Group - III

Paper 13 – Management Accounting – Strategic Management

1. **Objective Questions.**

(a) State whether the following statements are 'true' or 'False' with justification for your answer.

(i) 'Merger' is the purchase of controlling interest of another company.

(ii) A cost-plus policy can lead to inflexibility in a firm's pricing decisions.

(iii) 'CVP model' is a simple break-even model.

(iv) 'Time value' refers to the difference between the market value of an option and its intrinsic value.

(v) 'Repositioning' involves moving the product or brand into a different market segment.

(b) Define the following terms (in not more than one/two sentences):

(i) Barriers to entry

(ii) Man power strategy

(iii) Econometric Model

(iv) Systematic Risk

(v) Market Segmentation

(c) Choose the most appropriate one from the stated options and write it down :

(i) An anti takeover defense that creates securities that provide their holders with special rights in the event of a takeover is called:-

(a) Poison Put
(b) Poison Pill
(c) Flip Pill
(d) Proxy rights

(ii) Reducing headcount and selling assets / belt-tightening to face business downturn is called by Prahalad and Hamel as:

(a) Numerator Management
(b) Denominator Management
(c) Turnaround Management
(d) Crisis Management

(iii) Kaplan and Norton's generic strategic map does not include:

(a) Internal perspective
(b) Customer perspective
(c) Financial perspective
(d) Competitor perspective

(iv) Value drivers identified in Differentiation Strategy do not include

(a) Sales growth rate
(b) Waste reduction
(c) Operating profit margin
(d) Fixed capital investment

(v) Value Chain includes

(a) Customer service, distribution, marketing.

(b) Production, Product and service and process design

(c) Research and development

(d) All of the above.

Answer.

(a)

(i) **False** - Merger is the combination of two or more corporations in which one of the corporations survives and the other corporation cease to exist. A merger occurs when two companies combine to form a single company.

(ii) **False** - As per BCG Matrix, "dogs" are units with low market share in a mature, slow-growing industry.

(iii) **True** - Break even analysis is based on cost-volume-profit (CVP) of a firm.

(iv) **True** - Difference in value, positive/ negative arises over a period of time.

(v) **True** - 'Repositioning' is a strategic marketing approach and involves moving the product into different market segment.

(b)

(i) **Barriers to entry**: The expression indicates the factors like economies of scale, product differentiation and capital requirements, which make it difficult for a entrant to enter and gain a foothold in an industry.

(ii) **Man power strategy**: involves reviewing current manpower resources, forecasting future requirements and availability and taking steps to ensure that the supply of people and skill meet demand.

(iii) **Econometric Model**: is the model that studies the different economic variables and their interrelationships and used for forecasting.

(iv) **Systematic Risk**: Systematic Risk refers to the variability of return on stock or portfolio associated with changes in return on the market as a whole. Such risks cannot be eliminated by diversification.

(v) **Market Segmentation**: Market Segmentation is the division of a market into fairly homogeneous subsets, where each subset can be chosen, reached and served by its own tailored marketing mix.

(c)

(i) (b) – Poison Pill

(ii) (b) - Denominator Management

(iii) (d) - Competitor perspective

(iv) (b) - Waste reduction

(v) (d) - All of the above

2. Write short notes on the following :

(i) **Role of brands in the construction of barriers to entry**

(ii) **Objectives of Sales Promotion activities**

(iii) **Freewheeling Opportunism**

(iv) **Premium and Penetration Pricing**

(v) **Classification of goods based on Consumer habit**

Answer.

(i) A barrier of entry makes it difficult for a new entrant to gain a foothold in a market. Barriers to entry include economies of scale, product differentiation, capital requirements, switching costs, access to distribution, and other cost advantages. Brands function as entry barrier in the following ways:

- Product differentiation - Porter discusses two criteria. Brand image is built up through advertising and other special features and reflects both use and signalling criteria.
- Existing firms in an industry may have built up a good brand image and strong customer loyalty over a long period of time, through advertising, product quality, etc.
- A firm might develop a variety of brands to crowd out the competition. Some firms own many brands to make it harder for competitors to get noticed by consumers, as there are so many alternatives. This creates a barrier of entry, because new entrants would have to spend heavily to overcome the existing brand loyalties and to build up a brand image of their own.
- With some brands, there are also quite high switching costs, which is why many people are unwilling to change bank account because of the inconvenience of so doing.

Economies of scale are also relevant. A certain amount of volume may be necessary to justify the promotion of the brand. Existing producers may already have built up a distribution network which functions best at this level.

(ii) Non-media advertising and below the line advertising are alternative terms which mean sales promotion activities. Some of the commonly attempted sales promotion objectives include:

- Increase sales
- Make the sales of slow moving products faster
- Identifying and attract new customers
- Launch a new product quickly
- Educate customers regarding product developments
- Reduce the perception of risk associate with the purchase
- Motivate dealers to stock and sell more
- Attract dealers to participate in display and sales contests
- Obtain better and more shelf space and displays
- Bring more customers to dealer stores
- Make good move faster through dealers
- Improve manufacturer-dealer relationship
- Motivate sales force to achieve more than targets
- Counter competitor's marketing efforts
- Provide punch to the advertising efforts
- Build goodwill.

(iii) Freewheeling Opportunism

It is possible to operate a system whereby opportunities are exploited as they arise, judged by their individual merits and not with in the rigid structure of an overall corporation strategy. This approach is sometimes called freewheeling opportunism.

Advantages:

- Opportunities can be seized when they arise, where as a rigid planning framework might impose restrictions so that the opportunities are lost.

- It is flexible and adaptable.
- It might encourage a more flexible, creative attitude among lower level managers.

Disadvantages:
It fails to provide a coordinating framework for the organisation, as a whole.
It cannot guarantee that all opportunities are identified and appraised.
It emphasizes the profit motive to the exclusion of all other considerations.

(iv) Premium Pricing: New products when entering the market may resort to pricing at a premium. This Idea is to sell the product, which is a novelty item at a higher price, at the beginning, capture the niche market and later on lower the price and thereby make huge initial cash flows.

Following are the situations, when Premium Pricing is effected:

When the new product is a drastic improvement or is far superior to the existing options. In such situations and assuming consumers are less sensitive to price in the early stages, marketer can charge high price for its offering.

(a) When the product seems to have a high esteem value;
(b) When the potential customers are willing to pay high prices;
(c) When there is demand-elasticity for the demand of the product;
(d) When the BRAND of the product is identifiable and distinguishable.
(e) The Initial high price also serves to skim the cream of the market, as long as a section of the market, (i.e. early adopters) are keen to buy a superior quality product.
(f) This sort of premium pricing strategy is okay as long as the demand is likely to be far greater than firm's ability to meet the level of demand.

However, premium, pricing strategy is not always appropriate. It does have some drawbacks. It does not encourage rapid adoption or diffusion of the product. Moreover, as premium pricing usually results in high profit margins, it is likely to invite more new competition.

Penetration Pricing: It is a strategy where marketer deliberately keeps the offering at a somewhat lower price as a wedge to get into mass market early.

It is appropriate when:

(a) The main target is to capture major portion of the market share.
(b) Market is highly price sensitive and the demand is highly elastic.
(c) It is possible to manage with low prices and low margin as long as the sales volume is large, (e. g. Lifebuoy soap, Nirma detergent)
(d) Market is unwilling to pay a higher price to obtain the same product. This was the case in case of handsets of mobile phones in India. With drop in price, the market expanded at a rapid pace.

Example: Reliance has penetrated into the Telecom market with its low price and has obtained a big chunk of the market share.

(v) Consumer Goods can be broadly classified under the following heads, based on Consumer habits:

- Convenient Goods
- Shopping Goods

- Specialty Goods
- Unsought Goods

Convenient Goods are goods that the customer purchases frequently, of low unit value, immediately and with a minimum of efforts. There could some variations amongst the Convenient Consumer Goods as listed below:

- Staples- are goods which consumers buy as a part of their staple diet.
- Impulse Goods- are purchased without any planning or search effort.
- Emergency Goods-are purchased when a need calls for a SOS. (very urgent)

Shopping Goods: are goods the consumers purchases after doing a good deal of window-shopping and the purchase is based on a variety of criteria like: quality, suitability, style, price quoted for similar goods by different shops etc.

Specialty Goods: are Goods, with unique characteristics and/or brand identification for which a significant group of buyers are habitually willing to make a special purchasing effort.

Unsought Goods are Goods that the consumer does not know about. It may also include those Goods which the consumer, normally does not even think of buying.

3. Discuss how 'Gap Analysis' might be applied to a product/market situation.

Answer.

If 'gap analysis' is applied to product/market situation, the organisation will consider its targets for different types of products it wants to manufacture and different types of markets/ market segments where it wants sell its products.

The product/market targets may be quantified —

(i) The organisation should have targets (quantitative) for its products it wants to sell, classified into
- Those in the introductory stage of their life, those in the growth stage, those in the maturity stage and those in the decline stage (PLC classification);
- Cash cows, stars, dogs and question marks (BCG classification);
- What sort of products the organisation wants to sell, e.g. does it want more diversified range of products?

(ii) There should also be targets for markets/market segments that the organisation would like to be in and targets for
- Market share or market segment share (both in the existing markets and the markets it would likely to enter into);
- Market positioning - positioning is concerned with such matters as product quality, image and reliability, price, outlets, types of customers.

A projection of the organisation's products and the market shares and market positioning for each of its products would be made on the assumption that:—
- No products are developed.
- The market mix for the existing products remains the same

The gap could be analysed in terms of -
- What products the organisation will be missing from the product range?
- What markets/market segments it is failing to enter into?
- How far out of position in the market will the product be?

Strategies to close the gap would include

- new product development strategies or market development strategies;
- a strategy of product and market diversification through takeover policy;
- marketing mix strategy to gain the required position in target markets.

4. (a) Name any major organisation and list down the strengths, weaknesses opportunities and threats for that organisation. (b)Explain the methodology adopted to identify such a SWOT.

Answer (a)

Take, for instance, the case of TISCO. Its

strengths have been:

- Locational advantages coming from proximity to the inputs and its marketing channels;
- High quality, cheap and market friendly steel products;
- Technology of steel manufacture and its product-mix;
- Excellent financial performance over the years and the main issues in such excellence;
- Management practices and congenial industrial relations; and
- Innovative policies marked by highly respectables and transparent actions of the Tatas leading to the situation that they have been able to remain in the saddle even with a small fraction of the total shareholding.

Its weaknesses have been mainly that

- Steel making technology requires continuous updating which was not allowed as easily necessary during the preliberalisation regime;
- Growing competition from SAIL with individual plants more than equal to the size of
- TISCO, allowing greater scale economies;
- With the lifting of controls, SAIL has been showing enterprise and better competitive edge in terms of greater market share and profitability which in turn would require increasing readiness for dealing with issues such as production, product-mix, cost and price; and
- Shrinking total market share for individual companies in view of several new steel manufacturers coming into the scene.

Opportunities that could be spelt in these circumstances are:

- Greater leeway for strengthening the operational strategies in the new regime;
- Building up reputation in the areas of marketing and distribution, areas which have overtly gathered most during the regime of controls of various kinds;
- Introducing foreign technology, know-how and perhaps investment to take full advantage of the atmosphere of freedom in recent years; and
- Better chances of expanding capacity, divestment of me lines, integration and diversification both vertical and horizontal; and
- Improving financial performance by way of different structural changes.

The lurking threats for the organisation are several:

- The growing feasibility of substitutes in the areas of traditional uses of steel;
- Growing competition from SAIL and other units coming up in different areas in the country with state-of-the-art technology;
- Difficult capital market conditions with a large number of financial instruments tossing around with varying costs and benefits; and
- Likelihood of growing foreign competition, along with Indian, underlining that there would be little scope for resting on oars.

Answer (b)

The methodology generally adopted in the context of SWOT analysis relates to:

- Environmental scanning covering both first-hand surveys of demand and supply, stressing forecasts and second-hand information emerging from various sources such as Country Studies by the Economist Intelligence Unit, NCAER and others.
- Scenario planning taking into consideration the emerging problems and prospects with attention given to response management.

Both of theseessential aspects of sensitive management, involved as it is in making the future today. The prospects of growth and the hurdles to cross to be identified to enable management to take appropriate action, considering that the decisions of today could bind the organisation to particular lines in terms of resource commitment and the outcome of such a decision may not be certain and may remain bound by risks. Supervening impossibilities for different reasons may not, however, be fully anticipated in view of their very nature

5. (a) What is the role of Objectives in Strategic Management?
(b) List the Environmental factors that can affect an organisation's Strategy.

Answer (a):

Objectives are those ends which the organisation seeks to achieve through its existence and operations. A variety of different objectives are pursued by business organisations. Thus, objectives represent managerial commitment to achieve specific performance targets within specific time frame - they are a call for results that connect directly to the company's strategic vision, and core values. Objectives accordingly play important roles in Strategic management.

Such roles are :

1. Defining the organisation in its environment. Most organisations need to justify their existence, to legitimise themselves in the eyes of the Government, customers and society at large. And by stating objectives, they also attract people who identify with the objectives to work for them. Thus objectives define the enterprise.
2. Helping in coordinating decisions and decisions makers. Stated objectives direct the attention of employees to desirable standards of behaviour. It may reduce conflict in decision making if all employees know what the objectives are. Objectives become constraints decisions.

3. Providing standards for assessing organisational performance. Objectives provide the ultimate standards by which the organisation judges itself. Without objectives, the organisation has no clear basis for evaluating its success.

4. They are more tangible targets than mission statements The products of an organization or the services it performs (outputs) are probably the most familiar terms in which people tend to think of objectives' or goals.

Answer (b):

An indicative list of the environmental factors that can affect anorganisation's strategy are :

The demographic change -

- A general change in educational level;
- A distinct shift in the value system;
- Increase in productivity, augmented by automation;
- A general erosion of values and ethics;
- Decreasing family sizes;
- Loss of stability of family units;
- Decreasing power of religion;
- Increasing geographic mobility;
- Increasing domestic mobility;
- Increasing role and power of men in society;
- Change in worker's attitude to work.

The economic environment -

- Inflation;
- Energy shortage;
- Energy resource;
- Growth rate in productivity;
- Individual savings rate;
- Growing international interdependence;
- Clear environment;
- Quality education;
- Old age security;
- National economic factors.

The Political/Legal environment -

- Economic goals of the government;
- Fiscal policies;
- Monetary policies;
- Foreign exchange/balance of payment;
- Privatisation policies;

- Education policies;
- Corporate and industrial laws.

The technological environment -

- R & D facilities for new technologies;
- Tax and interest incentives;
- Investment in new technologies;
- Growth in new technologies.

The industry environment

- Market size/age;
- Number of competitors;
- Rules of game;
- Industry trends/driving forces;
- Industry attractiveness.

6. What do you know about recycling of strategy?

Answer:

Where the basic position of a company is changed and/or the fundamental premises on which the present strategy is founded are challenged, it becomes imperative to recycle the strategy. Recycling refers to reformulation or remaking of strategy. Recycling may take place when the company's strategic position has undergone significant changes. Thus, for instance, the management's thrust of stability or survival of the organisation due to a sudden and impending decline in sales and earnings or due to emerging financial crises, forces the organisation to take drastic actions and reformulate corporate strategy to solve the immediate and future problems.

At times, phenomenal and unexpected changes in environmental conditions occur in and outside the country. For instance, the energy crisis of the 70s and subsequent changes in customers' preferences forced many automobile companies to reformulate their strategies. In addition to external events, changes in the internal position of the company such as change in the top management of the company or acquisition of other forms may also being about phenomenal changes in the current strategy.

The general process of recycling of strategy is the same as that entailed in strategy making. However, recycling is less formal and is quickly formulated and executed because it is carried out in urgency and only those elements which are affected by the new strategy need the attention of the management.

Reformulation of strategy is managed by all those engaged in formulation and execution of corporate strategy. Management adopts a sensing-adjusting response mechanism for the reformulation of strategy.

One of the major problems involved in reformulating strategy is the success syndrome. Generally, the management of a successful organisation is not interested in change and often acts in too slovenly a manner to be effective. Another problem that may arise in the course of reformulation of strategy relates to changes in overall corporate policy. It has been found in real life that policy changes may not be appreciated by all senior managers and may result in resentment and resignation of some sensitive managers. This, in turn, is likely to jeopardise the

exiting organisational structure with further complicates the situation.

Implementation of a reformulated strategy poses still greater problem because it requires transitional period during which existing concepts and methods are discarded, new ones are tried and accepted, and the newly structured organisation put into operation.

7. What is the relationship between structural analysis and competitive strategy? Answer:

Michael E. Portel, the renowned author of Competitive Strategy, Competitive Advantage and Competitive Advantage of Nations, has provided structural analysis of industries. According to this analysis, which has gained great popularity, the state of competition in an industry depends five basic competitive forces, viz.,

1. Rivalry among existing firms
2. Threat of new entrants
3. Threat of substitutes
4. Bargaining power of suppliers
5. Bargaining power of buyers

Porter's analysis, thus, shows that competition in an industry goes well beyond the established players. Knowledge of these underlying sources of competitive pressure highlights the critical strengths and weaknesses of the company, animates its positioning in its industry, clarifies the areas where strategic changes may yield the greatest payoff, and highlights the areas where industry trends promise to hold the greatest significance as either opportunities or threats. Understanding these sources will also prove to be useful in considering areas for diversification, thought the primary focus here is on strategy in individual industries. Structural analysis is the fundamental underpinning for formulating competitive strategy.

Threat of Entry: A prospective industry often faces threat of new entrants which can alter the competitive environment. There may, however, be a number of barriers to entry. Potential competition tends to be high if the industry is profitable or critical, entry barriers are low and expected retaliation from the existing firms is not serious.

Following are some of the important common entry barriers.

(i) Government Policy: In many cases government policy and regulation are important entry barriers. For example, prior to the economic liberalisation in India, government-dictated entry barriers were rampant, like reservation of industries/products for public sector and small sector, industrial licensing, regulations under MRTP Act, import restrictions, restrictions foreign capital and technology etc.

(ii) Economies of Scale: Economies of scale can deter every in two ways: it keeps our small players and discourages even potentially large players because of the risk of large stakes.

(iii) Cost Disadvantages Independent of Scale: Entry barrier may also arise from the cost advantages, besides that of economies of scale, enjoyed by the established firms which cannot be replicated by new firms, such a proprietary product technology, learning experience curve, favourable accessto raw materials, favourable location, government subsidies etc.

(iv) Product Differentiation: Product differentiation characterised by brand image, customer loyalty, product attributes etc. may form an entry barrier forcing new entrants to spend heavily to overcome this barrier.

(v) Monopoly Elements: Proprietary product/technology, monopolisation / effective control over raw material supplies, distribution channels etc. are entry barriers which insurmountable or difficult to overcome.

(vi) Capital Requirements: High capital intensive nature of the industry is an entry barrier to small firms. Further, the risk of huge investment could be a discouraging factor even for other firms.

Rivalry among Existing Competitors:

Rivalry among existing competitors is often the most conspicuous of the competitions. Firms in industry are "mutually dependent" - competitive moves of a firm usually affects others and may be retaliated. Common competitive actions include price changes, promotional measures, customer service, warranties, product improvements, new product introductions, channel promotion etc.

There are a number of factors which influence the intensity of rivalry. These include:

(i) Number of firms and their relative market share, strengths etc.

(ii) State of growth of industry:

In stagnant, declining and, to some extent, slow growth industries a firm is able to increase its sales only by increasing its market share, i.e., at the expense of others.

(iii) Fixed or storage costs:

When the fixed or storage costs are very high, firms are provoked to take measures to increase sales for improving capacity utilization or reducing storage costs

(iv) Indivisibility of capacity augmentation:

Where there are economies of scale, capacity increases would be in large blocks necessitating, in many cases, efforts to increase sales to achieve capacity utilisation norm

(v) Product standardisation and switching costs:

When the products of different firms are standardised, price, distribution, after-sales service, credit etc become important strategic variables of competition. Absence of switching costs makes firms more vulnerable.

(vi) Strategic stake:

Rivalry in an industry becomes more volatile if a number of firms have high stakes in achieving success there. For example, a firm which regards a particular as its core business will give great importance to success in that industry.

(vii) Exit barrier:

High exist barriers (for example, compensation for labour, emotional attachment to the industry etc.) tend to keep firms competing in an industry even though the industry is not very attractive.

(viii) Diverse competitors:

Rivalry becomes more complex and unpredictable when competitors are very diverse in their strategies, origins, personalities, relationships to their parents etc.

(ix) Switching Costs:

In some cases a barrier to entry is created by switching costs (i.e., one-time costs facing the buyer of switching from one supplier's product to another's) such as cost of retraining

the employees, cost of new ancillary equipment etc

(x) Expected Retaliation:

The potential entrants' expectations about the reactions of the existing competitors may also sometimes deter entry.

Threat of Substitutes:

An important force of competition is the power of substitutes. Substitutes limit the potential returns in an industry by placing a ceiling on the price firms in the industry can profitably charge. The more attractive the price performance alternative offered by substitutes, the firmer the lid on industry profits.

Firms in many industries face competition from those marketing close or distant substitutes. Porter points out that substitute products that deserve the most attention are those that (1) are subject to trends improving their price performance trade off with the industry's product, (2) are produced by industries earning high profits.

Bargaining Power of Buyers: For several industries, buyers are potential competitors - they may integrate backward. Besides, they have different degrees of bargaining power. "Buyers compete with the industry by forcing down prices, bargaining for higher quality or services, and playing competitors against each other - all at the expense of industry profitability".

Important determinants of the buyer power, explained by Porter, are the following:

1. The volume of purchase relative to the total scale of the seller.
2. The importance of the product to the buyer in terms of the total cost
3. The extent of standardisation differentiation of the product.
4. Switching costs
5. Profitability of the buyer (low profitability tends to pressure costs down).
6. Potential for backward integration by buyer.
7. Importance of the industry's product with respect to the quality of the buyer's production or services.
8. Extent of buyers' information.

Bargaining Power of Suppliers:

The important determinants of supplier power are the following:

1. Extent of concentration and domination in the supplier industry.
2. Importance of the product to the buyer.
3. Importance of the buyer to the supplier.
4. Extent of substitutability of the product.
5. Switching costs
6. Extent of differentiation or standardisation of the product.
7. Potential for forward integration by suppliers.

Structural Analysis and Competitive Strategy: The purpose of the structural analysis is to diagnose the competitive forces and to identify the strengths' to help formulate an effective competitive strategy that "takes offensive defensive action in order to create defendable

position against the five competitive forces". Following are some of the possible approaches in this respect.

1. Making such positioning of the firm that its capability provides the best defence against the existing array of competitive forces.
2. Improving the firm's relative position through strategic moves which influence the balance of forces.
3. Exploiting change, i.e., adopting appropriate strategy for the changing environment ahead of the rivals.

8. How do you analyse Competitive Environment?

Answer:

Closely allied with the economic environment is the competitive environment. With growing industrialisation, expanding size of business operation and rapid advancement of technology, degree of competition within the industry and across the industry has increased tremendously. There is neck-to-neck competition among the business organisations who are investing massive funds on research and development to innovate new methods of production or new uses of existing products or adopting new marketing devices in their market share. Under these circumstances managers must be fully aware of the competitive environment and formulate strategy to cope with the competition. The competitive environment should be analysed from the viewpoint of all such factors which affect the ferocity of competitive behaviour. These factors are market share of the participants in the industry, growth, rate of the industry, general level of profits, cost of entry into and exit from an industry, degree of differentiation, economies of scale and nature of product.

Analysis of market share of different firms at a point of time and over a period of time provides insight into the competitive strength of the organisation. Such analysis should be undertaken to discern the factors responsible for differential market share of firms. These factors could be product differentiation, pricing, high corporate competence, wide distribution network, customer service, dispensation of discount facilities, etc. The management must keep these factors in view while formulating strategy. Furthermore, analysis of the competitive environment presents a picture of dominance of the industry by a few firms. An industry dominated by one firm having a significant market share tends to be less fiercely competitive than the one having firm with dominant market share.

In studying the competitive environment it should also be the prime concern of the management to find out if there is a minimum critical mass for the product. Critical mass is the market share which a firm must obtain so as to become fully competitive on price and cost

Growth rate of the industry decisively affects the competitive behaviour. Where growth rate of the industry is relatively high and demand of industrial products tends to expand, competitive behaviour will be less aggressive because each firm can increase its sales without necessarily increasing its market share. But in an industry with falling growth rate, competition will tend to be intense. In such a situation the management should diversify the product line. High level of profits in one industry is likely to provide a measure of tolerance for competitors. A change to tower profits may trigger off more aggressive behaviour.

Cost of entry and exit is another vital factor which needs comprehensive appraisal. If market shares in the industry are widely diffused and small investment is needed to enter the business and if the government does not foreclose entry to the industry, there will be great mobility of

firms in and out In such a case, a firm in the industry lacks security of its position because any entrepreneur with a small capital and small operation can enter the market. Such a tendency poses a serious threat of entry particularly to large established organisations which lack the flexibility and quick response possessed by small firms. Small organisations will, however, consider such an environment as an opportunity to them. Where investment is large, highly specialised and fixed costs are a relatively high proportion of total costs; competition will not be aggressive because the scope of new entrants will be very limited.

High degree of product differentiation creates a barrier to entry of new firms since they might have to spend a great deal on advertising and sales promotion in order to overcome the loyalty of consumers to the existing brand. But the competition is likely to be fiercest when all firms are offering products of commodity status

Competitive behaviour is likely to be more aggressive when there exist marked economies of scale in the industry. This may happen when cost levels depend on large volumes. The competitive behaviour will tend to be more fierce in a growth market with elastic demand and product subject to mass production. However, new firms will have to be very large so as to avoid cost disadvantages. Nature of the product is another factor to be considered while studying the competitive environment. A durable product is likely to be less vulnerable to random price cutting than one which can not be preserved easily and cheaply.

The management must also try to study the possibility of availability of substitutes of the product in the market because the industry's prospects depend on it. With the emergence of new substitute, a number of new firms with different cost structures may come into existence in the competitive arena. A substitute will often increase the buying power of the buyer and decrease the power of the seller.

9. What do you understand by 'Implementation Control'? Discuss the basic types of implementation control.

Answer:

Implementation Control: The action phase of strategic management is located in the series of steps, programs, investments, and moves undertaken over a period of time to implement the strategy. Special programs are undertaken. Functional areas initiate several strategy related activities. Key people are added or reassigned. Resources are mobilised. In other words, managers convert broad strategic plans into concrete actions and results for specific units and individuals as they go about implementing strategy. And these actions take place incrementally over an extended period of time designed ultimately to enact the planned strategy and achieve long-term objectives.

Strategic control can be undertaken within this context. Implementation control is designed to whether the overall strategy should be changed in light of unfolding events and results associated with incremental steps and actions that implement the overall strategy. The example of Prudential Insurance Company updating cost and revenue projections based on early experiences with regional home offices is an illustration of an implementation control. The two basic types of implementation control are (1) monitoring strategic thrusts (new or key strategic programs) and (2) milestone reviews.

Monitoring Strategic Thrusts: Implementing broad strategies often involves undertaking several new strategic projects specific narrow undertakings that represent part of what needs to be done if the overall strategy is to be accomplished. These projects or thrusts provide source of

information from which managers can obtain feedback that helps determine whether the overall strategy is progressing planned and whether it needs to be adjusted or changed.

While strategic thrusts seem a readily apparent type of control, using them as control sources is not always easy to do. Early experience may be difficult to interpret. Clearly identifying and measuring early steps and promptly evaluating the overall strategy in light of this early, isolated experience can be difficult. Two approaches are useful in enacting implementation controls focused on monitoring strategic thrusts. One way is to agree early in the planning process on which thrusts or phases of those thrusts are critical factors in the success of the strategy or of that thrust. Managers responsible for these implementation controls single these out from other activities and observe them frequently.

The second approach for monitoring strategic thrusts is to use stop go assessments linked to a series of meaningful thresholds (time, costs, research and development, success, etc.) associated with particular thrusts. Days Inns' nationwide market development strategy in the early 1980s included a strategic thrust of regional development via company owned inns in the Rocky Mountain area. Time problems in meeting development targets led company executives to reconsider the overall strategy, ultimately deciding to totally change and sell the company.

Milestone Reviews: Managers often attempt to identify critical milestones that will occur over the time period the strategy is being implemented. These milestones may be critical events, major resource allocations, or simply the passage of a certain amount of time. In each case, a milestone review usually involves a full scale reassessment of the strategy and the advisability of continuing or refocusing the direction of the company.

A useful example of strategic implementation control based on milestone review can be found in Boeing's product development strategy to enter the supersonic transport (SST airplane market. Competition from the joint British/French Concord effort was intense. Boeing had invested millions of dollars and years of scarce engineering talent through phase I of its SST venture. The market was believed large, but the next phase represented a billion dollar decision for Boeing. This phase was established as a milestone review by Boeing management. Cost estimates were greatly increased, relatively few passengers and predictions of rising fuel costs raised estimated operating costs, the Concord had massive government subsidy, while Boeing did not. All factors led Boeing management to withdraw, in spite of high sunk costs, pride, and patriotism. Only an objective, full-scale strategy reassessment could have led to such decision.

In this example, a major resource allocation decision point provided the appropriate point for a milestone review. Milestone reviews might also occur concurrent with the timing of a new major step in the strategy's implementation or when a key uncertainty is resolved. Sometimes managers may even set an arbitrary time period, say, two years, as a milestone review point. Whatever the basic for selecting the milestone point, the critical purpose of a milestone review is to undertake a thorough review of the firm's strategy so as to control the company's future.

Strategic Surveillance: By their nature, premise control and implementation control are focussed control. The third type of strategic control, strategic surveillance, is designed to monitor a broad range of events inside and outside the company that are likely to threaten the course of the firm's strategy. The basic idea behind strategic surveillance is that some form of general monitoring of multiple information sources should be encouraged, with the specific intent being the opportunity to uncover important yet unanticipated information.

Strategic surveillance must be kept unfocused as much as possible and should be designed a

loose "environmental scanning" activity. Trade magazines, The Wall Street Journal, trade conferences, conversations, and intended and unintended observations are all sources of strategic surveillance. While strategic surveillance is loose, its important purpose is to provide an ongoing, broad-based vigilance in all daily operations so as to uncover information that may prove relevant to the firm's strategy.

Special Alert Control: Another type of strategic control, really a subset of the other three, is special alert control. Special alert controls are the need to thoroughly, and often rapidly, reconsider the firm's basic strategy based on a sudden, unexpected event. A political coup in the Middle East, an outside firm suddenly acquiring a leading competitor, an unexpected product difficulty like Tylenol's experience with poisoned capsules all of these represent sudden changes that can drastically alter the company's strategy.

Such an occurrence should trigger an immediate and intense reassessment of the company's strategy and its current strategic situation. Many firms have developed crisis teams to handle initial response and coordination when faced with unforeseen occurrences that may have immediate effect on the firm's strategy. Increasingly, companies are developing contingency plans along with crisis teams to respond to such circumstances.

Operations controls are concerned with providing action control. Strategic controls concerned with "steering" the company's future direction. Both are needed to manage the strategic process effectively.

10. Corporate growth requires strategic direction and conscientious management. Throughout the growth process, management is faced with complex problems and has to take various strategic decisions relative to products, markets, operations and resources – In this context,

(a) Explain the term 'growth strategy', and

(b) Identify and discuss some of the strategies adopted in the pursuit of corporate growth.

Answer

(a) According to Ansoff and Stewart, 'a growth strategy is one that an enterprise pursues when it increases its level of objectives upward in a significant increment. Much higher than an extrapolation of its past achievement level. The most frequent increase indicating a growth strategy is to raise the market share and/or sales objective upward significantly'. They are of the view that at least three reasons are dominant in the pursuit of a growth strategy :

a. In volatile industries, growth is a necessity for survival;

b. To many executives, growth is equated with effective performance; and

c. As an objective, growth is the important one.

A company pursuing a growth strategy will always strive for better results every year than the previous year in the areas of production, sales and profits.

(b) Strategies in pursuit of corporate growth :

The growth strategies listed below are relevant in the early stage of potential development :

1. Hold relative position in high-growth product/ markets.

The growth associated with the strategy is directly attributable to the growth in demand for the product/ service being produced by the firm. Ability to remain competitive in terms of

product development, promotion and advertising and distribution as well as in terms of productive capacity is the key to this strategic choice. A principal risk inherent in this strategy is that a competitor may embark on a preemptive strategy designed to capture market share. This risk is relatively high when the product is in about the mid-range of the growth stage of product life cycle. Those firms which have the greatest capacity to assume the financial risks associated with preemptive capacity expansion are most likely to adopt this strategy.

2. Increase market share in high-growth market.

This strategy is highly suitable for commodity –type products. Essential to the success of this strategy is 'getting there first'. This strategy demands management's ability to significantly differentiate the products from those of competitors, associated with aggressive investment in advertising and distribution etc.

3. Increase market share in mature markets.

Two major approaches are seen to be employed to capture market share in slow-growth markets. These are as follows –

a. Rationalizing production in a way that will achieve cost leadership, and thereby yielding higher margins than those enjoyed by competitors. Reducing the number of models in the product line and taking market-related competitive moves such as 'price-cut' are envisaged in this approach.

b. Segmenting the market in search for high growth potential segments and reallocating resources to those segments that will result in a product-mix —which in the aggregate is superior to that of competitors in terms of growth potential.

4. Hold strong relative position in mature market, use 'excess' cash flow, funds capacity and other resources to support penetration of multinational markets with existing product line.

Any management deciding on this strategy typically expose its firm to a wide variety of patterns of opportunity and risk. For most Indian managements, moving their firm's resources into the multinational market arena opens a bewildering array of new uncertainties including complexities of international money markets and global politics.

5. Hold strong relative position in maturing market; use 'excess' cash flow, external funds capability, and other resources to support penetration of new product/ market areas domestically.

The management of a firm deciding to follow this strategy can do so either by developing new products internally or by acquiring firms with already developed products and perhaps, market positions. The latter approach is typically the faster and less risky. It, however, requires larger initial investment.

6. Hold strong relative position in multinational markets with present product line; use 'excess' cash flow, funds capability, and other resources to diversify products.

This strategy leads to the formulation of the multi-market/multi – product strategies. The approach of it is that : having already achieved geographic market diversification, managers striving for further growth for their firms must begin to think about product diversification.

7. Hold strong relative position in diversified product – line domestically; use 'excess' cash flow, funds capability, and other resources to diversify markets.

With this strategy, corporate managers view each of the product lines as in growth strategy 4 above. Several product lines instead of one product line pose additional complexity here. Thus, plans for geographic expansion in relation to one product line must be carefully integrated from all functional and geographic perspective with such plans for the other product lines.

11. Is service marketing different from product marketing? How do marketers try to overcome the limitations of delivering uniform service quality? Discuss the problems of maintaining quality for any service business.

Answer.

A service is any act or performance that one party can offer to another that is essentially intangible and does not result in the ownership of anything. Its production may or may not be tied to a physical product. Services are intangible. Unlike physical products, they cannot be seen, tasted, felt, heard or smelled before they are bought. The person getting a 'face lift' cannot see the results before the purchase, and the patient in the psychiatrist's office cannot predict the outcome. To reduce uncertainty, buyers will look for signs or evidence of the service quality. They will draw inferences about service quality from the place, people, equipment, communication material, symbols, and price that they see. The service provider's task is to 'manage the evidence'. Whereas product marketers are challenged to add abstract ideas, service marketers are challenged to put physical evidence and imagery on their abstract offers. Services are typically produced and consumed simultaneously. This is not true of physical goods that are manufactured, put into inventory, distributed through multiple resellers, and consumed still later. If a person renders the service, then the provider is part of the service. Since the client is also present as the service is produced, provider – client interaction is a special feature of services marketing. Both the provider and the client affect the service outcome. Services are highly variable, since they depend on who provides them and when and where they are provided. Moreover, services cannot be stored. The perish ability of services is not a problem when demand is steady because it is easy to staff the services in advance. When demand fluctuates, service firms have difficult problems. Each characteristic poses problems and requires strategies. Thus, marketers have to find ways to 'tangibles' the intangible; to increase the productivity of providers who are inseparable from the product; to standardize the quality in the face of variability; and to influence demand movements and supply capabilities in the face of service perish ability.

One of the major ways of becoming successful, service firm is to deliver consistently higher quality service than competitors. The key is to meet or exceed the target customer's service quality expectations. Their expectations are formed by their past experiences, word of mouth, and service-firm advertising. The customers choose providers on this basis and, after receiving the service, they compare the perceived service with the expected service. If the perceived service falls below the expected service, customers lose interest in the provider. If the perceived service meets or exceeds their expectations, they are apt to use the provider again. To overcome the limitations of delivering uniform service quality, the marketers may try to share the following common practices of excellently managed service companies :

- A strategic concept : top service companies are 'customer obsessed'. They have developed a distinctive strategy for satisfying the needs that wins enduring customer loyalty.
- A history of top-management commitment to quality : the management should look not only at financial performance on monthly basis but also at service performance.
- The setting of high standards : the standards must be set appropriately high.
- Systems for monitoring service performance : the top service firms audit service performance, both their own and competitors, on a regular basis.
- Systems for satisfying complaining customers : well-run service businesses respond quickly and generously to customer complaints.
- Satisfying the employees as well as the customers : excellently managed service companies believe that employee relations will reflect on customer relations. Management carries out

internal marketing and creates an environment of employee support and rewards for good service performance. Management regularly audits employees' satisfaction with their jobs.

There are, however, five gaps that cause unsuccessful service delivery as follows :

- Gap between consumer expectation and management perception;
- Gap between management perception and service –quality delivery;
- Gap between service quality specifications and service delivery;
- Gap between service delivery and external communications;
- Gap between perceived service and expected service.

There are five determinants of service quality that may create problems of maintaining quality as follows :

- Reliability : The ability to perform promised service dependably and accurately.
- Responsiveness : The willingness to help customers and to provide prompt service.
- Assurance : The knowledge and courtesy of employees and their ability to convey trust and confidence.
- Empathy : The provision of caring individualized attention to customers.
- Tangibles : The appearance of physical facilities, equipment, personnel and communication materials.

12. What is Insurance ? What are the requirements & characteristics of an insurance contract?

Answer.

Insurance can be defined as transferring or lifting of risk from one individual to a group and sharing of losses on an equitable basis by all members of the group. In legal terms insurance is a contract (policy) in which one party (insurer) agrees to compensate another party (insured) of its losses for a consideration (premium). Exposure to loss is the insured's possibility of loss.

Insurance is a means whereby a large number of people agree to share the loss which a few of them are likely to incur in the future. Insurance is also a means for handling risk. There is an uncertainty related to the risk. The business of Insurance is related to the protection of the economic value of any asset. So, every asset that has a value needs to be insured. Both tangible goods and intangibles can be insured.

Requirements of an insurance contract

Four requirements are laid down for a valid insurance contract as below:

- Agreement must be for a legal purpose, i.e., the contract of Insurance should not violate the principle of Insurable Interest and it is a contract of Uberrimae Faide (Utmost Good Faith)
- Parties must have legal capacity to contract; Minors, Lunatics, Insolvents, Intoxicated persons, etc. do not have the legal capacity and cannot enter into an insurance contract
- There should be a valid offer and acceptance and
- There must be exchange of consideration in response to an agreement which defines the quantum of possible loss to the insured. The premium amount is paid by the Insured by way of consideration on the basis of the policy risk insured. The Insurer's consideration will be a promise to indemnify the loss of the insured on the occurrence of the insured's risk.

Characteristics of insurance contract

Following are the unique characteristics which are distinct from other forms of contract.

Aleatory contract (Dependent on chance): The values exchanged by the contracting parties in an insurance contract are unequal as they are dependent on chance or in other words in an insurance contract result depends entirely as risk. If the loss arises, compensation is paid by the Insurer on the occurrence of peril. If it doesn't occur insurer does not pay any compensation while the premium gets paid to the insurer. The question of paying compensation does not arise.

Conditional Contract: Insurance contracts lay down conditions like providing proof of insurable interest, immediate communication of loss, proof of loss, and payment of premium by the insured.

Contract of Adhesion: Legally obligatory on the part of the insurer to explain the terms of contract fully to all the parties. This is particularly important as under contract of adhesion, any ambiguity in the wording of the agreement will be interpreted against the insurer as he had laid down the terms.

Unilateral Contract: Insurer is the only party to the contract who makes promises that can be legally enforced.

Generally, Non life insurance contracts are usually annual contracts and have to be renewed each year. Each time the policy is renewed a new contract is issued by the Insurer.

13. (a) What are solvency related measures for risk management?
(b) What are performance related measure for risk management?

Answer.

(a) Solvency-related measures (these measures concentrate on the adverse "trail" of the probability distribution – and are relevant for determining economic capital requirements)

Probability of ruin – the percentile of the probability distribution corresponding to the point at which the capital is exhausted.

Shortfall risk – the probability that a random variable falls below some specified threshold level. (Probability of ruin is a special case of shortfall risk in which the threshold level is the point at which capital is exhausted.)

Value at risk (VAR) – the maximum loss an organization can suffer, under normal market conditions, over a given period of time at a given probability level. VaR is a common measure of risk in the banking sector, where it typically calculated daily and used to monitor trading activity.

Expected policy holder deficit (EPD) or economic cost of ruin (ECOR) – an enhancement to the probability of ruin concept (and thus shortfall risk and VaR) in which the severity of ruin is also reflected. Technically, it is the expected value of the shortfall.

Tail Value at Risk (Tail VaR) or Tail Conditional Expectation (TCE) – an ECOR-like measure in the sense that both the probability and the cost of "tail events" are considered.

Tail events – unlikely but extreme events, usually from a skewed distribution. Rare outcomes, usually representing large monetary losses.

Answer (b)

Performance-related measures (these measures concentrate on the mid-region of the probability distribution –see "risk profile" above – i.e., the region near the mean, and are relevant for determination of the volatility around expected results):

- Return on equity (ROE) – net income divided by net worth
- Operating earnings – net income from continuing operations, excluding realized investment gains

- Earnings before interest, dividends, taxes, depreciation and amortization (EBITDA) – a form of cash flow measure, useful for evaluating the operating performance of companies with high levels of debt (when the debt service costs may overwhelm other measures such as net income).
- Cash flow return on investments (CFROI) – EBITDA divided by tangible assets.
- Weighted average cost of capital (WACC) – the sum of the required market returns of each component of corporate capitalization, weighted by that component's share of the total capitalization.
- Economic value added (EVA) – a corporate performance measure that stresses the ability to achieve returns above the firm's cost of capital. It is often stated as net operated profits after tax less the product of required capital times the firm's weighted average cost of capital.

14. Explain the concept of risk pooling and diversification.

Answer.

Whether it is the individual, an insurance company or insurer or a corporate, which necessarily has to insure all its risks, the proper way to look at the exigencies is to pool the risk. The concept of pooling risk is the process of identification of separate risks and put them all together in a single basket, so that the monitoring, combining, integrating or diversifying risk can be implemented. Monitoring becomes easier when the specific agency put in charge knows that all the risks have been identified and they are being monitored according to the system drawn up to quantify the total risk through pooling and with a control figure i.e., plan the way to monitor, actually monitor, and then check whether there are variations from the monitoring exercise and then act to correct the deviation. This correction act can be combining risks or integrating risks or diversifying risks.

For example, whenever a project is put up, insurance (Marine insurance) is taken for shipping the various plant and machinery from the manufacturers to the port near the project site. The logistics from the port to the project site is taken care of by the carrier and he insures (transit insurance) the risk for that segment. The material is received at site and stored until erection (storage insurance). During erection of different plant and machinery, mechanical, electrical, etc, risk is covered (erection insurance). The erected plant and machinery is then tested and trial runs are taken for guarantee purposes on continuous run as per the contract. The risk during this period is covered as risks for commercial run. All these risks put together is pooling and each separate policy has a risk value and premium and conditions attached there to by the insurer and insured has to carry out those obligations. This is the process of monitoring. To reduce risk after pooling it can be combining through a comprehensive policy from the plant and machinery Freight on Board (FOB) to the completion of final commercial guarantee run. Integrating risks will be to take care of all the foreign shipments together, inland transit risks together so that these risks which are similar are taken together.

Diversification of risk :

This involves identifying that fraction, which is systematic and the remaining unsystematic. Systematic risk is that inherent and peculiar to the type of business or the organization and can be reduced or diversified by acting with in the organization, which is through functional level strategy. The unsystematic risk, which is the market risk is external to an organization and is also termed as market risk. The identification of characteristics of market risk through statistical correlation "Beta", which is a measure of market risk, lends itself for manipulation through portfolio management.

15. What is Risk Management ? Discuss the strategies involved in risk management.

Answer.

Risk management is the identification, assessment, and prioritization of risks followed by coordinated and economical application of resources to minimize, monitor, and control the probability and/or impact of unfortunate events. Risks can come from uncertainty in financial markets, project failures, legal liabilities, credit risk, accidents, natural causes and disasters as well as deliberate attacks from an adversary.

In ideal risk management, a prioritization process is followed whereby the risks with the greatest loss and the greatest probability of occurring are handled first, and risks with lower probability of occurrence and lower loss are handled in descending order. In practice the process can be very difficult, and balancing between risks with a high probability of occurrence but lower loss versus a risk with high loss but lower probability of occurrence can often be mishandled.

The International Organistaion for Standardisation identifies the following principles of risk management :

- Risk management should create value.
- Risk management should be an integral part of organizational processes.
- Risk management should be part of decision making.
- Risk management should explicitly address uncertainty.
- Risk management should be systematic and structured.
- Risk management should be based on the best available information.
- Risk management should be tailored.
- Risk management should take into account human factors.
- Risk management should be transparent and inclusive.
- Risk management should be dynamic, iterative and responsive to change.
- Risk management should be capable of continual improvement and enhancement.

Strategy for risk management

Risk management strategies are seven fold and they are: Avoid Risk, Reduce Risk, Retain Risk, Combine Risks, Transfer Risk, Share Risk and Hedge Risk.

Avoid Risk :

Avoid risk is the prevention method and proven method. This method results in complete elimination of exposure to loss due to a specific risk. It may involve avoidance of an activity which is risky. This can be approached in two ways

(i) Do not assume risk: This means that no risky projects are undertaken. E.g., the Government has clearly mandated that no hazardous chemical industry can be put up near a populated area. This is a proactive avoidance.

(ii) Discontinuance of an activity to avoid risk: While a proactive avoidance follows a sound decision knowing fully the perils of the risk, abandoning a project to avoid risk midway is a

decision taken while handling the project. E.g., A PVC plant was being put up on the basis of alcohol as a raw material to be converted to an intermediate product known as ethylene-di-chloride. Unpredictability of alcohol supplies suddenly became risk due to a distillery which was supposed to come up in this area did not materialize. So the root of using alcohol was abandoned half way through the PVC product and ethylene-di-chloride was imported to be processed to PVC.

Reducing Risk :

Reduction of risk is attempted to decrease the quantum of losses arising out of a risky happening e.g., earthquake, storm, floods, etc. Risk reduction can be achieved through Loss Prevention and Loss Control.

Loss Prevention: Prevention of loss is the most insignificant of dealing with the risk, prevention systems like fire sprinkler systems, burglar alarms, etc., are typical prevention measures to reduce the risk of fire burglary. Other measures are the understanding of the risk or the comprehension of the risk arising out of an activity is environment and relationship between the activity and the environment. This will help in the following way:

Modify the risk involved in the activity itself through improved design or technology;

Tailor the surroundings where the risky activity is to take place by isolation or notification or proper layout;

Identify the linkage between the activity and the environment and institute suitable safe guards through training of people, safety devices and providing knowledge and institute mock exercises, etc.

Loss Control: Is accomplished through measures which will dowse the fire in the case of fire accident, e.g. using fire hydrants, fire extinguishers. Loss control is also accomplished by on line process control which operates in the event of a risky happening, e.g., Gas leaks fires.

Retain Risk :

Risk retention is adopted when it cannot be avoided, reduced or transferred. It can be a voluntary or involuntary action. When it is voluntary it is retained through implied agreements, involuntary retention ensures when the organization is unaware of the risk and faces it when it come up.

Combine Risks :

When the business faces two or three risks the over all risk is reduced by a combination. This strategy is prevalent mainly in the area of financial risk. Different financial instruments being negative risk return of co relation like Bonds and Shares are taken in a single port folio to reduce the risk. A physical risk of non- availability of a particular material is often solved by having more than one supplier.

Transfer Risk :

Normally in projects assignments or multifaceted exercises, execution is fought with risks. Different agencies work together and these agencies take care to transfer risk in their areas to another agency which is better equipped to take care of a risk for a consideration. Here the concept of core competence curves in and whenever a particular agency, individual or a firm finds that it is

dealing in a area where it does not have the core competence to deal with it seeks the help of another agency which has the specific core competence to transfer its own risk. The risk may be in the form of loss of reputation or sub quality performance and this risk is taken care of through transfer.

Sharing Risk :

Insurance is a method of sharing risk for a consideration, viz., premium insurance loss, undertakes to share the risk with the companies and share their own risk through re-insurance with other companies. Some times big conglomerates share risk among their own group of companies in proportion to their risk bearing strengths by creating a corpus instead of paying premium to insurance companies.

Hedging Risk :

Exposures of funds to fluctuations in foreign exchange rates, interest rates, prices, etc. bring about financial risks resulting in losses or gains. The downside risk is often taken care of by hedging. Hedging is done by an agency taking over the risk for a consideration for a period and select band of fluctuation.

Risk optimization :

Risk optimization means utilizing information on risk to compute precisely what types and combinations of risk to take. It also develops the precise trade off between risk and reward and the corresponding appropriate product pricing to reflect the risk taken.

16. How is project management done in practice

Answer.

In reality, the risk assessment is done through considering the various components of the financial estimates and developing certain judgmental approaches:

Estimation of revenues : Revenues projected for a project need to be justified on the basis of real data available and then the projections are made conservatively. This avoids optimistic projections of income.

Cost estimates : Always include a margin of safety to take care of impact of inflation over the time horizon for which the projections are being made. Here again the margin of safety is computed on the basis of trend analysis of inflation over the recent past and the lead indicators that are available from fundamental analysis.

Acceptable return on investment : This is the prime measure and as such it should be arrived at on the basis of certain consensus. It will depend on the payback period to be assumed, the industry experience and the company's norm for return on any new project on the basis of the current experience.

Overall certainty index : The critical risks of the project are identified and the certainty index of each of these risks is quantified. Then the overall certainty index is developed as an average of the critical indices already computed. For instance, raw material availability, power availability, intensity of competition is a few of the risks, which are quantified in terms of certainty indices. The cumulative average is the overall certainty index.

Judgmental perceptions : Three different estimates of return on the investment are developed – pessimistic, most likely and optimistic on the basis of the stage at which the particular industry is in its life cycle. On the basis of the three estimates and comparing them with the earlier methods available on certainty equivalent coefficient, a judgmental decision can be taken.

17. How would you classify Strategic Alternative based on risk? Discuss specific contributions, if any, in this respect.

Answer:
From the point of view of an organisation, Strategic Alternatives may be classified on the basis of degree of risk involved. Thus there are:
- low risk strategic alternatives;
- moderate risk strategic alternatives;
- high risk strategic alternatives;

Within this broad classification, there may be a number of specific courses of action. The above clarification provides the following strategic option in that order of risk:
- Niche
- Vertical integration - backward and forward
- Horizontal expansion
- Diversification

Niche Strategy: Niche means concentrating around a product and market. It is a strategy involving very low degree of risk and represents the typical behaviour of the small companies. Such organisations in general, are scared of growing big as it could entail them into legal, labour and management problems. They are content with their present position and wished to capitalise on their superior knowledge of local conditions and chase a very narrow segment of market. NIRMA originally followed this alternative with great success.

In India, the government policy has always favoured small scale units. Such units have been accorded a favourable treatment in the matter of licensing, credit and supply of raw materials. Thus the factors internal to the organisation and govt. policies have contributed to the growth of small companies of India.

Vertical integration: This can assume two forms; backward and forward. Backward integration means in-house production of critical inputs for the main business or going in for marketing of products by opening retail outlets. The company may also add to the existing products/process by taking up the production of intermediate goods. In the case of forward integration the companies try to reach customers through their own distribution network. Organisations follow forward integration to take advantage of the closer contact with the customers and to ensure a control over retail price of their products. Reliance Company has pursued this strategy very effectively. Integration is a moderate risk alternative.

Horizontal expansion and diversification: Horizontal expansion results when a firm adds new products or enters into new markets. Most pharmaceutical companies follow this strategy. In diversification, an enterprise takes up new products or business which may be related or unrelated to its existing business.

Diversification in particular, involves high degree of risk as it amounts to manufacturing new products or entering into new markets unfamiliar to the organisation. There are two broad categories of organisations that follow diversification. The first category includes those which are not doing too well in the traditional lines and are exploring the possibility of other products or markets. The second category would include organisations which enjoyed considerable resource strength and would like to expand operation by looking at new businesses.

Companies in India have followed both vertical integration and diversification. For instance, Walchand group's activities cover mainly large construction projects, heavy engineering, sugar, concrete pipes, confectionery, machine tools castings and fabrication etc. Hindustan Lever has pursued a strategy of vertical integration for soaps and toiletry business. It has also followed diversification in basic chemicals. Some business houses have gone in for large scale diversification i.e. DCM, TATAs, BIRLAs, THAPARs, ITC etc.

18. (a) Discuss briefly the different strategies of joint venture.
(b) What should be the criteria for evaluation of the strategy adopted by a firm?

Answer.

(a) There are three different strategies of joint venture.

(i) Spider-Web strategy: A small firm establishes a series of joint ventures so that it can survive and is not swallowed by its large competitors. For example, an oil firm jointly bidding for drilling rights along with five or six other firms. It does not have enough funds to bid on its own or it does not wish to spread resources to increase the rate of success or to reduce the chance of being taken over.

(ii) Together- Split strategy: In this strategy, the firms agree to a joint venture for a specific product line or for a specific length of time. When the project is completed, they split, e.g., many construction projects. This strategy can also evolve when the two partners have grown to the point where they do not need each other for economies of scale or efficiency related reasons.

(iii) Successive Integration Strategy: In this strategy, a firm begins a relationship which is not that strong and then develop several joint ventures which can lead to a merger. In fact, a joint venture can be a pilot project prior to a full-fledged merger.

The Spider-Web Strategy makes sense for small companies or for large, undiversified firms organised into an oligopoly. Together- Split Strategy makes sense for firms that prefer independence but are financially unable to go alone. Successive Integration Strategy is chosen by firms whose managements are risk-averse type regarding merger but uses joint ventures to test the water.

(b) A number of important questions (stated below) can be regularly asked in order to evaluate the strategy adopted by a firm.

- Is the strategy identifiable and has it been made clear either in words or through practice?
- Is the strategy in some way unique?
- Does the strategy fully exploit domestic and international environmental opportunities?
- Is the strategy consistent with corporate competence and resources, both present and projected?
- Are the major components of the strategy and the major policies of the organisation internally consistent?
- Is the chosen level of risk acceptable in economic and personal terms?
- Is the strategy appropriate to the personal values and aspirations of the key executives?
- Is the strategy appropriate to the desired level of contribution to the society?
- Does the strategy provide a stimulus to the organisational efforts and commitment?
- Are there early indications of the responsiveness of markets and market segments to the strategy?

One cannot have simple tests of soundness of a corporate strategy. However, an analytical look at any company's strategy against several criteria (the list given above is only indicative but not exhaustive) will give the concerned person(s) an idea about the quality of strategy and its implications.

19. What is market share analysis? How is it determined?

Answer.

Market share analysis – Before a discussion is made about market share analysis, it is important to understand the meaning of the term 'market share'. Market share is the percentage of a business's sales relative to the combined sales of all competition in a given market. By achieving a large share of the market in which it competes, a business firm can gain important advantages over its smaller rivals. Market share analysis refers to a technique by which the relative merits of a company's product in comparison with the competitor's products are determined. It assists in knowing the present and long-term demand for the particular product of a company in relation to the total demand for the same product in the market. Such analysis requires an explicit evaluation of competition and of the company's market plans in terms of their effect of a firm's position in the industry. This analysis is a part of corporate planning vis-a-vis market planning exercise. The market share analysis is effective when trends are reasonably predictable and competition is centered on market share. In industries like fashion garments or toys for children, market shares are very unstable. Thus, any attempt to project market shares from historical data is likely to be misleading both in the short-run and in the long-run. It is only an approximate indicator of market position due to changing market conditions.

Determination of market share: In order to determine the market share, the total demand forecast is subjected to competitive analysis and a sales forecast for the company is prepared. The measurement of market share becomes meaningful if the 'industry' can be precisely defined in terms of directly substitutable, non-differentiated products. In practice, market share measures can be only approximations of the market positions. In other words, we find that there are three determinants to ascertain market share – (i) total demand forecast, (ii) competitive analysis, and (iii) sales forecast.

(i) Demand forecast – There are various methods and techniques of quantitative forecasting of demands such as extrapolation, regression analysis, input-output analysis, and economic models.

Extrapolation implies projection of past trends. For example, a graph of past demand and sales for a product may be projected in the future and adjusted for any changes that are expected to occur. Time series analysis and exponential smoothing are used for the purpose of extrapolation.

Regression analysis is an independent forward projection technique that uses casual relationships between the elements of a situation. It predicts the dependent variable (say, demand in quantities of a product) on the basis of value of one or more independent variables (such as population changes, purchasing power, employment level, etc.).

Input-output analysis, which is appropriate for a short-term, demand forecast, can be used to study a company and a market. It shows the inter industry flow of products ands services within the national economy on the assumption that output of one industry is the input of another industry and that there is no technology change over the forecasting horizon.

Econometric models, which are predictive and descriptive in nature, take the help of economics, mathematics, and statistics in order to express economic relationships. It is a system, whereby hypotheses are developed concerning the relationships among a set of variables and a certain economic phenomenon.

(ii) Competitive analysis – It involves (a) identification of competitors and their present market share; (b) comparison of the marketing strategies (product quality/ pricing/ discount/ packaging/ distribution/ promotion, etc.) of different competitors; and (c) forecast of changes in marketing strategies and their impact on the market share of each competitor.

(iii) Sales forecast – There may be long-term and short-term sales forecasting. The function of long-term forecast necessitates information about market conditions for a good length of period (5 or 10 years) upon which a rational plan of expansion, modernization, or diversification is based. In short-term forecasts, emphasis is on seasonal fluctuations in demand or on temporary changes in national income levels.

20. (a) What is 'Situation Audit' in strategic planning?

(b) Discuss its fundamental purposes with a brief description of the contents.

Answer.

Strategic planning is the process of making current risk-taking decision with the best possible knowledge of the future consequences and situations. It thus requires sensing of expectations and needs, creating awareness throughout the organization, crystallizing the development focus and making people committed to achievement of specific goals. 'Situation audit' refers to the analysis and appraisal of these basic planning premises and covers the entire process of determining the following pertinent issues –

(i) Expectations of major outside interests in relation to : society, community, stakeholders, customers, suppliers and creditors;

(ii) Expectations of major inside interests in relation to : top managers, senior and middle-level managers, supervisors, staff and workmen;

(iii) Data base with respect to past performance, current situation and forecasts; and

(iv) Evaluation of environment (i.e. opportunities and threats) and of company (i.e. strengths and weaknesses).

Fundamental purposes of Situation Audit.

(i) A major objective of the situation audit is to identify and analyse the key trends, forces and phenomena that may have a potential impact on the formulation of strategies. This helps a company to identify specific elements in the environment that will be addressed.

(ii) The situation audit serves to emphasise the importance of systematic assessment of environmental impacts.

(iii) The situation audit is a forum for sharing and debating divergent views about relevant environmental changes. The more open the debate about them, the more likely the planning system will be effective.

(iv) Systematic attempts to appraise the environment, through situation audit, help individuals to sharpen vague amorphous attitudes about forces operating in the environment.

(v) Finally, all of the information collected in the situation audit provide a base for completing the strategic planning process in all of its phases, from revaluating missions to formulating strategies and implementing them.

Contents of Situation Audit

(i) Expectations of outside constituents : The constituents viz. outside people and groups are interested to understand what a large corporation wants to do. Systematic examination of the attitudes, demands, and expectations of these groups and their considerations in appropriate forms help a corporation in the strategy formulation.

(ii) Expectations of inside constituents : The values, attitudes and interests of individuals and groups within a corporation constitute significant premises for planning. The value systems of top management particularly are basic and fundamental premises in any comprehensive corporate planning system. These value systems not only influence objectives but also influence all sorts of decisions made in the planning process.

(iii) Data base :

a. Past performance : The data about it are useful as a base for assessing the present situation and possible developments in the future. Data about the past covers the basic information as sales, profits, return on investment, productivity, marketing systems, and so on. Current situation – the data about it could include the company's financial position, market share, competition, customers and markets, evaluation of managerial and employee skills, various measures of efficiency (e.g. sales per employee, plant utilization, investment per employee), constituent demands, government regulations, general environmental setting, and so on.

b. Forecasts : The data about this would certainly include forecasts of markets, sales, competition and selected economic trends of prime concern to the company. These are traditional projections. But the estimates of future technological developments, changing social expectations, anticipated political and regulatory forces likely to affect the company and other trends of particular concern to the firm (e.g. population, international political turbulence, etc.) are vitally necessary in the situation audit.

(iv) SWOT analysis : Environment — This is a critical phase of the situation audit. In this phase, a company seeks to identify the principal opportunities that appear to exist in the environment of the future as well as the threats that may adversely affect the company. The assessment of company strengths and weaknesses in relation to the perceived opportunities and threats affects the strategy formulation and its implementation.

21. What are the strengths of the BCG approach?

Answer.

The BCG Matrix :

The most publicized matrix is a four-square grid developed by the Boston Consulting Group. It treats the development of corporate strategy as a problem that can be researched, mainly by examining economic, financial, and marketing data. The BCG matrix evaluates two variables: (1) the growth rate of the industry on the vertical axis, and (2) the firm's relative competitive position in the industry, or its market share, on the horizontal axis. The market-share leadership is directly related to profitability. Based upon these two criteria, a business is plotted on the matrix by drawing a circle in one of four possible quadrants, or cells. Hence, a specific function for each

product or market segment is represented on the finished matrix allowing the strategists to integrate each unit's position into a total company strategy.

The matrix is divided into four cells, with each cell representing the desirability of the combination of competitive position and growth. The four cells are labeled stars, cash cows, question marks, and dogs. Strategists will plot their SBU in one of the four cells, and then pursue the appropriate strategic action.

Relative Market Share
(Strengths and Weaknesses)

		H	L
Market	H	Stars	Question Marks
Growth	L	Cash	Dogs

1. The "stars" cell (upper left) represents businesses in a high-growth industry, with a high market share. Businesses in this quadrant offer excellent profit and growth opportunities. A good strategy for a firm in this position would be to continue its current course of action and make every effort to maintain the status quo even though this may require substantial investment. Stars usually require considerable cash to support expansion of production facilities and working capital needs. They also tend to generate a large internal cash flow. These businesses are the ones the corporation will depend upon to boost performance of the overall portfolio.
2. The "cash cows" cell (lower left) represents businesses in a low growth industry, but that have a relatively good competitive position in that industry. These businesses are able to generate good cash flow with relatively little investment. A typical strategy for these businesses is to maintain them as cash cows for as long as possible, using the profits to finance other endeavors. Thus, a business in this cell will be "milked" of its cash to support other SBUs within the organization. A firm must guard against a cash cow turning into a dog. The suggested strategy for an organization with an SBU in this cell is to acquire cash cows, if possible.
3. The "dogs" cell (lower right) represents the least desirable position of low industry growth and low market share. These businesses produce low, if any, profits. Businesses in the dog quadrant should be harvested, divested, or liquidated, depending on which alternative gives the most positive cash flow. Occasionally, a turnaround strategy can be used to make these busiinesses profitable. They are in weak competitive positions and have low profit potential associated with slow growth or impending market decline. Dogs usually cannot generate cash flows on a long-term basis.
4. The "question mark" or "problem child" cell (upper right) represents businesses with high growth potential but low market share. Profit potential in this quadrant is questionable. A company can move to either star or dog status from this tenuous position; but creating a star may require considerable investment. However, the potential reward may be well worth the investment risk. Businesses in this cell must be carefully monitored. These businesses are usually "cash dogs" because they require high investment levels to ensure rapid growth and product development. Their internal cash generation is low because their low market share gives less access to experience- curve effects and economies of scale, thus resulting in thinner margins than the market leader. The corporation has to decide whether it is worthwhile to invest in the question-mark business. The BCG matrix was designed to draw attention to various business units cash flows and investment levels, and to aid in the allocation of overall financial resources. The goal of using the BCG matrix is to enhance the entire portfolio. Two disastrous sequences in the BCG scheme can occur: (a) a business in the star quadrant can decline into a question-mark position and then into a dog position, or (b) a cash cow business can lose market share and eventually become a dog.

The most stringent BCG standard calls for the dividing line between high and low relative market share to be placed at 1.0. Relative market share is the ratio of a business's market share to the market share held by the largest rival firm in the industry, with market share being measured in terms of unit volume, not in currency. Business units that fall to the left of this line are leaders in their industries, while those falling to the right trail the market share leader. A less stringent criterion is to fix the boundary so that businesses to the left enjoy positions as market leaders (but not necessarily the leader), while those to the right are considered in underdog market-share positions.

Relative market share is used rather than actual market share because the relative position is a better indicator of comparative market strength and competitive position. An actual market share of 10 percent can be very good if the market leader has only 12 percent, but the same 10 percent actual share can be bad if the market leader has 50 percent. The basic assumption of the BCG analysis is the learning-curve effect: total cost per unit will decline (perhaps by 20 to 30 percent) every time total production is doubled.

The BCG approach is seen to have several strengths, but it also poses a number of weaknesses. First, the strengths: The BCG approach allows the organization's various businesses to be viewed as a collection of cash flows, and it is a major step forward in understanding the financial aspects of corporate strategy. The matrix highlights the financial interactions in a corporate portfolio to show the kinds of considerations with which an organization must deal. This explains why the priorities for corporate-resource allocations can be different from business to business. The matrix also provides good rationalization for both investment and divestitures.

The BCG also has a number of weaknesses. First, the matrix works better in a growing economy than in a declining economy. Second, a four-cell matrix hides the fact that many businesses are in average growth markets or average share positions. Third, although the categories can be useful, they can lead to oversimplification. Not all businesses with low relative market share are truly dogs or question marks— some have proven track records for growth and profitability. Fourth, the matrix is not a reliable indicator of relative investment opportunities across business units. The matrix does not show whether a question- mark business is a potential winner or a potential loser.

22. Benchmarking exercise is based on "best exercise" and not on "best performances". Explain. Also state briefly the important benchmarking processes used in strategy implementation.

Answer:

The term "Benchmarking" is defined as the continuous process of measuring the products, services and business practices of a company against the toughest competitors or those companies search for industry's best practices that lead to superior performance.

In other words, it is a tool for improving performance by continuously identifying, understanding, adopting and adapting best practices and processes followed by an entity- both internally as well as externally. From this definition, it is evident that a benchmarking exercise has to be based on "best practices" and not on "best performances". Practices signify continuity in use while performances may be flash in the pan and not continuous.

Best practice is a continuous process of learning, feedback, reflection and analysis of what works or does not work and the reasons therefore. Important benchmarking processes used in strategy implementation.

The following are some of the important benchmarking processes used in strategy implementation:

- Strategic Benchmarking: This aims at enhancing company's holistic performance by analysing the long-term approaches and strategies adopted by the 'best practice companies' for their success in any sector across the globe.
- Functional Benchmarking: Optimisation of functional processes or activities through Benchmarking can be done by comparing with different business sectors but engaged in similar functions or processes.
- Process Benchmarking: The initiating firm focuses its observation and investigation of business processes with a goal of identifying and observing the best practices from one or more benchmark firms. Activity analysis will be required where the objective is to benchmark cost and efficiency. This type of Benchmarking processes are applied to back office processes, where outsourcing may be a consideration.
- Product Benchmarking (or Competitive Benchmarking): This is confined to the area relating to the performance characteristics of the company's key products and services of the companies in the same sector.
- Internal Benchmarking: This involves Benchmarking against the companies own divisions or branches or strategic business units situated at different locations. The purpose is to develop a database which gives access to information and a cross fertilisation of the managerial acumen within the company.
- Financial Benchmarking: This involves performing a financial analysis and comparing the results in an effort to assess the company's overall competitiveness.

23. Balanced scorecard identifies exactly where the company is heading and what the company is trying to achieve. Discuss.

Answer:

Approach to a balanced scorecard has following steps:

a. How do we look to shareholders? Or to succeed financially how should we appear to our shareholders? – Financial perspective
(i) Identify goals / strategic objectives
(ii) Develop measures
(iii) Set targets
(iv) Develop key performance indicators
(v) Take initiatives

b. What must we excel at? Or to satisfy our shareholders and customers what business processes must we excel at? – Internal business
(i) Identify goals / strategic objectives
(ii) Develop measures
(iii) Set targets
(iv) Develop Key performance Indicators
(v) Take initiatives

c. Can we continue to improve and create value? Or to achieve our vision how will we sustain our ability to change and improve? – Innovation and learning perspective
(i) Identify goals / strategic objectives
(ii) Develop measures
(iii) Set targets
(iv) Develop Key performance Indicators
(v) Take Initiatives

d. How do customers see us? Or to achieve our vision how should we appear to our customers?

– Customer perspective
(i) Identify goals / strategic objectives
(ii) Develop measures
(iii) Set targets
(iv) Develop Key performance Indicators
(v) Take Initiatives

24. Is service marketing different from product marketing? How do marketers try to overcome the limitations of delivering uniform service quality? Discuss the problems of maintaining quality for any service business.

Answer.

A service is any act or performance that one party can offer to another that is essentially intangible and does not result in the ownership of anything. Its production may or may not be tied to a physical product. Services are intangible. Unlike physical products, they cannot be seen, tasted, felt, heard or smelled before they are bought. The person getting a 'face lift' cannot see the results before the purchase, and the patient in the psychiatrist's office cannot predict the outcome. To reduce uncertainty, buyers will look for signs or evidence of the service quality. They will draw inferences about service quality from the place, people, equipment, communication material, symbols, and price that they see. The service provider's task is to 'manage the evidence'. Whereas product marketers are challenged to add abstract ideas, service marketers are challenged to put physical evidence and imagery on their abstract offers. Services are typically produced and consumed simultaneously. This is not true of physical goods that are manufactured, put into inventory, distributed through multiple resellers, and consumed still later. If a person renders the service, then the provider is part of the service. Since the client is also present as the service is produced, provider – client interaction is a special feature of services marketing. Both the provider and the client affect the service outcome. Services are highly variable, since they depend on who provides them and when and where they are provided. Moreover, services cannot be stored. The perish ability of services is not a problem when demand is steady because it is easy to staff the services in advance. When demand fluctuates, service firms have difficult problems. Each characteristic poses problems and requires strategies. Thus, marketers have to find ways to 'tangibles' the intangible; to increase the productivity of providers who are inseparable from the product; to standardize the quality in the face of variability; and to influence demand movements and supply capabilities in the face of service perish ability.

One of the major ways of becoming successful, service firm is to deliver consistently higher quality service than competitors. The key is to meet or exceed the target customer's service quality expectations. Their expectations are formed by their past experiences, word of mouth, and service-firm advertising. The customers choose providers on this basis and, after receiving the service, they compare the perceived service with the expected service. If the perceived service falls below the expected service, customers lose interest in the provider. If the perceived service meets or exceeds their expectations, they are apt to use the provider again. To overcome the limitations of delivering uniform service quality, the marketers may try to share the following common practices of excellently managed service companies :

- A strategic concept : top service companies are 'customer obsessed'. They have developed a distinctive strategy for satisfying the needs that wins enduring customer loyalty.
- A history of top-management commitment to quality : the management should look not only at financial performance on monthly basis but also at service performance.

- The setting of high standards : the standards must be set appropriately high.
- Systems for monitoring service performance : the top service firms audit service performance, both their own and competitors, on a regular basis.
- Systems for satisfying complaining customers : well-run service businesses respond quickly and generously to customer complaints.
- Satisfying the employees as well as the customers : excellently managed service companies believe that employee relations will reflect on customer relations. Management carries out internal marketing and creates an environment of employee support and rewards for good service performance. Management regularly audits employees' satisfaction with their jobs.

There are, however, five gaps that cause unsuccessful service delivery as follows :

- Gap between consumer expectation and management perception;
- Gap between management perception and service –quality delivery;
- Gap between service quality specifications and service delivery;
- Gap between service delivery and external communications;
- Gap between perceived service and expected service.

There are five determinants of service quality that may create problems of maintaining quality as follows:

- Reliability : The ability to perform promised service dependably and accurately.
- Responsiveness : The willingness to help customers and to provide prompt service.
- Assurance : The knowledge and courtesy of employees and their ability to convey trust and confidence.
- Empathy : The provision of caring individualized attention to customers.
- Tangibles : The appearance of physical facilities, equipment, personnel and communication materials.

25. Discuss various pricing methods based on competition.

Answer.

(i) Skimming pricing method : This refers to a pricing policy which sets relatively high prices at the outset and successively offers lower prices as the market expands at later stages.
The idea behind this pricing policy is that the introduction of a new product with a high price is an efficient way to segment the markets with different price elasticities of demand. The initial high price can serve to skim the cream off those segments which are less sensitive to price. Subsequent price reductions reach customers with higher elasticities and enlarge the size of the market.
A higher price at the initial stage of market penetration can achieve a larger sales volume and a higher sales revenue. This higher sales revenue ensures profit maximization and provides a good base for sound financing necessary for the production expansion and promotional activities during the later stages of the market development.

(ii) Penetration pricing method : This method refers to a pricing policy of setting a relatively low initial price with an intention to help the product penetrate into the markets to hold a position. This method is just opposite to the skimming pricing method. This pricing strategy is adopted when there seems to be no distinctive classes of customers with different price elasticities, and when advantages of mass production drastically reduce costs, and when the product's distinctiveness i.e. protection from the competitors is likely to be short-lived.

This strategy aims at capturing the market at the very outset and in case of a competitive product, aims at capturing the major share of the market, and discourages the competitors to enter.

(iii) Seasonal discount pricing method : This is a type of pricing strategy to promote sales by offering special discounts during certain seasons. This policy is found to be followed by the manufacturers of air conditioners, refrigerators, electric fans, etc.

(iv) Going-rate pricing method : This method refers to a pricing policy whereby the prices are fixed in consideration of the prices of competitors and the firm's costs. This is like 'follow the leader' i.e. price leadership. It is quite popular because it is easy to avoid competition and make reasonable profits. Under this method, prices are fixed near about the prices of the leaders. This pricing policy does not have any scientific basis like considerations of cost and marketing factors. Small firms usually determined this pricing strategy on the considerations that the big firms have determined the prices carefully and scientifically, and that the general consumers are price conscious.

(v) Discriminatory pricing method : This method of pricing refers to a policy of following different prices for different customers based on their ability to pay or place of customers. It involves
'selling a product or service at two or more prices and the difference in price is not base don difference in costs', according to Philip Kotler.

(vi) Oligopolistic pricing : An oligopolistic competition, by definition, refers to 'a market in which there are a few sellers who are highly sensitive to each other's pricing and marketing strategies'. In other words, each seller in the market has a significant effect on the market price and each seller considers the likely effect of price changes on the competitors. The life cycle of a product and corresponding market stage play a great role in this pricing policy. During the later stage of market growth or early stage of market maturity of a product of perishable distinctiveness, an oligopolistic pricing situation develops.

(vii) Monopolistic pricing : A monopolistic competition, by definition, refers to "a market in which many buyers and sellers trade over a range of prices rather than a single market price" (Philip Kotler). This state of competition offers a greater degree of flexibility in the pricing strategy as such market is characterized by : (a) large number of competitors, and (b) price change by any one competitor tends to have little effect on other competitors. While pursuing a price reduction strategy under monopolistic competition, the marketing management of a company must consider the possibility that too drastic a reduction may set off a price war throughout the whole industry.

26. According to Porter, what are the three generic strategists in multiple SBU firms? Also discuss the areas of concern.

Answer.

Porter's Generic Strategies :

There are many sources of a sustainable competitive advantage, and many ways to achieve one. Porter shows that low cost, differentiation, and focus are three generic strategies available to flrms to achieve a sustainable competitive advantage.

The overall cost leadership position can be achieved through a large market share or through other advantages such as favorable access to raw materials or state-of-the-art manufacturing equipment. The differentiation strategy can be implemented by creating a higher quality image through technology, innovation, features, a customer service dealer network, and so on.

The third strategy involves focusing the business upon either a relatively small buyer group or a restricted portion of the product line. Even with the focus strategy, however, the flrm still must apply

either a differentiation or a low-cost strategy. Thus focusing is not so much a different strategy, but restricting or focusing the husiness can sometimes be central to success. and it is worth explicitly identifying it as a distinct strategy.

Cost-leadership strategy. This strategy is also known as low-cost strategy. It is designed to outperform competitors by producing goods and rendering services at a lower price than the competitors can. It is an advisable strategy when you are an industry leader or the product differences in the market are not clear to consumers. This strategy will produce larger profits than the competition makes and will put the business in a position to fight off price wars. As development costs go down, the sales volume goes up. For example, Southwest Airlines, which traditionally served a limited market, adopted this strategy. The company uses one type of airplane (Boeing 737) and provides no meals, no assigned seating, and reusable boarding passes. Other company examples are McDonald's, Burger King, Kmart, Lowe's, and Wal-Mart. Some of the high-tech companies adopted low cost strategies because of the continuous changes and breakthroughs in that industry. The prices of semiconductors, computers, and other communication devices (such as satellites) have been dramatically decreasing over the years.

Cost leaders offer to customers only products that are proven to be wanted and therefore the company seeks to gain market share. These businesses do not spend large amounts for development but do develop unique ways to produce the products or services that will result in reduced costs. Examples of such cost reductions are: large sales orders, which would allow for longer production runs and allow for volume buying of materials at discounts; a stable customer base, allowing for planning of production runs; and the use of tight budget controls in the production process. Businesses using this strategy make all efforts to contain their costs in production, marketing, and distinctiveness through a mind-set of cost minimization.

The idea behind an overall cost leadership strategy is to be able to produce and deliver the product or service at a lower cost than the competitors. Cost leadership is usually attained through a combination of experience and efficiency. More specifically, cost leadership requires close attention to production methods, marginal overhead costs, and overall cost minimization in areas such as sales and research and development. A cost leadership strattegy is attractive for a number of reasons, including the following :

1. Giving the firm above-average returns even in the face of strong competitive force
2. Defending the firm against rivalry from competitors because it is difficult for competitors to force the firm out on the basis of price
3. Guarding the firm against powerful suppliers by providing flexibility to deal with input cost increases
4. Defending the firm against powerful buyers because buyers can exert pressure only to drive prices down to the level of the next most efficient competitor
5. Providing substantial barriers to entry (such as expensive production equipment)
6. Putting the firm in a favorable position to defend against substitutes from the firm's competitors.

Achieving an overall low-cost position usually requires that the company develop some unique advantage or advantages over its competitors. Examples include a high market share, favorable access to raw materials, use of state-of-the-art equipment, or special design features that make the product easy to manufacture.

Differentiation strategy :

This strategy attempts to make products or services seem unique in the customer's eyes. This perceived uniqueness will enable the business to charge premium prices when customers are deemed to be satisfied. Premium prices mean that the business should have above-average returns and outperform its competition. The less the product resembles others, the more it is protected from competition and the wider its market appeal is. An example of this strategy is to have the customer perceive that the luxury automobile Lexus is far superior to Honda automobiles. Other examples include the following :

- Superiority brand image (Izod or Polo in sportswear)

- Design image (Tiffany in glassware)
- Technology (Hewlett-Packard in small computers)
- Quality image (Mercedes, BMW, or Rolls-Royce in cars; May tag quality and dependability; KitchenAid appliances; Coca-Cola and the positive image that firm is associated with; Xerox and its high-quality image)
- Customer service (IBM in office equipment and computers, Sears in home appliances)
- Dealer network (Caterpillar and John Deere)
- Any combination of these

In the differentiation strategy, the company will still attempt to control costs of production, although marketing costs may be significantly higher in order to develop brand loyalty. The main problem for this type of business is to maintain its perceived uniqueness in customers' eyes in an age when uniqueness is imitated and copied by competitors.

Following a differentiation strategy does not imply that the business should have little concern for costs, but rather that the major competitive advantage is sought through differentiation. Differentiation has several potential advantages:

1. It can provide protection against competition because of brand loyalty by customers and their resulting willingness to support higher prices for brand items.
2. It can increase margins because of the ability to charge a higher price.
3. Through higher margins, it can provide flexibility for dealing with supplier power (such as raising the cost of raw materials).
4. It can mitigate buyer power because there are no comparable alternatives.
5. It can provide entry barriers for competitors as a result of customer loyalty and the need for a competitor to overcome product or service uniqueness.
6. Because of customer loyalty, it can put the company in a favorable position to defend against substitutes from competitors.

Depending on what is required to achieve differentiation, a company may or may not find it necessary to incur relatively high costs. For example, if high-quality materials or extensive research is necessary, the resulting product or service will create a willingness on the part of the customers to pay the premium price. While such a strategy can be very profitable, it may or may not preclude gaining a large share of the market. For example, Rolex demands a very high price for its watches and makes a profit, but it has a very small share of the market. In contrast, IBM generally demands some higher prices than its competitors and still maintains a large market share.

Focus strategy : A third generic competitive strategy is to focus on a particular market segment. A particular buyer group, a geographic market segment, or a certain part of the product line may define the segment sought. As opposed to low cost and differentiation strategies, which have an industry-wide appeal, a focus strategy is based on the premise that the firm is able to serve a well-defined but narrow market better than competitors who serve a broader market. The basic idea of a focus strategy is to achieve a least-cost position or differentiation, or both, within a narrow market. The company in this strategy focuses on small-volume custom products or services and leaves the large-volume standardized market to the cost leader. Small speciality companies exploit a gap in the market and develop a product the customers want. These companies may eventually become large companies using the cost leadership strategy.

Gucci has followed a focus strategy by targeting that segment of the ladies' handbag industry that is attracted by exclusivity. In the automobile industry, Lamborghini has focused on the sports car market.

After a company has decided on its market segment, it can use either a differentiation or a low-cost marketing approach. The differentiation approach means that the organization competes on the key differentiation in its industry, but in just one or a few aspects. The focused organization can only compete on a limited number of aspects because competing on numerous aspects would bring it into direct competition with stronger key differentiators.

In the low-cost approach, the focused company competes with the cost leader of the industry in one of two ways. First, the focuser may be able to sell locally produced products to its small segment at a lower cost than the industry's cost leader. The focused company could also compete by offering custom-made products that the cost leader is unable to supply.

The three generic strategies each provide defenses against forces in the economic environment. The firms that develop one of these strategies will earn higher than average returns in their industries. The implication is that firms that do not develop one of the basic strategies will earn lower than average returns in their industries. Porter calls this being "stuck in the middle." Such a firm lacks the market share, capital investment, and resolve to use the low-cost strategy or the industry-wide differentiation necessary for low-cost position in a more limited sphere.

If some of the firms in an industry follow one of the three basic strategies and earn higher than average returns, then some firms in the industry must be earning lower than average returns (not all firms can perform above average). The in-between firms lose all the high-margin business. They cannot compete well for high-volume business from customers who demand low prices, for the high-margin business of the differentiated fmns, nor for the low-cost or focus-differentiated businesses.

The high returns are earned by the industry-wide firms with large market shares (the low cost and differentiated firms) and the firms that are focused with small market shares. Those firms in between, in terms of market share, earn lower than average returns. The result is a U-shaped curve. John Deere is the industry leader and earns high returns. However, small specialty manufacturers such as Hesston and New Holland also earn high returns. Massey Ferguson and J.1 Case are trapped in the valley, and International Harvester has a substantial market share, but earns low returns.

Areas of Concern :

At the conceptual level, Porter's theory of generic strategy can be condensed into two propositions : (1) there are only three generic and comprehensive strategies, and (2) success depends upon using only one of the three generic strategies. Although generic strategy is valuable to many organizations and has provided a real contribution to business literature, several questions arise. First, the generics are viewed as separate and completely distinct from one another (each strategy is mutually exclusive). Second, the framework fails to show techniques that could be employed to shift from one strategy to another. Third, although Porter 's generic strategies are based on earlier work, they lack theoretical or empirical substantiation. Fourth, Porter, along with others, believes that competing simultaneously with low cost and differentiation is inconsistent. This means that when a business emphasizes differentiation, it cannot maintain low cost at the same time. Also, a business that keeps costs low cannot produce significantly differentiated outputs.

The fact is that many empirical and theoretical studies demonstrate that a dual emphasis on low costs and differentiation can result in high performance. A low-cost differentiation strategy can be effective if the company provides an environment in which the strategy begins with an organizational commitment to quality process, products, and services. When a company provides high-quality output, it immediately differentiates itself from its competitors. Inevitably, customers are drawn to high-quality products and services. This will result in a higher demand for the company's output. It follows an increase in market share leading to economies of scale, thereby permitting lower per-unit cost in the company's overall cost structure. The successes of Anheuser-Busch, General Electric, Coca-Cola, and Pepsi-Cola support this scenario. All of these companies have differentiated their outputs through offering high-quality products while simultaneously maintaining low per-unit cost operations.

27. Define TQM. Explain the effect of TQM on Strategic management.

Answer:

Total Quality Management: Total quality management (TQM) refers to the systematic improvement of quality and cultural transformation in management techniques through the involvement of everyone in the organisation and in all aspects of the business operation. This concept refers to the philosophy that promoting quality values in all organisations should be the driving force behind managing, planning, designing, and improvement initiatives. TQM is a long-term concept and not a quick fix for corporate problems. Evidence of the importance of TQM can be seen in the enthusiastic response to the Malcolm Baldrige National Quality Award, which was initiated August 20, 1987, to recognise high quality in American industry. Some of the companies that won the Baldrige award include Globe Metallurgical Inc. (1988), Federal Express Corporation (1990), GTE Directories Corporation (1994), and ADAC Laboratories (1996).

Robert C. Stempel, the former chairman of General Motors Corporation, was quoted as saying, "The worldwide quality revolution has permanently changed the way we all do business. Where once quality was limited to technical issues, it is now a dynamic, perpetual improvement process involving people in all aspects of the business". In 1989, the American Society for Quality Control conducted a survey which showed that 54 percent of the executives rated service quality as extremely critical and 51 percent gave U.S. products less than an 8 on a 10-point scale. Correspondingly, some Fortune 500 executives said U.S. products merited no better than a C+.

"Total quality" in the business world has become an important and competitive issue. The concern for quality has been around for centuries. However, the emphasis on worldwide quality revolution is permanently changing the way we do business. When Edward Deming and Joseph Juran talked about quality control in the 1950s, few American companies were listening. American businesses at that time were booming. They were the front-runners in innovation and industry. They did not foresee the future consequences of not adopting such a system.

Role of TQM in strategic management: An organisation must apply strategic management plan to be able to implement TQM. Companies might need to change their strategy in order to improve the current system, or re-design the system from scratch. Typically, the TQM process starts with defining a problem, setting objectives, gathering data, setting certain standards, examining the environment, allocating resources, and taking a course of action. Strategic planning is the process of developing and maintaining strategic fit between the organisation and its changing environment. Bushnell and Halus argue that the steps involved in designing and implementing a strategic plan can be seen to closely parallel many of the key concepts involved in TQM.

Barrett argues that one aspect of the strategic planning process should be to implement a TQM program. Chalk states that strategic planning is essential for TQM. Henderson argues that the basics of TQM can govern executive-level strategic planning and goal setting. He states that TQM can be reduced to the following strategic management objectives:

1. Continuous improvement in quality goods and services
2. Company responsibility to its customers
3. Flexibility in adjusting to customer needs and expectations
4. Cost reduction through improved quality and non-value-added waste elimination

The TQM approach has companies moving toward proactive improvement to match customer needs and provide superior customer value. Managers began to respond and quality improvements proliferated. Organisations that successfully incorporated TQM practices share some common positive effects:

1. When employees are more involved in the process of improvement, productivity and consumer satisfaction will increase. This also gives the employees a sense of importance and leads to higher motivation, reduced employee turnover, increased productivity, and increased profits.

2. Employees gain a personal understanding of TQM, which in turn leads to more effective worker involvement.
3. TQM offers employees greater participation in decision making and thus makes the implementation of company's objectives much faster.
4. TQM allows for in-time consideration of potential problems.
5. TQM reduces management bureaucracy. Teams are self-managing and do their own hiring and firing.

TQM promotes reduction in the production cycle. Empowered workers feel responsible for the quality of their processes; they strive for defect reduction and delay reduction.

TQM and strategic management are management-led processes. The senior leaders in a company must create clear and visible quality values, as well as high expectations. Reinforcement of the values and expectations requires substantial personal commitment and involvement. Leaders in TQM, as in strategic management, are guided by clear, visible statements of values, usually in the form of mission statements.

Policies that support the goals and objectives of an organisation provide the necessary direction for the TQM process. These guidelines ensure that every employee understands and is responsible and accountable for TQM in daily business activities. For example, McDonald's has incorporated environmental policies into its TQM process to emphasise part of its corporate mission. The policy, as stated by Bennet, Freierman, and George, says, "McDonald's believes it has a special responsibility to protect our environment and future generations .We will lead in word and in deed". The policy further states that the company is guided by four principles: "effectively managing solid waste, conserving and protecting natural resources, encouraging environmental values and practices, and ensuring accountability procedures".

TQM and the strategic management process are not two separate structures. Quality is made part of the business through integration in the strategic planning process, according to George and Weimerskirch.

One of the goals of TQM is continuous improvement toward the ideal of zero defects. This concept plays a major role in the strategic plans that guide a company. Further, strategic management defines policies and ensures the acceptance and implementation of TQM throughout the company.

The TQM approach, like strategic management, involves extending the improvement process into the future. Achieving the highest levels of quality and competitiveness requires a well defined and well executed approach to continuous improvement, a process that must contain regular cycles of planning, execution, and evaluation. These same cycles are vital to the strategic management process.

Therefore, the benefits of TQM mirror the overall goals of strategic management. They consist of improved (1) customer satisfaction, (2) organisational effectiveness, and (3) competitiveness.

28. What are the conflicts that arise between MNCs and the local environment? How can relations be harmonized?

Answer.

MNCs' operations in foreign countries often give rise to conflicts between the MNC and the host country with regard to business, developmental, environmental, health, and safety protection

issues. MNCs have been frequently subject to charges of exploitation and colonization in third world countries. The sources of these conflicts are mainly the divergence of goals and the abuse of power both by MNCs and the host countries. For instance, increased automation aimed at promoting safety may run counter to host policies for promoting local employment; location in a densely populated area with a large pool of potential workers may be incompatible with safety; and reliance on trained foreign experts may conflict with the desire for local control.

Organizational routines that differ across national cultures also contribute to the conflicts between MNCs and host countries. For example, the expatriate Japanese practice of tapping inattentive American factory workers on the head with long wooden sticks led to escalating resentment and violence before Mazda stopped the practice. To lessen the conflicts, role-based routines must be painstakingly taught to workers. Unfortunately, many MNC managers are often insulated from clearly seeing potential in understanding the cultures of nations, too. Rather than imposing their will on company units overseas, leaders of MNCs should give up the mind-set and adapt to the different environment.

To maintain a lasting, harmonized relationship with the local environment, MNCs should have an ethical commitment to providing the host country workforce with adequate training to prepare expatriate managers for their new assignment. Others suggest MNCs should allow the local population greater access to ownership and control of productive assets, sharing surpluses with local employees and impacted communities, and decentralizing decision making concerning activities that affect the local quality of life.

Multinational corporations must operate in a two-way open system. This means it welcomes inputs from the host government and provides information about its operation to the public. The expectation from the MNC abroad is to act ethically and in a socially responsible way. Ethical practices can enhance overall corporate health and improve relationships with the stake-holders. Therefore, cooperation between the MNC and the host country's government is highly recommended.

MNCs share information based on global experiences, provide input into host-government developmental policies, and aid in their implementation; the government, in turn, would provide a reasonable regulatory environment. Such a relationship calls for ongoing interactions among officials at all levels of both parties, with the local corporate subsidiary playing a critical role.

The host government has a responsibility to set rules that are clear, consistent, and economically and technically feasible.

29. Discuss Re-engineering in the context of strategic management.

Answer.

In today's competitive environment, corporations are being required to find new and improved methods of doing business. Although this may not be that difficult, it adds to the necessity of reducing cost while being innovative and this task becomes extremely difficult. Reengineering is the term used to describe the concept and method of radically redesigning business processes. Reengineering plays a critical role in the strategic management process to help organizations significantly change. The goal is to develop and create superior business processes to produce unique goods and services customers' value highly.

Some companies have turned to work reengineering to pave the way for TQM. Although no single generally accepted definition has yet emerged for the concept. Reengineering can be defined as the practice of modifying company policies, procedures, methods, practices, processes, structure, organisation, systems and technology to achieve dramatic improvements in performance relative to appropriately defined critical success factors and performance measures.

Work reengineering differs from other process improvement methodologies in that it is typically approached from a project perspective, with process improvement goals and objectives and a

limited time frame in mind. This project orientation keeps work reengineering focused on getting real results. Work reengineering also seeks to attain dramatic step-change increases in performance rather than the incremental change advocated by continuous improvement. This concept helps an organisation to revitalise its process. It seeks the optimal solution to operational problems without regard to what exists today. It allows a company to address policies and procedures, organisation and structure, people and culture, system and technology, all of which are subject to review and change in the search for improvement. Work reengineering recognises the risks but seeks the rewards associated with rapid and substantial change.

The success of reengineering depends not only on management's ability to lead the corporation in change, but management's ability to diagnose what that change should be. Before reengineering takes place, management must determine the primary purpose and the focus of the business, the culture, and organisational culture. Before reengineering, Union Carbide made a strategic decision to focus on commodity chemicals and exit from many of its specialty chemical markets. Union Carbide was then able to focus the reengineering to meet its strategic goals. Both Kodak and IBM assumed that their visions were correct and that they could reengineer their way to prosperity. They were wrong and their employees and shareholders have suffered.

Once the vision and strategy are finalised, then companies can begin planning the reengineering. This type of change does not come about from moving a few people around or changing a couple of boxes on the organisational structure. This type of success comes from completely redesigning the organisation from scratch. That means beginning with the corporate vision and strategy.

Management needs to start with a blank piece of paper and design the organisation that will best accomplish those strategies. Many companies claim they are reengineering when in reality they are squandering corporate resources on projects that have too narrow a scope to have any impact on the bottomline. In order to affect the results of the business unit or corporation, there is a need to restructure the things that are fundamental to the functioning of the unit. Anything less will have little impact on the bottom line.

During this process, it is critical that management not only creates the right vision and the right structure but also is involved in communicating why change is necessary. Management must realise that this type of change is very upsetting to the employees. Failing to provide information only increases anxiety and makes the changes more difficult to implement. Here internal communication through effective public relations is crucial. Re-engineering can be successful when the participants of the company share the vision and the mission of the company and strive diligently to make it succeed.

Strategic management is a process by which an organisation keeps itself aligned with changing conditions. Reengineering is linked to strategic management because reengineering is doomed to failure if corporate strategy is not part of the process. Successful reengineering must be aligned with mission and vision, which are part of strategic management, to help an organization change those business processes that are fundamental to the success of the organisation.

30. (a) Discuss the factors that influence the portfolio strategy of business organisation.
(b) Explain why a direct relationship between the cost of production and a selling price may be inappropriate as a pricing strategy.

Answer (a):

There are a number of factors — historical, personal, strategic, environmental etc. — which influence portfolio strategy. Importances of such factors are discussed, in brief, below:

(i) Mission/Vision: The mission of the company is one of the most important factors which influence the portfolio strategy because the mission defines the scope and purpose of the company. Formulation of clear vision about the future leads the restructuring of portfolio.

(ii) Value system: A factor very much complimentary to the mission that influences the portfolio strategy is the value system of the promoters or major stockholders.

(iii) Future of current business: The future of the current business is a very important factor influencing the portfolio strategy. If a current business, particularly the most important one has a bleak future. A company would be tempted to divest or diversify into a growing business.

(iv) Position on the portfolio matrix/PLC: The position of different businesses on the product portfolio matrix or product life cycle also may influence portfolio strategy of a company. Products in the declining stage may be dropped. Similarly, some of the dogs or question marks could also be eligible candidates for divestment.

(v) Government policy: Government policy sometimes is an important determinant of portfolio strategy. For example, in India, the pre-1991 regulatory regime did not permit many companies, particularly large ones and foreign firms, to pursue the type of growth and diversification strategies they would have followed in an environment of business freedom, resulting in distorted portfolios. The liberalisation has very significant -transformed the environment.

(vi) Competitive environment: The competitive environment too has its influence on a portfolio strategy of many companies when competition is absent or limited, as, in a protected market, even firms which are inefficient may be able to thrive. The protection itself may prompt firms to enter such business. However, as the market becomes competitive, things may undergo drastic changes. Many firms which survived or flourished in the protected regime would not be able to survive the competition.

(vii)Company resources: The resources and strength of the company, undoubtedly, are important factors influencing the portfolio strategy.

(viii)Supply/Demand conditions: Problems with input supplies may encourage backward integration. Similarly, problems with marketing the output, or advantages of value addition, may encourage forward integration. When products/services can be obtained cheaply/more efficiently from outside, it may encourage the dropping of such business and dependence on outside sources.

(ix) Competitive moves: Some firms have a tendency to imitate the growth pattern of the established popular firms. There are firms which follow almost the same portfolio strategies of competitor. Some firms resort to portfolio change as a counter-competitive move.

(x) Portfolio strategy of parent: The portfolio strategy of subsidiaries may be influenced by the portfolio strategy of the parent.

(xi) Business environment: The business environment, in general, is an influence of the portfolio strategy and, quite obviously, significant changes in business environment have important implications for portfolio strategy.

(b) The reasons:

(i) The link between price and demand: Cost plus pricing fails to recognise that since sales demand may be determined by the sales price, there is likely to be a profit-maximising price, which is not directly related to the cost of the product.

(ii) Determining the cost of production: The determination of production cost is a subjective exercise because of the need to apportion and absorb overheads and joint production costs. Arbitrary apportionment decisions can dramatically affect the apparent production cost and would have knock-on effect on the selling price. Use of such arbitrary cost information does not provide a consistent foundation for a firm’s pricing policy.

(iii) Lack of flexibility: A cost plus policy can lead to a lack of flexibility in a firm's pricing decisions. For example, a firm may have spare capacity and could be anxious to attract marginal businesses. The use of cost plus policy could lead to high prices for losing potential customers.
(iv) Perceived benefits: A firm will not necessarily incur high costs in providing valued benefits and they may lose the chance to command a price premium if they use cost as the basis for determining selling price.
(iv) Volume of production: Unit cost tends to reduce as output increases because of the spreading of fixed costs. In the early stages of the products life cycle in particular, it may incur high unit costs, before economies of scale and learning curve benefits are achieved.
Firms which base their prices on these high costs may not attract sufficient demand for achieving the desired market share.
In addition, the use of cost plus pricing can lead to an upward spiral of price increases if it is applied regularly. If prices are high, the sales volume is likely to fall. This will increase unit costs, which would then dictate higher prices. Sales volume would then fall still further and so on.