. Conservation and biodiversity issues for businesses

Biodiversity refers to all species of plants and animals, including any genetic variations within those species, and the complex ecosystems they live in.

The world is losing biodiversity at an ever-increasing rate as a result of human activity. All types of business operating near protected areas should be aware of their responsibilities for conservation and protecting biodiversity. This doesn't just apply to land-based industries such as forestry or farming, but to all offices, factories and other business activities based on or near these areas.

Protected areas include:

- Local nature reserves - places with wildlife or geological features that are of special interest locally.
- National scenic areas - areas of particular natural beauty in need of conservation.
- National parks - tracts of the countryside that have been given protection for the conservation and enhancement of their special qualities.
- National nature reserves - important areas of wildlife habitat.
- Sites of special scientific interest - good examples of natural heritage of wildlife habitats, geological features and landforms.
- Special areas of conservation - strictly protected sites for habitat types and species that are considered to be most in need of conservation.
- Special protection areas - strictly protected sites classified for rare and vulnerable birds.
- Wetlands

- UNESCO biospheres - areas of terrestrial and coastal/marine ecosystems which are internationally recognised under UNESCO's Man and the Biosphere programme.

5. Prevent and remedy pollution incidents

Every year there are thousands of cases of damage to the environment. The Environmental Regulations relate to the most serious cases, covering:

- damage to species and habitats
- damage to water
- risks to human health from contamination of land

The regulations apply to both actual cases of damage and threats of imminent damage. If you are responsible - ie you are the 'operator' of the activity that causes or threatens the damage - you must take immediate action to prevent or remedy this.

ECONOMIC RESPONSIBILITIES OF A BUSINESS

A business has economic responsibilities to its direct stakeholders—its investors, employees, and customers. A business has an ethical obligation to meet these responsibilities. There are four basic economic responsibilities a business has to its direct stakeholders:

1. **Profitability:** A business creates profit when it sells products or services that are more valuable than the materials and labor it uses to create them. Put simply, the business creates profit by adding value. Adding value and creating profit serve the interests of all of a company's direct stakeholders. The company produces products or services that are valuable to customers. The company uses profits to reward investors and pay employees.
2. **Transparency:** When a business acts with transparency, it provides as much information as practical about its operations. The company allows direct stakeholders to clearly see its practices, strategies, and financial positions. Transparency benefits direct stakeholders. Transparency serves the interests of investors by giving them information they need to evaluate the potential risks and rewards of investing in the company. Transparency lets employees and customers see how a company is run. They can make informed decisions about where they work and where they spend their money.
3. **Nondiscrimination:** In an economic sense, nondiscrimination doesn't refer to the absence of bias against gender or ethnic groups. It means a business applies the same financial criteria to all of its customers, suppliers, and employees. Direct stakeholders benefit from nondiscrimination because the company makes decisions on the financial merit, rather than on the biases and preferences of decision makers.
4. **Sustainability:** Businesses ensure the sustainability of their operations by improving business processes and developing secure, long-lasting relationships with suppliers and customers. An organization's investors, employees, and customers are called direct stakeholders because they have a stake in the company's future.

Direct stakeholders benefit from the sustainability of a business because when a business has a secure future, investors continue to earn dividends, workers continue to draw paychecks, and customers continue to buy the company's products and services. Why do business organizations exist? Their primary purpose is economic—to make profits for owners and direct shareholders and to provide jobs for employees. Their first ethical responsibility is to fulfill these economic goals.

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