Answer No.2 (a)

(i) Definition of Strategic Management

Strategic management can be defined as the art and science of formulating, implementing, and evaluating cross-functional decisions that enable an organization to achieve its objectives.

As this definition implies, strategic management focuses on integrating management, marketing, finance/ accounting, production/ operations, research and development and computer information systems to achieve organizational success. The term strategic management in this text is used synonymously with the term strategic planning. The latter term is more often used in the business world, whereas the former is often used in academia. Sometimes the term strategic management is used to refer to strategy formulation, implementation and evaluation, with strategic planning referring only to strategy formulation. The purpose of strategic management is to exploit and create new and different opportunities for tomorrow; long-range planning, in contrast, tries to optimize for tomorrow the trends of today.

(ii) Stages of Strategic Management

The strategic management process consists of three stages: strategy formulation, strategy implementation, and 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 business to enter, what business to abandon, 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 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 (1) reviewing external and internal factors that are the bases for current strategies, (2) measuring performance, and (3) taking corrective actions. Strategy evaluation is needed because success today is no guarantee of success tomorrow! Success always creates new and different problems; complacent organization experience demise.

Answer No.2 (b)

Why Some Firms Do No Strategic Planning

Some reasons for poor or no strategic planning are as follows:

Fire-Fighting – An organization can be so deeply embroiled in crisis management and fire-fighting that it does not have time to plan.

Poor Reward Structures – When an organization assumes success, it often fails to reward success. When failure occurs, then the firm may punish. In this situation, it is better for an individual to do nothing (and not draw attention) than to risk trying to achieve something, fail, and be punished.

Too Expensive – Some organizations are culturally opposed to spending resources.

Waste of Time – Some firms see planning as a waste of time since no marketable product is produced. Time spent on planning is an investment.

Content with Success – Particularly if a firm is successful, individuals may feel there is no need to plan because things are fine as they stand. But success today does not guarantee success tomorrow.

Laziness – people may want to put forth the effort needed to formulate a plan.

Fear of Failure – By not taking action, there is little risk of failure unless a problem is urgent and pressing. Whenever something worthwhile is attempted, there is some risk of failure.

Prior Bad Experience – People may have had a previous bad experience with planning, that is, cases in which plans have been long, cumbersome, impractical, or inflexible. Planning, like anything else, can be done badly.

Overconfidence – As individuals amass experience, they may rely less on formalized planning. Rarely, however, is this appropriate. Being overconfident or overestimating experience can bring demise. Forethought is rarely wasted and is often the mark of professionalism.

Fear of the Unknown – People may be uncertain of their abilities to learn new skills, of their aptitude with new systems, or of their ability to take on new roles.

Self-Interest – When someone has achieved status, privilege or self-esteem through effectively using an old system, he or she often sees a new plan as a threat.

Honest Difference of Opinion – People may sincerely believe the plan is wrong. They may view the situation from a different viewpoint, or they may have aspirations for themselves or the organization the are different from the plan. Different people in different jobs have different perceptions of a situation.

Suspicion – Employees may not trust management.

Answer No.2 (c)

Integration Strategies

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

Guidelines for when **forward integration** may be an especially effective strategy are:

- When an organization's present distributors are especially expensive, or unreliable, or incapable of meting the firm's distribution needs.
- When the availability of quality distributors is so limited as to offer a competitive advantage to those firms that integrate forward.
- 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 if its basic industry falters.
- When an organization has both the capital and human resources needed to manage the new business of distributing its own products.
- 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.
- 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.

Guidelines for when **backward integration** may be an especially effective strategy are:

- 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.
- When the number of suppliers is small and the number of competitors is large.
- 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.
- When an organization has both capital and human resources to manage the new business of supplying its own raw materials.
- When the advantages of stable prices are particularly important; this is a factor because an organization can stabilize the cost of its raw materials and the associated prices of its product(s) through backward integration.
- When present suppliers have high profit margins, which suggests that the business of supplying products or services in the given industry is a worthwhile venture.
- When an organization needs to acquire a needed resource quickly.

Guidelines for when **horizontal integration** may be an especially effective strategy are:

- 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.
- When an organization competes in a growing industry.
- When increased economies of scale provide major competitive advantages.
- When an organization has both the capital and human talent needed to successfully manage an expanded organization.
- 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.

Answer No.3 (a)

Characteristics of a Mission Statement

A Declaration of Attitude

A mission statement is more than a statement of specific details; it is a declaration of attitude and outlook. It usually is broad in scope for at least two major reasons. First, a good mission statement allows for the generation and consideration of a range of feasible alternative objectives and strategies without unduly stifling management creativity. Excess specificity would limit the potential of creative growth for the organization. On the other hand, an overly general statement that does not exclude any strategy alterative could be dysfunctional. <u>Apple Computer's mission statement, for example, should not open the possibility for diversification into pesticides – or Ford Motor Company's into food processing.</u>

Second, a mission statement needs to be broad to effectively reconcile differences among, and appeal to, an organization's diverse stakeholders, the individuals and groups of individuals who have a special stake or claim on the company.

Stakeholders include employees, managers, stockholders, boards of directors, customers, suppliers, distributors, creditors, governments (local, federal, and foreign), unions, competitors, environmental groups, and the general public. Stakeholders affect and are affected by an organization's strategies, yet the claims and concerns of diverse constituencies vary and often conflict. For example, the general public is especially interested in social responsibility, whereas stockholders are more interested in profitability. Claims on any business literally may number in the thousands, and they often include clean air water, jobs, taxes, investment opportunities, career opportunities, equal employment opportunities, employee benefits, salaries, wages and community services. All stakeholders' claims on an organization cannot be pursued with equal emphasis. A good mission statement indicates the relative attention that an organization will devote to meeting the claims of various stakeholders. Many firms are environmentally proactive in response to the concerns of stakeholders, as indicated in the "Natural Environment Perspective" box.

The fine balance between specificity and generality is difficult to achieve, but is well worth the effort.

A customer orientation

A good mission statement describes an organization's purpose, customers, products or services, markets, philosophy, and basic technology. According to Vern McGinnis, a mission statement should

(1) define what the organization is and what the organization aspires to be,

(2) be limited enough to exclude some ventures and broad enough to allow for creative growth,

(3) distinguish a given organization from all others,

(4) serve as a framework for evaluating both current and prospective activities, and
(5) be stated in terms sufficiently clear to be widely understood throughout the organization.
A good mission statement reflects the anticipations of customers. Rather than developing a product and then trying to find a market, the operating philosophy of organization should be to identify customers' needs and then provide a product or service to fulfill those needs. Since more and more customers are using the Internet, all firms should post their vision and mission statements at the company's home page.

A Declaration of Social Policy

The term policy embraces managerial philosophy and thinking at the highest levels of an organization. For this reason, social policy affects the development of a business mission statement. Social issues mandate that strategists consider not only what the organization owes its various stakeholders but also what responsibilities the firm has to consumers, environmentalists, minorities, communities and other groups. After decades of debate on the topic of social responsibility, many firms still struggle to determine appropriate social policies.

The issue of social responsibility arises when a company establishes its business mission. The impact of society on business and vice versa is becoming more pronounced each year. Social policies directly affect a firm's customers, products and service, markets, technology, profitability, self-concept, and public image. An organization's social policy should be integrated into all strategic-management activities, including the development of a mission statement. Corporate social policy should be designed and articulated during strategy formulation, set and administered during strategy implementation, and reaffirmed or changed during strategy evaluation. The emerging view of social responsibility holds that social issues should be attended to both directly and indirectly in determining strategies.

Answer No.3 (b)

(i) The Nature of an External Audit

The purpose of an external audit is to develop a finite list of opportunities that could benefit a firm and threats that should be avoided. As the term finite suggests, the external audit is not aimed at developing an exhaustive list of every possible factor that could influence the business; rather, it is aimed at identifying key variables that offer actionable responses. Firms should be able to respond either offensively or defensively to the factors by formulating strategies that take advantage of external opportunities or that minimize the impact of potential threats.

Key External Forces

External forces can be divided into five broad categories:
(1) economic forces;
(2) social, cultural, demographic and environmental forces;
(3) political, governmental, and legal forces;
(4) technological forces; and
(5) competitive forces.
External trends and events significantly affect all products, services, markets, and organizations in the world.

(ii) The Process of Performing an External Audit

The process of performing an external audit must involve as many managers and employees as possible. Involvement in the strategic management process can lead to understanding and commitment from organizational members. Individuals appreciate having the opportunity to contribute ideas and to gain a better understanding of their firm's industry, competitors, and markets.

To perform an external audit, a company first must gather competitive intelligence and information about economic, social, cultural, demographic, environmental, political, government, legal, and technological trends. Individuals can be asked to monitor various sources of information, such as key magazines, trade journals, and newspapers. These persons can submit periodic scanning reports to a committee of managers charged with performing the external audit. This approach provides a continuous stream of timely strategic information and involves many individuals in the external-audit process. The Internet provides another source for gathering strategic information, as do corporate, university, and public libraries. Suppliers, distributor's salespersons, customers, and competitors represent other sources of vital information.

Once information is gathered, it should be assimilated and evaluated. A meeting or series of meetings of managers is needed to collectively identify the most important opportunities and threats facing the firm. These key external factors should be listed on flip charts or a blackboard. A prioritized list of these factors could be obtained by requesting that all managers rank the factors identified, from 1 for the most important opportunity/ threat to 20 for the least important opportunity/ threat. These key external factors can vary over time and by industry. Relationships with suppliers or distributors are often a critical success factor. Other variables commonly used include market share, breadth of competing products, world economies, foreign affiliates, proprietary and key account advantages, price competitiveness, technological advancements, population shifts, interest rates and pollution abatement.

Freund emphasized that these key external factors should be
(1) important to achieving long-term and annual objectives,
(2) measureable,
(3) applicable to all competing firms, and
(4) hierarchical in the sense that some will pertain to the overall company and others will be more narrowly focused on functional or divisional areas.

A final list of the most important key external factors should be communicated and distributed widely in the organization. Both opportunities and threats can be key external factors.

Answer No.3 (c)

Management Audit Checklist of Questions

The checklist of questions provided below can help determine specific strengths and weaknesses in the functional area of business. An answer of no to any question could indicate a potential weakness, although the strategic significance and implications of negative answers, of course, will vary by organization, industry, and severity of the weakness. Positive or yes answers to the checklist questions suggest potential areas of strength.

1- Do managers at all hierarchical levels plan effectively?
2- Does the firm use strategic-management concepts?
3- Are company objectives and goals measurable and well communicated?
4- Is the organization's structure appropriate?
5- Are employee turnover and absenteeism low?
6- Are organizational reward and control mechanisms effective?
7- Do managers delegate authority well?
8- Are job descriptions and job specifications clear?
9- Is employee morale high?

Answer No.4 (a)

The Strengths-Weaknesses-Opportunities-Threats (SWOT) Matrix

The Strengths-Weaknesses-Opportunities-Threats (SWOT) Matrix is an important matching tool that helps managers develops four types of strategies. SO (strengths opportunities) Strategies, WO (weakness-opportunities) Strategies, ST (strengths threats) Strategies, and WT ((weakness-threats) Strategies. Matching key external and internal factors is the most difficult part of developing a SWOT Matrix and requires good judgment – and there is no one best set of matches.

SO Strategies use a firm's internal strengths to take advantage of external opportunities. All managers would like their organizations to be in a position in which internal strengths can be used to take advantage of external trends and events. Organizations generally will pursue WO, ST, or WT strategies in order to get into a situation in which they can apply SO Strategies. When firm has major weaknesses, major threats, it will seek to avoid them in order to concentrate on opportunities.

WO Strategies aim at improving internal weaknesses by taking advantage of external opportunities. Sometimes key external opportunities exist, but a firm has internal weaknesses that prevent it from exploiting those opportunities. For example, there may be a high demand for electronic devices to control the amount and timing of fuel injection in automobile engines (opportunity), but a certain auto parts manufacturer may lack the technology required for producing these devices (weakness). One possible WO Strategy would be to acquire this technology by forming a joint venture with a firm having competency in this area. An alternative WO Strategy would be to hire and train people with the required technical capabilities.

ST Strategies use a firm's strengths to avoid or reduce the impact of external threats. This does not mean that a strong organization should always meet threats in the external environment head-on. An example of ST Strategy occurred when Texas Instruments used an excellent legal department (a strength) to collect nearly Rs.700 million in damages and royalties from nine Japanese and Korean firms that infringed on patents for semiconductor memory chips (threat). Rival firms that copy ideas, innovations, and patented products are a major threat in many industries. This is still a major problem for U.S. firms selling products in China.

WT Strategies are defensive tactics directed at reducing internal weaknesses and avoiding external threats. An organization faced with numerous external threats and internal weaknesses may indeed be in a precarious position. In fact, such a firm may have to fight for its survival, merge, retrench, declare bankruptcy or choose liquidation.

A schematic representation of the SWOT Matrix is provided. Note that a SWOT Matrix is composed of nine cells. As shown, there are four key factor cells, four strategy cells, and one cell that is always left blank (the upper-left cell). The four strategy cells, labeled SO, WO, ST, and WT, are developed after completing four key factor cells, labeled S, W, O, and T. There are eight steps involved in constructing a SWOT Matrix:

1- List the firm's key internal strengths.
2- List the firm's key external opportunities.
3- List the firm's key internal weaknesses.
4- Match internal weaknesses with external threats and record the resultant WT Strategies.
5- Match internal strengths with external threats and record the resultant ST Strategies.
6- Match internal strengths with external opportunities and record the resultant SO Strategies in the appropriate cell.
7- List the firm's key external threats.
8- Match internal weaknesses with external opportunities and record the resultant WO Strategies.

SWOT Matrix

Always leave blank	STRENGTHS–S 1. 2. 3. 4. 5. List strengths 6. 7. 8. 9. 10.	WEAKNESSES–W 1. 2. 3. 4. 5. List weaknesses 6. 7. 8. 9. 10.
OPPORTUNITIES–O 1. 2. 3. 4. 5. List opportunities 6. 7. 8. 9. 10.	SO STRATEGIES 1. 2. 3. 4. 5. Use strengths to take 6. advantage of opportunities 7. 8. 9. 10.	WO STRATEGIES 1. 2. 3. 4. 5. Overcome weaknesses by 6. taking advantage of 7. opportunities 8. 9. 10.
THREATS–T 1. 2. 3. 4. 5. List threats 6. 7. 8. 9. 10.	ST STRATEGIES 1. 2. 3. 4. 5. Use strengths of avoid 6. threats 7. 8. 9. 10.	WT STRATEGIES 1. 2. 3. 4. 5. Minimize weaknesses 6. and avoid threats 7. 8. 9. 10.

Answer No.4 (b)

Because strategies must be effective in the marketplace and capable of gaining internal commitment, the following tactics used by politicians for centuries can aid strategists:

- **Equifinality** – It is often possible to achieve similar results using different means or paths. Strategists should recognize that achieving a successful outcome is more important than imposing the method of achieving it. It may be possible to generate new alternatives that give equal results but with far greater potential for gaining commitment.
- **Satisfying** – Achieving satisfactory results with an acceptable strategy is far better than failing to achieve optimal results with an unpopular strategy.
- **Generalization** – Shifting focus from specific issues to more general ones may increase strategists' options for gaining organizational commitment.
- **Focus on Higher-Order Issues** – By raising an issue to a higher level, many short-term interests can be postponed in favor of long-term interests. For instance, by focusing on issues of survival, the auto and steel industries were able to persuade unions to make concessions on wage increases.

- **Provide Political Access on Important Issues** – Strategy and policy decisions with significant negative consequences for middle managers do not have an opportunity to take a position on such decisions in appropriate political forums, they are capable of successfully resisting the decisions after they are made. Providing such political access provides strategists with information that otherwise might not be available and that could be useful in managing intervention behaviour.

Answer No.4 (c)

Reasons of conflicts

Interdependency of objectives and competition for limited resources often leads to conflict. Conflict can be defined as a disagreement between two or more parties on one or more issues. Establishing annual objectives can lead to conflict because individuals have different expectations and perceptions, schedules create pressure, personalities are incompatible and misunderstandings between line managers (such as production supervisors) and staff managers (such as human resource specialists) occur. For example, a collection manager's objective of reducing bad debts by 50 percent in a given year may conflict with a divisional objective to increase sales by 20 percent.

Establishing objectives can lead to conflict because managers and strategists must make trade-offs, such as whether to emphasize short-term profits or long-term growth, profit margin or market share, market penetration or market development, growth or stability, high risk or low risk, and social responsiveness or profit maximization. Conflict is unavoidable in organizations, so it is important that conflict be managed and resolved before dysfunctional consequences affect organizational performance. Conflict is not always bad. An absence of conflict can signal indifference and apathy. Conflict can serve to energize opposing group into action and may help managers identify problems.

Various approaches for managing and resolving conflict can be classified into three categories: avoidance, defusion, and confrontation.

Avoidance includes such actions as ignoring the problem in hopes that the conflict will resolve itself or physically separating the conflicting individuals (or groups).

Defusion can include playing down differences between conflicting parties while accentuating similarities and common interests, compromising so that there is neither a clear winner nor loser, resorting to majority rule, appealing to a higher authority, or redesigning present positions.

Confrontation is exemplified by exchanging members of conflicting parties so that each can gain an appreciation of the other's point of view, or holding a meeting at which conflicting parties present their views and work through their differences.

Answer No.5 (a)

Reviewing Bases of Strategy

Following are the basic questions for reviewing the strategy to assess the achievement of firm's objective:

1- Why are competitors making certain strategic changes?
2- How have competitors reacted to our strategies?
3- How have competitors' strategies changed?
4- How could we more effectively cooperate with our competitors?
5- Why are some competitors' strategies more successful than others?
6- How satisfied are our competitors with their present market positions and profitability?
7- Have major competitors' strengths and weaknesses changed?
8- How far can our major competitors be pushed before retaliating?

Answer No.5 (b)

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

1- Profit margin
2- Market share
3- Return on investment/ Return on assets (ROI/ ROA)
4- Sales growth
5- Asset growth
6- Return on equity (ROE)
7- Debt to equity
8- Earnings per share

But there are some potential problems associated with using quantitative criteria for evaluating strategies.

First, most quantitative criteria are geared to annual objectives rather than long-term objectives.

Also, different accounting methods can provide different results on many quantitative criteria.

Third, intuitive judgments are almost always involved in deriving quantitative criteria.

For these and other reasons, qualitative criteria are also important in evaluating strategies. Human factors such as high absenteeism and turnover rates, poor production quality and quantity rates, or low employee satisfaction can be underlying causes of declining performance. Marketing, finance/ accounting R&D or management information systems factors can also cause financial problems. Seymour Tilles identified six qualitative questions that are useful in evaluating strategies.

1- Is the strategy appropriate in view of available resources?
2- Is the strategy workable?
3- Is the strategy internally consistent?
4- Is the strategy consistent with the environment?
5- Does the strategy have an appropriate time framework?
6- Does the strategy involve an acceptable degree of risk?

Answer No.6 (a)

RATIO	WHAT IT MEASURES
Current ratio	The extent to which a firm can meet its short-term obligations.
Acid-test (Quick) ratio	The extent to which a firm can meet its short-term obligations without relying upon the sale of its inventories.
Average Collection Period	The average length of time it takes a firm to collect on credit sales (in days)
Inventory Turnover	Whether a firm holds excessive stocks of inventories and whether a firm is selling its inventories slowly compared to the industry average
Debt-to-Total Net worth	The percentage of total funds that are provided by creditors
Debt-to-total capitalization	The balance between debt and equity in a firm's long-term capital structure
Gross Profit Margin	The total margin available to cover operating expenses and yield a profit
Net Profit Margin	After-tax profits per dollar of sales
Assets Turnover	Whether a firm is generating a sufficient volume of business for the size of its asset investment
Return on Assets (ROA/ ROI)	After-tax profits per dollar of assets; this ratio is also called return on investment (ROI)

Answer No.6 (b) (i)

		2007	2008	2009
1	Current ratio	1.19	1.25	1.20
2	Acid-test ratio	0.43	0.46	0.40
3	Average collection period	18	22	27
4	Inventory turnover	–	8.2	6.1
5	Total debt to net worth	1.38	1.40	1.61
6	Long-term debt to total capitalization	0.33	0.32	0.32
7	Gross profit margin	0.200	0.163	0.132
8	Net profit margin	0.075	0.047	0.026
9	Asset turnover	2.80	2.76	2.24
10	Return on assets	0.21	0.13	0.06

Answer No.6 (b) (ii)

The company's profitability has declined steadily over the period. As only Rs.100,000 is added to retained earnings, the company must be paying substantial dividends. Receivables are growing slower, although the average collection period is still very reasonable relative to the terms given. Inventory turnover is slowing as well, indicating a relative buildup in inventories. The increase in receivables and inventories, coupled with the fact that net worth has increased very little, has resulted in the total debt-to-total capitalization ratio increasing to what would have to be regarded on an absolute basis as a high level.

The current and acid-test ratios have fluctuated, but the current ratio is not particularly inspiring. The lack of deterioration in these ratios is clouded by the relative building in both receivables an inventories, evidencing a deterioration in the liquidity of these two assets. Both the gross profit and net profit margins have declined substantially. The buildup in inventories and receivables has resulted in a decline in the asset turnover ratio, and this, coupled with the decline in profitability, has resulted in a sharp decrease in the return on assets ratio.

Answer No.6 (b) (iii)

The banker does not feel comfortable to grant short term and long term loan to the company due to the following reasons:

- Profitiblity has declined steadily over the period, (both gross profit and net profit margin have declined substantially).
- Total debt to worth ratio is increasing.
- Acid-test ratio and current ratio is not inspiring.

THE END