Lesson 9.20

LEVELS OF STRATEGIES, PORTER'S MODEL AND STRATEGY DEVELOPMENT (BCG) AND IMPLEMENTATION

Level of Strategies

Many organizations develop strategies at three different levels. These three different and distinct levels of strategy are corporate, business, and functional:

Corporate-level strategy is developed by top-level management and the board of directors. The **corporate-level strategy** seeks to determine what businesses a corporation should be in or wants to be in. Two popular approaches for answering the question of what business(es) should we be in are the grand strategies framework and the corporate portfolio matrix.

1. **These strategies address**
    a. What business the organization will be coordinated to strengthen the organization's competitive position.
    b. How the strategies of those businesses will be coordinated to strengthen the organization's competitive position.
    c. How resources will be allocated among businesses.

2. **Business-level strategy** concentrates on the best means of competing within a particular business while also supporting the corporate-level strategy.
    a. The distinction between corporate-level and business-level strategy applies only to organizations with separate divisions that compete in different industries.
    b. A **strategic business unit (SBU)** is a distinct business, with its own set of competitors that can be managed reasonably independently of other businesses within the organization.

3. **Functional-level strategy** focuses on action plans for managing a particular functional area within a business in a way that supports the business-level strategy.
    a. Functional areas include operations, marketing, finance, human resources management, accounting, research and development, and engineering.
    b. Functional strategies are usually developed by functional managers and are typically reviewed by business unit heads.

4. **Coordinating** strategies across these three levels is critical in maximizing strategic impact.

The role of competitive analysis in strategy formulation and implementation

Porter's Forces Model:

Michael E. Porter, a noted strategy expert, has devised the **five competitive forces model** as an approach for analyzing the external environment for both the nature and the intensity of competition in a given industry in terms of five major forces.

1. The model provides an environmental assessment of strategically significant elements of the organization's task environment.
2. Rivalry is the extent to which competitors use tactics to lower the profits of their competitors.

3. The bargaining power of suppliers is the extent to which suppliers can exert power over business in an industry by threatening to raise prices or reduce the quality of goods and services they provide.
4. The bargaining power of buyers depends on the factors such as number of customers in the market, customer information, and the availability of substitute which determine the amount of influence that buyers have in an industry.
5. The threat of new entrants is the threat of a price war if new competitors can enter the market.
6. The threat of substitute products or services is the extent to which businesses in other industries can offer substitute products, thus reducing the profit potential for the industry.

The competitive environment, in some industries, may reach the point of **hyper competition-**a state of rapidly escalating competition. When this happens, environments may become upward spirals of uncertainty, dynamism, and heterogeneity of players making it difficult for any organization to sustain competitive advantage.

An **organizational assessment** determines how organizational factors in the internal environment affect the competitive situation.

1. The resource-based strategic view is a useful approach to internal assessment as it focuses on competitive implications of several sets of organizational resources and capabilities.
   a. Financial resources include debt, equity, retained earnings, and other money related matters.
   b. Physical resources include buildings, machinery, and other materials to operate.
   c. Human resources include skills, abilities, experience, and other work related characteristics of those associated with the organization.
   d. Organizational resources include the history, relationships, levels of trust, and other culture dimensions.

2. Assessing the competitive implications of these resources and capabilities relative to the environment involves answering questions about four critical factors.
   a. How much value does any resource or capability add?
   b. What, if any, degree of rareness does each resource or capability have among competing firms?
   c. What is the degree of imitability by competitors of each resource or capability?
   d. Is the organization of the firm's resources and capabilities by the formal reporting relationships, the control and reward systems, and other factors such so as to achieve the best competitive advantage?

3. Achieving sustained competitive advantage requires both the development in industries in which competitive forces are favorable and upon the development of resources and capabilities that are valuable, rare, and are difficult to imitate. When a firm has valuable, rare, and difficult to imitate resources and capabilities, it is said to have a **distinctive competence.**

Formulating Corporate-level Strategy

A. **A grand strategy** (master strategy) provides the basic strategic direction at the corporate level of the organization. Four grand strategies have been identified.

1. **Growth strategies** are grand strategies that involve organizational expansion along some major dimension.
    a. **Concentration** focuses on effecting the growth of a single product or service or a small number of closely related products or services.
        1) <u>Market development</u> is gaining a larger share of a current market or expanding into new ones.
        2) <u>Product development</u> is improving a basic product or service or expanding into closely related products or services.
        3) <u>Horizontal integration</u> is adding one or more business that is similar, usually by purchasing such business.
    b. **Vertical integration** involves effecting growth through the production of inputs previously provided by suppliers or through the replacement of a customer role (Such as that of a distributor) by disposing of one's own outputs.
        1) <u>Backward integration</u> occurs when a business grows by becoming its own supplier
        2) <u>Forward integration</u> occurs when organizational growth encompasses a role previously fulfilled by a customer.

Diversification entails effecting growth through the development of new areas that are clearly distinct from current businesses.

1) <u>Conglomerate diversification</u> takes place when an organization diversifies into areas that are unrelated to its current business.
2) <u>Concentric diversification</u> occurs when an organization diversifies into a related, but distinct, business.

c. These growth strategies can be implemented through a number of means:
    1) Internal growth occurs as the organization expands by building on its own internal resources.
    2) An **acquisition** is the purchase of all or part of one organization by another.
    3) A **merger** is the combining of two or more companies into one organization.
    4) A joint venture occurs when two or more organizations provide resources to support a given project or product offering.

2. A **stability strategy** is a second type of grand strategy that involves maintaining the status quo or growing in a methodical, but slow, manner.
    a. Small, privately owned businesses are most likely to adopt this strategy.
    b. Some of the reasons for adopting a stability strategy are that it
        1) Avoids the risks or hassles of aggressive growth.
        2) Provides the opportunity to recover after a period of accelerated growth.
        3) Lets the company hold on to current market share.
        4) May occur through default.

3. **Defensive strategies,** the third class of grand strategies, are sometimes

called retrenchment strategies. They tend to focus on the desire or need to reduce organizational operations usually through cost reductions, such as cutting back on non-essential expenditures and instituting hiring freezes, and/or asset reductions such as selling land, equipment, or the business itself.

a. **Harvest** entails minimizing investments while attempting to maximize short-run profits and cash flow, with the long-run intention of existing with the market.
b. A **turnaround** is designed to reverse a negative trend and restore the organization to appropriate levels of profitability.
c. A **divestiture** involves an organization's selling or divesting of a business or part of a business.
d. A **bankruptcy** is a means whereby an organization that is unable to pay its debts can seek court protection from creditors and from certain contract obligations while it attempts to regain financial stability.
e. **Liquidation** entails selling or dissolving an entire organization.

B. A **portfolio strategy approach** is a method of analyzing an organization's mix of businesses in terms of both individual and collective contributions to strategic goals. Two portfolio approaches are used most frequently. Each uses a two-dimensional matrix, and each may apply to either the existing or to potential strategic business units (SBUs). The portfolio concept is analogous to an individual's selecting a portfolio of stocks to achieve balance in terms of risk, long-term growth, etc.

The **Boston Consulting Groups (BCG) growth-share matrix** compares various businesses in an organization's portfolio on the basis of relative market share and market growth rate. The corporate portfolio matrix approach has been a popular approach to determining corporate-level strategy.

The **BCG matrix,** developed by the Boston Consulting Group, is a strategy tool to guide resource allocation decisions based on market share and growth of SBUs.

a. Relative market share is determined by the ratio of a business's market share compared to the market share of its largest rival.
b. Market growth rate is the growth in the market during the previous year relative to growth in the economy as a whole.

The matrix defines four business groups. SBUs plotted on the BCG matrix can be categorized:

1) The **Star** has a high market share in a rapidly growing market.
2) A **Question Mark** (problem child) has a low market share in a rapidly growing market.
3) The **Cash Cow** has a high market share in a slowly growing market.
4) A **Dog** has a low market share in an area of low growth.

c. Strategies are suggested by the SBU's position on the matrix.

1) Use funds from cash cows to duns stars and possibly question marks.
2) Divest dogs and less desirable question mark.

1. The **product/market evolution matrix** (sometimes called the life-cycle

portfolio matrix) is a 15-cell matrix in which business is plotted according to the business unit's business strengths or competitive position, and the industry's stage in the evolutionary product/market life cycle.

a. While the BCG matrix measures market growth rate the product/market evolution matrix shows the industry's stage in the evolutionary life cycle.
b. The maturity and saturation stage is particularly important because it may last for an extended period of time and is a stage that presents special challenges to preserve market share while facing the prospect of the decline stage.

2. In **assessing these portfolio matrixes** remember that each model offers a somewhat different perspective. Portfolio matrices do not provide advice about specific business within the organization-such specifics are derived at the business level.

The BCG matrix (and the portfolio concept) has lost much of its merit because:

a. Not every organization has found that increased market share leads to lower costs.
b. The portfolio concept assumes that an organization's businesses can be divided into a reasonable number of independent units.
c. Contrary to predictions, many so-called dogs have shown consistently higher levels of profitability than their growing competitors with dominant market shares.
d. Given the rate at which the economy has been growing and the fact that a market can have only one leader, well over half of all businesses by definition fall into the dog category.
e. Strategic implications of the BCG matrix are: "milk" the cash cows; invest resources in the stars; liquidate or sell the dogs; and sell off or invest in the question marks.

Formulating Business-level strategy

A. Business-level strategies provide advice about specific strategies for various businesses.
B. Michael E. Porter has developed three business-level strategies that are generic, i.e., widely applicable to a variety of situations.

1. A **cost leadership strategy** involves emphasizing organizational efficiency so that the overall costs of providing products and services are lower than those of competitors.
   a. The business should have a cost advantage that is not easily or inexpensively imitated.
   b. Managers should consider making those product or service innovations that are most important to customers.

2. A **differentiation strategy** involves attempting to develop products and services that are viewed as unique in the industry.
   a. Differentiation may occur in brand image, technology, customer service, features, quality, and election.
   b. Costs are not as important as product or service uniqueness.

3. A **focus strategy** entails specializing by establishing a position of overall cost leadership, differentiation, or both, but only within a particular portion, or segment, or an entire market.

Formulating functional-level strategy

A. Strategies at the functional level are important in supporting a business-level strategy.

B. Functional areas develop the distinctive competencies that lead to potential competitive advantages.

Strategy Implementation

Strategies at the functional level are important in supporting a business-level strategy. Functional areas develop the distinctive competencies that lead to potential competitive advantages.

Strategy implementation includes the various management activities that are necessary to put the strategy in motion, institute strategic controls that monitor progress, and ultimately achieve organizational goals.

A. Managers need to synchronize major factors within an organization needed to put a chosen strategy into action.
   1. **Technology** is the knowledge, tool, equipment, and work technique used by an organization in delivering its product or service.
   2. **Human resources** are the individuals who are members of the organization.
   3. **Reward systems** include bonuses, awards, or promotions provided by others, as well as rewards related to internal experiences, such as feeling of achievement and challenge.
   4. **Decision processes** include the means of resolving questions and problems that occur in organizations.
   5. **Organization structure** is the formal pattern of interactions and coordination designed by management to link the tasks of individuals and groups in achieving organizational goals.

B. Managers need to be able to monitor progress through strategic control.
   1. Strategic control involves monitoring critical environmental factors that could affect the viability of strategic plans, assessing the effects of organizational strategic actions, and ensuring that strategic plans are implemented as intended.

Strategic control systems include information systems that provide feedback on the implementation and effectiveness of strategic plans