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Unit – I

Objective Type Questions and Answers

Unit - I

Objective Type Questions and Answers

A. Choose the most appropriate one from the stated options:

Question: 1

The environmental factors that affect an organisation's strategy are:

(a) Exchange rate movements, political and legal developments, capital base and nature of the tax system

(b) Technological factors, economic factors, social conditions, political & legal developments

(c) Public vs. private sector ownership, industrial climate, technological base, skilled manpower

(d) Demographic composition, financial constitution, political environment, infrastructural facilities

(e) Any other combination - to be stated by you

Answer: (b) technological factors, economic factors, and social conditions, political and legal developments

Question: 2

A corporate strategy can be defined as:

(a) A list of actions about operational planning and statement of organisation structure and control system

(b) A statement of how to compete direction of growth and method of assessing environment

(c) A statement of organisation's activities and allocation of resources

(d) A course of action or choice of alternatives, specifying the resources required to achieve certain stated objectives

(e) A statement of where and how the company will prefer to operate

Answer: (d) A course of action or choice of alternatives, specifying the resources required to achieve certain stated objectives

Question: 3

Gap analysis identifies:

(a) The steps that should be taken by way of evolving new strategies to meet company's targets

(b) Strengths, weaknesses, opportunities and threats to its business

(c) yapping of different competitive offerings and identify possible market opportunities
(d) The possible projections of current activities Mo the future
(e) Where the company is placed today vis-à-vis its competitors,

Answer: (a) The steps that should be taken by way of evolving new strategies to meet company's targets

Question: 4

Management accounting information is found to be inadequate compared to strategic management because:

(a) It reported only certain technical data and lacked any objective assessment
(b) It offered merely certain budgetary picture and control systems
(c) It lacked a future projection of company's position'
(d) It reported pool of historical figures which are not adequate for future decision making purpose
(e) It never showed a picture of the future,

Answer: (d) It reports pool of historic figures which are not adequate for future decision making purpose

Question 5:

Strategic analysis is concerned with stating, the position of the organisation in terms of:

(a) Mission, choice of market segments, product selection, financial targets, external appraisal
(b) Mission, goals, corporate appraisal, position audit and gap analysis
(c) Mission goals, identification of key competitors, SWOT and environmental appraisal
(d) Mission, targeted ROI, manpower planning, position audit
(e) Mission, SWOT, competitive strategies, stakeholder's position and institutional goal

Answer: (b) Mission, goals, corporate appraisal, position audit and gap analysis

Question: 6

Board of directors has certain basic tasks as follows:

(a) To define the corporate mission and stop irregular practice
(b) To design the course of strategic options and appointment of top management
(c) To set the ROI and other business performance targets
(d) To monitor plan and keep abreast of external threats
(e) To evaluate and monitor courses of actions

Answer: (a) To define the corporate mission and stop irregular practices & (b) To design the course of strategic options and appointment of top management

Question: 7

Degree of involvement of Board of Directors may vary from passive to active level it may participate in one or more of the following activities (state which ones are more appropriate as a judicious mix):

(a) It constantly oversees the company's mission, objectives and policies

(b) It approves issues like R & D, foreign collaborations, linkages with financial institutions

(c) Capital budgeting, new product launch and competitive strategy building

(d) It tries to ensure that the company remains aligned with changing social, political and economic milieu

(e) Oversees only the financial performance of the company

Answer: (a) It constantly oversees the company's mission, objectives and policies &

(b) It approves issues like R&D, foreign collaborations, linkages with financial institutions.

Question: 8

E. W. Reilly has described functions of the top management as following: (You may choose most appropriate ones.)

(a) Establishing policies and assigning responsibilities

(b) Measuring and evaluating financial-results

(c) Mergers and acquisition for the company

(d) Performance appraisal of managers

(e) Stimulating creative thinking,

Answer: (a) Establishing policies and assigning responsibilities and

(e) Stimulating creative thinking

Question: 9

A strategic business unit (SUB) is defined as a division of an organisation:

(a) That helps in the marketing operation

(b) That enables managers to have better control over the resources

(c) That helps in the choice of technology

(d) That helps in the allocation of scarce resources

(e) That helps in identifying talents and potentials of people

Answer: (b) That enable managers to have better control over the resources.

Question: 10

The difference between strategy and operational efficiency can be best explained in terms of

(a) choices that the manager has to make

(b) choices in relation to the trade-offs that the manager has to make

(c) as a necessary and sufficient condition for profitability

(d) as a necessary but not sufficient condition for profitability

(e) as neither necessary nor sufficient condition for profitability

Answer: (b) choices in relation to the trade-offs that the manager has to make.

Question: 11

State Bank of India's slogan of "reaching out" would be in your mind, best described as a

(a) mission statement
(b) vision statement
(c) a strategic intent statement
(d) a competency statement
(e) none of the above

Answer: (b) vision statement and
(c) a strategic intent statement.

Question: 12

When Philips says, "Philips Invents", it is making a statement

(a) for all stakeholders
(b) for its employees
(c) for its shareholders
(d) for its customers
(e) as a warning to its competitors

Answer: (b) for its employees.

Question: 13

The difference between strategic alliances and joint ventures can best be explained by

(a) all strategic alliances are joint ventures
(b) all joint ventures are strategic alliances
(c) all strategic alliances are temporary phenomena
(d) all joint ventures involve equity participation
(e) there is no connection between SAs and JVs

Answer: (b) all joint ventures are strategic alliances.

Question: 14

Which would best describe the SBU format?

(a) General Insurance Corporation of India
(b) Hindustan Lever limited
(c) ITC
(d) Steel Authority of India Limited
(e) HDFC

Answer: (a) The General Insurance Corporation of India

Question: 15

Which of the following could be a core competence?

(a) A brand name
(b) Land
(c) Plant and machinery
(d) Enlightened leadership
(e) None of the above

Answer: (e) none of the above.

Question: 16

The difference between forward integration and concentric diversification can best be explained in terms of

(a) organisation structure
(b) relative importance
(c) systems dynamics
(d) core products
(e) none of the above

Answer :(a) organisation structure.

Question: 17

The role of leadership can be best evaluated by looking at

(a) vision
(b) strategy
(c) communication
(d) succession planning
(e) all of the above

Answer: (e) all of the above.

Question: 18

Strategy is a scientific response to

(a) External threats
(b) Internal factors
(c) face competition
(d) uncertainty
(e) planned growth

Answer: (a) and (d) i.e. external threats and uncertainty.

Question: 19

Most Indian firms did not have a mission statement till recently because

(a) It was not a statutory requirement

(b) Companies were not professionally managed

(c) Growth options were controlled by Government policy

(d) There was lack of specialists

(e) All of the above.

Answer: (c) Growth options were controlled by Government policy.

Question: 20

Pepsi's 'Nothing Official About it' would be an example of

(a) Mission
(b) Vision
(c) Strategic intent
(d) Policy

Answer :(c) strategic intent.

Question: 21

The difference between strategic alliances and joint ventures can best be explained by

(a) All strategic alliances are joint ventures
(b) All joint ventures are strategic alliances
(c) All strategic alliances are temporary phenomena
(d) There is no connection between SA and JVs.

Answer: (b) All joint ventures are strategic alliances.

Question: 22

Which of the following could be a core competence?

(a) A brand
(b) Fixed asset
(c) Ability to manage the integrity of the asset
(d) Enlightened leadership

Answer: (c) Ability to manage the integrity of the asset.

Question: 23

The difference between forward integration and concentric diversification can best be explained in terms of

(a) Organisation structure
(b) Relative importance
(c) Systems dynamics
(d) Core products

Answer: (a) Organisation structure.

Question: 24

Which is not an essential component of leadership?

(a) Vision
(b) Strategy
(c) Operational efficiency
(d) Succession planning

Answer : (c) Operational efficiency.

Question: 25

The product life cycle is decreasing for an increasing number of products, because of

(a) Technological changes in materials and processes
(b) Changing tastes of consumers
(c) Competitive activity aimed at increasing market share
(d) All of the above

Answer: (d) All of the above

Question: 26

In the differentiation strategy a longer lasting competitive edge may be based on

(a) Cost
(b) Quality
(c) Design
(d) (b) and/or (c)

Answer : (d) (b) and/or (c)

Question: 27

A firm with key internal strengths but facing an unfavorable environment should pursue a

(a) Turnaround strategy
(b) Defensive strategy
(c) Diversification strategy
(d) Aggressive strategy

Answer : (c) Diversification strategy.

Question: 28

The BGG growth matrix is based on two dimensions

(a) Market size and Competitive intensity
(b) Profit margins and Market size
(c) Relative market share and Market/Industry growth rate
(d) Market size and Profit margins.

Answer : (c) Relative market share and market/ industry growth rate.

Question: 29

The difference between Horizontal integration and Vertical integration can be best explained in terms of:

(a) economics
(b) vision
(c) choices
(b) perspective
(e) profitability.

Answer: (a) economics.

Question: 30

BSNLs plan behind introduction of "Internet Plan 99", ISDN Virtual Private Network etc would be an example of:

(a) Utilisation of newer technologies
(b) Portfolio generation
(c) Diversification of business
(d) Product development
(e) Encase new opportunities.

Answer: (d) Product development.

Question: 31

Mckinsey's T-s framework consists of:

(a) structure, strategy, software, skills, styles, staff and supervision.
(b) Structure, strategy, systems, skills, styles, syndication and shared values,
(c) Structure, strategy, systems, skills, steering power, styles and shared values.
(d) Structure, strategy, staff, skill, systems, shared values, super ordinate goal.
(e) None of the above.

Answer: (e) None of the above.

Question: 32

Strategic planning is:

(a) an attempt to make future decisions.

(b) a process of deciding what business the firm is in and what kind of business it will seek to enter or leave.

(c) a single prescribed methodology or a set of strategic procedures.

(d) the development of a set of plans that are to be used day after day into the far distant future.

(e) an attempt to improve operational efficiency.

Answer: (b) a process of deciding what business the firms are in and what kind of business it will seek to enter or leave.

Question: 33

The maturity stage of the PLC is most often associated with:

(a) rapid growth

(b) uncertainty in market

(c) improvements in manufacturing processes

(d) high exit barriers

(e) re-alignment of competitive structure.

Answer: (c) improvements in manufacturing processes.

Question: 34

The BCG growth matrix is based on two dimensions:

(a) market size and competitive intensity

(b) relative market share and market/industry growth rate

(c) profit margins and market size

(d) market size and market share

(e) relative market share and profitability margin.

Answer: (b) relative market share and market/ industry growth rate.

Question: 35

The corporate governance framework should ensure:

(a) equitable treatment of all shareholders

(b) rights of stakeholders as established by law

(c) timely and accurate disclosure of all material matters including finance, performance and ownership of the company

(d) all of the above and social responsibility

(e) ethical business practices with growth.

Answer: (d) all of the above and social responsibility.

Question: 36

The strategy of preplanned series of relaunches is:

(a) harvesting strategy
(b) offensive strategy
(c) defensive strategy
(d) pruning strategy
(e) repositioning strategy

Answer: (e) repositioning strategy.

Question: 37

Diversification strategy involves development of products of services:

(a) that caters to the overseas markets
(b) that serves similar customers in new markets
(c) that is different from present product line and nurture new markets
(d) that serves existing markets only.

Answer: (c) that is different from present product line and nurture new markets.

Question: 38

TISCO's famous advertising campaign of "we also make steel" was meant to: gain buyer loyalty to its products

(a) charge a price premium
(b) inform new buyers about its product portfolio
(c) enhance product quality perception
(d) achieve corporate's social responsibility.

Answer: (d) achieve corporate's social responsibility

Question: 39

The essential ingredients of Business Process Re-engineering are:

(a) Continuous improvements of products, processes and technologies.
(b) Advanced planning in the areas of technologies, processes and strategic partnerships etc.
(c) Fundamental rethinking and radical redesign of business process to achieve dramatic results.
(d) Generation, comparison and evolution of many ideas to find out one worthy of development.
(e) Identification and selection of layouts most suited for products and processes.

Answer: (c) Fundamental rethinking and radical redesign of business process to achieve dramatic results.

Question: 40

Offensive strategy is a strategy:

(a) For small companies that consider offensive attacks in the market.

(b) For those companies that search for new inventory opportunities to create competitive advantage.

(c) For the market leader who should attack the competitor by introducing new products that make existing ones obsolete.

(d) For those companies who are strong in the market but not leaders and might capture a market share from the leader.

(e) None of the above.

Answer: (d) For those companies who are strong in the market but not leaders and might capture a market share from the leader.

Question: 41

The maturity stage of the PLC is most often associated with:

(a) rapid growth

(b) uncertainty in market

(c) improvements in manufacturing processes

(d) high exit barriers

(e) re-alignment of competitive structure.

Answer: (c) improvements in manufacturing processes or

(e) re-alignment of competitive structure.

Question: 42

Benchmarking is:

(a) The analytical tool to identify high cost activities based on the 'Pareto Analysis'.

(b) The search for industries best practices that lead to superior performance

(c) The simulation of cost reduction schemes that help to build commitment and improvement of actions

(d) The process of marketing and redesigning the way a typical company works

(e) The framework that earmarks a linkage with suppliers and customers

Answer :(b) The search for industries best practices that lead to superior performance

Question: 43

When two firms together produce, warehouse, transport and market products, it is said to be a case of:

(a) Consolidation

(b) Amalgamation

(c) Joint Venture
(d) Strategic Alliance
(e) All of the above.

Answer: (c) Joint Venture

Question: 44

The strategy of preplanned series of re-launches is:

(a) harvesting strategy
(b) offensive strategy
(c) defensive strategy
(d) pruning strategy
(e) repositioning strategy

Answer: (e) repositioning strategy

Question: 45

Identifying and evaluating key social, economic, technological and competitive trends/ events comprise of:

(a) Developing a mission statement:
(b) An implementing strategy
(c) Performing an external audit
(d) Identifying market trends
(e) Conducting an internal audit.

Answer: (c) Performing an external audit

Question: 46

SAIL's famous advertising campaign of "there is a bit of steel in everyone's life was meant to:

(a) gain buyers awareness about its versatile product range
(b) create an image of superior performance
(c) inform new buyers about its special products
(d) enhance product quality perception
(e) achieve its mission.

Answer: (e) achieve its mission. Or
(a) gain buyers awareness about its versatile product range

Question: 47

Technology can modify industry structure through:

(a) change in economy of scale
(b) creation of new products and/or services

(c) change in the bargaining between the industry and its buyers or its suppliers
(d) combination of (a) and (b) above
(e) all of the above

Answer: (e) all of the above

Question: 48

Marketing Research studies are undertaken:

(a) to measure brand loyalty of a class of consumers
(b) to predict market potential of a product on a future date
(c) to understand product-price relationships
(d) to make out a case for revision of an existing strategy
(e) all of the above.

Answer: (e) all of the above

Question: 49

Successful differentiation strategy allows the company to:

(a) gain buyer loyalty to its brands
(b) charge too high a price premium .
(c) depend only on intrinsic product attributes
(d) have product quality that exceeds buyers' needs
(e) segment a market into distinct group of buyers

Answer: (a) gain buyer loyalty to its brands

Question: 50

The corporate governance frame work should ensure

(a) rights of stakeholders as established by law
(b) equitable treatment to all shareholders
(c) timely and accurate disclosure of all material matters including finance, performance and ownership of the company
(d) all of the above and social responsibility
(e) none of the above

Answer: (d) all of the above and social responsibility

Question: 51

Organisation culture is:

(a) appreciation for the arts in the organisation
(b) ability of the organisation to act in a responsible manner to its employees
(c) combination of (a) and (b) above

(d) deeper level of basic assumptions and beliefs that are shared by the members of the firm
(e) none of the above

Answer: (d) deeper level of basic assumptions and beliefs that are shared by the members of the firm

Question: 52

Switching costs refer to the:

(a) cost of changing a firm's strategic group
(b) cost of installing new electric switches in a factory when technology changes.
(c) one time costs incurred by the customers when they buy from a different supplier
(d) all of the above
(e) none of the above

Answer: (c) one time costs incurred by the customers when they buy from a different supplier.

Question: 53

Backward integration occurs when:

(a) a company produces its own inputs
(b) an integrated company disintegrates into units
(c) a company is concentrated in a single industry
(d) there are no linkages among the business units

Answer: (a) a company produces its own inputs

Question: 54

Innovation strategy is:

(a) defensive strategy
(b) offensive strategy.
(c) responding to or anticipating customer and market demands
(d) guerrilla strategy
(e) harvesting strategy

Answer: (c) responding to or anticipating customer and market demands

Question: 55

Porter's 5 forces model have not touched upon:

(a) Threats of potential new entrants.
(b) Competitive strategy of different players
(c) Technological development within similar industry
(d) Bargaining power of buyers/sellers

(e) Price Strategy of substitutes

Answer: (c) Technological development within similar industry or (e)Price Strategy of substitutes

Question: 56

Technology adaptation is:

(a) the complete assimilation of technical know-how acquired from a collaborator

(b) the acquisition of technical know-how from the source external to the firm

(c) the acquisition of design from a collaborator and carrying onto necessary modifications thereto

(d) the improvement of the level or quality

(e) none of the above

Answer: (c) the acquisition of design from a collaborator and carrying onto necessary modifications thereto

Question: 57

The Input/Output model explains the dominant influence of the

(a) external environment on strategic action

(b) firm's resource base on firm's strategic action

(c) external and internal environment on firm's strategic actions

(d) demographic factors on firm's strategic actions

(e) none of the above.

Answer: (a) External environment on strategic action

Question: 58

If suppliers are unreliable or too costly, which of the following strategies may be appropriate?

(a) Horizontal integration

(b) Backward integration

(c) Market penetration

(d) Concentric diversification

(e) Forward integration.

Answer: (b) Backward integration

Question: 59

Intensity of competition is ____________in low return industries.

(a) low

(b) non-existent

(c) high

(d) not important
(e) dependant on industry nature.

Answer: (c) High

Question: 60

What are the enduring statements of purpose that distinguish one business from other similar firms?

(a) Policies
(b) Mission statements
(c) Objectives
(d) Rules
(e) Nature of ownership.

Answer: (b) Mission statement

Question: 61

Ansoff proposed that for filling the corporate planning gap, one follows four strategies namely,

(a) market penetration, product differentiation, market identification and diversification
(b) market penetration, product development, marketing research and diversification
(c) market penetration, product development, market development and diversification
(d) market identification, product development, positioning and diversification
(e) differentiation, product innovation, market opportunity and diversification

Answer: (c) Market penetration, product development, market development and diversification

Question: 62

Primary activities of the 'Value Chain' model include all of the following except

(a) in-bound logistics
(b) operations
(c) out-bound logistics
(d) marketing
(e) procurement.

Answer: (e) procurement

Question: 63

McCarthy's marketing mix refers to

(a) price, push, pull and product
(b) price, promotion, place and product

(c) price, profit, promotion and product
(d) price, promotion, profit and product portfolio
(e) price, promotion, positioning and product.

Answer: (b) Price, promotion, place and product

Question: 64

Directional Policy Matrix is the same as

(a) the BCG model
(b) the 9-cell GE matrix
(c) the Life cycle portfolio analysis
(d) the PIMS matrix
(e) the 3× 3 competitive positioning matrix.

Answer: (b) the 9 cell GE Matrix.

Question: 65

The strategy of the Tata Group in India could be viewed as a good example of

(a) Conglomerate diversification
(b) Market development
(c) Price transfers
(d) Concentric Diversification
(e) Cost leadership

Answer: (d) Concentric Diversification

Question: 66

Foreign actress in Bollywood, her pretty face would be a/an

(a) Asset
(b) Strategic asset
(c) Core competency
(d) Capability
(e) All of the above

Answer: (b) Strategic asset

Question: 67

Foreign entrepreneur

(a) Vision is before the mission
(b) Mission is before the vision
(c) Both are developed simultaneously

(d) Vision or mission is un-important issue

(e) Profitability is most crucial.

Answer: (a) Vision is before the mission

Question: 68

According to Porter, industry attractiveness depends on

(a) The technology
(b) The competitor's technology
(c) Cost of production
(d) The structure of the industry
(e) Bargaining power of buyers

Answer: (d) The structure of the industry

Question: 69

Which of the following market structures would be commonly identified with FMCG products?

(a) Monopoly
(b) Monopolistic competition
(c) Oligopoly
(d) Perfect competition
(e) None of the above.

Answer: (c) Monopolistic competition

Question: 70

The Product Market matrix comprising of Strategies of Penetration, Market Development, Product Development and Diversification was first formulated by

(a) Ansoff
(b) Drucker
(c) Porter
(d) Andrews
(e) Prahlad

Answer: (a) Ansoff

Question: 71

If an airline company purchases a hotel, this would be an example of

(a) Strategic alliance
(b) Backward integration
(c) Forward integration

(d) Market Expansion
(e) None of the above

Answer: (c) Forward integration

Question: 72

The acquisition of IDPL, Vadodara by Reliance Petrochemicals would be a good example of

(a) Horizontal Integration
(b) Vertical Integration
(c) Concentric Diversification
(d) Forward Integration
(e) Diversification

Answer: (d) Forward integration

Question: 73

HLL's decision to buy out Lakhme, when both are in the cosmetic business, would be an example of

(a) Horizontal Integration
(b) Corporate Advantage
(c) Learn-Organisation
(d) Forward Integration
(e) Strategic tie-up.

Answer: (a) Horizontal Integration

Question: 74

Indian Airlines decreasing the airfare on the Delhi-Mumbai sector following the introduction of the no frills airlines would be an example of

(a) Cost Leadership
(b) Price Leadership
(c) Product Differentiation
(d) Focus
(e) Market Retention

Answer: (b) Price Leadership

Question: 75

The acquisition of Corus by Tata Steel would be an example of

(a) Horizontal integration
(b) Vertical integration
(c) Concentric diversification

(d) Forward integration

Answer: (a) Horizontal integration

Question: 76

The strategy of the Reliance Group in India would be a good example of

(a) Conglomerate diversification
(b) Market development
(c) Price Transfers
(d) Concentric Diversification.

Answer: (a) Conglomerate diversification

Question: 77

In 1982 there were 4 firms producing colour TVs in Indi(a) In 1988 there were 44. In 2004 there are 5 firms that account for 80% of the market share. This would be an example of:

(a) Product Penetration
(b) Market consolidation
(c) Technology convergence
(d) Web structures

Answer: (b) Market consolidation

Question: 78

In Product life cycle "DODOS" indicates

(a) Negative cash flows
(b) High shares, low growth, large cash flows
(c) Low share and low growth
(d) Low share, negative growth and negative cash flow.

Answer: (d) Low share, negative growth and negative cash flow,

Question: 79

Consultant/s who contributed to the concept of TQM:

(a) W. Edwards Deming
(b) Joseph Juran
(c) A. V. Feigenbaum
(d) All of the above

Answer: (d) All of the above

Question: 80

Strategy/s that may be chosen by a company for exiting business:

(a) Divestment
(b) Harvest
(c) Liquidation
(d) Any of the above

Answer: (d) Any of the above

Question: 81

When a firm with substantial internal strengths faces major environmental threats, it should pursue:

(a) Turn around strategy
(b) Related diversification strategy
(c) Sell out strategy
(d) Market penetration strategy

Answer: (b) Related diversification strategy

Question: 82

The strategy of HMT Lt(d), streamlining its product line and thereby eliminating a few dozens of various specifications and concentrating on producing cost-effective varieties only could be viewed as a good example of:

(a) Retrenchment
(b) Restructuring
(c) Pruning
(d) Divestment

Answer: (c) Pruning

Question: 83

The acquisition of 'Hutch' by 'Vodafone' is an example of

(a) Horizontal Integration
(b) Forward Integration
(c) Vertical integration
(d) Concentric Diversification

Answer: (a) Horizontal Integration

Question: 84

The agreement of Standard Chartered Bank with Manhattan Bank to acquire the latter s entire Issued share capital illustrates the case of

(a) Take over Strategy
(b) Acquisition Strategy

(c) Merger Strategy
(d) Horizontal Integration Strategy

Answer: (b) Acquisition Strategy

Question: 85

A Product line is a group of products that

(a) are closely related
(b) are marketed through the same channel
(c) Perform a similar function for being sold to the same customers
(d) All of the above

Answer: (d) All of the above

Question: 86

Michael Porter's competitive forces model does not touch upon

(a) Threats of new entrants
(b) Threats of substitute products or services
(c) Price strategy of substitute products or services
(d) Bargaining power of suppliers and customers

Answer: (c) Price strategy of substitute products or services

Question: 87

The BCG growth matrix is based on the two dimensions:

(a) Market Size and Market Share
(b) Market Size and Profit Margins
(c) Market Size and Competitive Intensity
(d) None of the above

Answer: (d) None of the above

Question: 88

Outsourcing is the

(a) Spinning off of a value-creating activity to create a new firm
(b) Selling of a value-creating activity to other firms
(c) Purchase of a value-creating activity from an external supplier
(d) Use of computers to obtain value-creating data from the Internet

Answer: (c) Purchase of a value-creating activity from an external supplier

Question: 89

New entrants to an industry are more likely when.

(a) It is difficult to gain access to distribution channels
(b) Economies of scale in the industry are high
(c) Product differentiation in the industry is low
(d) Capital requirement in the industry are high

Answer: (c) Product differentiation in the industry is low

Question: 90

Which of the following is NOT an entry barrier to an Industry?

(a) Expected competitor retaliation
(b) Economies of scale
(c) Customer product loyalty
(d) Bargaining power of suppliers

Answer: (d) Bargaining power of suppliers

Question: 91

Competitive advantage typically comes from

(a) Individual resources
(b) One unique resource
(c) Several outstanding resources used independently
(d) The unique bundling of several resources

Answer: (d) The unique bundling of several resources

Question: 92

The existence of price-wars in the airline industry in India indicates that

(a) Customers are relatively weak because of the high switching costs created by frequent flyer programs.
(b) The industry-is moving towards differentiation of services
(c) The competitive rivalry in the industry is severe
(d) The economic segment of the external environment has shifted, but the airline strategies have not changed

Answer: (c) The competitive rivalry in the industry is severe

Question: 93

Attacking other niche markets and exploiting them one by one is

(a) Aggressive strategy
(b) Attack strategy
(c) Acquisition strategy
(d) Take over strategy

Answer: (a) Attack strategy

Question: 94

For an actor in Bollywood, his outstanding performance would be a/an

(a) Asset
(b) Strategic asset.
(c) Core competency
(d) Capability

Answer: (c) Core Competency

Question: 95

In product life cycle, 'warhorses' indicates

(a) Negative cash flows
(b) High share and negative growth
(c) Low share and negative growth
(d) High share, negative growth and positive cash flow

Answer: (d) High share, negative growth and positive cash flow

Question: 96

In product life cycle, 'cash cows' indicates

(a) High share
(b) Low growth and negative cash flow
(c) High share, low growth and large positive cash flow
(d) Low share, high growth and large positive cash flow

Answer: (c) High share, low growth and large positive cash flow

Question: 97

A new organisation built through the combined resources of two or more existing entities is a

(a) Joint venture
(b) Merger
(c) Reorganisation
(d) Association

Answer: (a) Joint venture

Question: 98

According to Porter, three generic strategies available to business are

(a) Low cost, market development and diversification

(b) Market development, niche and diversification
(c) Differentiation, low cost and niche
(d) Differentiation, diversification and market development

Answer: (c) Differentiation, low cost and niche

Question: 99

A product that offers either a radical performance advantage over competition or drastic lower price or both is a

(a) Competitive product
(b) Improved product
(c) Breakthrough product
(d) Credence product

Answer: (c) Breakthrough product

Question: 100

In Value-chain model, primary activities include all of the following except

(a) In bound logistics
(b) Operations
(c) Customer service
(d) Procurement

Answer: (d) Procurement

Question: 101

3-'C' model in business management (value-based) consists of

(a) Customers, cost and competitors
(b) Customers, context and channels
(c) Cost, capital and capability
(d) Competitors, channels and context

Answer: (a) Customers, cost and competitors.

Question: 102

The introduction- of 'Nano' by Tata Motors could be viewed as a good example of

(a) Price leadership
(b) Cost leadership
(c) Product leadership
(d) Technology leadership

Answer: (b) Cost leadership

Question: 103

Nine-cell GE Matrix is the same as the

(a) BCG Matrix
(b) Directional Policy Matrix
(c) PIMS Matrix
(d) 3x3 Competitive positioning Matrix

Answer: (b) Directional Policy Matrix

Question: 104

The major elements of physical distribution are

(a) Transportation and inventory management
(b) Order processing and protective packaging
(c) Acquisition, warehousing and material handling
(d) All of the above

Answer: (b) Order processing and protective packaging

Question: 105

Loss leader is the

(a) Leader who is unable to conceptualize and analsed strategic decisions/problems
(b) Leader who fails to make SWOT exercise of his firm
(c) Product that is not successful in a competitive bid
(d) Product that is sold at lower-than-normal margin to attract more customers

Answer: (d) Product that is sold at lower-than-normal margin to attract more customers

Question: 106

Brand names such as Coca-Cola, Sony, McDonald's and Nike are a source of competitive advantage as:

(a) They are owned by global firms
(b) They are more than 50 years old
(c) They are well- managed brands
(d) They are highly innovative firms

Answer: (c) They are well- managed brands

Question: 107

Nike & Reebok focus on design and marketing while outsourcing most of their manufacturing because

(a) That ensures better quality
(b) Its cheaper

(c) Enables them to nurture their other critical competencies
(d) They emulate each other

Answer: (c) Enables them to nurture their other critical competencies

Question: 108

In the words of Michael Dell, CEO, Dell Computer Corporation,

"No advantage and no success are ever permanent. The winners are those who keep moving". This requires the firm to have

(a) Focus
(b) Strategic flexibility
(c) Ability to diversify
(d) Ability to enter new emerging industries

Answer: (b) Strategic flexibility

Question: 109

Focus on cost reductions

(a) may result in overlooking competitor's efforts to differentiate what has
(b) traditionally been an undifferentiated commodity like product
(c) is the best way to compete to earn higher profits
(d) takes care of changes in customer needs and expectations
(e) can not create value for the customers

Answer: (a) may result in overlooking competitor's efforts to differentiate what has

Question: 110

The effort by the manufacturer to persuade middlemen to stock and promote his product (e.g. Trade discount) is termed as

(a) Pull

(b) Push

(c) Swap

(d) None of these

Answer: (b) Push

Question: 111

In PLC, 'Dodos' indicates

(a) Negative cash flows
(b) Low share and low growth
(c) Low share, negative growth and negative cash flows

(d) High share, low growth and large cash flows.

Answer: (c) Low share, negative growth and negative cash flow

Question: 112

If an organisation acquires its supplier, it is an example of:

(a) Horizontal integration
(b) Forwards vertical integration
(c) Backwards vertical integration
(d) Downstream vertical integration.

Answer: (c) Backward Vertical Integration

Question: 113

Typically Profits are highest in which stage of the industry life-cycle?

(a) Introduction
(b) Growth
(c) Maturity
(d) Decline

Answer: (b) Growth

Question: 114

Diversification into many unrelated areas is an example of:

(a) Risk Management
(b) Good Management
(c) Uncertainty reduction
(d) Sustainability

Answer: (a) Risk Management

Question: 115

Segmentation is a way of:

(a) Subdividing Markets
(b) Subdividing industries
(c) Differentiating products
(d) Subdividing organisations into departments.

Answer: (a) Subdividing markets

Question: 116

The strategy which concentrates around a production market is:

(a) Vertical Integration

(b) Niche
(c) Horizontal Expansion
(d) Diversification

Answer: (b) Niche

Question: 117

Delphi Technique is used in

(a) Budgeting
(b) Projecting Business
(c) Market Research Technique
(d) Technological Forecasting

Answer: (d) Technological Forecasting

Question: 118

'Harvesting' allows a market share to

(a) Fall in order to earn better short-run profits
(b) Rise in order to earn better short-run profits
(c) Fall in order to earn long-run profits
(d) Rise in order to earn long-run profits

Answer: (a) Fall in order to earn better short-run profits

Question: 119

The scheme of gaining ownership and control of raw materials and component supplies is termed:

(a) Forward integration strategy
(b) Backward integration strategy
(c) Horizontal integration strategy
(d) Downstream integration strategy

Answer: (b) Backward integration strategy

Question: 120

'Corporation vision' is the same as

(a) Corporate dream
(b) Corporate mission
(c) Corporate goal
(d) Corporate strategy

Answer: (a) Corporate dream

Question: 121

'Niche' is similar to the

(a) Growth strategy
(b) Milking strategy
(c) Flanking strategy
(d) Survival strategy

Answer: (c) Flanking strategy

Question: 122

PIMS attempts to establish

(a) the profitability of various marketing strategies
(b) the link between the size of return on capital and market share
(c) Both of (a) and (b)
(d) None of (a) and (b)

Answer: (c) Both of (a) and (b)

Question: 123

Successful 'differential strategy' allows a company to

(a) Gain buyer loyalty to its brands
(b) Charge too high a price premium
(c) Have product quality that exceeds buyers' needs
(d) Depend only on intrinsic product attributes.

Answer: (a) Gain buyer loyalty to its brands

Question: 124

Intensity of competition is _____________in lower-return industries

(a) lowest
(b) non-existent
(c) highest
(d) not important

Answer: (c) Highest

Question: 125

A supplier group is powerful if

(a) It is not concentrated
(b) Offers unique products
(c) Its customers can backward integrate

(d) There are no switching costs

Answer: (b) Offers unique products

Question: 126

A company's actual strategy is

(a) mostly hidden to outside view and is known only to top-level managers
(b) typically planned well in advance and usually deviates little from the planned set of actions and business approaches because of the risks of making on-the-spot changes
(c) partly proactive and partly reactive to changing circumstances
(d) mostly a function of the strategies being used by rival companies (particularly those companies that are industry leaders)

Answer: (c) Partly proactive and partly reactive to changing circumstances

Question: 127

The managerial task of implementing strategy primarily falls upon the shoulders of:

(a) The Chief Executive Officer (CEO)
(b) First line supervisors, who have day-to-day responsibility for seeing that key activities are done properly
(c) All managers, each attending to what needs to be done in their respective areas of authority and responsibility
(d) All of the above

Answer: (c) All managers, each attending to what needs to be done in their respective areas of authority and responsibility

Question: 128

Delphi Technique:

(a) is an attempt to describe a sequence of events that demonstrates how a particular goal might be reached
(b) is a method of obtaining a systematic refined consensus from a group of experts
(c) is assessing the desirability of future goals and thereafter selecting those areas of development that are necessary to achieve the desired goals
(d) is concentrating on the impact which various forecasted technological developments might have on particular industries

Answer: (b) is a method of obtaining a systematic refined consensus from a group of experts

Question: 129

Product development policy and strategy involves four phases namely:

(a) Concept development, product marketing, product/process engineering and product launch

(b) Concept development, product planning, product/process engineering and pilot production/ramp up
(c) Product planning, product/process engineering, pilot production/ramp up, marketing
(d) None of the above

Answer: (b) Concept development, product planning, product/process engineering and pilot production/ ramp up

Question: 130

Price fixation for the first time takes place when

(a) a company develops or acquires a new product
(b) introducing existing product into a new geographic area or a new distribution channel
(c) a service, the company bids for a new contract work
(d) all of the above

Answer: (d) all of the above

Question: 131

Financial risks do not include:

(a) trade cycles
(b) interest rate risk
(c) inflation rate risk
(d) exchange risk

Answer: (a) trade cycles

Question: 132

Risk Management techniques do not include:

(a) risk avoidance
(b) risk premium
(c) risk retention
(d) risk transfer

Answer: (b) risk premium

Question: 133

Project risk does not include:

(a) Institutional risk
(b) Turbulence
(c) Completion risk
(d) Uncertainty

Answer: (d) Uncertainty

Question: 134

Risk is defined as

(a) A variation from the actual
(b) A variation from the expected
(c) A possible event
(d) A possible uncertainty

Answer: (a) A variation from the actual

Question: 135

General insurance do not include:

(a) Fire Policy
(b) Burglary policy
(c) Contractor's all risk policy
(d) Life policy

Answer: (d) Life policy

Question: 136

The reason for failure of Strategic Management may be ascribed to

(a) Over-estimation of resource competence
(b) Failure to obtain senior management commitment
(c) Failure to obtain employee commitment
(d) All of the above

Answer: (d) All of the above

Question: 137

The growing predominance of the shareholder wealth culture is largely a consequence of

(a) Manipulation of stock markets through different means
(b) Globalisation and deregulation of capital markets
(c) Improving attractiveness of companies to global investors
(d) Value based management with emphasis on corporate governance

Answer: (d) Value based management with emphasis on corporate governance,

Question: 138

Corporate Social Responsibility implies

(a) The continuing commitment by business to behave ethically
(b) Fulfilling all legal expectations

(c) Fulfilling responsibility towards customers, employees, shareholders and the community at large
(d) None of the above

Answer: (c) Fulfilling responsibility towards customers, employees, share holders and the community at large

Question: 139

A Simulation Model is normally used

(a) When an organisation has to take inter-related decisions
(b) As a method for interpreting a company's performance
(c) In developing a relationship between prices, cost and volumes of business
(d) To arrive at a relationship between input and output

Answer : (a) When ah organisation has to take inter-related decisions

Question: 140

Blue Ocean Strategy is concerned with

(a) moving into new market with new products.
(b) creating a new market places where there is no competition
(c) developments of products and markets in order to ensure survival
(d) making the product unique, in terms of attributes

Answer : (b) creating new market places where there is no competition

Question: 141

An anti take-over defense that creates securities that provide their holders with special rights in the event of a take-over is called:

(a) Poison Pill
(b) Poison Pill
(c) Bear Hug
(d) Flip Pill.

Answer: (a) Poison Pill

Question: 142

For an actor in Bollywood, his outstanding performance would be a /an

(a) Asset
(b) Strategic Asset
(c) Core competency
(d) Capability

Answer: (c) Core competency

Question: 143

A Question Mark in BCG Matrix is an investment, which

(a) Yields low current income but has bright growth prospects.
(b) Yields high current income and has bright growth prospects.
(c) Yields high current income and has bleak growth prospects.
(d) Yields low current income and has bleak growth prospects.

Answer: (a) Yields low current income but has bright growth prospects.

Question: 144

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: (d) All of the above.

Question: 145

The World Class approach to Cost Management would require understanding

(a) Total Production Management
(b) Total Quality Management
(c) Align the total Cost Management on the lines of the above two strategies
(d) None of the above.

Answer: (c) Align the total Cost Management on the lines of the above two strategies

Question: 146

Commercial Insurance do not include

(a) Jewelers block policy
(b) Bankers Indemnity policy
(c) Endowment policy.
(d) Marine cargo policy.

Answer: (c) Endowment policy.

Question: 147

Risk Management Strategies are

(a) Avoid Risk, Reduce Risk, Retain Risk, Combine Risk
(b) Transfer Risk, Share Risk and Hedge Risk
(c) Both (a) and (b)

(d) None of the above.

Answer: (c) Both (a) and (b)

Question: 148

Unsystematic Risk relates to

(a) Market Risk
(b) Beta
(c) Inherent Risk
(d) Interest Rate Risk.

Answer: (c) Inherent Risk

Question: 149

Variability in return on investment in the market is referred to as

(a) Market Risk
(b) Physical Risk
(c) Pooling Risk
(d) Business Risk.

Answer: (a) Market Risk

Question: 150

Choose the most appropriate one from the stated options:

Life Insurance do not include:

(a) Whole life
(b) Pension
(c) Accident
(d) Endowment
(e) Motor Vehicle

Answer: (e) Motor Vehicle

Question: 151

Types of risks do not include:

(a) Business risks
(b) Market risks
(c) Interest rate risks
(d) Default risks
(e) Uncertainty

Answer: (e) Uncertainty

Question: 152

Insurance is not:

(a) A contract of Uberrimae Fidei
(b) A contact based on insurable interest
(c) A contract of indemnity
(d) A contract of guarantee
(e) A cover for risk

Answer: (d) A contract of guarantee

Question:153

Which one of the following is not part of expansion?

(a) Mergers
(b) Aquisition
(c) Tender offers
(d) Joint ventures
(e) Exchange offers

Answer: (e) Exchange offers

Question: 154

Which one of the following is not part of Sell-offs?

(a) Spin offs
(b) Split offs
(c) Divestitures
(d) Equity carve outs
(e) Proxy contests

Answer: (e) Proxy contests

Question: 155

Which one of the following is not part of corporate control?

(a) Premium buy backs
(b) Expansion
(c) Stand still agreements
(d) Anti take over amendments
(e) Proxy contests

Answer: (b) Expansion

Question: 156

Which one of the following is not part of changes in ownership structure?

(a) Joint ventures
(b) Exchange offers
(c) Share repurchases
(d) Going private
(e) Leveraged buyouts

Answer: (a) Joint ventures

Question: 157

Which of the following is not part of rationale for existence of a corporate?

(a) Transaction cost efficiency
(b) Bounded rationality
(c) Individual proprietorship
(d) Computational capacity
(e) Opportunism

Answer: (c) Individual proprietorship

Question: 158

Which of the following does not relate to BPR?

(a) Ambition
(b) Process focus
(c) Gap analysis
(d) It is an enabler
(e) Reverse engineering

Answer: (e) Reverse engineering

Question: 159

Which of the following does not form part of Benchmarking process?

(a) Redesign
(b) Planning
(c) Analysis
(d) Integration
(e) Action

Answer: (a) Redesign

Question: 160

Which one of the following is not a measure related to Balanced Score Card?

(a) Financial
(b) Customer satisfaction

(c) Internal processes
(d) Gap analysis
(e) Innovation

Answer: (d) Gap analysis

Question: 161

Which of the following does not relate to EVA?

(a) Customer satisfaction
(b) Operating profit
(c) Tax
(d) Cost of capital
(e) Sales value

Answer: (a) Customer satisfaction

Question: 162

Which of the following does not relate to turn around Process?

(a) Decline
(b) Response initiation
(c) Budgetary control
(d) Transition
(e) Outcome

Answer: (c) Budgetary control

Question: 163

Which one of the following does not relate to strategic alliance?

(a) Split up
(b) Boot strap
(c) Disguised sale
(d) Evolution to a sale
(e) Alliances of the weak

Answer: (a) Split up

Question: 164

Value drivers identified in cost leadership model do not include

(a) Sales growth rate
(b) Operating profit margin
(c) Differentiation
(d) Working capital investment

(e) Cost of capital

Answer: (c) Differentiation

Question: 165

Value drivers identified in Differentiation Strategy do not include

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

Answer: (b) Waste reduction

Question: 166

Numerator-Focused management focuses on

(a) Reducing headcount
(b) Tightening belts
(c) Selling assets
(d) Improving productivity
(e) Restructuring

Answer: (d) Improving productivity

Question: 167

Denominator-Driven Programme Focuses on

(a) Improving productivity
(b) Value engineering
(c) Synergy
(d) Profit maximising
(e) Reducing headcount

Answer: (e) Reducing headcount

Question: 168

Benchmarking Focuses on

(a) Production
(b) Best practices
(c) Best performance
(d) Supply chain management
(e) Profit

Answer: (b) Best practices

Question: 169

Improving quality is not due to

(a) Pressure from customers
(b) Good training programmes
(c) Motivated supervision
(d) Inadequate documentation
(e) Modern machinery

Answer: (d) Inadequate documentation

Question: 170

Strategic Control does not include

(a) Strategic surveillance
(b) Premise control
(c) Implementation control
(d) Budgetary control
(e) Special alert control

Answer: (d) Budgetary control

Question: 171

Steps for crisis management do not include

(a) Identification of areas of risk
(b) Stock options
(c) Avoid chances of risks becoming crisis
(d) Train crisis management team
(e) Clear communication strategy which is transparent

Answer: (b) Stock options

Question: 172

Defensive measures to counter Takeover attacks do not include

(a) Golden parachutes
(b) Poison pill
(c) Anti takeover amendments
(d) Authorisation of preferred stock
(e) Bear hug

Answer: (e) Bear hug

Question: 173

Which is not included in efficiency theories?

(a) Differential efficiency
(b) Operating synergy
(c) Operating efficiency
(d) Pure diversification
(e) Under valuation

Answer: (c) Operating efficiency

Question: 174

Question for competitiveness does not include

(a) Restructuring port folio
(b) Downsising
(c) Reengineering
(d) Regeneration
(e) Capacity utilisation

Answer: (e) Capacity utilisation

Question: 175

The new strategy paradigm does not include

(a) Competitive challenge
(b) Analysing the past
(c) Finding the future
(d) Mobilising for the future
(e) Getting to the future first

Answer: (b) Analysing the past

Question: 176

Decomposing the economic engine does not include

(a) Concept of served market
(b) Revenue and margin structure
(c) Configuration of skills and assets
(d) Flexibility and adaptiveness
(e) Exchange of shares

Answer: (e) Exchange of shares

Question: 177

Inability to escape the past does not include

(a) Contentment with current performance
(b) Vulnerability to new rules

(c) Resources substitute for creativity
(d) No gap between expectations and performance
(e) Accumulation of abundant resources'

Answer: (b) Vulnerability to new rules

Question: 178

Inability to invent the future does not include?

(a) Optimised business system
(b) Deeply etched recipes
(c) Failure to reinvent leadership
(d) Unparalleled track record of success
(e) Success confirms strategy

Answer: (d) Unparalleled track record of success

Question: 179

SEBI stands for

(a) Securities and exchange body of India
(b) Securities and exchange board of India
(c) Shares equities board of India
(d) Stock exchange board of India
(e) Stock exchange board of investors

Answer: (b) Securities and exchange board of India

Question: 180

Psychological influences on demand do not include

(a) Motivation
(b) Attitude
(c) Segmentation
(d) Learning
(e) Loyalty

Answer: (c) Segmentation

Question: 181

Standard classes of organisation structure do not include

(a) Simple structure
(b) Machine bureaucracy
(c) Professional bureaucracy
(d) Capital structure

(e) Adhocracy

Answer: (d) Capital structure

Question: 182

GAP Analysis is the Analysis of

(a) Difference between the planned targets with the existing performance
(b) Difference between past performance and present performance
(c) Difference between two forecasts
(d) Difference between past targets and past performances
(e) Difference between master budget and flexible budget

Answer: (a) Difference between the planned targets with the existing performance

Question: 183

Which one of the following is not the form of restructuring?

(a) Expansion
(b) Reengineering
(c) Sell offs
(d) Corporate control
(e) Change in ownership structure

Answer: (a) Expansion

Question: 184

Business Process Re-engineering is:

(a) Redesigning operational process
(b) Eliminating loss making processes
(c) Introducing qualified engineers
(d) Changing the product line
(e) Changing the business line

Answer: (a) Redesigning operational process

Question: 185

A core competence

(a) Refers to a company's best executed functional strategy
(b) Is usually associated with one or more of a company's operating strategies
(c) Is something a firm does especially well in comparison to rival companies?
(d) All of the above except (b).
(e) None of the above

Answer: (d) All of the above except (b).

Question: 186

McKinsey's 7-s framework is used to analsed strategic attributes of an organisation. Of the 7-s factors, which of the following can not be seen as a soft factor?

(a) Staff
(b) Systems
(c) Skills
(d) Shared values
(e) None of the above

Answer: (e) None of the above

Question: 187

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

(a) Internal perspective
(b) Customer perspective
(c) Financial perspective
(d) Competitor perspective
(e) Learning and Growth perspective

Answer: (d) Competitor perspective

Question: 188

Following relationship between firms allows them to create more value than they could create individually, while maintaining their independence.

(a) Horizontal merger
(b) Vertical merger
(c) Integration
(d) Corporate Restructuring
(e) Strategic Alliance

Answer: (e) Strategic Alliance

Question: 189

An international or global competitive strategy is inherently more complex to formulate and manage because of:

(a) Differences in markets from country to country
(b) Differences in competitors and competition from country to country
(c) Differences in labors costs, energy costs, transportation costs, tariffs and import restrictions, foreign exchange rate fluctuations, and the roles of governments from country to country.
(d) All of these

(e) None of these because global strategies are no more or no less complex than other strategies.

Answer: (d) All of these

Question: 190

The motivation for participating in international markets includes:-

(a) A desire to seek new markets
(b) A desire to access natural resource deposits in other countries
(c) A desire to lower costs
(d) The need to compete on a more equal footing with foreign competitors endeavoring to build a globally dominant market position.
(e) All of these.

Answer: (e) All of these

Question: 191

The Government encourages industry, investment and FDI by creating SEZ's. The term SEZ stands for:-

(a) Special Equity Zones
(b) Software Export Zones
(c) Special Economic Zones
(d) Special Entitlement Zones
(e) Special Effort Zones

Answer: (c) Special Economic Zones

Question: 192

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
(e) Transition Management

Answer: (b) Denominator Management

Question: 193

The best test of a successful strategy implementation is:-

(a) Whether structure is well matched to strategy.
(b) Whether strategies and procedures are observed in a strategy supportive fashion.

(c) Whether actual organisational performance matches or exceeds the targets spelled out in the strategic plan.
(d) Whether it is made after the strategy is formulated so that it is supportive of the strategy.
(e) The extent to which managers and employees fully support the company's strategy and long term direction.

Answer: (c) Whether actual organisational performance matches or exceeds the targets spelled out in the strategic plan

Question: 194

Business Process Re-engineering differs from TQM in bringing about

(a) Incremental improvements
(b) Slow and steady changes
(c) Radical and drastic changes
(d) Long term improvements
(e) Process improvements

Answer: (c) Radical and drastic changes

Question: 195

In assessing whether an organisation is instilled with a spirit of high performance, the key test is:-

(a) Whether employees are happy and satisfied.
(b) The level of employee morale
(c) Whether employees get along well together
(d) The extent to which the organisation is focused on achievement and excellence
(e) Whether minimal levels of employee turnover rates and absenteeism

Answer: (d) The extent to which the organisation is focused on achievement and excellence

Question: 196

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
(e) Bear Hug

Answer: (b) Poison Pill

Question: 197

Joint Ventures may fail due to any/all of the following reasons, except:-

(a) Lack of commitment and time in implementing the project
(b) Refusal by managers of one company to share knowledge with their counterparts in the Joint Venture
(c) Gaining of tax advantages
(d) Lack of commitment and time in project implementation
(e) Inability to develop the desired technology

Answer: (c) Gaining of tax advantages

Question: 198

According to C K Prahalad, competing for the future will be for:

(a) Competency Leadership
(b) Operational Efficiency
(c) Cost Leadership
(d) Product Leadership
(e) Market Leadership

Answer: (a) Competency Leadership

Question: 199

Major reason for the lower success in cross border merger is:-

(a) Different cultures involved
(b) Shortage of finance
(c) Distance
(d) Government policies
(e) Technology transfer

Answer: (a) Different cultures involved

Question: 200

Motorola learning lessons from Domino's Pizza and Federal express, to improve the speed of delivery for its cellular phones, comes under:

(a) Strategic Benchmarking
(b) Functional Benchmarking
(c) Process Benchmarking
(d) Performance Benchmarking
(e) Internal Benchmarking

Answer: (a) Strategic Benchmarking

Question: 201

The Balanced Scoreboard is about:-

(a) Creating the Vision, Communicating and Linking, Business Planning and Target Setting, Feedback and Learning
(b) Translating the Vision, Communicating and Linking, Business Planning and Target Setting, Feedback and Learning
(c) Translating the Vision, Coordinating, Business Planning and Target Setting, Feedback and Learning
(d) Creating the Vision, Coordinating, Business Planning and Target Setting, Feedback and Learning
(e) Creating the Vision, Communicating and Linking, Business Planning and Target Setting, Feedback and Learning

Answer: (b) Translating the Vision, Communicating and Linking, Business Planning and Target Setting, Feedback and Learning

Question: 202

Following is not the characteristics of a MNC:-

(a) The Managing Director should be from the Home Country
(b) It should have operations in a no. of countries around the globe
(c) Employees, stockholders and managers should be from different countries
(d) A high proportion of the company's assets, revenues or profits should be accounted for by the overseas operations.
(e) It should have affiliates or subsidiaries in foreign countries.

Answer: (d) A high proportion of the company's assets, revenues or profits should be accounted for by the overseas operations.

Question: 203

Sharing investment is one of the basic motives of:

(a) Strategic alliances
(b) Joint Ventures
(c) MOU
(d) Conglomerate acquisition
(e) Vertical merger

Answer: (b) Joint Ventures

Question: 204

Coke acquiring many bottling companies to augment its marketing and supplying capabilities is an example of:

(a) Vertical merger
(b) Conglomerate merger
(c) Horizontal merger

(d) Merger of equals
(e) Merger Through Amalgamation

Answer: (a) Vertical merger

Question: 205

In a hostile takeover, the acquirer trying to put pressure on the management of the target firm by threatening to make an open offer is known to be:

(a) Tender offer
(b) Street Sweep
(c) Bear Hug
(d) Strategic Alliance
(e) Brand Power

Answer: (a) Tender offer

Question: 206

Shamsud Chowdhury identified and named the macro and external factors responsible

for a firms decline as:

(a) K-Factor
(b) R-Factor
(c) Q-Factor
(d) Z-Factor
(e) E-Factor

Answer: (a) K-Factor

Question: 207

Backward integration occurs when:

(a) a company produces its own inputs
(b) an integrated company disintegrates into units
(c) a company is concentrated in a single industry
(d) there are no linkages among the business units

Answer: (a) a company produces its own inputs

Question: 208

For an entrepreneur

(a) Vision is before the mission
(b) Mission is before the vision
(c) Both are developed simultaneously
(d) Vision or mission is un-important issue

(e) Profitability is most critical

Answer: (a) Vision is before the mission

Question: 209

When strategy of preplanned series of re-launches is:

(a) harvesting strategy
(b) offensive strategy
(c) defensive strategy
(d) pruning strategy
(e) repositioning strategy

Answer: (e) repositioning strategy

Question: 210

Which of the following best describes an investment centre?

(a) A centre for which managers are accountable only for costs
(b) A centre for which managers are accountable only for financial outputs in the form of generating sales revenue.
(c) A centre for which managers are accountable for profit.
(d) A centre for which managers are accountable for profit and current and noncurrent assets

Answer: (d) A centre for which managers are accountable for profit and current and noncurrent assets

Question: 211

A flexible budget is

(a) A budget which by recognising different cost behavior patterns is designed to change as volume of activity changes.
(b) A budget for a twelve month period which includes planned revenues, expenses, assets and liabilities.
(c) A budget which is prepared for a rolling period which is reviewed monthly, and updated accordingly.
(d) A budget for semi-variable overhead costs only.

Answer: (a) A budget which by recognising different cost behavior patterns is designed to change as volume of activity changes.

Question: 212

Types of insurance do not include

(a) Life
(b) Property

(c) Break down of machinery
(d) Consequential losses
(e) Intellectual capability

Answer: (e) Intellectual capability

Question: 213

Insurance premium is computed by

(a) The product of annual rate and sum insured
(b) The product of annual rate and value of property
(c) The product of monthly rate and sum insured
(d) The product of monthly rate and value of property
(e) Sum of annual rate and sum insured

Answer: (a) The product of annual rate and sum insured

Question: 214

Portfolio management reduces

(a) Systematic risk
(b) Unsystematic risk
(c) Interest rate risk
(d) Default risk
(e) Inflation risk

Answer: (a) Systematic risk

Question: 215

Instruments that hedge against risk do not include

(a) Letter of credit
(b) Guarantee
(c) Underwriting
(d) Factoring
(e) Rights issue

Answer: (e) Rights issue

Question: 216

RORAC means

(a) Risk oriented return against capital
(b) Return on real asset computation
(c) Return on risk-adjusted capital
(d) Return on risky assets and capital

(e) Return on risk associated capital

Answer: (c) Return on risk-adjusted capital

Question: 217

RAROC means

(a) Risk-adjusted return on capital
(b) Return adjusted risk oriented capital
(c) Risk and return on capital
(d) Risk affected return on capital
(e) Return associated risk on capital

Answer: (a) Risk-adjusted return on capital

Question: 218

VaR means

(a) Variation associated risk
(b) Valuation and risk
(c) Value at risk
(d) Value and return
(e) Variance at risk

Answer: (c) Value at risk

Question: 219

Standard deviation measures

(a) Risk
(b) Uncertainty
(c) Certainty
(d) Variance
(e) Forecast errors

Answer: (a) Risk

Question: 220

NRAA has been created in November 2006 to support up gradation and management of dry land and rain fed agriculture. NRAA stands for

(a) National Rain fed Area Authority
(b) National Rural farming Areas Authority
(c) National Reconstruction Asset Allocation
(d) National Reallocation of Available Assets

(e) None of the above

Answer: (b) National Rural farming Areas Authority

Question: 221

(NAIS) according to Indian Government stands for

(a) National Assets Insurance Scheme
(b) National Agricultural Insurance Scheme
(c) National Aerospace Information System
(d) National Agricultural Investment Scheme
(e) None of the above

Answer: (b) National Agricultural Insurance Scheme

Question: 222

(NREGS) according to Indian Government stands for

(a) National Rural Energy Guarantee Scheme
(b) National Rural Employment Guarantee Scheme
(c) National Rural Executive Grievance Scheme
(d) National Reconstruction Gains Scheme
(e) None of the above

Answer: (a) National Rural Energy Guarantee Scheme

Question: 223

Contribution of management accountant in validation of Mission is

(a) Be part of feedback sessions for validation to identify the impact of external forces
(b) Be part of feedback sessions for validation to identify the impact of financial aspect
(c) Be part of feedback sessions for validation to identify the impact of technological forces
(d) Be part of feedback sessions for validation to identify the impact of competitive forces
(e) None of the above

Answer: (b) Be part of feedback sessions for validation to identify the impact of financial aspect

Question: 224

Contribution of management accountant in environmental scan and SWOT analysis is

(a) Research information on competitive activity
(b) Collate information on key environmental factors and statutory regulations
(c) Research, collect and collate information on statutory regulations
(d) Research, collect and collate information on key environmental factors including statutory regulations and competitive activity

(e) None of the above

Answer: (d) Research, collect and collate information on key environmental factors including

Question: 225

Contribution of management accountant in strategic change portfolio exercise is

(a) To lay down strategic initiatives in a chronological order over the time horizon of the strategy

(b) Be part of cross functional team to lay down tactical initiatives

(c) Be part of cross functional team to lay down strategic initiatives in a chronological order over the time horizon of the strategy

(d) Be part of cross functional team to perform financial audit

(e) None of these

Answer: (c) Be part of cross functional team to lay down strategic initiatives in a chronological order over the time horizon of the strategy

Question: 226

Contribution of management accountant to sustain kaizen strategy is

(a) Be part of cross functional teams to identify assumptions and critical success factors which need revision

(b) Be part of the cross functional team to identify critical business process which need specific attention for modification and improvement

(c) To lead production team for modification and improvement of production processes

(d) Both (a) and (b)

(e) None of the above

Answer: (d) Both (a) and (b)

Question: 227

Target price is

(a) Market driven

(b) Product driven

(c) Cost driven

(d) Investment driven

(e) None of the above

Answer: (a) Market driven

Question: 228

Value analysis aims at

(a) increasing sales by economising expenditure and increasing productivity

(b) reducing cost by economising expenditure and increasing productivity
(c) reducing profits by increasing expenditure and increasing productivity
(d) reducing cost by economising expenditure and increasing man power
(e) None of the above

Answer: (b) reducing cost by economising expenditure and increasing productivity

Question: 229

Value engineering job plan consists of the following phases

(a) General phase, Information phase, Function Phase
(b) Creation Phase, Evaluation Phase, Investigation Phase
(c) Recommendation Phase
(d) All the above
(e) Non of the above

Answer: (d) All the above

Question: 230

ABC involves

(a) Innovative approach to reduction of costs
(b) Process analysis, cost drivers and innovative approach to reduction of costs
(c) Process analysis and innovative approach to reduction of costs
(d) Process analysis and cost drivers to reduction of costs
(e) None of the above

Answer: (b) Process analysis, cost drivers and innovative approach to reduction of costs

Question: 231

The attribution of costs other than the purchase price, (e.g. distribution, warehousing, retailing) to each product line. Thus the net profit as opposed to gross profit can be identified for each product. This concept is known as:

(a) Direct product profitability
(b) Indirect product profitability
(c) Direct product costs
(d) Indirect product cost
(e) None of these

Answer: (a) Direct product profitability

Question: 232

MTO stands for

(a) Mark to order

(b) Move to order
(c) Move to open area
(d) Make to order
(e) None of the above

Answer: (d) Make to order

Question: 233

MTS stands for

(a) Make to sell
(b) Make to stock
(c) Move to sell
(d) Move to store
(e) Mail to store

Answer: (b) Make to stock

Question: 234

MTA stands for

(a) Mark to area
(b) Move to assembly
(c) Make to assembly
(d) Monitor in area
(e) Move to accelerate

Answer: (b) Move to assembly

Question: 235

The variables involved in the location of a warehouse are:

(a) Processing cost of volume shipment, Transportation cost of volume shipment
(b) Warehousing cost of average shipment, Local delivery of average shipment
(c) Number of average shipments per volume shipment, Processing cost of average shipment, Direct freight cost of average shipment
(d) All of the above
(e) None of the above

Answer: (d) All of the above

Question: 236

Pre-loss objectives in risk management are

(a) Understanding environment, Fulfillment of external obligations – statuary requirements
(b) Reduction in anxiety through preventive measures

(c) Social obligations to make people aware of the risks
(d) Both (a) and (b)
(e) All the above

Answer: (e) All the above

Question: 237

Post-loss objectives in risk management are

(a) Survival of the organisation, Continuance of the organisation's operations
(b) Initiate and improve the income /earnings
(c) Obligation to society
(d) Both (a) and (b)
(e) All the above

Answer: (e) All the above

Question: 238

Physical Risk includes

(a) Natural calamities: fire, tsunami, floods, earthquake, etc.
(b) Factory accidents due to fire, mishandling of equipment, breakdown and explosions
(c) Occupational hazards
(d) Both b and c
(e) All the above

Answer: (e) All the above

Question: 239

Business Risk which is inherent to a business due to

(a) Its nature and susceptibility to environment, e.g., change of fashion, business cycles
(b) Its nature and susceptibility to environment, e.g., conflicts like war, insurgency
(c) Its nature and susceptibility to environment, e.g., cross border terrorism, technological obsolescence, etc.
(d) All of the above
(e) None of the above

Answer: (d) All of the above

Question: 240

Financial Risk arises out of

(a) The nature of financial transactions
(b) Conduct of business and investment
(c) Both (a) and (b)

(d) Increased competition

(e) None of the above

Answer: (c) Both (a) and (b)

Question: 241

Physical risk arising out of Social, Political, Economic and Legal Environments are often identified

(a) Through the performance of lead indicators

(b) Through the performance of lagging indicators

(c) Through the performance of lead and lag indicators

(d) Through the performance of the government

(e) None of the above

Answer: (a) Through the performance of lead indicators

Question: 242

While applying statistical analysis, two concepts are applied for assessment of risk:

(a) Measures of Central Tendency

(b) Measures of Variation

(c) Measures of end result

(d) Both (a) and (b)

(e) All the above

Answer: (c) Measures of end result

Question: 243

Often analysts focus on characteristics of loss distributions, such as

(a) Expected Loss

(b) Standard Deviation of loss

(c) Maximum probable loss

(d) Both (b) and (c)

(e) All the above

Answer: (e) All the above

Question: 244

The concept of 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.

(a) Physical risk

(b) Financial risk

(c) Pooling risk
(d) Business risk
(e) Sharing risk

Answer: (c) Pooling risk

Question: 245

________________refers to the uncertainty of market volumes in the future and the quantum of future income caused by the variations in the interest rates.

(a) Market risk
(b) Physical risk
(c) Interest rate risk
(d) Pooling risk
(e) Exchange risk

Answer: (c) Interest rate risk

Question: 246

______________is the uncertainty of the purchasing power of the monies to be received, in the future.

(a) Purchasing power risk
(b) Market risk
(c) Physical risk
(d) Interest rate risk
(e) Exchange risk

Answer: (a) Purchasing power risk

Question: 247

"Building block" approach related to asset liability model refers to successive levels in an organisation. The levels are:

(a) Standalone risks within a single risk factor are accumulated (Ex, credit risk)
(b) Accumulation of risks arising out of different risk factors with in a single business area (Ex, combining the assets, liability and operating risks in companies operations)
(c) At this level risks across all the business lines in a corporate are aggregated together
(d) All the above
(e) None of the above

Answer: (d) All the above

Question: 248

______________is a technique to compute matching of assets and liabilities by which a prudent management of an investment portfolio can be properly taken care of.

(a) Liability management
(b) Asset liability management
(c) Risk management
(d) Creditor management
(e) None of the above

Answer: (b) Asset liability management

Question: 249

The most commonly used techniques for measurement of liquidity risks is

(a) The gap analysis of maturing assets to the maturing liabilities
(b) The financial analysis
(c) The audit of maturing assets
(d) The gap analysis of current assets to the maturing liabilities
(e) None of the above

Answer: (a) The gap analysis of maturing assets to the maturing liabilities

Question: 250

ECOR in risk management means

(a) Expected cost of ruin
(b) Expected cost of opportunity loss
(c) Economic cost of ruin
(d) Economic cost of opportunity loss
(e) None of the above

Answer: (c) Economic cost of ruin

Question: 251

EPD in risk management means

(a) Economic policy holder deficit
(b) Expected probability of holder deficit
(c) Expected policy holder deficit
(d) Expected policy holder default
(e) None of the above

Answer: (c) Expected policy holder deficit

Question: 252

Solvency related risk measures do not include

(a) Probability of ruin
(b) Short fall risk

(c) Value at risk
(d) Return on equity
(e) Tail value at risk

Answer: (d) Return on equity

Question: 253

Performance related risk measures do not include

(a) Operating earnings
(b) EBITDA
(c) WACC
(d) EVA
(e) Shortfall risk

Answer: (e) Shortfall risk

Question: 254

Value migration suggests the need to be monitor on a continuous basis to detect and measure the changes happening in value flows:

(a) Between the industries
(b) Between companies
(c) Between divisions of a company
(d) Both (a) and (b)
(e) All the above

Answer: (e) All the above

Question: 255

The a-priori segmentation method does not include

(a) Standard industrial classification groups (SIC)
(b) Patterns of product purchase and usage
(c) Usage groups (Volume users, lean users, and non-users)
(d) VALS (Values and lifestyles classification system) and
(e) PRISM (Geo demographic classification system)

Answer: (b) Patterns of product purchase and usage

Question: 256

Post-hoc segmentation method does not include

(a) Preferences to product attributes and values
(b) Basic demographic groups (Age, sex and household composition)
(c) Brand preferences and brand loyalty

(d) Price sensitivity

(e) Usage groups (Volume users, lean users, and non-users)

Answer: (b) Basic demographic groups (Age, sex and household composition)

Question: 257

Judy Strauss and Raymond Frost's e-marketing model defines e-business as

(a) EB = EC + SCM + ERP

(b) EB = EC + BI + CRM + SCM + ERP

(c) EB = EC + BI + CRM

(d) EB = CRM + SCM + ERP

(e) EB = SCM + ERP

Answer: (b) EB = EC + BI + CRM + SCM + ERP

Question: 258

The differential effect on a customer whose response to a product or service is through the knowledge of the brand comparison with other brands is known as

(a) Customer equity

(b) Market share

(c) Brand equity

(d) Brand loyalty

(e) Product life cycle

Answer: (c) Brand equity

Question: 259

SCO means

(a) Successful competitor outcome

(b) Successful commercial organisation

(c) Successful customer outcomes

(d) Successful competitor outlet

(e) None of the above

Answer: (c) Successful customer outcomes

B. Define the following terms in just a sentence or two:

1. Likert scales
2. Tax haven
3. Franchising
4. Man power strategy
5. Transfer Price
6. Exit barrier
7. Acquisition
8. Conglomerate diversification
9. Eye Camera
10. Barriers to entry
11. Stake-holder
12. Market Skimming
13. Strategic vision
14. Values
15. Overtrading
16. Corporate appraisal
17. Devaluation
18. EFT
19. Franchise
20. Counter trade
21. Core business
22. Fiscal policy
23. Loss Leader
24. Long range Planning
25. Forecasting
26. Econometric Model
27. Human Resource Strategy
28. Marketing Strategy
29. EVA
30. Cost of Capital
31. Balanced Scorecard
32. Portfolio Planning
33. Value Engineering
34. Channels of Distribution
35. Market Segmentation
36. Activity Based Management
37. Systematic Risk
38. Cash Cow

Answer:

1. **Likert scales:** is one in which a respondent is asked to indicate his measure of agreement or disagreement with a series of statements put to him- i.e. , strongly agree, agree, uncertain, disagree , strongly disagree.
2. **Tax Haven:** A tax haven is a place where certain taxes are levied at a Sow rate or not at all. Important factors necessary for a place to be a tax haven are - No or only nominal taxes, Protection of personal financial information.
3. **Franchising:** Franchising is a method of doing business wherein a "franchisor" authorizes a "franchisee" it's proven method of doing business for a given set of return.
4. **Manpower Strategy:** Manpower 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.
5. **Transfer Price:** Transfer pricing refers to the pricing of assets, tangible and intangible, services, and funds etc within an organisation. The choice of the transfer price will affect the allocation of the total profit of the company.
6. **Exit barrier:** is that which makes it difficult for an existing supplier to leave the industry,
7. **Acquisition:** is the purchase of the controlling interest of another company.
8. **Conglomerate diversification:** consists of making entirely new products for new classes of customers. These new products have no relationship to the company's current technology, products or markets.
9. **Eye Camera:** are recording devices used to monitor the responses of individual customer behavior and records eye reactions. It is sometimes used to test responses to advertisements.
10. **Barriers to entry:** The expression indicates the factors like economies of scale, product differentiation and capital requirements, which make it difficult for a new entrant to enter and gain a foothold in an industry.
11. **Stakeholder:** An individual or organisation whose behaviour can directly affect the firm's future but is not directly under the control of the firm,
12. **Market Skimming:** A policy to gain high unit profit very early when a product is first launche(d) It is at the opposite end of the spectrum to penetration prices in the range of prices that are possible,
13. **Strategic vision:** is a road map showing the route a company intends to take in developing and strengthening its business. It paints a picture of a company's destination and provides a rationale for going there. A Strategic vision portrays a company's business scope ("where we are going")
14. **Values:** Beliefs, business principles and practices that are incorporated into the way the company operates and the behaviour of the company personnel.
15. **Overtrading:** means excessive trading by a business with insufficient long-term capital at its disposal, raising the risks of liquidity problems.
16. **Corporate appraisal:** This involves critical assessment of Strengths, Weaknesses, Opportunities and Threats in relation to the internal and external factors affecting a firm.

17. **Devaluation:** refers to a reduction in the fixed or pegged exchange rate between one currency (say-$) and the other currency (like say Rs.)
18. **EFT Electronic Funds Transfer:** refers to a system whereby companies can transfer funds by means of electronic communication with their banks.
19. **Franchise:** is the least risky way of extending existing products to new markets.
20. **Counter trade:** is a general term used to describe a variety of commercial arrangements for reciprocal international trade or barter.
21. **Core business:** A business identified with certain products or markets to which most of its activities are devoted having a common thread, running through all of its activities , in order to earn a high return on investments.
22. **Fiscal policy:** A policy that involves taxation and other sources of income, government spending and borrowing whenever spending exceeds income.
23. **Loss Leader:** A product or service sold at lower-than-normal margins (probably at a loss) in order to attract customers who might then buy other items at normal prices.
24. **Long Range Planning:** becomes the basis for the strategies to be pursued to drive an organisation towards its mission. It is a long-term view of what an organisation is planning to become in future, indicating the basic thrust of the firm, including its products, business and markets. It focuses on forecasting the future by using economic and technical tools.
25. **Forecasting:** involves the analysis of revenues, costs and volumes for making the projections into the future, based on the past trends and after considering all the other factors, affecting profits and returns.
26. **Econometric Model:** is the model that studies the different economic variables and their interrelationships and used for forecasting.
27. **Human Resource Strategy:** The primary objective of this strategy is to improve productivity by reducing the unit cost of output/employee, optimising costs in the areas of man-machine relationship, structuring wage levels, outsourcing, introducing automation, et(c).
28. **Marketing Strategy:** is basically the formula for achieving marketing success in business. It is the plan for getting the best return from resources, the selection of the kind of business to engage in and the scheme for obtaining a favorable position in the business file(d)
29. **EVA:** Economic Value Addition (EVA) measures the difference, in monetary terms, between the return on a company's capital and the cost of that capital. It is similar to conventional accounting measures except that EVA considers the cost of all capital.
30. **Cost of Capital:** The Cost of Capital is the expected return that the provider of capital plans to earn on the investment, which should exceed the aggregate of the cost of equity and preference capital as well as debt capital.
31. **Balanced Scorecard:** Balanced Scorecard is a system that measures and evaluates the progress of an organisation towards strategic objectives, incorporating financial indicators as well as three other perspectives namely customer, internal business and learning/ innovation.
32. **Portfolio Planning:** Portfolio Planning attempts to describe methods of analysing a product-market portfolio with the aim of identifying the current strengths and weaknesses of an organisation's products in the markets and the state of growth or decline in each of

these markets and also to identify what strategy is needed to maintain a strong position in each of these products.

33. **Value Engineering:** Value Engineering is a systematic method to improve the 'value' of goods or products and services by using an examination of function. This is achieved by either improving the function or reducing the cost of the product simultaneously ensuring that basic functions of the product are preserved and not reduced as a consequence of pursuing \ value improvements.

34. **Channels of Distribution:** Channels of Distribution are the institutional linkage between the producers and consumers, commonly referred to as middlemen.

35. **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.

36. **Activity Based Management:** Activity Based Management is a discipline that focuses on the efficient and effective management of activities as the route to continuously improving the value received by customer and the profit received by providing this value.

37. **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.

38. **Cash Cows:** Cash Cows needs very little capital expenditure and generate high levels of cash income. Normally stars will become cash cows, with a high share of a low-growth market.

C. True or false

(1) State whether the following statements are 'true' or 'false':

(i) 'Niche' means concentrating around a product and market

(ii) Offensive strategy is appropriate for small companies and requires that they concentrate on just one segment of market.

(iii) The 'generic product' is the basic product in terms of what it is.

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

(v) Performance measures for monitoring strategies cannot be mainly financial.

Answer: i) True, ii) False iii) True iv) True v) True.

(2) State whether the following statements are 'true' or 'false' with justification.

(i) "Meta-Technology" is the science and study of sociological and technological developments, values and trends -with a view to planning for the future.

(ii) "Loss Leader" is the leader, who is unable to conceptualize and analsed strategic problems.

(iii) "Management buy-in" refers to the purchase of all or part of a business firm from its owners by the managers.

(iv) "Merger" is the purchase of controlling interest of another company.

(v) "Dogs" are the products in a high-growth market but where they have a low market share.

Answer:

(i) False. Meta-technology is a technology whose field of action is the determination of reality. It proceeds by unbelief—by decrease in credulity relative to the prevailing culture. The term was propounded by Henry (a) Flynt, Jr.(1979),

(ii) False. In marketing, a loss leader is a type of pricing strategy where an item is sold below cost in an effort to stimulate other profitable sales. It is a kind of sales promotion.

(iii) False. A Management buy-in (MB) occurs when a manager or a management team from outside the company raises the necessary finance, buys it, and becomes the company's new management.

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

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

(3) State whether the following statements, based on the quoted terms, are 'True' or 'False' with justifications for your Answer. If any given statement is 'False', you are required to give the correct terms duly quote(d). No credit will be given for Answers without justifications.

(i) 'Strategic Planning' focuses on forecasting the future by using economic and technical tools.

(ii) 'Market forecast' by a company involves the selection of its market and setting as an objective a target share of each market segment.

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

(iv) 'Divestment' means selling off a part of a firm's operations, or putting out of certain product-market operations.

(v) 'Debt recovery' is an arrangement to have debts collected by a factor company, which advances a proportion of the money it is due to collect.

Answer:

(i) FALSE. The appropriate term is 'Long range planning' instead of the words 'Strategic Planning' in Long range planning, we make more use of economic and technical tools. Thus the corrected statement is- 'Long range planning' focuses on forecasting the future by using economic and technical tools.

(ii) FALSE. The appropriate term is 'Market Positioning' or 'Product Positioning' or 'Target Marketing' instead of the words 'Market Forecast'. Market selection and target share of it are aimed in 'Market Positioning' and not in 'Market Forecast'. Thus the corrected statement is - 'Market Positioning' by a company involves the selection of its market and setting as an objective a target share of each market segment.

(iii) TRUE. 'Repositioning' is a strategic marketing approach and involves moving the product into different market segment.

(iv) TRUE. The term 'divestment' denotes getting rid of something.

(v) FALSE. The appropriate term is 'Factoring' instead of the word 'Debt recovery'. 'Debt recovery' is a recovery of debts from borrowers. Thus the corrected statement is-

'Factoring' is an arrangement to have debts collected by a factor company, which advances a proportion of the money it is due to collect.

(4) State whether the following statements, based on the quoted terms, are True' or 'False' with justifications for your Answer. If any given statement is 'False', you are required to give the correct terms, duly quote(d). No credit will be given for Answers without justifications:

(i) "Management buy-out" refers to the purchase of all or any part of a business firm from its owners by new managers from outside the business firm.

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

(iii) 'Acquisition' is nothing but the joining of two separate firms to form a single firm.

(iv) 'Stars' are the products in a high-growth market but where they have a low-market share.

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

Answer:

(i) False; The correct statement is: Management buy-in (not Management buy-out) refers to the purchase of all or any part of a business firm from its owners by new managers from outside the business firm.

(ii) True; Break Even Analysis is based on cost-volume-profit (CVP) of a firm.

(iii) False; The correct statement is: 'Merger' is nothing but the joining of two separate firms to form a single firm.

(iv) False; The correct statement is: 'Question Marks' are the products in a high-growth market but where they have a low-market share. 'Question Mark', being a problem child has a low market share whereas 'Star' has a high-market share.

(v) True; Difference in value, positive/negative arises over a period of time. Hence the statement is true.

(5) State whether the following statements, based on the quoted terms, are 'True' and "False with justifications for your Answer.

(i) "Strategic Management" is concerned with the formulation of possible courses of actions, their evaluation and the choice between them.

(ii) 'Technology up gradation' means carrying out required changes/modifications in the design acquired from collaborators.

(iii) 'Cash cows' are products in a high-growth market but where they have a low market share.

(iv) 'Kanban' attempts to identify key results and does not list all the tasks of each manager.

(v) ‘Diversification’ means selling off a part of a firm’s operations or pulling out of certain product-market areas.

Answer:

(i) False: The appropriate term is ‘Strategic choice’, instead of ‘Strategic management’. Strategic management concerns itself with corporate values, managerial capabilities and organisational responsibilities and systems in a way that links strategic and operational decision making leading to an effective strategy or strategies. But the given statement is indicative of choice of a strategy.

(ii) False: The appropriate term is ‘Technology adaptation’ instead of ‘Technology upgradation’. Carrying out changes/modifications in the design leads to adaptation and not upgradation- by means of any improvement in the technology level.

(iii) False: The appropriate term is ‘Question Marks’ instead of ‘Cash Cows’. Cash cows have high market share in low-growth market. Hence the given statement is false.

(iv) False: The appropriate term is ‘key result analysis’ instead of Kanban,’ ‘Kanban’ is a system of markers for passing components around a factory only when they are neede(d)

(v) False: The appropriate term is ‘Divestment’ instead of ‘diversification’. Diversification seeks new products and /or new market, where a firm has no previous market share.

(6) State whether the following statements are ‘True’ or ‘False’.

If ‘False’, put up with the correct statement:

(i) ‘Concentric Diversification’ consists of making entirely new products for new lasses of customers.

(ii) ‘Divestment’ is pulling oat from certain product market areas.

(iii) ‘Forward Integration’ means in-house production of critical inputs for the main business.

(iv) ‘Leveraged take-over’ is achieved using a high proportion of debt.

Answer:

(i) False - ‘Conglomerate Diversification’ consists of making entirely new products for new classes of customers.

(ii) True.

(iii) False- ‘Backward Integration’ means In-house production of critical inputs for the main business,

(iv) True.

(7) State whether the following statements, based on the quoted terms, are True’ or ‘False’ with justifications for your Answer.

(i) ‘Mergers’ are equity arrangements between two or more independent firms.

(ii) The formal information collection for organised intelligence system is done through grapevine.

(iii) ‘Dogs’ are products with a low share, negative growth and negative cash flow.

(iv) Simulation model always offers a guaranteed and the best solution.

(v) Penetration Pricing is the use of price to drive a competitor out of business.

Answer: The correct words have been underlined:

(i) False; The correct statement is: 'Joint Ventures' are equity arrangements between two or more independent firms.

(ii) False; The Correct statement is: The 'informal' information collection for organised intelligence system is done through grapevine.

(iii) False; The correct statement is: 'Dodos' are products with a low share, negative growth and negative cash flow.

(iv) False; The correct statement is: Simulation model does not always offers a guaranteed and the best solution.

(v) False; The correct statement is: Predatory Pricing is the use of price to drive a competitor out of business.

(8) State whether the. following statements, based on the quoted terms, are True' or 'False' with justifications for your Answer. If any given statement is 'false', you are required to give the correct terms, duly quote(d) No credit will be given for any Answers without justifications.

(i) Physical risk arising out of Social, Political, Economic and Legal Environments are often identified through the performance of lead indicators;

(ii) 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;-

(iii) Purchasing power risk is the uncertainty of the purchasing power of the monies to be received, in the futures.

(iv) EPD in risk management means 'Expected Policy Holder' deficit;

(v) ECOR in risk management means 'Economic Cost of Ruin'.

Answer:

All the given five statements are TRUE. Hence the correct statements remain the same as given in the Question as per below:

(i) Physical risk arising out of Social, Political, Economic and Legal Environments are often identified through the performance of lead indicators;

(ii) 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;

(iii) Purchasing power risk is the uncertainty of the purchasing power of the monies to be received, in the future;

(iv) EPD in risk management means 'Expected Policy Holder' deficit;

(v) ECOR in risk management means 'Economic Cost of Ruin'.

(9) State whether the following statements are 'True' or 'False'.

(i) Business Process Re-engineering is an important ingredient of Reverse Engineering.

(ii) Strategic surveillance is resorted to ward off potential threats, internal or external.

(iii) Synergy signifies a condition where the whole is greater than the sum of its parts.

(iv) 'White Knight Strategy' is a part of the strategy of hostile take-over.

(v) Brand equity is the added value to the shares held by the equity share-holders of a company.

Answer:

(i) False

(ii) True

(iii) True

(iv) False

(v) False

(10) State whether the following statements are 'True' or 'False':

(i) Measures relating to risk profiling are related to the level of operational efficiency of the company.

(ii) Capital Asset Pricing Model attempts to measure the risk for capital assets of a company

(iii) Risk management techniques include among other things the risk premium payable.

(iv) Risk cannot be avoided through insurance but may be considered as a means to transfer the risk.

(v) The concept of certainty equivalent coefficient represents the computation of a certain amount equivalent to a probable income or loss.

Answer:

(i) False

(ii) False

(iii) False

(iv) True

(v) True

(11) State whether the following statements, based on the quoted terms, are TRUE or FALSE with justifications for your Answer. If any statement is False, you are required to give the correct terms, duly quote(d) No credit will be given for any Answers without justifications.

(i) "Benchmarking" is the simulation of cost reduction schemes that help to build commitment and improvement of actions.

(ii) Contribution to Management Accountant in environmental scan and SWOT analysis is Research information on Competitive activity.

(iii) RAROG in Risk Analysis means Risk and return on capital.

(iv) Interest Rate Risk refers to the uncertainty of market volumes in the future and the quantum of future income caused by the variations in the interest rates.

Answer:

(i) False; Benchmarking is the search for industries best practices that leads to superior performance.

(ii) False; Contribution of Management Accountant in environmental scan and SWOT analysis is Research, collect and collate information on key environmental factors including statutory regulations and competitive activity.

(iii) False; RAROG in Risk analysis means Risk-Adjusted Return on Capital.

(iv) True; interest Rate Risk refers to the uncertainty of market volumes in the future and the quantum of future income caused by the variations in the interest rates.

Notes

Unit – II

Short Notes

Unit - II

Short Notes

1. The McKinsey 7S Framework:

The McKinsay 7S framework is shown in the given figure.

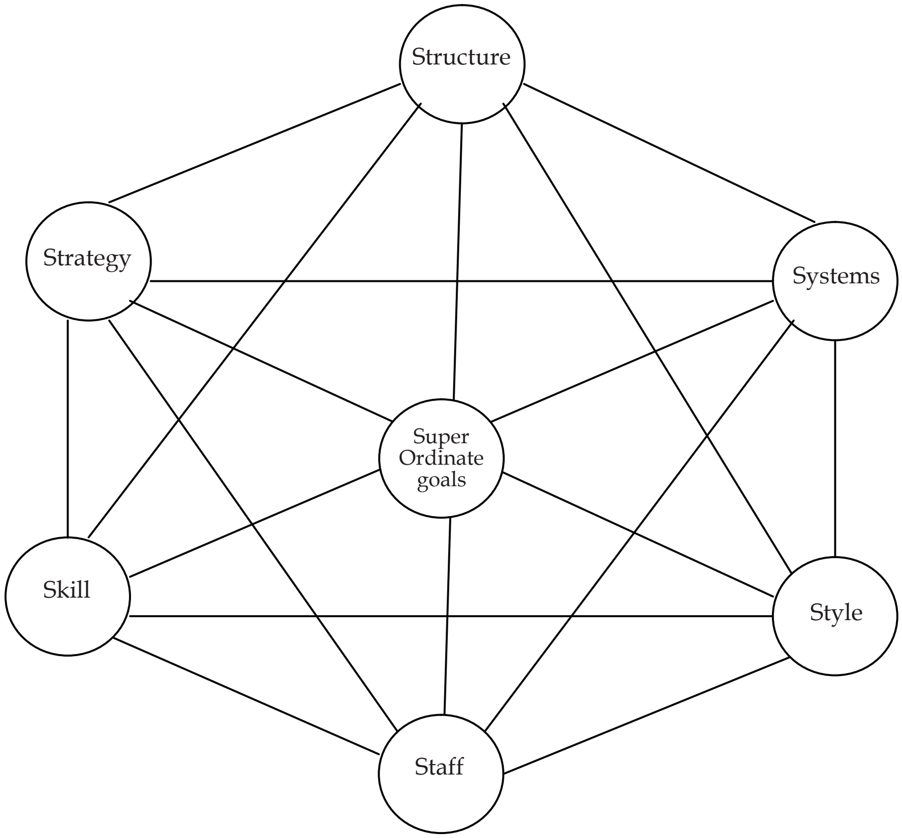
The model considers the criteria for success of a business or organisation and forms an interconnected framework of seven elements:

- Structure
- Strategy
- Skills
- Staffs
- Systems
- Style and
- Shared value.

Of these, the first two, strategy and structure from the hardware of the organisation. The remaining components constitute the software. The hard components are easily recognised as important, the soft ones, often barely recognised, are equally critical and important for the success of a firm. Of these, shared values, systems, style all relate to behevioural patterns involving a staff (people) and their skill. This behavioural pattern act as the binding fabric that successfully holds the company's cohesive activities and strategies together. Four major aspects of this behavioural fabric are of crucial importance.

These are:

- power
- leadership;
- culture; and
- risk



The Seven-S Model

2. Sensitivity Analysis:

For many managerial decision making models, time, cost and resource availability may take it impossible to verify the veracity or accuracy of the model and consequently its solution, derived or indicated. Simulation is an effective tool in such situations. Simulation is a way of manipulating a model so that it imitates reality. It has particular value when the model contains stochastic variables that are difficult or impossible to evaluate analytically. A stochastic variable is one whose value at any moment of time is a random selection from some probability distribution of possible values. The basis of simulation is random sampling of a variable's values from a distribution of that variable (sometimes called the Monte Carlo method). For random sampling from a probability distribution, it usually require three things.

(i) a set of random numbers;

(ii) a way of converting these number into another set of numbers, random variables, which have the same distribution as the variable involved;

(iii) a sampling — estimating procedure.

3. Scenario:

A scenario is an attempt to describe a sequence of events which demonstrate how a particular goal might be reached. This sequence of possible events may be conceived differently by different individuals leading to the creation of a number of possibilities. Thus, it is really conceptualising a range of different features which the organisation might have to deal with, to ensure that the less likely possibilities, threats and opportunities are not overlooked, and to encourage a high level of flair and creativity in strategic thinking. This becomes all the more necessary because the order of magnitude increases in times of environmental turbulence resulting in significantly increased uncertainty about the future.

4. Role of brands in the construction of barriers to entry:

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.

5. Licensing Agreement:

A Licensing agreement is a commercial contract whereby the licenser gives something of value to the licensee in exchange of certain performance and payments.

(i) The licencer may provide any of the following:

- Right to produce a potential product or use a potential production process.
- Manufacturing know-how.
- Technical advice and assistance.
- Right to use a trade mark, brands, etc.

(ii) The licenser receives a royalty,

(iii) The licensee may eventually become a competitor.

(iv) Licensing results in improved supply of essential materials, components, plants, etc.

6. Strategic Business Unit:

First conceived by McKinsey, the concept of Strategic Business Units (SBU) has become an essential building block for the strategic planning process. A SBU is normally defined as a division of the organisation where the managers have control over their resources and direction over the deployment of resources within specified boundaries. SBUs have, an external market, for goods/services, distinct from those of other SBUs. In essence SBUs must have or be:

A unique business mission;

An identifiable set of competitors and

A viable competitor

Moreover the SBU strategic manager can make a strategic decision or implement relatively independent of other SBUs.

Crucial operating decisions can be made with in the SBUs.

7. Corporate culture:

Corporate culture is the deeper level of basic assumptions and beliefs that are shared by the members of an organisation that operate unconsciously - and that define in a basic 'taken for granted' fashion an organisation's view of itself and its environment. It works well enough to be considered valid and is taught to new organisational members as a correct way of perceiving, thinking, and feeling in relation to problems of external adoption and internal integration. It thus characterizes the behavioural pattern and value system of the members of the organisation.

8. Objectives of Sales Promotion activities:

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.

9. 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.

10. Hyper competition:

Hyper competition is a term that is often used to capture the realities of the 21st century competitive landscape. According to Richard A.D. Aveni, hyper competition results from the dynamics of strategic manoeuvring among global and innovative combatants. It is a condition of rapidly escalating competition based on price-quality positioning, competition to create new know how and establish first mover advantage, competition to protect or to invade established product or geographic markets and competition based on deep pockets and the creation of even deeper pocketed alliances. The two primary factors responsible for hyper competition are the emergence of a global economy and rapid technological changes.

11. The Flanking Warfare:

According to Ries and Trout, flanking is the most innovative form of marketing warfare. Over the years, most of the biggest marketing success has been flanking moves. It is recommended to firms with limited resources. These firms cannot afford to fight the large firms holding number one or two positions on the same battle ground. The entry of Promise tooth paste with clove oil clout is an example of flanking warfare. Flanking can be achieved in many manners such as, flanking with low price, flanking with high price, flanking with small size, flanking with large size, flanking with distribution, flanking with product form. One should see a parallel between a marketer cutting a niche and flanking. Basically, they mean the same thing i.e. creating a distinctive position for itself and avoiding any head on collision with the leaders. The principles of flanking warfare are:

- A good flanking move must be made in an uncontested area
- Tactical surprise ought to be an important element of the plan.
- The pursuit is just as critical as the attack itself.

12. Environmental analysis and diagnosis process:

Environment of the Firm:

- Socioeconomic
- Technological
- Suppliers
- Competitors
- Government
- Geographical

Strategic analysis and diagnose gaps Analysis:

(i) Identify the current strategy. What are the assumptions or predictions about the environment on which current strategy is based?

(ii) Predict the future environment. Are the assumptions or predictions the same? Is there a gap?

(iii) Assess the significance of the gap between the current and future environments for the firm. Are changes in objective needed? Do changes in strategy appear useful to consider? Will they reduce the gap?

Environmental analysis is the process by which strategists monitor the environmental settings to determine opportunities and threats to the firm. Environmental diagnosis consists of decision made as a result of the environmental analysis. In effect, diagnosis is an opinion resulting from an analysis of the facts to determine the nature of a problem with a view to acting to take advantage of an opportunity of effectively manage a threat.

13. Strategic cost analysis in marketing:

Cost analysis with reference to marketing relate mostly to the traditional approaches and some modern approaches too. The discipline called strategic cost management has the important tenets of total cost management, activity based costing; value chain analysis etc.

According to Porter (Competitive Strategy), industry's profitability is a function of the collective strength of five competitive forces, bargaining power of suppliers, bargaining power of buyers, the threat of substitutes, the entry of new competitors, and the rivalry among the existing competitors. These five forces determine the industry's profitability because they influence the prices, cost and required investments of firms in an industry, Cost analysis oriented towards strategic advantages should therefore address all these five areas.

14. Volatile environment:

Volatile environment is that where substantial changes occur but are infrequent, irregular and, thus, less predictable (also known as uncertainties). Comprehensive and timely diagnosis is more necessary in volatile, dynamic environs than in stable environs. Firms which face dynamic uncertain and complex environs, thus develop more complete diagnosis and, thus, strategies. Those who do not do so are more likely to fail.

15. Unsought goods:

Many consumers do not know about some new products or innovations and therefore do not go for shopping at all. For example, consumers had to be informed about smoke alarms by way of advertising. Many new products — simply because they are new — fall into this category.

Other unsought goods are those which consumers know about but make little effort to purchase. These include life insurance, etc. Manufacturers of unsought goods need to, invest heavily in advertising of all kinds and personal selling.

16. Economic advantages of intermediaries:

Although intermediaries take a share of the profit from a product, it may be commercially profitable for a manufacturer to use them for the following reasons -

i. Intermediaries might bear the cost of-
   - stock holding
   - transportation
   - consolidation of small orders into large ones
   - providing display facilities.

ii. trying to sell directly to the customers

iii. Consolidation of small orders into larger ones

iv. The manufacturer may not have retailing know-how.

17. ETOP:

"ETOP" stands for "Environmental Threat and Opportunities". E T O P is considered to be a useful device for environmental analysis. Assessment of the environmental information and determining the relative significance of threats and opportunities require a systematic evaluation of the information developed in the course of environmental analysis. For this purpose E T O P is considered as a useful technique of diagnosis. Preparation of a profile of ETOP is a convenient means by which attention of top management may be drawn to the most critical factors and their potential impact on the strategy of the firm as whole and key aspects of its operations.

18. Benefits of Strategic management:

Strategic management is defined as a set of decisions and actions resulting in formulation and implementation of strategies designed to achieve the objectives of an organisation.

The following are some of the benefits that would accrue to any company if it practices sound strategic management.

(i) Financial benefits: Improved financial performance in terms of both profit and growth
(ii) Enhanced capability of problem Prevention:
(iii) Improved quality of strategic decisions through group interaction,
(iv) Greater Employee Motivation.
(v) Reduction of gaps and overlaps in activities
(vi) Minimum resistance to change,
(vii) Positive impact on the long-term prosperity of the firm
(viii) Leads to better analysis and diagnosis of the current and likely future environment, identifying opportunities and threats.

19. STOP LIGHT Strategy Model:

This is also known as "Business Planning Matrix" and was developed by General Electric & Mickinsey Co., in USA. The strategic planning approach in this model in based on analogy of traffic control lights at street crossing.

- Green (Go) Amber or
- yellow (Caution) &
- Red (Stop)

This model emphasises that strategic decisions are ought to be made on the basis of 2 key variables namely "Business strength" and "Industry Attractiveness". Business strength is rated considering such factor as size, growth rate, market share, profitability, technology, profit margins, positions, image & people.

Industry attractiveness is similarly rated in the light of several factors like size, market growth and pricing, industry profitability technical role etc. The ratings may be High Medium Low in respect of "industry attractiveness" and "strength of business".

If the product falls in the Green (Go) section, i.e. if the business position is strong and industry is at least medium in attractiveness, the strategic decision should be to expand, to invest and grow.

If the business strength is low but industry attractiveness his high, the product is in the Amber/ Yellow zone. It needs caution.

A product is Red (stop) zone indicates that the business strength is low and so is industry attractiveness. The appropriate strategy in this case should be retrenchment, divestment or liquidation. The SBUs in the Green section may be said to belong to the category of "Stars" or "Cash cows" in the BCG model. Those in the Red zone are like "DOGS" & those in the yellow or amber zone are like "Question Marks".

20. Pricing below cost:

Normally it is not expected that a producer will fix his selling price below the total cost. But under special circumstances, a firm may find it useful to set the price of a product, so as to recover at least the marginal cost (i.e. variable direct costs and the variable element of the semi-variable costs). In other words, the marginal (out-of-pocket) costs may be the lower limit and the selling price may be established within the range between the marginal cost and the total cost.

Such a pricing may be adopted in cases

- Where excess capacity exists and the overhead fixed costs cannot be absorbed regular sales outlets.
- Where it is possible to increase the level of operation by selling products as a reduced price, generally to a different class of customers, and
- Where the additional sales at reduced prices do not affect the long term pricing option i.e. lower prices do not become "sticky ".

Typically these conditions may be found to exist in the case of industries with heavy fixed costs relatively to the variable cost i.e. Airlines, Hotels, Movie-houses, etc. Thus hotels may find to profitable to offer reduced "off-season " rates provided the additional revenue derived exceeds the "out of pocket " costs. Similarly, the Airlines can afford to offer concessional fares for group travel.

Liquidation of excess inventory in anticipation of a general decline in prices may also necessitate selling the product at below cost.

Sometimes the retailers may sell certain standard items below cost, so as to attract customers for sale of other item made by them.

21. SICA, 1985:

Enactment of Sick Industrial Companies (Special Provision) Act, 1985 (SICA) has been aimed at dealing with Sick Industrial Companies with a coordinated approach.

A Sick Industrial Co., is defined as one, which has been in existence for at least 5 years and which has accumulated losses in a financial year equal to or more than its net worth, It is obligatory for the Board of Directors of a sick company to report it sickness to the Board for Industrial & Financial Reconstruction (BIFR) constituted under the Act.

BIFR is empowered to institute necessary enquiries to determine whether the Co. is sick or not. If the BIFR comes to the conclusion that the Co. is sick, it can either give reasonable time to the company concerned to make its net worth positive or it may devise suitable measures (like change of management, financial reconstruction, merge/ amalgamation etc.) for the purpose. SICA 1985 was amended in Dec, 1992, so as to bring all public enterprises also under its purview.

22. Strategic Planning & Marketing:

Marketing plays an important role in the company's strategic planning in several ways:

(i) It provides a guiding philosophy for strategy formulation. A company strategy should revolve around serving the needs of important consumer groups.

(ii) It helps in the identification of attractive market opportunities. It also helps in the assessment of the firm's potential for taking advantage of them. Thus, marketing provides inputs of the strategic planners.

(iii) It helps in the design of strategies for achieving the unit's objectives. A marketing manager has a significant role to play in —
- defining the business mission
- analysis of environmental, competitive and business situations,
- developing objectives, goals and strategies and
- defining product, market, distribution and quality plans to implement business strategies.

23. Crisis Turnarounds:

Crisis turnaround refers to the management measures which reverse the negative trends in the performance indicators of the company. In other words, turnaround management refers to the management measures which turn a sick company back to a healthy one or those measures which reverse the deteriorating trends of the performance indicators such as falling market share, sales (in, constant rupees), profitability and worsening debt-equity ratio.

The exact nature of crisis turnaround and the relative importance of different factors may vary from company to company. The important factors commonly employed in turnaround management are:

(i) management factor,
(ii) human resources factor,
(iii) production facilities,
(iv) financial management,
(v) product-mix modifications and
(vi) marketing strategy.

According to one leading organisation scientist, the elements of a successful turnaround strategy are:

(i) change in top management,
(ii) initial credibility-building actions,
(iii) neutralising external pressures,
(iv) initial control,
(v) identifying quick pay-off activities,
(vi) quick cost reductions,
(vii) revenue generation,
(viii) asset liquidation for generating cash,
(ix) mobilisation of the organisation and
(x) better internal co-ordination.

24. The Life Cycle Portfolio Matrix:

In this matrix, the market situation is described in four stages (from embryonic to ageing and the competitive situation is shown in five categories (from weak to dominant). The purpose of the matrix is to establish the appropriate-- ness of a particular strategy in relation to these two dimensions.

The position within the life cycle and of the company is determined in relation to eight external factors (or disciplines) of the evolutionary stage of the industry. These are:

(i) market growth rate
(ii) growth potential
(iii) breadth of product line
(iv) number of competitors
(v) spread of market share among the competitors
(vi) customer loyalty
(vi) entry barriers and
(viii) technology.

It is the balance of these factors which determines the life cycle.

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

Stages of Industry Maturity

Fig. The life cycle Portfolio Matrix

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

The competitiveness of the organisation can be established by looking at the characteristics of each category. Thus, a dominant position usually results from quasi-monopoly.

Strong organisations are those that can follow strategies of their own choice without too much concern for competitors.

25. Financial engineering:

Financial engineering underlies devising of instruments which are distinct and novel, acceptable in law, attractive for whom it is intended and, in the process, ensures that funds do not require servicing; free funds being raised to the maximum, in case servicing becomes essential, deferring such servicing as long as possible; assessment on the relative cost of sources of funds and raising such funds at the minimum cost; and cost of capital is the minimum in the given circumstances. In particular, financial engineering may involve bringing into play instruments which are in the nature of bond or debenture with warrants, entitling shares after a certain period, issued at discount or at par, being convertible or even non-convertible; giving sufficient leverage in the process of conversion either of a portion of such bonds or debentures or redeemable at different intervals designed in such a way as would not cause any financial constraints; stipulation of lock-in periods and even allowing for some complexity for the investor to comprehend the rate of return on the investment made by him.

With markets turning buoyant, the share price would shoot up and, thus, would mean much cost on the part of the company while at the some time the investor may reap the benefit of capital appreciation. Financial engineering would require assessment of not only the company's fund position but also the circumstances in which funds are sought to be raised and deployed and the externalities that influence the sourcing of such funds. Both the company and the investor can benefit from the new ways in which funding of operations is attempted.

26. Business Process Re-engineering (BPR):

BPR has been defined as fundamental thinking and radical design of business procedures to achieve dramatic improvement in critical contemporary measures of performance, such as cost, quality, service and speed.

(i) Fundamental:

We must ask ourselves the basic question about

how we operate?

Who we do?

What we do now?

Re-engineering first determines what a company must do to survive and flourish, then how to do it.

(ii) Radical: Radical design means essentially ignoring and discarding existing ways and means of achieving results.

(iii) Dramatic: Marginal improvements need only fine tuning. Re-engineering calls for banishing the old and replacing it with something new.

27. Contingency Plan:

A company should be well prepared to deal with contingencies, i.e., unforeseen or other critical developments that affect the company, like major changes in competitive environment, government policy or budget allocation, strikes, war, internal disturbances, natural calamities, etc. A contingency plan, thus, is a plan to cope with critical developments which mark major deviations from the strategic planning process. Some examples of such critical problems are given below.

(i) If an important player is taken over by another firm, what strategy should the company employ to deal with the new situation?

(ii) If the government lowers the import barrier, how will the company face the competitive forces unleashed by it?

(iii) If the market is affected by a short supply, should and will the company be able to increase supply to take advantage of the situation?

The advantage of contingency planning is that when external opportunities occur contingency plans could allow an organisation to capitalise on them quickly. Contingency planning gives user's three major benefits - it permits quick response to change, it prevents panic in crisis situations, and it makes managers more adaptable by encouraging them to appreciate just how variable the future can be.

28. McGregor's Theory Y:

According to McGregor, traditional organisations with its centralised decision-making, superior-subordinate pyramid, and external control of work is based upon certain assumption about human nature and human motivation.

McGregor's Theory Y assumes that people are not, by nature, lazy and unreliable. It postulates that man can be basically self-directed and creative at work if properly motivated. Therefore, it should be an essential task of management to help realise this potential in man. The properly motivated employee can achieve his own goals best by directing his own efforts towards accomplishing organisational goals. Managers who accept assumptions of human nature do not usually structure and control the work environment or closely supervise the employees. Instead, they attempt to help their employees nature by exposing them to progressively less external control, allowing them to assume more and more self control. Employees are able to achieve the satisfaction of social, esteem and self-actualisation needs within this kind of environment, often neglected on the job. To the extent that the job does not provide need satisfaction at every level, today's employee will usually look elsewhere for significant need satisfaction. This helps explain some of the current problems management is facing in such areas as turnover and absenteeism. McGregor argues that this does not have to be the case.

29. Commercial work of an ESO:

It can be divided into three distinctive categories:-

(i) Entrepreneurial work concerned with divesting from obsolete products/services; creating new products/services; identifying customers for them; finding ways to make the products attractive to the potential customers and establishing the new products/services to the market.

(ii) Operations work concerned with converting input resources into finished products/ services.

(iii) Marketing work concerned with selling and delivery of the products/services to the customers.

30. Turbulence:

Turbulence can be defined as a disruption in the relationship with the environment in which the organisation operates. It is perhaps easy to regard the environment as given with slow and easily measurable rates of change. However, in many cases the opposite is true 'Skyes' has identified five levels of turbulence.

(i) Repetitive - little changes, things happen as before.

(ii) Expanding - efficiency gains allow for an organisation to expand its operations in the environment.

(iii) Changing - turbulence is largely caused by changes in the competitive environment. so that an organisation's relation to the wider environment is mainly determined by market factors.

(iv) Discontinuous - there are major changes in the wider environment, such as a change in the law, or some other shock.

(v) Surprising - new technologies, for example, mean that a new environment is created and the organisation perhaps is able to determine this relationship.

Examples of causes of turbulence include the speed of technological innovation, the complexity of the environment and the interrelationship between the various elements in it. Specific causes include:

(i) The development of new technologies and materials:

(ii) World political changes;

(iii) Global exchange rate movements; and

(iv) Culture pressure.

31. Resource audit:

A Resource audit is a review of an organisation's resources. The information that is gathered might be obtained from the answers to different questions in the following areas:

- Materials and components
- Human resources
- Management
- Fixed assets
- Working capital
- Finance
- Intangibles
- Knowledge

An assessment of a random collection of resources on its own is insufficient for a proper Resource audit. Resources are of no value unless they are organised into system, and so a Resource audit should go on to consider how well and how badly resources have been utilised, and whether the organisations systems are effective and efficient.

A further aspect of the resource audit should be an assessment of how well resources have been controlled. Some resources might be used both efficiently and effectively, but control of the resources could still be poor for:

- Not enough of the resources were obtained,
- Key resources could have been used more efficiently and effectively, if they had been diverted to a different purpose.

32. Channels of distribution:

The term 'channels of distribution' refer to the marketing institutions through which goods or services are transferred from the original producers to the ultimate customers. Channels of distribution include the following:

(i) Retailers, who may be classified by -
  - Type of goods sold
  - Type of service
  - Size
  - Location

(ii) Wholesalers
(iii) Distributors and dealers
(iv) Franchisees
(v) Multiple stores
(vi) Direct selling

33. Concentration Strategy:

When a firm directs its resources to the profitable growth of a single product, in a single market and with a single technology, it is known as concentration strategy.

Concentration strategy offers lowest in risk and in additional resources required. It is based on known competencies of the organisation. But it results in a narrow range of investment options and in slow growth rate and profitability.

However, by adopting this strategy a firm can gain a significant competitive advantage over its more diversified competitors in production skills, marketing knowhow, customer sensitivity and reputation in market. This helps to increase the market share.

34. Conglomerate diversification:

When a large firm acquires a business because it represents an investment opportunity for them and a source of earning profits, the strategy is known as conglomerate diversification.

There is no concern to create product or market synergy with the existing business. Financial synergy is what is proposed to be achieved. It may seek to balance current business with cyclical sales and acquired, business having counter cyclical sales to balance.

35. Privatisation in India:

The first attempt in this direction of disinvestment was made by the Govt. of India in the fiscal year 1991 -92. During that year the Govt. of India sold equity shares of about 30 PSUs mainly to the public sector mutual funds in two rounds. It realised over 3000 crores by disinvesting nearly 8% of the equity of the PSUs chosen for disinvestment, though it had a permission to off-load upto20% of the equity capital. The primary objective was to reduce the budgetary deficit. Incidentally, it was hoped that there would be some efficiency gains too.

Enthused by the experience in 1991-92, the Cabinet Committee on Economic Affairs approved a proposal to disinvest shares upto 49%. The Government apparently wants to go gradually in this direction and has set a modest objective to mobilise Rs. 3500 Crores by way of disinvestment, primarily to contain the budgetary deficit.

The privatisation of public enterprises in India can take place either through:

(i) Ownership Transfer;

(ii) Management Transfer with option on equity;

(iii) Financial Transfer.

Ownership transfer has already taken place in the case of some PSUs. Example: Uttar Pradesh Auto Tractors Ltd. has been handed over to M/s. Sipani Automatives Ltd. The Allwyn Nissan Ltd. to Mahindra & Mahindra Ltd., Orissa Ferro Chome Ltd. to Tatas.

Management transfer has been taken place in the state loaned public enterprises in Rajasthan. Financial transfers are gaining a great momentum. The privatisation of Maruti Udyog Ltd. is a case in point wherein the government has become a minority shareholder. Some PSUs, viz. the Indo-Burma Petroleum Company; and the Indian Petro-Chemical Corporation Ltd. have approached the capital market to raise the working fund through commercial papers.

Privatisation of PSUs will impose upon these units, the requirement of fulfilling certain accounting, socio-economic and financial pre-conditions and financial adjustments.

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Since July 1991, 5 branches of disinvestments have been carried out, 2 in 1991-92 and 3 in 1992-93 involving a total of approximately 35 companies. But the government has never been able to realise the expected amount. The last of the 5 trenches proved disastrous. The amount realised was as mere as Rs. 45 crores compared to the required Rs. 1500 crores.

36. Captive company strategy:

A firm which retrenches via backward vertical integration is known as a captive company. A captive company strategy is followed when-

(i) a firm sells more than 75% of its products or services to a single customer; and

(ii) the customer performs many of the functions normally performed by the independent firm.

The strategy may be chosen because of-

(i) the inability or unwillingness to strengthen the marketing or other functions

(ii) the prescription that this strategy is the best means for achieving financial strength

37. Active and passive approach to R & D of new products:

Firms can be active or passive in their function in the following ways:

(i) Being innovative - the first to the market. This is an offensive, active approach in both research and development;

(ii) Being a fast second-these are firms which are active in development, but passive in research;

(iii) Being an imitator - a slow third. Some firms emphasise application engineering based on product modifications to fit particular customer segments. These firms tend to react to the needs, they identified in the environment. The difference between the active and passive approach is the idea that was planned from the start that it was not to reaction to unfavourable circumstances.

38. Maslow's theory of motivation:

Abraham Maslow sought to explain why people are driven by particular needs at particular times. Why does one person spend considerable time and energy on personal safety and another on pursuing the esteem of others? His answer is that human needs are arranged in a hierarchy, from the most pressing to the least pressing. In their order of importance, they are physiological needs, safety needs, social needs, esteem needs and self-actualisation needs. A person will try to satisfy the most important needs first. When a person succeeds in satisfying an important need, it will cease being a current motivator a»d the person will try to satisfy the next-roost important need. Maslow's theory helps the marketers understand how various products fit into plans, goals, and lives of potential consumers.

39. GE matrix is an attempt to correct some of the limitations of the BCG:

General Electric, in consultation with Mckinsey & Co., pioneered the development of the nine cell attractiveness - Capabilities matrix. In the context of taking resources allocation decisions among and between a wide portfolio of disparate SBUs, these matrices, although two dimensional, offer a more elaborate strategic planning tool - largely because they make use of multivariate dimensions and are able to cope with the businesses that occupy the twilight zones between High and Low positions. The Business Assessment Array (see figure below) substitutes for the univariate dimensions of the BCG; multivariate

Business Strength

Industry Attractiveness	STRONG	MEDIUM	WEEK
HIGH	9 Investment and Growth	8 Selective Growth	7 Selectivity
MIDIUM	6 Selective Growth	5 Selectivity (Improve and defend)	4 Harvest (Manage for cast)
LOW	3 Selectivity	2 Harvest	1 Harvest

Business Posture

Key	Overall Potential	Traffic Signal
	HIGH	GREEN
	MEDIUM	AMBER
	LOW	RED

Figure: The business assessment array and business postures

Dimensions which combine six factors in measuring "Industry Attractiveness" and nine in measuring "Business Strengths" See table hereinafter). In so doing it counters some of the early criticisms that were raised about the use of the GSM, namely that:

(i) A four-cell matrix overlooks the predominance and value of middle positions; (ii) and that Growth Rate and Market Share are inadequate descriptors of, respectively, Industry Attractiveness and Company competitive Position.

Industry Attractiveness (Business sector prospects)	**Business Strengths (Capabilities)**
Market size.	Domestic market share.
Market Growth.	World (export) market share.
Profitability.	Market share growth.
Cyclicality/Seasonality.	Relative market share.
Ability to recover from inflation.	Product quality (Substitution Threats).
World Scope.	Technological Skills (Product, process and R&D).
	Costs (scale & experience).
	Marketing capability.
	Relative profitability.

Table: Measures used in the Business Assessment Array by G.E.

40. Strategic Positioning:

Porter has carried the understanding of the generic strategies which 'characterise strategic options at the simplest and broadest level' to a 'greater level of specificity' by elaborating the concept of strategic positioning. The logic of strategic positioning is that competitive strategy which is about being different. It means deliberately choosing a different set of activities to deliver a unique mix of value. In other words, 'the essence of strategy is in the activities - choosing to perform activities differently or to perform different activities than rivals'.

Types of positioning — According to Porter, strategic options emerge from three distinct sources, which are not mutually exclusive and often overlap.

They are:

Variety based positioning,

Need based positioning and

Access based positioning

Variety based positioning: It is based on producing a subset of an industry's products or services. The focus, essentially, is on product or service varieties and not on customer segments.

Need based positioning: In it, the focus is on all or most of the needs of a particular group of customers. This strategy is appropriate when there are groups of customers with differing needs and when a tailored set of activities can serve these needs best. Obviously, this strategy comes closer to the strategy of targeting a particular segment of customers. Porter also points out that a variant of the need based positioning arises when the same customers have different needs on different occasions or different types of transactions.

Access based positioning: It is applicable when the needs of different sets of customers are similar but the best ways of accessibility are different due to factors like geography or customer scale.

Porter emphasised that choosing a unique position, however, is not enough to guarantee a sustainable advantage. There are two more essential conditions for ensuring sustainable advantage by preventing imitations. These are trade offs and fit. Trades off creates the need for choice and purposefully limit what a company offers. Fit locks out imitators by creating a chain that is as strong as its weakest link.

41. Market Espionage:

As a technique for environmental analysis and also as a part of market intelligence activity, it aims to secure information about competitors' plans and actions by secret means. It attempts to eliminate competitors, prevents new entrants, takes timely counter-action etc. Although it varies by industry, marketing espionage appears to be increasing.

42. Merchandising:

It is a method by which the manufacturer tries to ensure that a retailer sells as many of his products as quickly as possible. Merchandising is concerned with putting the manufacturers' goods in the right place at the right time.

(i) In the right place: The right place means not just the stores and shops with the highest turnover, but also the best locations within the store. In self-service stores; some shelves are in strategic positions which attract greater customer attention.

(ii) At the right time: In most stores, there are some days (e.g. the weekend) when demand is at a peak. Merchandising staff should try to ensure that if a strategic location is only available for a limited time, then this time should include a period of peak demand. Similarly, it is important to ensure that seasonal goods (Christmas or other festival items) receive prominent display at the right time of the year.

43. Milking policy:

Milking policy is employed by the management of some companies to exploit their business by squeezing the last paisa of profit from operations e.g. by failing to reserve a part of earnings for expansion and improvements, by paying flagrantly over liberal salaries, by not charging sufficient depreciation or by engaging other improper, although perhaps legal, accounting methods.

The term also applies to the director of public utility holding companies whose financial practices tended to enrich the stakeholders at the expense of the operating companies and their public through mal-management rather than mismanagement.

44. Different values of Brand Name:

The different values of brand name are:

1. Associational value of a name: the extent

   (i) with availability, (ii) with satisfaction of need; (iii) with pleasant things.

2. Memorisational value of a name: the extent to which it is

   (i) easy to spell; (ii)easy to remember; (iii) attracts attention.

3. Descriptional value of a name: the extent it (i), tells about the product; (ii) characterise the product.
4. Repurchase value of a name: for justification of expectation.
5. Motivational/promotional value of a name: degree of

   (i) reliability it creates; (ii) exclusiveness it connotes; (iii) desirability it develops,

45. Task of a Marketing Manager:

The different tasks of a marketing manager are:

— To create demand (where none exists)
— To develop latent demand and revitalise a sagging demand
— To attempt to smooth out (synchronise) uneven demand
— To sustain a buoyant demand (maintenance marketing)
— To reduce excess demand.

Occasionally, a product will need to be "killed off (e.g. for safety or health reason).

46. Markov Analysis:

This is a model of "Learned Behaviour". This shows the probability of moving from one state to any new state. This is developed to predict market share by considering brand loyalty and switching behaviour.

The main objectives are:

(i) To predict market share of a product on a future date.

(ii) To predict a steady feature share of a market,

(iii) To study the impact of sales promotion strategies on the future market share. As a management tool the Markov analysis has been mainly used as a marketing tool and for examining and predicting the behaviour of consumers in terms of their brand loyalty.

47. Marketing Audit:

Marketing Audit is an independent examination of all aspects of marketing efforts with a view to appraising what is being done and recommending effective changes to improve efficiency and effectiveness of marketing operations.

Accordingly, it should cover the following:

— The level of resources allocated to various marketing efforts as well as activities.

— Carrying out the programme

— Procedures and systems governing day-today marketing operations.

Moreover, Marketing Audit must review the marketing operations in the light of its ability to achieve the company's strategic objectives.

48. Penetration pricing:

Market penetration pricing is a policy of charging low prices, when the product is first lunched in order to gain sufficient penetration into the market. It is therefore, a policy of , sacrificing short term profits in the interest of long term profits.

The circumstances which favour a penetration policy are as follows:

(i) The firm wishes to discourage rivals from entering the market,

(ii) The firm wishes to shorten the initial period of the product's life cycle, in order to entire the growth and maturity stage as quickly as possible.

(ii) A firm might therefore, deliberately build excess production capacity and set its prices very low, as demand build up, the spare capacity will be used up gradually, and unit cost will fall; the firm might even reduce prices further as unit costs fall;

(iv) In this way early year losses will enable the firm to dominate the market and have the lowest costs.

49. Mixed economy:

A mixed economy is characterised by social ownership of the means of production along side the private ownership. State-owned means of production are so used as to promote social welfare; privately owned means of production may serve private interests but within the norms laid down by the state; such interests invariably cannot be allowed to run counter to the social interests. The use of the privately-owned means of production is effectively regulated by the State through the various instruments of economic policy, like fiscal, monetary and trade policies etc.

The State, however, is not expected to be identified with the interest of any class, but to permit the free interplay of interest of various groups and classes, like represented by unions, associations, lobbies etc.

The clear logic behind this policy of Mixed Economy was to transfer commanding heights of the economy into the hands of the State and at the same time allow private initiative full scope where scale economies are not important, permit big business to develop if it helped in acquiring technological capacity.

In modern-day Jargon, the role of the State was to prevent dependent development while the job of the private sector was to maximise production. Basically, the idea has been that through a judicious mixture of plan stimulus and market efficiency, both growth and equity would be promoted.

50. Black Money in Indian Economy:

The term "Black Money" implies unaccounted money i.e. the income that can not be taken account of in estimating national income is said to be 'Black' in nature. The amount of "Black Money" that is now circulating or concealed in India is as much as official recognised income- known as "White Money". Accordingly, "Black Money" has formed a parallel economy - operating side-by-side, with official economy. Black Money has its origin, out of Tax evasion, specially direct taxes, supposed to be paid by the richer classes. The existence of Black Money thus reduces the tax revenue of the government.

Secondly, tax evaded money can not be used for productive purpose. It is used for consumption or unproductive investment projects like acquisition of real estate, smuggling. hoarding, purchase of gold jewellery etc.

Thirdly, such 'Black Money' is used for purposes that adversely affect social welfare.

Fourthly, 'Black Money' is an underlying force behind inflation and inequality in the distribution of income and wealthy.

Fifthly, as 'Black Money' originates from industrial and business sectors, it leads to affluence and conspicuous consumption in the urban areas and mass poverty in the rural sector.

Finally, 'Black Money' weakens the credit control policies and of the Reserve Bank of India.

51. The Mission and Vision Statement:

The concept of mission is the logical starting point of the process of strategy. In practice, there are two senses in which mission affects an organisation's direction and performance.

- The strategy school- views mission primarily as a strategic tool, an intellectual discipline which defines the businesses' commercial rationale and target markets. It exists to Answer two fundamental Question: 'what is our business and what it would it be?'
- On the other hand, it is sometimes argued that a mission is the cultural glue that enables an organisation to function as a collective unity. In this case, it is a statement of values, rather than a description of ultimate commercial objectives.

Accordingly, when the mission of a business is carefully defined, it provides a formal statement to insiders and outsiders of what the company stands for-its image and characters.

Whereas, vision statement is a kind of aspirations of the organisation. Various visions are normally specific, measurable, attainable, result oriented and time bound. It may include statements about the target of the same company.

52. Elements of the marketing mix:

Marketing mix is the set of marketing tools that the firm uses to pursue its marketing objectives in its target market. There are literally dozens of marketing mix tools. McCarthy popularised a four-factor classification of these tools called the four P's: Product, Price, Place and Promotion. The most basic marketing-mix tool is product, which stands for the firm's tangible offer to the market, including the product quality, design, features, branding and packaging. A critical marketing-mix tool is price, namely the amount of money that the customers have to pay for the product. Place, another key marketing-mix tool, and stands for the various activities the company undertakes to make the product accessible and available to target customers. Promotion, the fourth marketing mix tool, stands for the various activities the company undertakes to communicate and promote its products to the target market.

53. The difference between the corporate strategy and business strategy:

Corporate strategy is the most general level of strategy in an organisation. In the words of Johnson and Scholes, corporate strategy is concerned with what, type of business, the company as a whole should be in and is therefore concerned with decisions of scope.

Business strategy however relates to how an organisation approaches a particular market, or the activity of a particular business unit.

Accordingly, while corporate strategy states some general level of various strategies, the company would pursue, business strategy contains detailed strategy-at the micro level of the same unit.

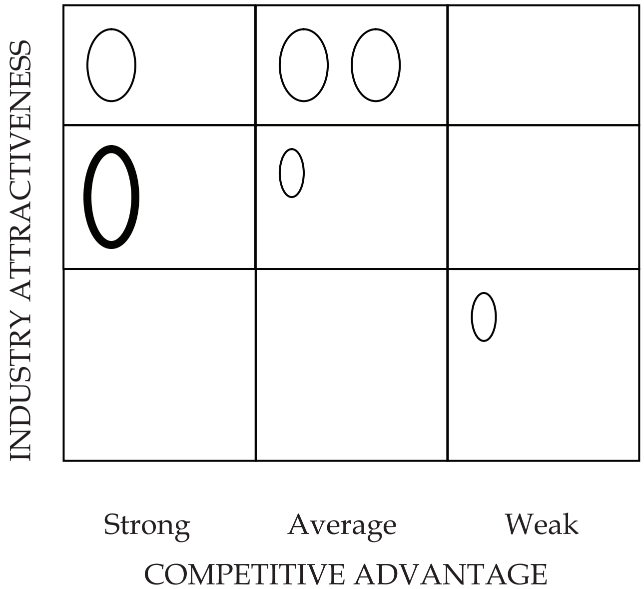
54. Importance of marketing research in decision making:

The importance of marketing research in decision making: They are inter alia:

- Enables the organisation to keep in touch with the market environment on continuous basis to know whether its policies, programmes and decisions are aimed at the right direction.
- Data base helps marketing managers to make sound decisions in the direction of countering competitor's strategy, evaluating consumer needs, forecasting business conditions and planning for the company's growth.
- Enables the identification of new market opportunities.
- Paves the way for effective decisions regarding new product introduction, selection of appropriate channels of distribution, pricing, advertising and promotional strategies etc.

55. The General Electric Industry attractiveness matrix:

The GE matrix, which is shown in following figure, uses two axes to represent industry attractiveness and competitive position. In this case, the-area of the circle is proportional to the size of the industry, and the pie-slices within the circles reflect the business market share. Industry attractiveness and competitive position are composite values used to plot each business position. Industry attractiveness is a functional of a number of factors, e. g. Market growth, market quality, supplier pressure, entry barriers etc.



The procedure involves assigning to each of the factors a weight corresponding to its perceived importance, followed by an assessment of how each business compares against each factor using a 1-5 rating scale, and then computing a weighted composite rating.

The same approach is used to measure competitive position, where aspects relevant to competitive position, e.g. competition, relative market share, R&D record and strength etc. is considered.

56. Brand Image or Equity:

Brands vary in the amount of power and value they have in the market place. At one extreme are brands that are not known by most buyers in the marketplace. Then there are brands for which buyers have a fairly high degree of brand awareness. Beyond this are brands that have a degree of brand acceptability in that most customers would not resist buying them. Then there are brands which enjoy a high degree of brand preferences. They would be selected over the others. Finally there are brands that command a high degree of brand loyalty. A powerful brand is said to have high brand image or equality. Brand equity is higher, the higher the brand loyalty, name awareness, perceived quality, strong brand association, and other assets such as patents, trademark and channel relationships. The point is that a brand is an asset insofar as it can be sold or bought for a price. Measuring the actual equity of a brand name is somewhat arbitrary, including basing it on the price premium, the stock value, the brand replacement value and so on. High brand equity provides a number of competitive advantages to a company. As an asset, a brand name needs to be carefully managed so that its brand equity doesn't depreciate.

57. Types of Buying Behaviour:

Consumer decision making varies with type of buying decision. Complex and expensive purchases are likely to involve more buyer deliberation and more participants. 4 types of consumer buying behaviour based on the degree of buyer involvement and the degree of difference among brands can be distinguished. They are:

- Complex buying behaviour - Consumer go through complex buying behavior when they are highly involved in a purchase and highly aware of significant differences among brands. Consumers are highly involved when the product is expensive, bought infrequently, risky and highly self-expressive. Typically the consumer does not know much about the product category and has much to learn.
- Dissonance - Reducing buying behavior: Sometimes the consumer is highly involved in purchase but sees little difference in the brands. The high involvement is again based on the fact that the purchase is expensive, infrequent, and risky. In this case, the buyer will shop around to learn what is available but will buy fairly quickly because brand differences are not pronounced.
- Habitual buying behavior - Many products are bought under conditions of low consumer involvement and the absence of significance brand differences. They go to the store and reach for the brand. If they keep reaching for the same brand, it is out of habit, not strong brand loyalty. Consumer behavior does not pass through the normal belief/ attitude / behavior sequence.
- Variety - Seeking buying behavior: Some buying situations are characterised by low consumer involvement but significant brand differences. Here consumers are often observed to do a lot of brand switching.

58. Brand Positioning:

It is an activity which seeks to determine and achieve a position in the perception of the buyers relative to that of the competitors. In order to effectively place a brand has to communicate carefully- choose the message which has best chance to get into prospect's mind - which prospect can understand, which behold his attention, gives him a reason to read. It should also provoke a thought process in his mind and should create a distinct image, a position for the brand in his mind, the message can create an unfavorable position or a favorable position. A favorable position is one which changes his attitude towards the brand leading him to accept it.

59. Emerging challenges in Indian Market:

Due to economic reforms, foreign participation in Indian industries covering manufacturing, infrastuctural, consumer and service sectors, flow of foreign capital and expertise etc. the Indian environment has suddenly become open before the international advancement. As a result lot of market adjustments are taking place with the consequent impact on our life and society. The recent liberalisation policies have eased the flow of new products, processes, technologies from develops countries.

The new technologies can shock a business organisation-because they require a quantum jump in an organisation's precision and integration. Traditional managerial attitudes cannot change without profound knowledge and reform in the modern mindset.

It may well require a new generation of executives. Moreover, as organisations struggle to gain advantage over competitors, most neglect their most potent weapon: time. Quality and price are still important because today's discriminating customer demands world-class quality at a competitive price. When all the leading firms in an industry achieve high levels of quality, a focus on quality alone will not attract new customers. A faster response to time must complement quality. Speed and quality are not a trade-off. Speed is a component of quality-one if the things we must deliver to satisfy customers.

60. Strategic leader:

A strategic leader influences the value, style and culture of the organisation. He requires a visionary element to create future strategy and its management in order to ensure that the organisation is following the appropriate strategies.

A strategic leader should have the following skills and attributes:

- ability to lead structural changes
- managerial talent
- knowledge of business and their environment
- will to create corporate growth and profit
- ability to perform and get results
- ability to conceptualise and analyse strategic problems
- ability to communicate and sell the vision and ideas
- ability to exercise power and to influence and create change
- skills to lead effectively and participate in groups
- ability and willingness to learn from experience and to adopt
- belief and faith more in success than in failure
- physical and mental stamina

It is argued that vision is crucial and that the most effective leaders are persons with ideas.

61. Corporate Restructuring:

Corporate restructuring refers to the process by means of which a firm makes an assessment and evaluation of itself at a point of time and alters what it owes and owns and refocuses itself to specific tasks of performance for improvements. Such restructuring radically alters a firm's capital structure, asset mix and organisation so as to enhance the firm's value. Its objective is to look upon every activity as a 'green field' project. It questions the firm's basic premise in order to engineer radical change rather than aim for just incremental gains.

Increased Competition, threat from imports, liberalisation of economy and globalisation of business concept have forced many business houses in the corporate would to restructure themselves.

A good scheme of corporate restructuring consists of a balanced mixture of all functional elements finance, technology marketing and personnel.

The strategies for Corporate restructuring can be thought of from two aspects: Hardware restructuring and Software restructuring. Hardware restructuring involves redefining and/or modifying organisation structure so as to make it more efficient through identification of core competency/ portfolio planning/ right sizing / benchmarking, etc. Software restructuring involves cultural and process changes needed for corporate growth.

62. Product line decisions:

A product mix consists of various products lines. A product line is a group of products that are closely related because they perform a similar function, and are sold to same customer, and are marketed through the same channels, or make up a particular price range.

A product line is usually managed by a manger who is responsible for the sales and profits of each item in the line. He/she must review how the product line is positioned against competitors' product lines. A product line of a company should have an optimal length. It is too short if the manager can increase profit by adding items; it is too big if the manager can increase profits by dropping items. The companies seeking high market share and market growth will carry longer product lines.

A company can enlarge the length of its product in two ways: by line stretching and line filling. Every company's product line covers a certain part of the total possible range. Line stretching occurs when a company lengths its product line beyond its current range. Similarly, line filling occurs when a company lengthens if product line by adding more items within its present range.

Further, unusual/abnormal length of a product line has the drawbacks of higher costs in the areas of design and engineering, inventory and processing, and so on.

63. Premium Pricing Strategy:

Premium Pricing strategy involves selling a price above competitive levels. In the case of a new product where there are no direct competitors, premium pricing involves setting a price at a level that high relative to competing product forms. The approach will be successful if a firm is able to differentiate its products in terms of higher quality, superior features, or special services at least, within one or more target segments.

It is important to note that a firm should continue to monitor the market place to determine whether a differential advantage is being maintained and whether the importance of price (relative to quality/ special services) remains unchanged in the target segments.

While pursuing this strategy, the essential conditions are

(i) demand is inelastic,
(ii) firm has exclusive technology,
(iii) very strong barriers to entry,
(iv) full cost method can be used for minimum price, and
(v) superb quality of the concerned product.

64. Strategic Management:

Strategic management could be defined in many ways. From practical point of view it should clearly spell out what is the mission statement of the business, what is to be achieved and how it plans to achieve that. It must be realistic, focused and state underlying assumptions, if any.

Strategic Management focuses on the major long-term issues that affect an organisaion. It is concerned with the implementation of policies that are considered to be appropriate. Strategic Management involves planning, implementation and control of an organisation's strategy. It will, therefore, be concerned with making decisions about the long-term goals and objectives of an organisation, an analysis of the environment within which it operates and an assessment of the current status.

Strategic Management decisions will be wide ranging and can result to a dramatic change to the organisation.

65. Product Differentiation:

It is a generic strategy to outperform other firms in an industry.

The marketer tries to choose specific dimensions of the product or certain aspects of the consumers' important buying criterion etc. It is a strategy to establish a kind of difference from other offerings in the minds of the consumers. It could be in the form of branding / positioning in select market segment.

66. Problems of Rural Marketing in India:

The main problems arise due to:

(i) vastness in size (nearly 6 lakh no. of villages) How to reach there?

(ii) too many languages and low literacy rate.

(iii) It is difficult to choose an optimum communication mode;

(iv) large variation in purchasing power makes price selection difficult.

67. Brand Equity:

A Brand is defined as any name, sign, symbol, package or a combination of them used to identify a product or a device. In today's world of consumer goods, where marketing is the 'mantra', brand is considered as an asset-called Brand Equity. Brand equity helps in enhancing the good-will for the company and adds prestige to the product.

Brand equity is the asset a marketer creates for a particular brand-over a period of time. This is to ensure continuity of satisfaction for the customer and profit for the supplier. The asset consists of brand name, logo, consumer attitudes, confidence of the distribution channels and other relationships. Thus Brand equity is a very important function in the augmented product level concept. Further, Brand equity gives a legal protection, similar to trademark to the manufacturer.

Examples: Coca-Cola, Microsoft, IBM, Nokia Titan, Lux are examples of the top brands in the market.

68. Premium and Penetration Pricing:

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.

(i) When the product seems to have a high esteem value;

(ii) When the potential customers are willing to pay high prices;

(iii) When there is demand-elasticity for the demand of the product;

(iv) When the BRAND of the product is identifiable and distinguishable.

(v) 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.

(vi) 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:

(i) The main target is to capture major portion of the market share.

(ii) Market is highly price sensitive and the demand is highly elastic.

(iii) 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)

(iv) 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.

69. Merger / Acquisition Strategy:

'Merger' is the joining of two separate companies to form a single company. It may be brought about in two ways:

(i) Acquisition of one business unit by another, or

(ii) Creation of a new company by complete consolidation of two or more units.

A Combination of two or more business units in which one acquires the assets and liabilities of the other in exchange for cash or shares and /or debenture, is generally known as 'Merger' through acquisition or absorption. When all the combining units are dissolved and a new company is formed to take over the assets and liabilities of those units against issue of new shares or debentures, it is described as 'amalgamation' or consolidation. Merger by way of acquisition as well as merger by way of amalgamation is widely recognised as desirable strategies of external growth.

Instances of 'Mergers', 'Acquisitions' and 'Amalgamation' are many in India. ACC was formed by an amalgamation of 11 Cement companies.

An example of merger through acquisition is the purchase of the Jamshedpur Bearings Unit of Meta Box Ltd. by TISCO.

Reasons for merger and acquisitions may be

Buyer's motives:

- Increasing the firm's growth rate;.
- Making a good investment;
- Improving the stability of the firm's earnings and sale;
- Balancing product line;
- Diversifying the product line;
- Reducing competition by purchasing a competitor;
- Increasing efficiency and profitability; and
- Tax reasons.

Sellers' motives:

- Increasing the value of owner's stock and investment;
- Acquiring the resources to stabilize operations and make them more efficient;
- Dealing with top management problems;
- Diversifying its owner's family holding beyond a firm and tax reasons.

70. Profit Impact on Marketing Strategies (PIMS):

PIMS analysis attempts to establish the profitability (i.e. return on capital) of various marketing strategies. PIMS researchers from analysing their database of at least 3000 firms, believe that 70% of the relative profit performance of an organisation, when compared to similar businesses, derives from the areas of competitive strength, market attractiveness and productivity.

A research study in the USA of 1973 found that there was a positive correlation between market share and return on investment, so that companies with higher market share earned high returns. Three possible reasons were put forward for this correlation.

Economies of scale enables a market leader to produce at lower unit costs than competitors, and so make bigger profits.

Bargaining power: A strong position in the market gives a firm greater strength in its dealings with both buyers and suppliers.

Quality of management: Market leaders often seem to be run by managers of a high caliber.

However, low market share does not inevitably mean poor returns. If this were so, small firms would always make low returns, and this is simply not true. A company can prosper with a low market share in the following ways :

Market segmentation. New market segments might be a small proportion of the total market, but profitable.

Emphasising product quality, and charging higher prices.

Wanting to stay small, and consciously avoiding growth.

Cost Control.

Businesses can also earn good profits with a low market share in a low growth market in the following circumstances.

The market is stable.

Product innovations are rare.

Most products are standardised.

Companies produce supplies or components for industrial customers, and have built up a close working relationship with these customers.

Repeat buying is frequent.

The value added to sales ratio of the product is high.

Finally, some firms are prepared to sacrifice profitability for market share over a period of time. Some Japanese firms were willing to charge low prices to buy market share and totally weaken the competitors, whose products were not as deep.

There are practical difficulties with PIMS research, which might raise questions about its usefulness. These are as follows :

Identifying each market segments properly. An upmarket producer is in a different market segment to a down-market cheap goods producer, and it would be wrong to classify them as competitors in the same market.

Measuring the actual size of the market, and so the company's own market share in proportional terms.

Establishing what returns are available from a particular market share.

It has also been argued that PIMS analysis is more relevant to industrial goods markets than to customer goods markets, where the correlation between high market share and high returns is not so strong.

71. Ethics in Accounting:

Public confidence in business practices had been badly shaken in recent times. Business practices are reflected largely in the published accounts, and relying on those, many investors, creditors and sundry other people have suffered enormous monetary losses, which have adversely affected their existence in many cases. The issue that is being debated seriously today is whether the Accountant is valuing and doing his job in the proper manner. It is here the question of ethics comes in. It may be noted here that by the term 'accountant' one includes the 'auditors' as well.

When one talks ethics in accounting what one is really concerned with are the ethical standards of the accountant himself. Accounts are the handiwork of human beings. By themselves accounts can not be ethical or non-ethical. It is the human mind whose attitude is reflected in the facts recorded in the books of accounts, in terms of money. What therefore one is concerned with is the mental makeup of the persons who prepare such accounting records and of the persons who are required to report whether the accounts examined by them reflect a true and fair view of the actual state of affairs as also of the profit or loss for the period.

The businessman by and large, is motivated by the urge to make profits and still more profits in his organisation. There are very many cases where one tries to make gains surreptitiously by restoring to downright falsehood in the accounting statements prepared by them. These take the form of understating income, overstating expenses, failing to bring to the notice of the users of the accounting statements the reality of the position of debts recoverable, and so on and so forth.

We hear everyday of the existence of a large amount of unaccounted money circulating in a parallel economy in India, and the government itself admits that not only does such black money operate in the country but that it is proliferating in a big way.

The question arises as to what the accountants have been doing in this environment? Is it very wrong for the general public to infer from the state of affairs that they (the auditors) are conniving at the wring doing of the businessmen and shielding them?

One has to search one's heart to ponder on the issue as to what remedial measures can be taken when corruption at all levels has today become a way of life in India! The answer to this problem may be provided by the accountants. If they do their jobs ethically, the root that has entered in the pores of the society, particularly in the field of the business, may perhaps be stemmed to a large extent. But the accountants form a part of that corrupt society itself. Can they remain unaffected by the disease which eats into the vitals of that very society, in which they are born and brought up ? This is the question that we have to ask ourselves today and here comes the recognition of the ethical values of the accountant.

In practicing is an ethical manner in the field of accountancy, the first requirement is a through knowledge of the subject itself, of its principles and their proper applications. A person who wants to serve as an accountant, be it as an employee or as a practitioner, will fails in the ethical tests at the very outset if he embarks on his work with only incomplete knowledge of the subject.

The second requirement for maintaining the ethical standard the accountant must continually update himself by learning about the new techniques in the field. A continued education programme is the only means to achieve this end. Only when an accountants keeps himself abroad of the continual changes taken place in his chosen field, he can rightfully call himself an accountant and accept the offer the rendering services in that capacity to those who may be desirous of his assistance in that regard. With a half baked knowledge a person, even though he may have obtained recognition as an accountant fails in observing proper ethical standards.

When a person is an accountant in practice, he is legally required to become a practising member of some professional regulatory bodies, which has formulated a prescribed code of conducts for its members and deviation from which is liable to be visited by disciplinary action. But such a regulatory code of conduct has its own limitations, because it is never possible to completely codify in writing as to how one should conduct oneself in one's profession. The environments are ever changing and what is required today may be unnecessary tomorrow and new requirements may take its place. But coded rules of conduct keep pace with time and ethics really cover the ground about which there are no written rules. Following what is prescribed does not require so much of the application of mind. There one is concerned with law and not ethics. Ethics deal with these matters for which there is no legal prescription. It is the sense of his or her individual morality which guides an accountant issue where written rules do not exist. It is generally however found that most of the accountants in the profession are busy to see merely that there is no violation of the written code. Beyond that they do not eager to venture at all. This is not a desirable state of affairs. There is no pursuit of excellence and only an ethical outlook going beyond the bounds of statutory prescriptions practically exercised will help the accountant to rise in the esteem of the public generally and the users of published accounting records in particular.

72. Corporate Internal appraisal factors:

The major internal appraisal factors are-

- Trend of results: Trend in profits, sales, capital employed, etc. , to gauge performance.
- Sources of Profit: Market share and profits-area-wise.
- Risk: Single product, single market, raw material scarcity, fast-changing technology,
- Manufacture: Cost/plant/production efficiency etc.
- Organisational behavior: Formal/informal behavior patterns, communication,
- Resources: Financial /physical resources, liquidity, cash flow, human capability, resources allocation, real profit/contribution etc.,
- Corporate capability: Synergy structure, organisation leadership, technology absorption/ adoption/ creation.

73. Porter's Competitive Analysis Model:

As per Michael Porter, Competition is at the core of the success or failure of firms. Competition determines the appropriateness of a firm's activities that can contribute to its performance, such as innovations, a cohesive culture or good implementation. Competitive Strategy is the search for a favourable position in an industry, the fundamental arena in which competition occurs. Competitive Strategy aims to establish a profitable and sustainable position against the forces that determine industry competition.

The five competitive forces as per Porter are:

- Rivalry among existing competitors

- Bargaining power of buyers
- Bargaining power of suppliers
- Threat of substitute products or services
- Threat of new entrants.

The strength of each of the competitive forces is a function of industry structure.

As per Porter, there are four generic strategies for maintaining its Competitive Advantage. These Strategies are:

- Cost Leadership
- Differentiation
- Cost Focus and
- Differentiation Focus.

74. Cost Leadership:

This is the first generic strategy, in it, a firm sets out to become the low-cost producer in its industry. If a firm can achieve and sustain overall cost leadership, then it will be an above-average performer in its industry. If a firm is the Cost Leader in its industry, it will derive an immense competitive Advantage. The sources of cost advantage would vary depending on the structure of the Industry.

Differentiation: The second generic strategy is differentiation. In this strategy, a firm seeks to be unique in its industry along some dimensions that are widely valued by buyers, it selects one or more attributes that many buyers in an industry perceive as important, and uniquely positions itself to meet those needs. It is rewarded for its uniqueness with a premium price.

Focus: The third generic strategy is focus. This strategy is quite different from the others because it rests on the choice of a narrow competitive scope within an industry. The focuser selects a segment or group of segments in the industry and tailors its strategy to serving them to the exclusion of others. By optimising its strategy for the target segments, the focuser seeks to achieve a competitive advantage in its target segments even though it does not possess a competitive advantage overall.

The focus strategy has two variants namely-Cost Focus and Differentiation Focus. In Cost Focus, a firm seeks a cost advantage in its target segment, while in Differentiation Focus, a firm seeks differentiation in its target segment. Both variants of the Focus Strategy rest on differences between a focuser's target segments and other segments in the industry. The target segments must either have buyers with unusual needs or else the production and delivery system that best serves the target segment must differ from that of other industry segments. Cost Focus exploits differences in cost behaviour in some segments, while Differential Focus exploits the special needs of buyers in certain segments.

75. Nine-cell G.E. matrix:

This is also known as 'Directional Policy Matrix' (QPM) This matrix is a nine-cell strategy model developed by General Electric Company (GE) of USA with the aid of the Boston Consulting Group (BCG) and Mckinsey & Co., The basic purpose was to provide the GE Strategic Business Units (SBUs) with a more informed review of the SBU strategies.

The two dimensions that are considered in this matrix are:

Business Strength and Industry Attractiveness.

Under both these dimensions are considered three state viz., High, Medium and Low.

Business Strength is a function of several factors like market size, brand Image, profitability, technology, capacity usage, managerial capability, distribution skills, patent protection, product efficiency, etc.

Industry Attractiveness is a function of several factors like availability of inputs, pricing, annual growth rate of markets, competitive structure, industry profitability, technical characteristics, ease of entry, etc.

A firm with a number of products can identify each of them in one of the 9 cells Based on the particular cell, where a product is located, different strategies can immediately be suggested.

The Table below suggests some strategies to be adopted, as per the GE 9 Cell Matrix:

Business Strength	Industry Attractiveness		
	High	Medium	Low
High	Premium: Invest for growth invest ➢ provide max. investment ➢ diversify	Selective: Invest for growth Invest heavily in selected Segments ➢ share ceiling	Protector/Refocus: Selectively for earnings. ➢ defend strengths
Medium	Challenge: Invest for growth build selectively on strengths only, ➢ avoid vulnerability	Prime: Selectively invest ➢ segment market ➢ make contingency plans	Restructure: harvest or divest-provide essential commitments ➢ shift to more attractive segment.
Low	Opportunistic: Selectively invest For earnings ➢ ride market product	Opportunistic: Preserve for harvest ➢ boost cash flow out	Harvest or Divest ➢ exit from market or prune

Careful thought must be given as to which cell a product should be placed in the GE Matrix. A much more difficult problem would be to analyse precisely what the strategy should be once a product is located.

76. Three commonly used sales promotion schemes:

Three commonly used sales promotion schemes are:

(i) Free Samples:

Free Samples are distributed to the selected customers particularly for cosmetic items etc. , when introduced as a new one in the market. To economize costs, sample packets of small sizes are made out by many firms. This system is an effective device as consumers get an opportunity to examine the product and to see its merits, e.g., Shampoo sachets.

(ii) Money refund offer:

This is usually mentioned in the Advertisement itself to the effect that the manufacturer will return the price paid within a stipulated period if the consumer is not satisfied with the product. 'Asian sky shop' promote its products this way.

(iii) Demonstrations:

These are arranged with the help of technical experts either at a centrally located place or at fairs and exhibitions during festive seasons, to promote and popularize new and existing products. The manufacturers, both large and small, get opportunities for explaining the special features and utilities and hence for exceeding the sales horizon.

77. Ansoff's Matrix:

Ansoff has identified four main strategies by the name' product- market components' that are open to a company. A diagram given below explains this.

Ansoff suggests that 'diversification' should be a 'last resort strategy' and a company should seek the product-market components, which make use of their distinctive qualities and which give an advantage over its competitors.

Market	Product-Market components	
	Product	
	Existing	New
Existing	1. Market penetration	2. Product development
New	3. Market Development	4. Diversification

1. Market Penetration- for increasing the efficiency and effectiveness of existing operations.
2. Product Development- for developing new products for existing markets.
3. Market development- for finding new markets for existing products.
4. Diversification- for developing new products for new markets.

78. Market signals:

Market signals are information that comes to light about competitor's actions in the market. They may be honest or they may be bluffs; nevertheless, they are significant for making decisions about marketing strategy.

Market signals might come from any of the following sources:

- A competitor making an announcement of what he intends to do but before he has done it. Prior announcements are publicity measures intended to achieve the following:
  - (i) a warn off to competitors from trying to do the same.
  - (ii) Test the competitor's reactions.
  - (iii) Win support from the investing public.
  - (iv) Create a threat of retaliatory action against something another competitor has already done.
- A competitor making an announcement of what he has done after the event.
- Competitors adopting a particular course of action when they would have been expected to do something else.
- An aggressive marketing action by a competitor.

79. Marketing Data Base:

Marketing database provides relevant information to any company about the total marketing environment in which the company is operating. This includes customers, competitors and the marketing mix strategies and enables managers to take appropriate decisions.

80. Target Market:

Target market is the market segment to which a particular product is marketed; it's often defined by age, gender, geography, and /or socio-economic grouping. In order to focus of the target market, the company needs to consider its own objectives & resources in relation to that segment even if the segment fits the company's objectives, the company - must consider whether it possesses the requisite skills & resources to succeed in that segment.

The company also has to appraise the impact on long-run profitability of five groups: industry, competitors, potential entrants, substitutes, buyers & suppliers, before finalising its target market.

Threat of intense segment rivalry: a segment is unattractive if it already contains number of strong or aggressive competitors.

Threat of new entrants: a segment is unattractive if it is likely to attract new competitors who will bring in new capacity, substantial resources & drive for market share growth.

Threat of substitute products: a segment is unattractive if there exists actual or potential substitutes for the product. This shall put a limit on the potential margin & profits.

Threat of growing bargaining power of buyers: a segment is unattractive if the buyers possess strong or increasing bargaining power. Buyers' bargaining power grows when they become more concentrated or organised, when the product represents a significant fraction of the buyers' cost, when the product is undifferentiated, when the buyers are price sensitive.

Threat of growing bargain power of suppliers: a segment is unattractive if the company's supplier-raw materials, equipments etc. are able to raise prices or reduce the quality or quantity of ordered goods or services.

Based on the above analysis, the company can decide for undifferentiated Marketing, differentiated marketing or concentrated marketing.

81. Market Positioning:

Positioning means the process by which marketers create an image or identity in the minds of their target market for any product, brand, or organisation. It is the 'relative position that a product occupies in a given market as perceived by the target market. The concept was propounded in 1969 by Al Ries and Jack Trout.

Generally, the product positioning process involves:

- Defining the market in which the product or brand will compete (who the relevant buyers are)
- Identifying the attributes (also called dimensions) that define the product 'space'
- Collecting information from a sample, of customers about their perceptions of each product on the relevant attributes
- Determine each product's share of mind
- Determine each product's current location in the product space
- Determine the target market's preferred combination of attributes (referred to as an ideal vector)

Positioning concepts: More generally, there are three types of positioning concepts

(i) Functional positions
- Solve problems
- Provide benefits to customers

(ii) Symbolic positions
- Self-image enhancement
- Ego identification
- Belongingness and social meaningfulness
- Affective fulfillment

(iii) Experiential positions
- Provide sensory stimulation
- Provide cognitive stimulation

Measuring the positioning

Positioning is facilitated by a graphical technique called perceptual mapping, various survey techniques, and statistical techniques like multi dimensional scaling.

82. Branding Strategies:

Branding and a firm's reputation are closely linked. Four basic types of branding strategies are-

❖ Individual Name: It is a stand alone product. It is unique.

- Family Branding: The power of the family name to introduce a new product is a very popular branding strategy. The brand Image of the family name can be very effective across a firm's range of products. There could be a 'blanket family brand'. Alternatively there could be separate 'family names' or 'trade names' with each individual product. E.g., TATA (NANO-small car project), Levis (for Shirts), Kellogg (Cornflakes), etc.
- Brand Extension: High consumer's loyalty to existing brand prompts companies to extend its Brand to its new products-say with new flavours, new sizes etc., e.g., Flury's Confectionery's brand extended to its new product like say its ice-cream.
- Multi-Branding: Using different names for similar goods, serving similar consumer tastes is a technique known as 'Multi-Branding'. Consumer will be making random purchases across different brands. E.g., HUL's different brands of soap products.

83. Classification of goods based on Consumer habit:

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.

84. Role of Board of Directors in Strategy making and its execution:

Although senior managers have lead responsibility for crafting and executing a company's strategy, it is the duty of the Board of Directors to exercise strong oversight and ensure that the important tasks of strategic management are done in a manner that befits all the stake-holders of the organisation.

The Board of Directors have to watch carefully the management's strategy-making and strategy-executing actions and make sure that the executive actions are not only proper and responsible but also are aligned with the interests of the stake-holders.

Every Company should have a strong, independent Board of Directors that has the courage to curb management actions they believe are inappropriate or unduly risky. Thus the Board of Directors has a very important oversight role in the strategy-making and strategy-executing process.

85. Market Communication:

Market Communication basically conveys information about the product and the company. It is an important promotional aspect in which the message of the organisation is communicated to the consuming public. To be effective, Market Communication should be integrated with the business strategy and the different marketing mix. The following are the important purposes of Mkt Communication:

- to create product awareness,
- to create 'buyer interest' and ' buying desire' in the consumers,
- to motivate a buyer to buy the product.

86. Benchmarking:

Traditionally Control involves the comparison of actual results with an internal standard or target. The practice of setting targets using external information is known as Benchmarking. Benchmarking is a tool that allows a company to determine whether the manner in which it performs particular functions and activities represent industry's 'best practices' when both cost and effectiveness are taken into account.

Benchmarking has proved to be a potent tool for learning which companies are best at performing particular activities and then using their techniques or 'best practices' to improve the cost and effectiveness of a company's own internal activities.

Benchmarking focuses on improvement in key areas and sets targets which are challenging but evidently achievable. Benchmarking implies that there is one best way of doing business. The concept of sharing of information can be a spur to innovation.

87. Reasons for failure of new products:

Some of the reasons for failure of new products are -

- The idea is good but the market size is over-estimated.
- The product is not well designed.
- The product is incorrectly positioned in the market.
- Improper/inadequate advertisement.
- Very high price for most consumers.
- Insufficient distribution outlets.
- R&D costs are higher than anticipated.
- Competing firms fight back harder than expected.

- Unfavorable market research findings, yet the idea of a new product is pushed through by the CEO.
- Extra differentiation features than necessary.

88. Organisational Buying Behavior:

The Organisational Buying Behaviour process has some similarities with consumer-buying behaviour. But Organisational Baying Behaviour is very much rational and a decision-making subject.

The Organisational Buying Behaviour process can be identified as:

- Need recognition
- Quality and quantity needed
- Specification development to guide procurement
- Search for and qualification potential sources
- Acquisition/evaluation/selection of proposals
- Selection of Suppliers
- Selection of order routine
- Performance feedback and evaluation.

The model of buyer behaviour proposed by Webster & Wind is probably one of the best known of the models of Organisational Buying Behaviour. As per them, the Organisational Buying Behaviour is influenced by the following set of variables:

- The individual characteristics of the members of the buying centre.
- The relationship between the members of the Decision-making unit.

Organisational characteristics including the buying and organisational task, the size and structure of the organisation, the use of technology etc., are also important considerations.

89. Family Branding Strategy:

The power of the family name (e.g. TATA) acts as a branding strategy to introduce and market a new product. This implies image of the family brand across a range of products. These might be:

- Blanket family brand
- Separate family names or
- Trade name with an individual product.

Examples: Levis for clothing, e.g. Shirts, pants. Tata Sumo Car, Kellogg's cornflakes.

90. Momentum Strategy:

Momentum Strategy essentially means exploiting to the maximum, the scope provided by the existing product. Evidently, Momentum Strategy is the most straight forward strategy, where the products are known and the market is well understood.

The stages in applying Momentum Strategy would be:

- Exploitation of the existing market.
- Exploitation of the new market with the existing products.
- Capital investment might be necessary for expanding the manufacturing facilities and the marketing set up.

91. Core Business Analysis:

The concept of the core business analysis basically aims to find new strategies to grow and improve a firm's business. It may be seen that most companies that sustain value creation possess only one or two strong cores. A company's core business is defined by that set of products, customer segments, processes and technologies in which one can build the greatest competitive edge. Investigating into core can lead to better strategies.

Having identified core business, the analysis requires the following steps :

- Define the core clearly. It means narrowing our focus,
- Detail those activities that he outside the core,
- Evaluate the core business markets in depth,
- Deliver excellence in the operation of the core business operations,
- Use value chain analysis to find new strategies that deepen our focus on the core business,
- Explore financial performance potential,
- Prioritize the most promising strategies and estimate the impact of each,
- Contemplate the divestment of activities that lie outside the core,
- Penetrate the market deeply; and finally
- Look to adjacent businesses.

92. Internet as a major technological force changing businesses around the world:

The Internet is acting as a national and even global economic engine that is spurring productivity. It is saving billions of Rupees in distribution and transaction costs from direct sales to self-service systems.

The Internet is changing the very nature of opportunities and threats by altering the life cycles of products, increasing the speed of distribution, creating new products and services, erasing limitations of traditional geographic markets and changing the historical trade-off between production, standardisation and flexibility.

The Internet is also altering the economies of scale, changing entry barriers and redefining the relationship between industries and various suppliers, creditors, customers and competitors.

With increasing exchange of information, the product life cycles are shortening steadily, as innovations get diffused rapidly and get overtaken by still newer offerings. An emerging consensus holds that technology management is one of the key responsibilities of strategists.

It is therefore very true that Internet is acting as a major technological force-changing the businesses around the world.

93. Major factors on which the intensity of competition depends:

Major factors on which the intensity of competition depends are as listed below:

- Whether there are large numbers of equally balanced competitors: When the industry is dominated by a small no. of large firms, intensity of competition is likely to be lower as they may avoid price competition or form cartels.
- The rate of growth in the Industry: When the growth rate is high, competitive rivalry is lower; when growth is slow or stagnant, competition intensifies for a greater market value.
- Where fixed costs are high: Here variable part of selling price is small and so, the firms attempt for price competition.
- Ease of switching encourages suppliers to compete.
- Capacity and unit costs: Economies of scale from capacity increase substantially lead an industry to face recurring periods of over-capacity and price-cutting.
- High strategic stakes: A high capital-intensive firm having good success history in the industry may adopt very competitive strategy to ensure achievement of targets.

94. Strategic Management Process:

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

Strategic Management is the means by which the management establishes purpose and pursues the purpose through co-alignment of organisational resources with environment, opportunities and constraints.

The Strategic Management process is most often described as a rational and an analytical process consisting of the following activities in 2 Phases viz., Phase-I & Phase-II.

Phase-I: Strategy Formulation:

- Environmental scanning basically for analysing each threat facing the company and opportunities;
- Developing Corporate Vision, Mission, Goals/Strategic Objectives;
- Organisational Analysis analysing the Mission, Strengths and Weaknesses, Opportunities and Threats;
- Strategic Goals Setting, which would-be-e4earr~easy to understand, easily measurable and achievable.

- Strategic Actions Formulations/An Action Plan to achieve the goals set;
- Developing the Functional Level Strategy, Business Level Strategy, Global Strategy and Corporate Level Strategy;
- Initiating Planning Process-Corporate Planning, Long Range Planning& Business Policy Planning.

Phase-II: Strategy Implementation:

- Laying down Principles for Corporate Performance, Governance and Ethics;
- Operationalising Strategy;
- Executing the strategy, using various tools;
- Introduce Controls;
- Detect Variance, Measure Variance, Match against Control & Initiate Feedback for Revision, if necessary;
- Strategy Evaluation and Control.

95. Nine Price-Quality Strategies:

Product Quality has a big bearing on the price. A Pricing Strategy, based on Quality is the Nine Price-Quality Strategies, which is as below:

	Quality High	Quality Medium	Quality Low
High Price	➢ Premium(a)	➢ Mega Value (b)	➢ Ultra Value(c)
Medium Price	➢ Overcharging(d)	➢ Average Value(e)	➢ Fair Value(f)
Low Price	➢ Rip off (g)	➢ Deceptive(h)	➢ Economy(i)

Essentially, the strategies (a)High Price-High Quality, (e)Medium Price-Medium Quality, and (i)Low Price-Low Quality can exist in a market at the same time as there is logic in pricing.

The strategies (b)High Price -Medium Quality, (c)High Price -Low Quality and (f)Medium Price -Low Quality are a consumer high surplus.

The Strategies (d)Medium Price -High Quality, (g)Low Price -High Quality and (h) Low Price -Medium Quality lead to over pricing to take advantage of a temporary shortage market.

All these strategies must follow a structured approach in the following manner:

- Selecting the pricing
- Determining the demand
- Estimating costs
- Analysing competitors
- Selecting the price for the second time
- Selecting the final price.

The pricing policy will also have to set out the objectives clearly as the strategies to be adopted will be determined by the following objectives:

- Survival
- Skimming the market
- Maximum current revenue
- Maximum sales growth
- Product-Quality leadership

Sensitivity Analysis in respect of price elasticity is yet another aspect, which should be taken care of for pricing.

The Management Accountant will always be involved in the pricing exercise and the relevance of the exercise is determined by the sensitivity analysis based on adequate reliable data.

96. Strategic Total Cost Management:

Strategic Total Cost Management is a new world-class approach to Cost Management. So long we had been classifying cost under 3 heads - as variable, semi-variable and fixed. When cost as a strategy is to be implemented, it presupposes that there is a time horizon, which is longer than a few accounting periods. In such a time-span, even the so-called fixed costs tend to vary e. g., rent, taxes, salaries, etc. So, the total cost management strategy has evolved a new classification namely,

Bed rock Fixed Costs e.g., depreciation, patent, amortisation, etc. , Managed Costs-like rent, taxes, salaries, maintenance, advertising, etc. , Truly Variable Costs- like materials, royalties, freight, overtime cost, etc.

The above classification helps in arriving at Break-even points, which are more credible and take into consideration the changes in the costs over a period. A single break even is not possible and not acceptable in the Total Cost Management.

Another very important feature of Total Cost Management is that almost all costs are manageable through cost strategy as even period costs tend to vary over time. For instance, rents, which are considered as fixed cost under normal parlance are treated as, managed costs in Total Cost Management Strategy. This is particularly so, because the quantum of rent variation can be managed through leasing, tax-planning etc.

Introduction of Strategic Total Cost Management can embrace many different areas in business and as such there are specific tools to be employed for the implementation as follows:

- Enterprise wide cost system,
- Production Cost System,
- Marketing Cost Management,
- Support Cost Management,
- Transformation Cost Management

Strategic Total Cost Management emphasizes that enduring cost benefits will accrue to a company only when the organisation aligns its information systems to its strategic goals. ERP (Enterprise Resource Planning) concept stems from this tenet and introduces automation in areas where the human intervention may not be so efficient but more costly.

97. Project Risk Management:

Projects are one time processes-unique in nature. Each project will be different and has different gestation periods. By its own nature, a project is based on many assumptions, to be realised at a future and is subjected to environmental changes and changes due to statutory policies. With a gestation period running into a few years, any change or revision in assumptions can transform itself into a big risk. Management of such, risks is called as Project Risk Management, which can be difficult and would require special tools and models.

Risks in Project Management are basically:

- Market Related Risks- mainly due to changes in demands.
- Completion Risks-due to both administrative & technical risks during implementation.
- Institutional Risks-due to unexpected changes in the conditions and norms laid down by the institutions that have funded the projects.

All the three risks can create certain consequences of events, compounded by unforeseen circumstances. This may lead to 'turbulence', when multiple issues arise, initiating moves and counter-moves and often ending in deadlock and the entire project may collapse.

98. Risk and Uncertainty:

Risk and Uncertainty are two terms, which are anathema to every manager. To expect the 'Unexpected' and handle the same successfully is the hallmark of a good manager.

Certainty and Uncertainty are the two extremities on a continuous platform and Risk is identified somewhere between these two extremes.

Risk, expressed mathematically, is the dispersion of a probability distribution i.e., how much do individual outcomes deviate from the expected outcome.

Physically, Risk can be identified as an event, which has different probabilities of happening but the time of the event is not known as also the impact of such risk can vary. E.g., Japan has been a country which has suffered many earthquakes over so many centuries and the risk of earthquake is known or it can be said that Japan is earthquake prone.

Uncertainty is a totally indefinable happening and is also unexpected. An Uncertain situation is faced when the variables are many and their interaction can be innumerable. For example, different people behave and react differently to the same situation and uncertainty arises.

While Uncertainty cannot be quantified, a Risk can be quantified through mathematical models, probability models, correlation etc., and can also be measured through quantitative models and technological tools.

99. Probability of Ruin:

Probability of Ruin is essentially a study of risk of insolvency for a company, with multiple business activity facing heavy claims from creditors. For this purpose, the company is permitted to transfer resources between business lines. But such transfers are restricted by transaction costs. Insolvency or Ruin occurs, when capital transfers cannot compensate the negative positions in one or more business lines. Such problems are normally solved on the basis of intermittent or continuous process. Mathematically, actuarial calculations are involved in such exercise. A clear expression of Laplace Transformation of the finite type, for computing Ruin Probability is one such method.

100. Audit Committee:

The Companies Act requires that every public company with paid-up capital .of not less than Rs.5 Crores should constitute an audit committee of the Board. It is not necessary that the company should be listed. Clause 49 of the Listing Agreement under SEBI regulations also requires a listed company to form an Audit Committee of the Board. Both regulations detail the constitution, powers and responsibilities of the Audit Committee.

Under Clause 49, Audit Committee should comprise at least 3 Directors. Two-third of them should be independent. At least one member shall have accounting or related financial management expertise. The committee chairman should be an independent director. The Audit Committee should meet at least thrice a year-one before finalisation of annual accounts and one necessarily every six months with the quorum being higher of two members or one-third with at least two independent directors.

Role of Audit Committee:

The role of the Audit Committee includes:

- Review of the company's financial reporting process and the disclosure of its financial information to ensure the financial statement is correct and credible,
- Recommending to the Board the appointment, re-appointment and if required, the replacement or removal of the statutory auditor and the fixation of audit fees,
- Reviewing, with the management, performance of statutory and internal auditors,
- Adequacy of the internal control systems, reporting structure coverage and frequency of internal audit, among others.

Powers of Audit Committee:

Powers of the Audit Committee includes:

- To investigate activities within its terms of reference,
- Seek information from any employee,
- To obtain outside legal or other professional advice,
- Secure attendance of outsiders with expertise, if it considers necessary.

101. Strategic Outsourcing:

Strategic Outsourcing has evolved beyond being viewed as a purely tactical exercise to reduce costs and increase operational efficiencies. Businesses today are using it to achieve their enterprise-wide strategic goals and focus on core competencies.

Strategic Outsourcing can help companies

- adapt flexibly to business change
- improve quality and productivity
- respond quickly to competition
- penetrate new markets.

Strategic Outsourcing services can range from Application Development and Maintenance (ADM) to business process outsourcing to setting up 'turnkey IT centres' on a BOT model (Build-Operate-Transfer), to business re-engineering.

Strategic Outsourcing provides access to a highly skilled global workplace, which can supply a wide array of services. To leverage these services effectively and benefit from lower operational costs and higher service levels, there are several business models to choose from.

These are:

- Staff augmentation-This model provides specialised resources, cost flexibility and satisfies short-term time-to-market demands.
- Out-tasking-This model is suitable for short-term business needs, to fill skill gaps. However the integration of different out-tasked outcomes may not be a seamless one.
- Project-based outsourcing-Vendors and clients share risks and rewards through this collaborative model. This model has high client benefits as it holds the vendor accountable for an entire project and allows the application of industry best practices in the outsourcing process.
- Managed services model-This model fosters the development of long-term, multi-year, SLA-based relationships to provide integrated solutions across the enterprises. The service provider takes responsibility and accountability for agreed-upon strategic business outcomes.

102. Five ways of Brand Valuation:

The five ways of valuation of brands are:

- Add up all costs of research and development and marketing expenditure of the brand over a specific time horizon. This method suffers from the limitation that it is difficult to identify all expenses relating to the brand and it only quantifies the cost and not the value.
- Consider the present value of the price premium that a brand commands over the unbranded product. However,
  a. It is difficult to identify a proper unbranded product for comparison.
  b. It does not recognize the stability attribute brought into the earnings by the brand.
  c. The possibility of a brand being a barrier to the entry and this aspect in terms of value is not included.

- If the brand were to be auctioned, the value may be fetched by such auction.
- However, it may not be practicable since brand market is very narrow and accurate valuation is not possible.
- Computation of value based on intangible measures such as esteem, recognition and awareness. However, translating these intangibles into commercial value is extremely difficult and the methods of quantification through use of statistics can be erroneous.
- Discounting future potential earnings for brand valuation. This method virtually includes all the information from the earlier four methods and in addition has to develop a reliable forecast of future earnings and growth. Here it is difficult to gauge the life of the brand and the time horizon to beset apart from quantifying earnings.

103. Public- Private Partnership (PPP):

The concept of Public- Private Partnership (PPP) has been a comparatively new one in our national economic development scenario. It has been observed that the growth of infrastructure has lagged behind and may assume serious proportions impeding our economic growth. To overcome this, Government of India has been actively pursuing PPP to bridge the gap in the infrastructure.

Under the overall guidance of the committee of infrastructure, headed by the Prime Minister, the PPP programme formulation and implementation are being closely monitored by the relevant ministry/departments. An appraisal mechanism has been given a mandate and guidelines for drawing up time-frame for according approvals to proposals in a speedy manner.

PPP projects normally involve long term contracts between the Government and the private parties detailing the rights and obligations of both the contracting parties. Government has decided to develop standardised frame-works, based on due diligence and agreements will follow international practices. They will also create a framework with a right matrix of risk allocation, obligations and returns.

Planning Commission has also issued Model Concession Agreement (MCA) for ports, state highways and operation maintenance agreements for highways. To promote PPP programme, all state governments and central ministries are setting up PPP cell with a senior level officer as a nodal officer. Technical assistance has been obtained from Asian Development Bank (ADB) including hiring of consultants and training of personnel.

104. Exposures relating to Agro and Bio Liabilities:

The basic liability issues arise due to:

- Farmer's credit liability;
- Consequential losses liability;
- Genetically modified crop seed liabilities;
- Consulting expenses and royalty liabilities;
- Casualty liabilities on farmers assets;

- Latent deficiencies liabilities(public and professional liabilities);
- Inflation liabilities(dynamic risks in risk management)affecting the farming community.

Dr. M.S. Swaminathan committee has identified insurance as a panacea for the above liabilities and the possible steps could be:

- Recognising agriculture as an 'open roof' industry and bringing in concepts of industrial liabilities;
- Pre-harvest hedging;
- Cross dimensional liability coverage for inability;
- Linking of life assurances of farming community with their property and casualty insurances.

105. 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 organisation and can be reduced or diversified by acting within the organisation, which is through functional level strategy. Systematic Risks influences a large number of assets. A significant political event for example could affect several of the assets in your portfolio. It is virtually impossible to protect against this type of risk.

The unsystematic risk, which is the market risk is external to an organisation and is also termed as market risk/specific risk. This kind of risk affects a very small number of assets. An example is news that affects a specific stock, such as a sudden strike by employees. Diversification is the only way to protect from unsystematic 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.

106. Impact of Macro Economic factors and Risk:

Relationship between risk and return can never be emphasised; higher the risk, the return needs to be higher and the computation of the risk premium has always been a million dollar Question. However, risk perceptions of investor's tend to be different with the onset of business cycles. In recession, investors tend to be conservative as their appetite for risk is reduced and they go after growth sectors, which have lower risk, in a security market low risk growth sector have always been biggest gainers in terms of returns. This explains that onset of recession upsets the risk return balance.

Macro economic factors like change in interest rates, inflation, money supply and index of industrial production have a big impact on the investors risk perception. Analysis has shown that in a regime of high interest rates and high inflation, low risk sectors perform better than high risk stocks. As the interest rates and inflation decline, the high risk sectors tend to do better.

107. Asset-Liability Management:

Asset-Liability Management: is a technique to compute matching of assets and liabilities by which a prudent management of an investment portfolio can be properly taken care of.

Asset-Liability Management is defined as "maximising the risk adjusted returns to share-holders over the long-run". It is also defined as the management of total balance-sheet in terms of size and quality (composition of Assets and Liabilities).

Liquidity Risk Management through Asset-Liability Management: The most commonly used techniques for measurement of liquidity risks is the gap analysis. The assets and liabilities are arranged according to their maturity pattern in time brackets. The gap is the difference between the maturing Assets to the maturing liabilities.

A positive gap indicates that maturities of assets are higher than those liabilities.

A negative gap indicates that some re-arrangement of funds will have to be done during that time-bracket.

Exchange Rate Risk Management through Asset-Liability Management.

At a particular exchange rate, assets and liabilities of financial Institution match exactly. As exchange rate fluctuates, this balance gets disturbed. A simple solution to correct this risk is to match assets and liabilities of the same currency.

108. Enterprise Risk Management:

"Enterprise Risk Management is the discipline by which an organisation in any industry assesses controls exploits finances and monitors risks from all sources for the purpose of increasing the organisation's short and long-term value to its stakeholders".

There are seven components to the Enterprise Risk Management and they are:

- Corporate risk governance
- Line management
- Portfolio management
- Risk transfer
- Risk analysis
- Data and technology resources
- Stakeholders' management.

Some Valuable points:

- Every Annual Report contains a section on Corporate Governance along with management's discussion on performance and future outlook.
- Line management develops the strategy on a cross functional basis, using various models identifying strengths, weaknesses, opportunities and threats.
- Risk transfer objectives aims at lowering the cost of hedging of risks, which are already balanced in a portfolio.
- The tools and techniques are used to evaluate Risk transfer products such as Derivatives, Issuances and Hybrid Products, etc.

Enterprise Risk Management is emerging as the best practice model, which is often benchmarked among the competitors. The Enterprise Risk Management becomes all the more important, for, the absence of it lead to Crisis Management.

109. Mission Statement:

Mission of an organisation can be viewed as a strategic tool and an intellectual discipline, which defines organisation's commercial rationale and target market. It exists to Answer two Question-

- What is our business?
- What would it be?

From another view-point, Mission is cultural glue which allows the organisation to function as a collective entity. Once a business's Mission is clearly defined, it provides a statement of values to both the insiders and outsiders about the company stands for, its image and character.

Missions identify the underlying design, aim or thrust of a company. Mission is qualitative in nature and may be expressed as a grand design. The mission of an organisation is drawn by its top-management and is value-based and reflects the vision of the corporate management.

The Mission Statement is a long-run version of what the organisation is trying to achieve. To develop a Mission Statement, management must take into account certain key elements like the organisation's history, its distinctive competencies and its environment.

Every organisation has a history of objectives, accomplishments, mistakes and policies. These critical characteristics and events of the past should be considered while formulating the Mission Statement.

The distinctive competencies, which an organisation possess, should get reflected in the Mission Statement Further the organisation's environment dictates the opportunities, constraints and threats, which must be identified before a mission statement is developed.

Characteristics of a Mission Statement:

It is extremely difficult to write a meaningful and effective mission statement. An effective mission statement should focus on markets rather than the products and should always be achievable, motivating & specific.

The following are the characteristics of a Mission Statement:-

Achievable: The mission statement should be realistic and achievable. It should open a vision of new opportunities but should not lead the organisation into unrealistic ventures far beyond its competencies.

Specific: A mission statement must be specific and provide direction and guidelines to management.

Motivational: A well-defined mission provides a shared sense of purpose 'outside' of the various activities taking place within the organisation.

Focus on Market rather than on Products:

The mission statement should be stated in terms of serving a particular group of clients or customers and meeting a particular class of need rather than on products or services the organisation is offering at present.

A Mission statement should be clearly articulated, should be precise and relevant, should be written in a positive tone and unique.

An example of a Mission Statement:

Larsen & Toubro's Mission Statement:

We shall be a value-driven group in the business of' EPC Projects and PMC services' in the fields of Food Processing, Cement, Petro-chemical & Refinery, Oil & Gas, Chemicals & Fertilisers and select special projects.

We shall endeavour to synergies strengths of all groups of our co. for delighting our customer's rough

- Quality products, services& safe practices;
- Effective project and risk management skills;
- Up-to-date integrated Information Technology;
- Access to state-of-the -art technology, backed by strong in-house R&D base;
- In-house manufacturing capabilities and
- Innovative Financing.

We shall continue to provide reliable post-commissioning support and work towards promoting eco friendly environment.

110. Product life cycle:

Product life cycle: Like human beings, Products too have a life-cycle. They pass through many stages in their lifecycle. These stages are:

(i) Introduction (ii) Growth (iii) Maturity and (iv)Decline

Introduction Stage:

In the first stage, the product is introduced in the market. It has to prove its worth and find a market. This is a difficult stage and many products like infants, do not survive this stage. Generally the price and advertising expenditure is high and sales are low. As a result, profits are very low and there may even be a loss.

Growth: As the products gains widespread acceptance, sales rise at a rapid rate. Advertising expenditure goes down and distribution network increases. Consequently profits will rise. This is the period of general acceptability, breakthrough and rapid growth.

Maturity: At this stage the products becomes well established. High sales and profits will

attract competition. The product is made available in a variety of forms to meet different requirements. High promotion expenditure is incurred to meet different competitive pressures. The market gets saturated. This is the appropriate time for making improvements in the product or to develop new products.

Decline: In this final stage, the original product dies out and disappears from the market. Changes in consumer tastes and introduction of better substitutes render the original product obsolete. Sales and profits decline rapidly.

Conventional strategies for companies in decline are either to divest or harvest; That is, to generate maximum cash flow from existing investment. However, these strategies assume that the declining industries are inherently unprofitable. However, sometime there is considerable profit potential is found within a declining industry. In such situation strategies like—Leadership, Niche, Harvest may be followed.

Relation between Product Life Cycle & Marketing Management:

Introduction	Growth	Maturity	Decline
➢ Product is new ➢ Sales are low & profits are low. ➢ There is delay in consumer acceptance. ➢ Money is needed to develop the mkt.	➢ Opens more opportunities for the new products. ➢ Mkt. share increases & profits also goes up. ➢ Economies of scale are introduced. Costs go down.	➢ Sales continue to increase. ➢ Price competition increases. ➢ Mktg Mgmt. concentrates on product improvement, new uses of products & more mkt segmentation ➢ Improvement considered in packaging, design, etc.	➢ Mkt demand slackens ➢ Mkt is saturated ➢ Weak Products gets dropped.

111. Distinctive competence:

A core competency is something a company can do exceedingly well. It is its key strength. When these competencies or capabilities are superior to those of its competitions, they are called 'Distinctive competencies.'

Distinctive competencies can be acquired by a company in many ways like say, foreign technical collaboration, product development.

Distinctive competencies enhance the company's ability to continue to bring successful new products to the market place- a necessity in a market where product variety is important to the buyer.

Relying on a firm's strongest resources is generally referred to as using a 'Distinctive competence' and in selecting amongst potential corporate strategies, a firm should usually rely on its Distinctive competencies or on competencies it can acquire.

The table below suggests some ways a firm can effectively employ it's various Distinctive competencies:-

Distinctive Competency	Potential Use
R&D Capability	Emphasize high technology in product development.
Financial resources ,	Acquiring other businesses.
Company reputation for quality	Select markets where reputation is known.
Strong Sales Force	Select new products that can be sold by the same sales force.
Control over materials & other supplies.	Emphasise products that require these resources; Compete as low-cost producer.

To call it a core competency, it must meet three tests:

1. Customer value (to be strongly perceived);
2. Uniqueness (should be superior to competitors' capabilities); and
3. Extendibility (something special to be used to develop new-products or enter new markets.

A company can gain access to distinctive competence through

(i) asset endowment such as a key patent;

(ii) acquisition from someone else; and

(iii) sharing with other business unit.

112. Bargaining Power of Customers:

This concept was originally proposed by Michael Porter in the five forces model.

Customers would want better quality products and services at a lower price. If they succeed in getting what they want, they will force down the profitability of the Supplier's in the Industry.

The profitability of an industry is therefore dependent very much on the consumer's bargaining power. In today's world of buyer's market, the customer is the 'king'. He alone dictates the terms and calls the shots. Consequently the bargaining power of customers had never before been so high as is felt in today's business scenario.

Just how strong the position of the customers will depend on a number of factors as per below:-

- If the customer's purchase represents a substantial proportion of total sales by the producer, the customer will be in a strong position relative to the seller.
- If most of a customer's supplies come from a single industry, the customer will be in a weaker bargaining position than if only a small-proportion did so.

- Whether the switching costs are high or low.
- Whether the products supplied by the Industry are standard items and undifferentiated.
- Suppliers will try to increase their bargaining power over the customers by creating a strong brand image.
- A customer who makes low profits will be forced to insist on low prices from suppliers.
- The threat that customers might take over sources of supply, if suppliers charge too much.
- The skills of the customer's purchasing staff or price-awareness of customers.
- When product quality is important to the customer, the customer is less likely to be price-sensitive and so the Industry might be more profitable as a consequence.

113. Hofer's Evolution Matrix:

Hofer's Evolution Matrix is useful to develop strategies that are appropriate at different stages of the Product Life Cycle.

This Matrix considered the following variables:-

Market and Consumer behaviour variables like:

- Buyer needs,
- Purchase frequency,
- Buyer concentration,
- Market Segmentation,
- Mkt Size,
- Elasticity of demand,
- Buyer loyalty,
- Seasonally and cyclically.

Industry Structure Variables like:

- uniqueness of the product,
- rate of technological change in product design,
- type of product,
- number of equal products,
- barriers to entry,
- degree of product differentiation, transportation and distribution costs,
- price/cost structure,
- experience curves,

- degree of integration,
- economy of scale, etc. , etc. ,

Competitor Variables: like

- Degree of specialisation within the industry,
- Degree of capacity utilisation,
- Degree of seller concentration,
- Aggressiveness of competition.

Supplier Variables: like

- Degree of supplier concentration,
- Major changes in availability of raw materials.

Broader Environmental Variables:

- Interest rates, Money supplies,
- GNP trend,
- Growth of population,
- Age distribution of population,
- Life Cycle changes.

Organisational Variables: like

- Quality of products,
- Market share,
- Marketing Intensity,
- Value added,
- Degree of Customer Concentration, etc. , etc. ,

Hofer then developed descriptive propositions for each stage of the Product Life Cycle.

For example: In the maturity stage of the Product Life Cycle, Hofer identified the following major determinants of business strategy:-

- Nature of buyer needs,
- Degree of product differentiation,
- Rate of technological change in the process design,
- Degree of market segmentation, ratio of distribution costs to manufacturing,
- Value added and

The frequency with which the product is purchased.

Hofer thereafter formulated normative contingency hypothesis using the above major determinants.

An example for the maturity stage is,

When:

- Degree of product differentiation is low,
- The nature of buyer needs is primarily economic,
- Rate of technological change in process design is high,
- (iv)Purchase frequency is high,
- Buyer concentration is high,
- Degree of capacity utilisation is low.

Then business firms should:

- Allocate most of their R&D funds to improvements in process design rather than to new product development.
- Allocate most of their plant and equipment expenditures to new equipment purchases.
- Seek to integrate forward or backward in order to increase the value they add to the product.
- Attempt to improve their production scheduling and inventory control procedures in order to increase their capacity utilisation.
- Attempt to segment the market.
- Attempt to reduce their raw material unit costs by standardising their product design and using interchangeable components throughout their product line in order to qualify for volume discount.

114. Sell-offs:

There are two major types of sell-offs, namely spin-offs and divestiture while synergy which says 2 + 2 = 5 is a motive behind many mergers, a motive behind sell offs often is energy which says 5-3 = 3. Sell-offs help sharpen business focus and better utilisation of resources, elimination of cross subsidies and better management.

115. Divestitures:

Divestiture involves the sale of a division unit or part of the asset of a company to another. In case of conglomerates or business groups it may also involve sale of a company. For the seller, the divestitures amount to business contraction and for the buyer it is business expansion.

116. Learning curve:

Learning effects are savings in costs that derive from learning by doing for e.g., a laborer learns through repetition as to how best he could perform a task. Effects of learning can be plotted on a curve known as Learning Curve. Studies have been instituted to understand the aspects of learning effects and to improve training, education of labor, under Indian ethos this approach is known as "SAMAVAYA" which is holistic to include the 5Ws and 1H, viz., WHAT, WHO, WHEN, WHERE, WHY and HOW. Studies have been conducted in manufacturing and services areas. It was noted that learning effects proved very beneficial whenever processes had complex steps like assembly processes, chemical processes, etc. In the area of services studies conducted in the health care industry proved that mortality rate came down significantly with the Learning Curve.

117. De-bottlenecking:

Increase output through synergy as well as effective utilisation of capacity without any increased fixed cost. This process reduces cost of the production significantly. Application of Theory of Constraints is a pointer in this direction to remove the bottle neck and effectively increase flow of materials through all processes thus increasing output. Superior efficiency could be achieved by improving productivity as well as through application of value engineering in providing alternative raw materials. This should not compromise quality.

118. Innovative projects:

Innovative project should be structured properly to include the following steps:

- Project selection should be made after a brain storming session of a group represents a cross section of a company as also include experts in a field drawn from external sources.
- The project so identified should be able to produce or innovate a product / service in a foreseeable future, i.e., 2 to 3 years, as the life cycle of a product / service is reducing very rapidly and technological obsolescence sets in very easily.
- Cross functional integration is extremely important in that the product identified is driven by customer needs; articulated or unarticulated, manufacturability of the new product is assured on a commercial scale. Development costs are held under check through quality function deployment and different milestones leading to commercialisation are fully understood by all the members of the cross functional team.

119. Experience curve:

Experience curve is utilising the local pool of employees through the learning effects and through economies of scale, the employees develop greater comprehension of the processes and are in a position to improve and innovate on these processes due to the experience they have gained over the years of repetitive operations. The advantages of experience curve have been reaped through empowerment by many big multi nationals. The conversion cost especially in the chemical industry and oil refining industry in India is nearly 1/10th of the cost prevailing in the developed countries. Many pharmaceutical multi nationals had chosen India for contract, production or formulation for catering to the markets in India and the Far East. This strategy has reduced their cost of production as also the logistic cost.

120. International Strategy:

International Strategy is based on transfer of distinctive competencies to foreign markets. Advantages include transfer of distinctive competencies. Disadvantages include inadequate local response, unrealised location economics, unavailable advantage due to experience curve.

121. Multi Domestic Strategy:

Multi Domestic Strategy depends on the ability to offer customised products catering to local market's requirements. Advantages include customisation of product to suit local market. Disadvantages include unrealised location economics, unrealised advantage due to experience curve, inability to transfer distinctive competencies.

122. Global Strategy:

Global Strategy is based on the ability to exploit both the economies of scale and experience curve effects while guarding their own technology through wholly owned subsidiaries. Advantages include advantage of Experience Curve, advantage of location economics. Disadvantages include inadequate Local Response.

123. Transnational Strategy:

Strategic outsourcing combines all the above three strategies to harvest the best of benefits. But this strategy is difficult to implement as complicated organisational structure to integrate both local and international talents will be required. Advantages include advantage of experience curve, advantage of location economics, advantage of customisation, benefits of global knowledge. Disadvantages include problems in implementation because of organisational structure and culture.

124. Contractual liability:

Contractual liability is caused when promises are made to deliver particular goods or services at a price already determined and at certain time. The liabilities can be two fold:

- Post completion contractual liability: A liability arises when an agreement is made by a contractor for a performance of an agreed service, e.g., building contractor.
- Professional services liability: A professional applies his special knowledge and skill in practice like a lawyer. Therefore a client or a patient can sue a professional for negligence or wrong doings.

125. Agro and Bio liabilities:

The basic liability issues arise as follows:

a. Farmers credit liability;

b. Consequential losses liability;

c. Genetically modified crop seed liabilities;

d. Consulting expenses and royalty liabilities;

e. Casualty liabilities on farmer's assets;

f. Latent deficiencies liabilities (public and professional liabilities);

g. Inflation liabilities (dynamic risks in risk management) affecting the farming community.

Dr. M.S. Swaminathan committee has identified insurance as a panacea for the above liabilities and the possible steps can be:

- Recognising agriculture as an "open roof" industry and bringing in concepts of industrial liability insurances;
- Pre-harvest hedging;
- Cross dimensional liability coverage for inability;
- Linking of life assurances of farming community with their property and casualty insurances.

126. Corporate risk governance:

Responsibility of a corporate body encompasses

- Identifying the organisation's appetite for risk in the areas of capital leverage, credit rating, etc;
- The capability of the organisation to manage risk and support it's business strategy;
- Establishing the structural relationship between the roles and responsibilities for risk management;
- Pooling of risk and develop such integrated risk measures encompassing the various spheres of activity like finance, marketing, human resources and operations;
- Establishing proper tools for risk assessment, measurement and analysis;
- Developing a proper culture and awareness in the organisation through leadership;
- Educating the various layers of organisation about risks absorption and management through case studies. Corporate governance has become a buzzword in Indian corporate world and SEBI has laid down guidelines in this regard. Every annual report contains a section on corporate governance along with management's discussion on performance and future outlook.

127. Portfolio management:

Pooling of risks should not just happen, but must be aggregated properly so that appropriate diversification of risk can be attempted. This will lead to optimal portfolio where natural hedges can be fully implemented so that risk and return are well balanced.

Portfolio theory essentially guides an investor to reach an optimal portfolio position. This theory has originally postulated by Harry M. Markowitz assumes that the utility of the investor is a function of mean return and variance of return [or standard deviation (Square root of variance)].

The expected return on a portfolio is simply the weighted arithmetic average of the expected returns on the assets constituting the portfolio. The riskyness of the portfolio is measured by the standard deviation of the portfolio rate of return which is a function of

- The proportions invested in the components;
- The riskyness of the components;
- The correlation of returns on component securities;
- The principle of portfolio theory can be likened to pooling of risks and diversifying them.

128. Differentiation:

Strategies dependent on differentiation are designed to appeal to customers with a special sensitivity for a particular product attribute. By stressing the attribute above other product qualities, the firm attempts to build customer loyalty. Often such loyalty translates into a firm's ability to charge a premium price for its product. Cross-brand pens, Brooks Brother's suits, Porsche automobiles, and Chivas Regal Scotch whiskey are all examples.

The product attribute also can be the marketing channels through which it is delivered, its image for excellence, the futures it includes, and the service network that supports it. As a result of the importance of these attributes, competitors often face "perceptual" barriers to entry when customers of a successfully differentiated firm fail to see largely identical products as being interchangeable. For example, General Motors hopes that customers will accept "only genuine GM replacement parts."

129. Joint Venture:

Joint venture is a popular strategy that occurs when two or more companies form a temporary partnership or consortium for the purpose of capitalising on some opportunity. Often, the two or more sponsoring firms form a separate organisation and have shared equity ownership in the new entity.

Other types of cooperative arrangements include research and development partnerships, cross distribution agreements, cross-licensing agreements, cross-manufacturing agreements, and joint-bidding consortia. Burger King recently formed a "conceptual agreement" with its fierce rival, Hungry Jacks, in Australia, whereby the two firms will join forces against market leader McDonald's. All Burger Kings in Australia are being renamed Hungry Jacks, but Burger King retains ownership under the unusual agreement.

With this agreement, Australia becomes Burger King's fourth-largest country market, tied with Spain. U.S. regional airline operator Mesa Air Group, based in Phoenix, Arizona, recently formed a joint venture with Chinese carrier Shenzhen Airlines, based in Shenzhen, China, to create China's first commuter airline.

The first joint venture ever between U.S. and Chinese passenger airlines, Beijing Airlines now links Beijing with many poorly or non served cities in China and Southeast Asia. One of China's largest privately owned carriers, Shenzhen Airlines aims to expand its fleet to 80 planes by 2008 and 160 planes by 2015.

Joint ventures and cooperative arrangements are being used increasingly because they allow companies to improve communications and networking, to globalize operations, and to minimize risk. Joint ventures and partnerships are often used to pursue an opportunity that is too complex, uneconomical, or risky for a single firm to pursue alone. Such business creations also are used when achieving and sustaining competitive advantage when an industry requires a broader range of competencies and know-how than anyone firm can marshal. Armani's joint venture is with Emaar Hotels & Resorts LLC to create, among others, the tallest building in the world in 2008: a 2,000-foot-tall hotel in Dubai's Burj Dubai. Kathryn Rudie Harrigan, professor of strategic management at Columbia University, summarizes the trend toward increased joint venturing:

In today's global business environment of scarce resources, rapid rates of technological change, and rising capital requirements, the important question is no longer "Shall we form a joint venture?".

Now the question is "Which joint ventures and cooperative arrangements are most appropriate for our needs and expectations?" followed by "How do we manage these ventures most effectively?"

Joint ventures among once rival firms are commonly being used to pursue strategies ranging from retrenchment to market development.

A few common problems that cause joint venture to fail are as follows:

1. Managers who must collaborate daily in operating the venture are not involved in forming or shaping the venture.
2. The venture may benefit the partnering companies but may not benefit customers, who then complain about poorer service or criticize the companies in other ways.
3. The venture may not be supported equally by both partners. If supported unequally, problems arise.
4. The venture may begin to compete more with one of the partners than the other.

Six guidelines for when a joint venture may be an especially effective strategy to pursue are:

- When a privately-owned organisation is forming a joint venture with a publicly owned organisation; there are some advantages to being privately held, such as closed ownership; there are some advantages of being publicly held, such as access to stock issuances as a source of capital. Sometimes, the unique advantages of being privately and publicly held can be synergistically combined in a joint venture.
- When a domestic organisation is forming a joint venture with a foreign company; a joint venture can provide a domestic company with the opportunity for obtaining local management in a foreign country, thereby reducing risks such as expropriation and harassment by host country officials.
- When the distinct competencies of two or more firms complement each other especially well.
- When some project is potentially very profitable but requires overwhelming resources and risks; the Alaskan pipeline is an example.
- When two or more smaller firms have trouble competing with a large firm. When there exists a need to quickly introduce a new technology.

130. Leveraged buyout:

A leveraged buyout (LBO) occurs when a corporation's shareholders are bought (hence buyout) by the company's management and other private investors using borrowed funds (hence leverage).

Besides trying to avoid a hostile takeover, other reasons for initiating an LBO are senior management decisions that particular divisions do not fit into an overall corporate strategy of must be sold to raise cash, or receipt of an attractive offering price. An LBO takes a corporation private.

131. DCF analysis:

This financial tool computes the present value of future cash flows over multiple periods using a discount factor. The formula for net present value of alternative decisions can be computed as below:

$$NPV= \sum_{t=0}^{n} \frac{E(NCF_t)}{(1+r)^t}$$

Where

$E(NCF_t)$ = Expected net cash flow in year t

r = opportunity cost of capital (reflects the risk of the cash flows)

132. Monte Carlo simulation analysis:

Monte Carlo simulation is a process of deriving a simulated distribution of an output variable (like cash flow or firm value) by randomly combining values of input variables in repeated drawings. It involves the following steps:

- Model the firm's value or cash flow as a function of macro-economic variables (exchange rate, interest rate, inflation rate and so on).
- Specify the probability distribution of each of the macroeconomic variables.
- Select a value, at random, from the probability distributions of each of the macro economic variables.
- Determine the firm's value or cash flow corresponding to the randomly generated values of exogenous variables.
- Repeat steps (3) and (4) a number of times to get a large number of values of the firm or cash flow so that the simulated distribution of firm's value or cash flow can be defined.

133. Risk adjusted performance measurement:

The best practice recommendation on risk management was enunciated in the G30 report on derivatives.

The recommendations have been considered very sound and are very much in use currently. They include:

Involve senior management

a. Establish independent risk managers for market and credit risk
b. Market to Market on a daily basis with consistent valuation measures
c. Measure and limit market and credit risk rating using value at risk (VaR) techniques to estimate probable loss over a period of time
d. Strengthen operational controls, systems and training
e. Make investment and funding forecasts
f. Identify revenue sources and next conduct stress testing

The above recommendations ensure that adequate information could be available for the management to manage risk and avoid nasty surprises. RAPM framework brings together and measures the trade off between risks and rewards.

134. Re-insurance:

All insurance companies have a risk appetite i.e. a limit on the amounts that they can settle for any given claim that is made by the Insured. Any claims made beyond this specified limit by the insured is settled by another company referred to as a Reinsurance company.

Thus, Reinsurance is insurance for insurance companies. Reinsurance is the transfer of part of the risk that a direct insurer assumes by way of an insurance contract on behalf of the insured, to a second insurance carrier, the Re-insurer who has no direct contractual relationship with the insured. Direct insurers need reinsurance to limit annual fluctuations in the losses they must bear on their accounts and to protect the assets of the company in the event of a catastrophe. Direct insurers take on hazards and risks from the policy holders. Re-insurers take on hazards and risks from the direct insurer.

Insurance companies typically enter into an agreement with the Re-insurer and sign a Reinsurance Treaty which states all the terms and conditions of the agreement. The Re-insurer agrees to accept a certain fixed share of risk upon terms as set in the agreement. The well known Reinsurance companies in the world are Swiss Re, Munich Re, and Zurich Re. For example, an Insurance company has a risk appetite of Rs.1 million. But has issued a general insurance policy for an engineering project where the sum insured is Rs.4 million. If a claim is made on this particular policy, the claim will be settled for Rs.4 million. Rs. 1 million will be paid by the Insurance Company that issued the policy and the remaining 3 million will be paid by the Reinsurer.

135. Pricing:

The process of determining or fixing the rates of premium for a particular product is known as pricing. Traditionally, premiums have been calculated based on tariffs set by the Insurance Regulatory Authority. The rates are derived based on various factors like past loss ratio, location of the asset, type of asset, as well as exposure to the risks. Rate is the pricing factor upon which the premium is based. For example, car insurance policies are priced based on factors such as make and model of the car, purpose for which the car is used, etc. Where SI is Sum insured.

Traditionally, for motor insurance, the parameters that are used to price a policy have been model of the car, age of the driver, location of the car and purpose for which the car is driven, etc. The industry will eventually move from price rating to risk rating. The pricing for each individual will be based on their track record. For example, for 'own damage' in a car insurance policy, the pricing parameters will be the model of the car, driver's age and engine capacity. This is of particular importance to a management accountant as it is in the nature of pricing a product.

The insurance premium can be broken up into four parts:

- Cost of payment for losses
- Cost of operation and maintenance of insurance pool
- Reserve for contingencies
- Return on Investment.

In the life insurance, calculation of insurance premium is very complicated exercise as the variables involve are many, e.g., factors aggravating mortality rates, like smoking, drinking, drugs and other habits, age of the insured, occupational hazard, etc. This computation is normally through actuarial computations involving mortality rates. Premium rate is often referred as rate per unit of exposure.

136. IRDA:

This institution came into existence on the basis of Insurance Regulatory and Development Authority Act (IRDA), 1999. Providing Licenses for transacting insurance business and reviewing premium rates are the twin activities of IRDA. IRDA is consumer friendly and protects the interests of the consumer through adequate checks, premium rates, products, procedures and investments made by the insurance companies.

The Insurance Regulatory Authority of India (IRDA) regulated the general insurance covers for over a decade. Owing to the increase in the number of players in the Indian insurance market in the last few years and the fierce competition in the General Insurance segment, IRDA wanted to de tariff the market in January 2007 and Insurers were given greater freedom to price the three insurance covers that were still regulated by IRDA: fire, engineering and motor. Policies can now be priced on a standalone basis, and therefore match the risk.

The second phase of de tariffing will allow the Insurers to structure their products as well where they may be allowed to offer some optional covers in addition to the compulsory covers. In other countries like U.S.A. where product structuring is allowed, factors like the colour of the car also can influence premiums.

Detariffing would allow Insurers to lower premiums. For policyholders, de tariffing is always beneficial. For the same amount of premium, customers can get a higher sum insured. The industry can also benefit from this, since lower premiums will lead to increased sales and thus product penetration.

137. Utility Theory:

The destruction caused by any unforeseen event is referred to as "Risk". In the insurance business, people exposed to the same risk form a group and share the loss together. Insurance companies collect the shares (Premiums) in advance from the group and create a fund. This fund is utilised to pay for the loss (Claims) that is incurred by any member of the group.

Risks can be classified into various types:

a) Financial and non-financial risks

b) Dynamic risks

c) Speculative risks

Risk cannot be avoided through insurance but may be considered as a means to transfer the risk. It is also a mechanism to compensate the financial and economic loss due to risk. Safety measures and damage control management can be adopted to mitigate or eliminate the magnitude of risk. The fundamental principle of insurance is to share the losses and to substitute uncertainty with certainty. Expected utility theory emphasizes that the demand for insurance is a demand for certainty. The conventional specification of the theory perceives that the buyers of insurance prefer certain losses to actuarially equivalent uncertain losses. But certain other surveys indicate that individuals actually prefer uncertain losses to actuarially equivalent certain losses. This can be explained by saying that "the purpose of any insurance policy is to convert an uncertain, but potentially large loss into a certain small loss. Such a conversion benefits the consumer, if greater losses cause progressively larger declines in utility (i.e., if there is diminishing marginal utility of wealth)". For example, insurance against fire peril where the bigger part of the loss will be insured that is uncertain for a specific premium today.

Another approach evaluates a conventional expected utility theory explaining the demand for insurance by an individuals demand for an uncertain payoff of income in a pre specified state. This can be explained through the demand for health insurance. According to this theory, becoming ill fundamentally changes preferences. Thus an insured customer is able to transfer income into the ill state where the marginal utility of income is greater.

138. CAPM:

Harry Markowitz developed an approach that helps an investor to achieve his optimal portfolio position. Hence, portfolio theory, in essence, has a normative character as it prescribes what a rational investor should do.

William Sharpe and others asked the follow up question: If rational investors follow the Markowitizian prescription, what kind of relationship exists between risk and return? Essentially, the Capital Asset Pricing Model (CAPM) developed by them is an exercise in positive economics. It is concerned with two key questions:

- What is the relationship between risk and return for an efficient portfolio?
- What is the relationship between risk and return for an individual security?

The CAPM, in essence, predicts the relationship between the risk of an asset and its expected return. This relationship is very useful in two important ways. First, it produces a benchmark for evaluating various investments. For example, when we are analysing a security we are interested in knowing whether the expected return from it is in line with its fair return as per the CAPM. Second, it helps us to make an informed guess about the return that can be expected from an asset that has not yet been traded in the market. For example, how should a firm price its initial public offering of stock?

Although the empirical evidence on the CAPM is mixed, it is widely used because of the valuable insight it offers and its accuracy is deemed satisfactory for most practical applications.

CAPM is based on the following assumptions:

- Investors are risk averse,
- Security returns are normally distributed,
- The utility function of investors is quadratic,
- Investors have homogeneous expectations – they have identical subjective estimates of the means, variances and co-variances among returns,
- The market is perfect: there are no taxes; there are no transactions costs; securities are completely divisible; the market is competitive,
- The quantity of risky securities in the market is given.

Looking at these assumptions, one may feel that the CAPM is unrealistic. However, the value of a model depends not on the realism of its assumptions, but on the validity of its conclusions. Extensive empirical analysis suggests that there is a lot of merit in the CAPM.

139. APT:

While the CAPM represents a seminal contribution to the field of finance, many empirical studies have pointed towards its deficiencies in explaining the relationship between risk and return.

A key challenge to the CAPM came from a set of studies that have suggested that it is possible to rely on certain firm or security characteristics and earn superior returns even after adjustments for risk as measured by beta.

Examples: Banz found that small cap stocks outperformed large cap stocks on a risk adjusted basis; Basu found that low P/E stocks outperformed high P/E stocks, after adjustment for risk; more recently, Fama and French documented that 'value stocks' (stocks with high book-to-market price ratios) generated larger returns than 'growth stocks' (stocks with low book-to-market ratios), on a risk adjusted basis.

In an efficient market such return differentials should not exist. Does it mean that the markets are not particularly efficient for long periods of time? Or, does it mean that the markets are efficient but a single – factor model such as the CAPM does not capture risk adequately?

Since it is unlikely that markets are inefficient for extended periods of time, financial economists began looking for alternative risk-return models, beyond the CAPM. In the mid-1970s, Stephen Ross developed an alternative model called the Arbitrage Pricing Theory (APT) which is reasonably intuitive, requires only limited assumptions, and allows for multiple risk factors. The APT does not require the following assumptions (which under gird the CAPM): the utility functions of investors are quadratic; security returns are normally distributed; the market portfolio that contains all risky assets is mean-variance efficient.

The APT only assumes that the capital markets are perfectly competitive and that investors always prefer more wealth to less wealth with certainty.

Unit – III

Long Type
Questions and Answers

Unit- III

Long Type Questions and Answers

Question 1

(a) Define strategy. Discuss the characteristics of a strategy.

(b) Briefly explain the steps involved in the process of Strategic Management.

(c) What are the various levels of strategy?

Answer (a)

Strategy: In military usage 'strategy is the science and the art of deploying forces for battle'.

By strategy, managers mean their large scale, future oriented plans for interacting with the competitive environment to optimise achievement of organisation objectives. Thus,

- Strategy represents a firms 'Game Plan'.
- Strategy provides a frame work for managerial decisions.
- A strategy reflects a company's awareness of how to compete, against whom, when, where, and for what.

Strategy is potentially very powerful tool for coping with the conditions of change with surround the firm today; but it is complex, costly to introduce, and costly to use. It is a managerial tool, not only for the firm but also for a broad spectrum of social organisations.

Definition: "A strategy is a set of decision-making rules for guidance of organisational behaviour".

Distinct rules:

- Rules (yardsticks) by which the present and future performance of the firm is measured (objectives).
- Rules for developing the firm's relationship with its external environment (what products, technology the firm will develop, where and to whom the products are to be sold, how wilt the firm gain advantage over competitors (Business strategy).
- Rules for establishing the internal relations and processes within the organisation (organisational concept).
- Rules by which the firm conducts its day-to-day business operations (operating policies).

Characteristics of a strategy:

1. The process of strategy formulation results in no immediate action. (Rather, if sets the general directions in which the firm's position will grow and develop).

2. Strategy must next be used to generate strategic projects through a search process. (The role of strategy in search is first to focus on areas defined by the strategy, and second to filter out and uncover possibilities which are inconsistent with the strategy).
3. Strategy becomes unnecessary whenever the historical dynamics of an organisation will take it where it wants to go. (This is to say, when the search process is already focussed on the preferred areas).
4. Strategy formulation must be based on incomplete and uncertain information about classes of alternatives.
5. Successful use of strategy requires strategic feedback.
6. Strategy and objectives are distinct.

Objectives represent the ends which the firm is seeking to attain,

- While the strategy is the means to these ends.
- A strategy which is valid under one set of objectives may lose its validity when the objectives of the organisation are changed.
- Formulation of strategy produces no immediate productive action in the firm. It is expensive process both in terms of money and managerial time.
- Strategy can usefully contribute to the firm's performance.

When to formulate strategy?

- When rapid changes occur in the environment of the firm. This may be caused by the saturation of traditional markets, technological discoveries inside or outside the firm, or a sudden influx of new competitors.
- Under these conditions, established organisational traditions and experiences no longer suffice for coping with the new opportunities and new threats without unifying strategy different parts of the organisation may develop different contradictory and ineffective responses. E.g. Marketing, Production, R & D Departments etc.

When confronted with discontinuities, the organisation is faced with two very difficult problems.

- How to choose the right directions for further growth from among many and imperfectly perceived alternatives?
- How to harness the energies of a larger number of people in the new choosen direction?

Answers to these questions are the essence of strategy formulation and implementation. At this point, strategy becomes an essential and badly needed managerial tool.

Answer (b)

Steps in the process of Strategic Management:

Strategic management is the implementation and control of an agreed strategy. According to Ward, it is an 'integrated management approach drawing together all the elements involved in planning integrating and controlling a business strategy'. Accordingly, strategic management covers the entire cycle of planning and control, at a strategic level.

1. **Strategic Analysis.**

It is concerned with understanding the strategic position of the organisation. The stages in strategic analysis are as follows:

(i) Mission: A mission might be expressed in a mission statement. It can serve three functions; it can be the fount of the organisation's value system; it can indicate the firm's long-term approach to business and its commercial rationale for existing; it can be used for public relations. A mission rarely changes.

(ii) Goals: Are not necessarily quantified, but they interpret the mission to the needs of different stakeholders (e.g. customers, employees, shareholders), who might have conflicting interests.

(iii) Objectives: Should embody mission. Generally, they are quantitative measures, against which actual performance can be assessed. Objectives to change.

(iv) Environment Analysis (External Appraisal): Is the scanning of the business environment for factor relevant to the organisation's current and future activities.

(v) Position Audit: (incorporating an Internal Appraisal) examines the current state of the entity in respect of resources of tangible and intangible assets and finance, products, brands and markets, operating systems such as production and distribution; internal organisation; current results; return to stakeholders.

(vi) Corporate Appraisal: Is a critical assessment of the SWOT in relation to the internal and environmental factors affecting an entity in order to establish its position prior to the preparation of a long term plan. This is also called SWOT analysis.

(vii) Gap Analysis: Arises from a projection of current activities into the future to identify if there is a difference between the firm's objectives and the results from its continuation of current activities.

2. **Strategic Planning.**

Choice of strategies: Is based on strategic analysis. It involves:

(i) Strategic option generation - A variety of alternatives are considered, relating to the firm's product and markets, its competitors and so forth. Examples of strategies might be:

- Increase market shares?
- International growth?
- Concentration or core competencies?
- Acquisition?

(ii) Strategic options evaluation - Each option is then examined on its merits.

- Does it increase existing strengths?
- Does it alleviate existing weaknesses?
- Is it suitable for the firm's existing position?
- Is it acceptable to stakeholders?

(iii) Strategic selection - involves choosing between the alternative strategies. (This process is strongly influenced by the values of the managers in selecting the strategies).

(a) The competitive strategies are the generic strategies for competitive advantages in organisation will pursue (a condition which is a proof against erosion by competitor behaviour or industry evolution). They determine how you compete.

(b) Product market strategies (which market you should enter or leave) determine where you compete and the direction of growth.

(c) Institutional strategies (i.e., relationship with other organisations) determine the method of growth.

3. **Strategy Implementation:** Implementation of strategy has to be planned. This is the conversion of the strategy into detailed plans or objectives for operating units.

(i) Some plan specifies in detail how the activities should be carried over.

(ii) Others specify targets which managers are expected to reach, using their own initiatives as to how they may reach them.

The planning of implementation has several aspects.

- Resource planning (i.e., finance, personnel) - This involves assessing the key tasks, and the resources to be allocated to them.
- Operation planning
- Organisation structure and control system

Sub-strategies are needed for products and markets, human resources and so on. The process is multi-layered.

(a) Corporate strategy: In the words of Johnson and Scholes corporate strategy is concerned with what type of business, the company as a whole should be in and is therefore concerned with decisions of scope. Corporate strategy involves issues such as:

- diversifying or limiting the activities of the business;
- investing in existing units, or buying new business;
- surviving

(b) Business strategy: For example, this can involve decisions as to whether in principle a company should:

- segment the market and specialise in particularly profitable
- Complete by offering a wider range of products.

(c) Operational and functional strategies - Involve decisions of strategic importance, but which are made or determined at operational levels. These decisions include product pricing, investment in plants, personnel policy and so forth. The contribution of these different functions determines the success of the strategy as effectively, a strategy is only implemented at this level.

4. **Review and control; Assess actual performance in the light of plans, etc.**

Answer (c)

In a multi-business enterprise, having several SBUs, there would be three levels of strategy, viz., corporate strategy, SBU strategy and functional strategy. In enterprises which do not have SBUs, there will be only two levels of strategy, i.e., corporate strategy and functional strategies.

Corporate Strategy: Corporate strategy is the long-term strategy encompassing the entire organisation. Corporate strategy addresses fundamental questions such as what is the purpose of the enterprise, what business/businesses it wants to be in (portfolio strategy) and how to expand/get into such business/businesses (for example, by establishing Greenfield enterprises or by M & As). In other words, "Corporate-level Strategic Management is the management of activities which define the overall character and mission of the organisation, the product/ service segments it will enter and leave, and the allocation of resources and management of synergy among its SBUs".

Corporate strategy is formulated by the top level corporate management (board of directors, CEO, and chiefs of functional areas).

SBU Strategy: SBU-level strategy, sometimes called Business Strategy or Competitive Strategy, is concerned with decisions pertaining to the product mix, market segments and manufacturing competitive advantages for the SBU. While corporate strategy decides the business portfolio (i.e., the types of business); the competitive strategy decides the strategy/strategies to succeed in the chosen business/businesses. SBU strategy has to conform, obviously, to the corporate philosophy and strategy.

In short, "SBU-level strategic management is the management of an SBU's effort to compete effectively in a particular line of business and to contribute to overall organisational purposes".

The responsibility for SBU strategy is with the top executives of the SBU who are normally second-tier executives in the corporate hierarchy. In Single-SBU organisations senior executives have both corporate and SBU-level responsibilities.

Functional Strategies: Functional-level strategies are strategies for different functional areas like production, finance, personnel, marketing etc. In other words, "functional-level strategic management is the management of relatively narrow areas of activity, which are of vital, pervasive, or continuing importance to the total organisation".

Functional-level strategy is the responsibility of functional area heads.

Question 2: "Every company needs both Financial Objectives & Strategic Objectives".

List the representative kinds of Financial Objectives and Strategic Objectives.

Answer:

Various financial objectives would include:-

- Growth in revenue
- Growth in earning
- Higher dividend
- Bigger profit margin
- Higher return on invested capital
- Attractive economic value added performance
- Strong bond and credit rating
- Bigger cash flow
- A rising stock price
- Attractive and sustainable increase in market value added
- Recognition as a blue chip company
- A more diversified revenue base
- Stable earning during period of recession

Various strategic objectives would include:

- Higher product quality
- Lower cost
- Bigger market share
- Ability to penetrate market
- Broader and more attractive product line
- Superior on time delivery
- Stronger brand name
- Superior customer service
- Stronger global distribution and sales capabilities
- Recognition as a leader in product innovation and technology
- Wider geographic coverage
- Higher levels of customer satisfaction.

Question 3: Differentiate:

(a) Plan and policy;

(b) Programmed and contingency strategy;

(c) Effects of learning and experience curve;

(d) Market and marketing research.

Answer (a)

Plan and policy: While plan is directed towards achievement of specific objectives over a specified period of times, a policy is a guide which delimits action but does not specify time. It is open ended, rather timeless. Thus, "a policy is not a plan, but a guiding cannon of interest". Policies are planned expressions or understandings towards the range of behaviour, which guide or channel thinking and action in decision making and limit for discretionary action by individuals responsible for implementing overall plans.

Answer (b)

Programmed and contingency strategy: A programmed strategy is a strategy which is planned in such a detailed and integrated way that it is difficult to change it, once it has begun to be implemented. A contingency strategy requires the planner to choose the preferred strategy, given the best estimates of conditions and other strategic choices. But it is flexible enough to allow for shifts in the thrust of the plan, when conditions warrant it.

In effect, programmed strategies emanate from first-generation planning. Second generation planning leads to contingency strategy formation. Programmed planning is suitable for stable environment with people who prefer well-defined roles. The contingency strategy is suitable for unstable environment with people who prefer variety and stimulation.

Answer (c)

Effects of learning and experience curve: Learning effects typically refer in a narrow way to labour costs alone, as they reflect short term cost reductions achieved through learning by doing. On the other hand, experience effects refer to the reduction in total costs achieved over the total life of a product. Both are measured by total accumulated output to date. But, learning and experience curves differ with respect to the range of costs covered, the range of output during which the reduction in costs supposedly takes place; and the causes of cost reduction. Learning by doing is then seen to be something that not only affects assembly operators, but everyone involved in an organisation, from the chairperson to the apprentice - all of whom should improve the performance of their role through experience. This is just a fancy way of saying that practice makes perfect.

Answer (d)

Market and Marketing Research: Market research properly, is only one part of marketing research. Information is essential if management is to set realistic objectives and strategies, and make effective decisions. Within the modern business, data from many sources is processed into information systems. Some of the necessary data can only be provided by specific research - marketing research, defined as "the systematic gathering, recording and analysing of data about problems relating to the marketing of goods and services".

Market research on the other hand, is concerned with information about specific markets, their makeup, their behaviour and the change in them. Market research tends to be quantitative and much of it is concerned with measurement of parameters which may have been shown to be important by marketing research.

Question 4: Discuss how 'Gap Analysis' might be applied to a product/market situation.

Answer:

If 'gap analysis' is applied to a 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 a 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 new 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 new market development strategies;
- ➢ a strategy of product and market diversification through a takeover policy;
- ➢ a marketing mix strategy to gain the required position in target markets.

Question 5: (a) What does Corporate Mission mean?

(b) What is a Mission Statement?

(c) State the benefits of Mission Statement?

Answer (a):

Corporate Mission: A mission can be defined as a general objective. It is the fundamental unique purpose that sets it apart from other firms of its type. It indicates the nature and scope of business operations in terms of product, market and technology.

Corporate mission establishes the principal concentration of company effort in terms of customers. It provides a systematic yet somewhat visionary overview of a company's position in the competitive world. A mission provides the basis of awareness of a sense of purpose, the competitive environment, the degree to which the firm's mission fits its capabilities and the opportunities which the environment offers.

BHEL describes its mission as follows: To achieve and maintain a leading position as suppliers of quality equipment, systems and services to serve the national and international markets in the field of energy. The areas of interest would be the conversion, transmission, utilisation and conservation of energy for applications in the power, industrial and transportation fields. To strive for technological excellence and market leadership in these areas'.

Through its mission, a company indicates what it is trying to achieve and in what field.

Mission represents company's objectives in qualitative terms. Ackoff refers to such objectives as stylistic objectives.

It may be noteworthy that corporate missions are more ethical and philosophical in character- and reflect the top management's values. They do not have a fixed time period. While stating its mission the company's management should go further and spell out in precise terms what the company has to accomplish and the extent of managerial action required to fill the gap. This is why an enterprise develops a set of long-range objectives.

Answer (b):

Mission Statement: A Mission Statement is a document, embodying some of the matters as outlined above. A Mission Statement provides a statement to insiders and outsiders on what the organisation stands for. It conveys the grand design of the firm and conveys what it wants to be. A Mission statement might be a short sentence, or a whole page. It is intentionally unquantified and vague and is sometimes seen as a statement of an organisation's values, rather than its distinctly commercial objectives. It should be a statement of the guiding priorities that govern a firm's behaviour. Mission statement should be simple to understand and as such jargons and buzzwords should be avoided. It should be appropriate to the organisation in terms of its culture, history and shared values. It should be consistent with the present situation. It should be written in a positive tone. Mission statement should be unique to the organisation. Further, it should be enduring and should guide and inspire the organisation for many years to come. Mission Statements are rarely changed as otherwise they have less force, and become mere slogans. However, there is no standardised content or format of Mission Statement.

Answer (c):

Benefits of Mission Statement:

The benefits of Mission Statements are:

Mission Statements

- describe what the company is about;
- provide a guideline philosophy : give direction in case of doubts;
- display the area in which the company is operating;
- define the broad social purpose and scope of the organisation;
- clearly chart out the future direction for the organisation and establishes a basis for organisational decision making;
- enable employees to clearly understand the values and principles that will guide them in the present and future activities;
- provides a realistic assessment of what is attainable in the future by the organisation, considering its culture, history and shared values;
- encourage commitment and energise all employees towards fulfilling the mission;
- guide and inspire the organisation for many years to come;
- stimulate debate as to how the mission can be implemented;
- of course, mission statements always run the risk of a cynical rejection.

Question 6: Distinguish between:

(a) Plan and Policies;

(b) Corporate Planning and Long-Range Planning;

(c) Strategic Management and Operational Management.

Answer (a)

Plan and Policies: Planning is an intellectual process of determining the objectives of an organisation. It is based on an analysis of the organisations.

(i) strengths and weakness &

(ii) competitive and environmental factors.

It identifies and evaluates alternative courses of achieving such objectives with a view to choosing one or more of the alternatives and finally developing programmes and operational plans for achieving these objectives.

- Planning is futuristic. It involves formal rational process.
- Policy is a guideline for action for subordinates.

It could be a major policy or a minor policy, the corporate policy or a divisional policy. The purpose of policy, as a guide to decision making is to spell out and clarify strategy. It sharpens the meaning of the strategy and guides specific decisions in a direction that supports the strategy. It is key administrative tool for effective implementation and execution of strategies.

Answer (b)

Corporate Planning and Long-Range Planning: Corporate planning is concerned with determination of objectives treating the company as a whole and developing means to achieve the overall Company's objectives. It may encompass both short periods as well as long periods. It is an integrated system approaching plans of different components of the organisation. Corporate Planning is done at the corporate level.

Long Range Planning is a systematic and formalised process concerned with directing and controlling future options of an enterprise towards desired objectives for periods spreading generally over 5 or more years. It provides an opportunity to management to anticipate future problems and to have greater freedom of action to resolve them in an orderly manner.

Answer (c)

Strategic Management and Operational Management: Strategic management is defined as the set of decisions and actions resulting in the formulation and implementation of the strategic designed to achieve the objective of the organisation. It relates the firm to its environment in a way which will assure its continued success and make it secured from surprise. It is non-routine and forward looking.

Operational Management relates to day-today activities or current operations and therefore; concentrates only on short term issues. It ensures that the functional activities of production, distribution, selling and accounting are efficient. Operational managers are thus concerned with day-today problems like resource allocation, scheduling, monitoring performance etc. and will ensure that the policies and procedures are implemented.

Question 7: (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 as was 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 some 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:

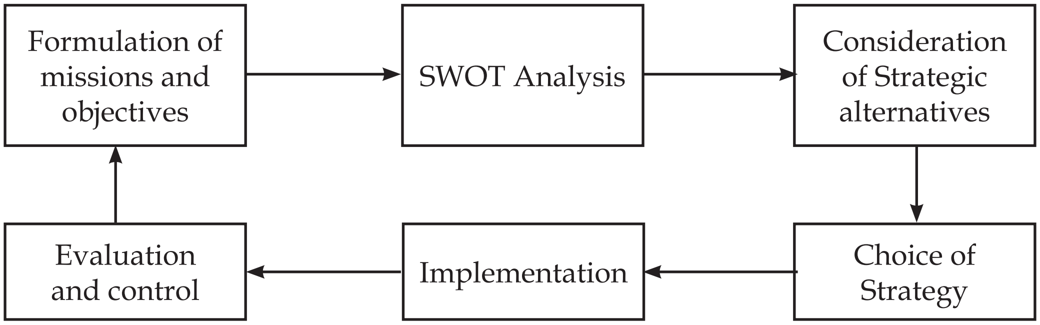
- Environmental scanning covering both first-hand surveys of demand and supply, stressing forecasts and second-hand information emerging from various sources such as Country Studies by the Economist Intelligence Unit, NCAER and others.
- Scenario planning taking into consideration the emerging problems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

Both of these are essential aspects of sensitive management, involved as it is in making the future today. The prospects of growth and the hurdles to cross are 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

Question 8: The strategic management process encompasses three phases-strategy formulation, implementation, and evaluation and control. —Discuss.

Answer:

1. The strategic management process encompasses three phases which together involve a number of systematic steps. These three phases are strategy formulation, implementation and evaluation and control.



Strategy formulation:

This phase involves four important steps, viz,

(i) determination of missions and objectives;

(ii) analysis of strengths and weaknesses of the firm and-the environmental opportunities and threats (SWOT Analysis);

(iii) generation of alternative strategies, and

(iv) choosing the most important strategy.

Strategic management can be defined as the art and science of formulating implementing and evaluating cross-functional decisions that enable an organisation to achieve its objectives. And, strategy is a means to achieve these objectives. It is, thus quite obvious that determining the mission' (which influences objectives) and objectives is the first step in strategy formulation.

The mission defines the broad social purpose and scope of the organisation whereas objectives more specifically define the direction to achieve the mission. Objectives help translate the organisational mission into results. While objectives may be generic in their expression, goals set specific targets to be achieved within a time frame.

In Strategic Management, the term strategic is used to mean 'pertaining to the relation between the firm and its environment'. This indicates the role of SWOT Analysis in Strategic Management. The strengths and weaknesses of the firm and opportunities and threats in the environment will indicate the portfolio strategy and other strategies it should pursue.

An organisation should address questions such as what are the changes (including possible future changes) in the environment which can be exploited utilising its strengths? What are the threats and does it have the strength to combat the threats? How can it mobilise its strength? What are its weaknesses? Can it overcome or minimise its weaknesses?

Given the mission and objectives and having analysed the strength and weaknesses of the firm and the environmental opportunities and threats, the strategists should proceed to generate possible alternative strategies. There may be different strategic options for accomplishing a particular objective. It is necessary to consider all possible alternatives to make the base for choice wide.

The purpose of considering different strategic options is to adopt the most appropriate strategy. This necessitates the evaluation of the strategic, alternatives with reference to certain criteria like suitability, feasibility and acceptability.

Implementation: Operationalising the strategy requires transcending the various components of the strategy to different levels; mobilising and allocation of resources; structuring authority, responsibilities, tasks and information flows; and establishing policies. Strategy implementation, often described as the action phase of the strategic management process, covers strategy activation and evaluation and control. Strategy is a blue print indicating the course of action to achieve the desired objectives. The objectives are achieved by proper activation of the strategy. The activation or implementation step in the strategic management encompasses the operational details to translate the strategy into effective practice - communicating and motivating; setting goals; formulating policies and functional strategies; organisational structuring; leadership implementation and resource allocation.

A good strategy by itself does not ensure success. The success depends, to a very large extent, on how it is implemented. Many strategies fail to generate the expected results because of the failure to properly implement the strategy. Strategy implementation is more operational in character, requires special skills in motivating and managing others, permeates all hierarchical levels and requires co-ordination among many.

The implementation process varies considerably between different types and sizes of organisations. The transition from strategy formulation to strategy implementation requires a shift in responsibility from strategists to divisional and functional managers. Implementation problems can arise because of this shift in responsibility specially if strategy-formulation decisions came as a surprise to the middle-level and lower-level managers.

Some writers break the strategy implementation phase into three components, viz.

(i) operationalising the strategy (communicating strategy, setting annual objectives, developing divisional strategies and policies, and resource allocation);

(ii) institutionalising the strategy (organisational structuring and leadership implementation)

(iii) evaluation and control of the strategy.

Evaluation and Control:

It is the last phase of the strategic management process. The objective is to examine whether the strategy as implemented is meeting its objectives and, if not, to take corrective actions. Continuous monitoring of the environment and implementation of the strategy is essential. In the diagram, the loop connecting the evaluation and control to the starting point of the strategic management process indicates the strategic management is a continuous process, the evaluation providing the feedback for modifications.

The traditional approach to control is to compare the actual performance with the standards established and to take corrective measures if there are deviations. This reactive measure is not sufficient to control a strategy that takes a long period for implementation and to produce results. The uncertain future environment makes continuous evaluation of the planning premise and strategy implementation necessary.

Competition for the future is different from competition for the present. It is necessary to exercise strategic control which is concerned with tracking the strategy as it is being implemented, detecting problems or changes in underlying premises, and making necessary adjustments. In contrast to past-action control, strategic control is concerned with controlling and guiding efforts on behalf of the strategy as action is taking place and while the end result is still several years into the future.

There are two broad types of control -strategic control and operational control. Strategic control augmented by operational control makes strategic implementation more effective. While strategic controls attempt to steer the company over extended time period (usually five years or more), operational controls provide post-action evaluation and control over short time periods (usually from one month to one year).

The basic types of strategic control are - premise control, implementation control, strategic surveillance and special alert control. The basic types of operational control are - budgeting, scheduling, and focusing on key factors.

Question 9: Objectives of a corporate organisation can be of different types. Elucidate.

Answer:

Objectives form the basis for the functioning of an organisation. Indeed, objectives help define 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 the organisation. Thus, objectives define the enterprise. Objectives are those ends which the organisation seeks to achieve by its existence and operations. Broadly speaking, objectives cover large-range company aims, more specific departmental goals, and even individual assignments. Thus objectives may pertain to a wide or narrow part of an enterprise, and they may be either long or short range.

Often objectives of a particular nature are given a special name, e.g. sales quotas, expense ratios, budgets, absentee rates, market positions. The use of such descriptive terms does riot remove them from broad category of objectives. Objectives may be tangible or intangible. Again, objectives should not be static, they should be dynamic, and i.e., changes in the environment and/or changes in the organisational strengths and weaknesses may call for modifications to objectives.

To formulate clear objectives, it is essential to get definite answers to certain questions, viz.

- ✓ 'What business the company is in'?
- ✓ 'What should the company's business be?'
- ✓ 'What will the company's business be?'

While the important long-term overall objectives may remain without significant change, modifications to or change of some of the objectives and the definition of the business may be necessitated by environmental factors.

Organisations with a hierarchical structure normally have a hierarchy of objectives to be pursued at different levels, viz. mission, corporate objectives, SBU objectives, divisional objectives, departmental objectives, individual objectives.

Objectives can be classified into different types which have been discussed below:

Economic objectives:

Some of the social and economic objectives are so intertwined that it is difficult to separate them and it may be more appropriate to describe them as socio-economic objectives. However the following may be regarded as the important economic objective of business.

(i) Survival: The primary business of every business is to stay in business. Constant monitoring of the business environment and strategic planning are needed for survival in a competitive environment.

(ii) Return on investment: This is an important economic objective not only for private enterprises but also for many public sector enterprises. Private business is often profit motivated but the level of profit of a private enterprise aims at is likely to be influenced by its social outlook and a number of environmental factors like government policy, attitude of society, competitive and other conditions of the industry, etc.

(iii) Growth: Growth over time is also an economic objective of most of the business enterprises. A business may grow either vertically, horizontally or by diversification into unrelated areas. Growth may benefit not only the promoters and shareholders but also the customers, suppliers and the national economy.

(iv) Innovation: The only one valid definition of business purpose is - 'to create a customer and because its purpose is to create a customer, the business enterprise has two-and only two basic functions,' i.e. marketing and innovation (Drucker).

(v) It is not enough for the business to provide just any economic goods and services; it must provide better and more economic ones. It is not necessary for the business to grow bigger; but it is necessary that it constantly grows better (Drucker).

(vi) Market Share: An increase in or maintenance of its market share is an important economic objective of many companies. Some companies also strive for market leadership and sometimes that may be even at the cost of profit maximisation.

Social objectives

There has been a growing recognition of the social objectives and responsibilities of business.

"Business traditionally has Been responsible for quantities - for the supply of goods and jobs, for costs, prices, wages, hours of work, and for standards of living. Today, however, business is being asked to take on responsibility for the quality of life in our society. The expectation is that business - in addition to its traditional accountability for economic performance and results - will concern itself with the health of the society that it will come up with the cures for the ills that currently beset us, and, indeed, will find ways of anticipating and preventing future problems in these areas". (Barker)

"The more educated the society becomes the more interdependent it becomes, and more discretionary the use of its resources the more marketing will become enmeshed in social issues. Marketing personnel are at interface between company and society. In this position, they have the responsibility not merely for designing a competitive marketing strategy, but sensitising business to the social, as well as the product, demand of society". (Stern).

Social objectives of business may be grouped into three broad categories, viz.,

(i) objectives which protect consumer interests;

(ii) objectives which protect the interests of employees; and

(iii) objectives which protect the interests of the society.

Social and economic objectives encompass promoting the interests of different categories of people like the shareholders, workers, consumers, local population and the general public. The economic and social and objectives may conflict with each other. Fulfilment of some of the social objectives may adversely affect the economic objectives. Again, some of the social-objectives may conflict with each other. It is, therefore, necessary to reconcile the conflicting objectives or to achieve a proper trade-off between the different objectives.

Primary and Secondary objectives:

Some companies establish two sets of objectives, viz., Primary and secondary objectives. In many such cases, the secondary objectives resemble what are generally described as the social responsibilities of business.

The important ultimate objectives of a responsible company are as follows:

(i) the extension, development and improvement of the company's business and the building up of its financial independence;

(ii) the payment of fair and regular dividends to the shareholders;

(iii) the payment of fair wages under the best possible conditions to the employees;

(iv) the reduction of prices to consumers.

The major secondary objectives of the company are:

(i) to provide a bonus for the employees;

(ii) to assist in promoting the amenities of the locality (without thereby attempting to dominate it);

(iii) to assist in developing the industry of which the firm is a member;

(iv) to promote education, research and development for -the industry or for any other purpose approved by the top management.

Short-run and long-run objectives:

A company may have short-run and long-run objectives. The short-run objectives may be a means to achieve long-run objectives, e.g., the short-run objective of market penetration may be a strategy to help achieve the long-run objective of market dominance or profit.

A company will normally pursue the secondary objectives (stated above) as long term objectives. But that does not mean that long-term objectives are secondary objectives. Some of the long-term objectives like profit are essentially primary objectives of several companies. However, some of the long-term objectives of several companies, like development of the local community, assisting the development of industry of which it is a part, etc., are secondary objectives.

Question 10: What are the advantages and disadvantages of a formal system of Strategic Planning?

Answer: The advantages of a formal system of strategic planning might be as follows -

- As companies increase in size, the risks also increase. (Risks would be defined as the potential losses from the inefficient and ineffective use of resources). Strategic planning helps in managing these risks.
- Strategic planning can give a sense of purpose to the personnel in the company, leading to an improved quality of management, and it can encourage creativity and initiative by tapping the ideas of the management team.
- Companies can not remain static - they have to cope with changes in the environment. A strategic plan helps to chart the future possible areas where the company may be involved and draw attention to the need to keep on changing and adopting, not just to stand still and survive.
- Strategic plans are not merely stating on paper the departmental objective which has always existed. They help to make them more effective and workable.
- A well prepared plan drawn up after analysis of internal and external factors - risks and uncertainties- is in the long term best interests of the company because better quality decisions will be made (on the whole) and management control can be better exercised.
- Long-term, medium-term and short-term objectives, plans and controls can be made consistent with one another.

Of course, a business can grow and prosper without a formal strategic plan or a strategic planning process. Strategic planning might appear to be the very antithesis of entrepreneurship. However, Drucker has argued that an entrepreneur who builds a long lasting business has a theory of business which informs his business decisions. In large organisations that theory of the business has to become public knowledge, as decisions can not be taken by only the person. As Drucker says, "business enterprise — requires that entrepreneurship be systemised, spelled out as a discipline and organised as work".

The disadvantages of a formal system of strategic planning might be as follows:

- Many of the strategic planning models fail to account for how strategies are made. The whole planning exercise - was programmed in great detail: the delineation of steps, the application of checklists and techniques, the scheduling of this whole thing. The missing detail was the strategy formation itself. In practice, there is little evidence to show that planning activities can be linked effectively to strategy formation.
- Empirical studies have not demonstrated that planning necessarily contributes to improved performance. Data about planning process is however, hard to gather. Anecdotal evidence does not point to its success.
- Strategic planning often occurs in an annual cycle. But a firm cannot allow it to wait every year for the month of February to address its problems.
- Formal planning discourages strategic thinking. Once a plan is locked in place, people are unwilling to question it.
- Planning can result in an obsession with control, which result in a reluctance to consider truly creative ideas, and a fear of risk. Planning gives an illusion of control even though the forecast assumptions on which it is based are wrong.
- Initial problems in planning often result in a negative image of planning. Good plans can be poorly implemented, resulting in failure. A good strategy can fail during implementation due to inadequate operating plans and policies.
- Organisational resource positions may be an obstacle to effective planning.
- Effective planning can be time consuming and expensive.

Question 11: (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 a managerial commitment to achieve specific performance targets within a 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 on 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 organisation 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 an organisation's strategy e:

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 women 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.

Question 12: (a) Define the following terms with illustrations:

(i) Tactics, (ii) Goals, (iii) Objectives and (iv) Strategies.

(b) List down at least three situations, where strategic planning is not suitable/ relevant.

Support your answer with examples.

Answer (a)

(i) Tactics: It represents a short range plan for operations where an element of conflict is involved; it represents a plan which can emphasis on counter actions of other players in. the environment. Tactics are adroit devices for achieving a goal. Thus, tactics represent a special type of short range plan.

(ii) Goals: The implication of a goal or target is to achieve an intermediate, specific, quantitative and qualitative aim by a certain time as part of the grand plan. A plan can have many goals.

For large engineering projects employing modern management techniques, goals are usually called events or milestones.

(iii) Objectives: Objectives are the ultimate end results, which are to be accomplished by the overall plan over a specified period of time.

(iv) Strategies: Strategies is an integrative and dynamic concept. It encompasses the objectives and sub-plans of the organisation and a plan of action for the achievement of these objectives and sub-plans incompetitive environment. It considers not only ends, but also means.

Answer (b)

The first limitation shows up in the way planning is usually restricted to hard business concerns like building facilities, setting up marketing programmes and balancing the portfolio of business units. These are critical matters, but there is a conspicuous lack of attention to the different new soft issues that have become so critical; the revolution information technology, labour productivity, product quality, customers' attitudes, government regulations and a vast range of other social concerns. The crux of the matter is that these problems are so unusual and confusing that few people know how they should be handled and they are often avoided because they involve sensitive socio-political controversies that can be personally disturbing.

The second problem involves difficulties in the working relations between executives, operating managers and employees. Most companies advocate decentralised planning, but the reality is that the chain-of-command usually imposes decisions on lower units, thereby interfering with the autonomy that people need to do their jobs in an innovative way. A hierarchical, authoritarian organisation is prone to create planning system that is merely an appendage to its bureaucracy, transforming what should be a creative entrepreneurial process into another useless chore. Procedures like annual planning cycle have not been terribly effective. Strategy becomes a routine exercise. The process ends up having the perverse effect of desensitising people to strategic issues.

The third limitation is that the planning process is isolated from the external groups that critically affect the company; labour leaders, consumer advocates, government officials and the like. Large firms have staffs responsible for consumer affairs, public policy and other such boundary spanning functions, but these units try to focus on conducting studies rather than working with stakeholders. Most companies are entangled in a hectic web of difficult external relationships, yet contracts with such groups are usually limited 10 accusatory exchanges with take place through the media and the courts. The participation of outsiders in strategic decisions is anathema to most managers and it poses a realistic problem of consuming time and risking painful confrontations. The most severe obstacles, however, is a common belief that stockholder collaboration is a moral luxury rather than a practical means of injecting a healthy dose of reality into the planning process.

Question 13: Differentiate: (a) Mission and Objectives, (b) ETOP and SAP, (c) Official & Operative Objectives.

Answer (a):

Missions and Objectives:

The two most basic questions faced by strategists are:

(i) What business are we in?

(ii) Why are we in business?

An answer to the first question requires a consideration of the mission definition or the scope of the business activities the firm pursues. The second question involves establishing objectives to be accomplished. Both questions help define the nature of the business and provide a framework for analysis, choice, implementation and evaluation processes.

Answer (b):

ETOP and SAP: Environmental diagnosis seeks a statement of problems and opportunities, the environment is offering. Preparation of Environmental Threat and Opportunity Profile (ETOP) is one of the systematic techniques for such purpose. The environmental sectors in the analysis are listed in summary fashion. In a more extensive diagnosis, the sub-factors would be examined first and the summary ETOP would be prepared.

The Strategic Advantage Profile (SAP) is a tool for making a systematic evaluation of the enterprise's strategic advantage factors which are significant for the company and its environment.

Executives develop a SAP and match it with the ETOP to create conditions for adjusting or changing strategies or policies.

Answer (c)

Official & Operative Objectives: Operative objectives are the ends actually sought by the organisation. They can be determined by analysing the behaviour of the executives in allocating resources. Official objectives are those ends which firms say they seek on official occasions, such as public statements to general audience. The objectives that count are those the strategists put their money and time behind. For instance, executive's official goals may focus on providing employees with a quality work environment, while whether the operative goals are the same depends on how much money is spent to improve actual working condition.

Question 14 : (a) Discuss, in brief, the elements of a meaningful mission statement of a corporate organisation.

(b) Characterise the legal and the strategic role of the Indian Board of Directors (BOD).

Answer (a):

(a) The major elements of an effective corporate mission statement are:

- **(i) Clearly articulated:** The mission statement should be succinct and easy to understand so that the values and purposes and goals of the organisation are clear to everybody in the organisation and will be a guide to them.
- **(ii) Relevant:** A mission statement should be appropriate to the organisation in terms of its history, culture and shared values.
- **(iii) Current:** A mission statement may become obsolete after some time. 'Very few definitions of the purpose and mission of a business have anything like a life expectancy of thirty, let alone fifty years. To be good enough for ten years is probably all one can normally; expect' (Drucker). Environmental factors and organisational factors may necessitate modifications of the mission statement.
- **(iv) Written in a positive tone:** A mission statement should be capable of inspiring and encouraging commitment towards fulfilling the mission.

(v) Unique: An organisation's mission statement should establish the individuality, if not uniqueness, of the company.

(vi) Enduring: A mission statement should continually guide and inspire and be challenged in the pursuit of the mission of the organisation, never achieving the ultimate goal.

(vii) Acceptable to the target audience: The target audience has a bearing on the length, tone and visibility of the statement. Ideally, mission statement should define the customers, products/services, markets, technology philosophy and self-concept. Many mission statements are not however, so comprehensive. There are, however, differences of opinion regarding what a mission shall reflect. There are two schools of thought. One, the strategy school, which describes mission in terms of business strategy. The other, the ethics school, argues that mission is the cultural bind and talks about generating cooperation's among employees through shared values and standards of behaviour. Again, there are differences of opinion regarding for whose benefit the company exists — for shareholders/customers /employees/society at large/a combination of some or all of them. Further, the mission may reflect the value system of the promoters or top echelons of the company.

Answers to the following questions would help a company to arrive at its mission and to prepare its mission statement.

- What is the basic purpose of the organisation?
- What is unique about the organisation?
- What is likely to be different about the organisation five years down the road?
- What is in the organisation that will make it stand out in a crowd?
- Who are and who should be, the organisation's principal customers?
- What are and what should be the organisation's principal economic concerns?
- What are the basic beliefs, values and philosophical priorities of the organisation?

Answer (b): The Indian Companies Act does not define the BODs. Even directors are defined blandly as: 'it includes any person occupying the position of directors, by whatever name called' [Sec. 2(13)]. With the help of this open definition, we may infer that a BOD is a group of individuals each of whom is labelled as 'director'.

What is a BOD supposed to do? This, again, we can know inferentially by referring to the definition of 'managers' and 'managing director' in Section 2 and also Sections 291-293. Both these incumbents have to exercise their powers of management subject to the superintendence, control and direction of the Board. Thus, the BODs, in broad terms, are expected to perform the role of overseeing the running of the enterprise by its chief executive. It is expected to do this on behalf of the shareholders, who elect the directors on the board. And it is the BODs which, in turn, select the chief executive. The directors individually, have no power in the eye of law. It is only the collective BOD which has a superior total power over the chief executive.

In regard to BODs and their powers, the legal provisions are rather scanty. With mounting uncertainties and changes taking place in the environment, the role of BODs has begun to be viewed in a broader frame. There are inherent limitations of the legal provisions in capturing the vital ramifications of the changing role of BODs. Whether members of BODs should oversee the operations from a distance or limit themselves to taking broad policy decisions or should get themselves involved in detailed operational aspects continue to be debatable questions.

The members of the board may be having varying commitments in terms of their involvement with the strategic tasks i.e. (a) to initiate and determine; (b) to evaluate and influence and (c) to monitor. The degree of involvement of the board in the strategic affairs can be viewed as a continuum, ranging from 'phantom' board, with no real involvement, to 'catalyst' board? with a very high degree of involvement. Expectedly, highly involved boards tend to be very active. They take their task of initiating, evaluating and influencing and monitoring seriously and provide advice to the management whenever it is felt necessary and keep them alert. A catalyst board may be deeply involved in the strategic management process. The BODs of BHEL, HMT, HLL, L & T etc. have a reputation for their active involvement in strategic affairs. The degree of involvement lessens through rubber stamp to phantom in continuum and can be described as passive boards. Such boards in general do not initiate or determine strategy. The members' interest may be aroused only when a crisis overtakes the company. Very few Indian companies are fortunate to have catalyst boards or even boards with active participation. The boards of most of the companies in private sector are of passive types.

While a BOD is not expected 10 involve itself in day to day operating decisions, they are nonetheless expected to consider and give their views on all such matters that have long-term connotations. The directing functions have internal and external components. Internal components relates to various actions taken by the executives and their implications. External components refer to identifying broad emerging opportunities and threats in the environment and feeding them to the management so those strategic mismatches do not occur.

It is quite likely that many CEOs and even some board members may not want the board to be involved in strategic matters at more than a superficial level. The reasons are not far to seek. Many companies may not have an explicit or well-articulated strategy. The management of such companies take strategic decisions intuitively rather than through a rigorous process of search and analysis. Further, the managements of some companies do not like outside directors to know enough about the strategic decisions or postures. They may perceive the involvement of board members in strategic decision making as a threat to their power.

Question 15: Differentiate : (a) Strategic Planning and Strategic Management;

(b) Efficiency and Effectiveness; (c) Demand-pull and Cost-push inflation.

Answer (a):

Strategic Planning and Strategic Management:

(1) Strategic planning is focussed on making optimal strategy decisions, while strategic management is focussed on producing strategic results ; new markets, new products and/ or new technologies. To paraphrase P. Drucker, strategic planning is management by plans, while strategic management is management by results.

(2) Strategic Planning is an analytical process, while strategic management is an organisational action process.

(3) Strategic planning is focussed on business, economic and technological variables. Strategic management broadens focus to include psychological, sociological and political variables. Thus, strategic planning is about choosing things to do, while strategic management is about choosing things to do and also about the people who will do them.

(4) strategic management consists of:

- ➢ formulating strategies
- ➢ designing the firm's capability
- ➢ managing implementation of strategies and capabilities.

Answer (b):

Efficiency and Effectiveness: Efficiency is concerned with how well resources are utilised, irrespective of the purpose for which they are being used. Efficiency can often be measured as a quantity or value of output per unit of input resource.

Effectiveness is concerned with whether resources have been deployed in the best possible way and are being used to achieve the most worthwhile objectives.

Accordingly, it is possible to be efficient doing things that have little or no value, and it is possible to be effective in getting a job done, but use resources inefficiently in doing so.

Answer (c):

Demand-pull and cost-push inflation: Inflation is the phenomenon of rising prices of goods and services in general. It can come about due to a scarcity of supplies in relation to demand; this is known as demand-pull inflation. It may also result from an increase in the cost of some critical input, such as steel or petroleum, which then triggers off a gradual rise in prices in general; this is known as Cost-push inflation.

Question 16: Explain with example the terms Mission, the Vision, and the Strategic Intent Statements. Why and when is there likely to be conflict between them?

Answer: There are two senses in which mission affects an organisation's direction and performance. The strategy school views mission primarily as a strategic tool, an intellectual discipline which defines the business's commercial rationale and target market. It is perceived as the first step in strategic management. It exists to Answer two fundamental Questions: what is our business and what should it be? On the other hand, it is sometimes argued that a mission is the cultural glue that enables an organisation to function as a collective unity. In this case, it is a statement of values rather than description of ultimate commercial objectives. It is possible, however, to reach a more expanded definition of mission to include four elements: purpose; strategies; policies & standards of behaviour; and values. For there to be a strong sense of mission, the four elements must be mutually reinforcing.

A vision, which is our preference for how it should be identified, provides an organisation with a forward looking, idealised image of itself and its uniqueness. Vision can appear to be soft and non managerial. Because of this, having a dream or vision for an organisation sometimes can bring discomfort both to the visionary or visionaries and those vision impacts. Nevertheless, regardless of what it is called - a purpose, a goal, a personal agenda, a legacy, or a vision or dream - the positive consequences of having one is clear. It provides members of the organisation with a view of the future that can be shared, a clear sense of direction, a mobilisation of energy, and a sense of being engages in something important.

Strategic intent has a shorter perspective with an emotional content. Sometimes strategic intent of an organisation forms the major slogan of an organisation. Since such slogans are mission based, if and when environment compulsions make a company change its set mission, its slogan should similarly be changed. Accordingly, mission is a statement of fact; vision is the aspiration; and strategic intent is a vision with an emotional context, ego; will help one to achieve desired mission state faster.

Conflicts between them are likely to arise: internally - of leadership and externally for product life cycle.

Question 17: Conceptually, strategy of a firm consists of two inseparable parts: business strategy and corporate strategy.

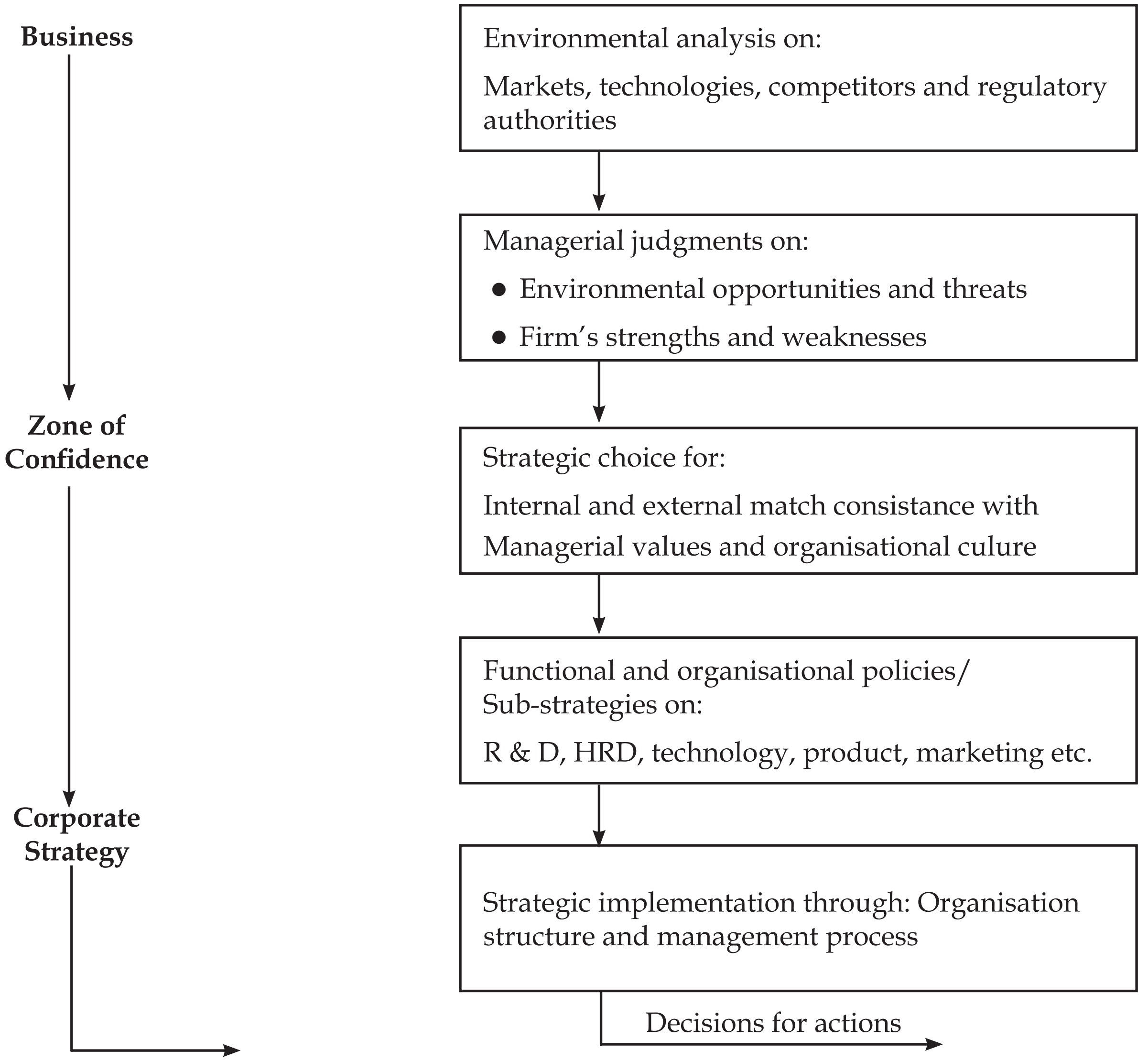
(a) Distinguish between business strategy and corporate strategy.

(b) Identify the key elements considered to develop and formulate such master strategy.

Answer (a):

Business strategy vs. corporate strategy:

Typically, both business strategy and corporate strategy coincide at a zone or stage in a strategic decision making framework presented below:



Business strategy: Once a firm has decided to operate in a particular business, it must then determine how to compete in that business. Decisions of this sort are known as business strategies. A firm's decision to choose product/service or expand the line etc. is called formulation of the business strategy since it enables the firm to compete more effectively in the chosen business.

Corporate strategy: On the other hand, corporate strategy defines the nature and range of businesses a firm intends to operate. A company's decision to expand its business portfolio move from cigarettes to biscuit and then confectionery or health drinks are examples of its corporate strategy decisions.

At the basic level, corporate strategy deals with the Question, "What businesses should we be?" whereas a business strategy addresses the Question, "How should we compete in that business?"

(b) Key elements to be considered to develop the master strategy:

The following key elements need to be deliberated upon to formulate the master strategy of a firm:

1. Markets to serve and an analysis of their nature.
2. Assess the current demand consumption rate, substitutes, identification of various types of consumers or market segment etc.
3. Supply related issues with due consideration of existing capacity, nature of technology and its impact; likelihood of adopting new technology.
4. Nature of industry who are the key players, assessment of competition, role of trade associations and governmental regulations.
5. Crucial factors for future success such as leadership in R & D, cost leadership, product/ service differentiation, customer service, product quality etc.
6. Position in market that is, measurement of marketing strengths, comparative assessment of market share, product quality, price etc.
7. Service abilities that are, rendering services fitted to consumer needs.
8. Financial management.
9. Adding to capabilities that are the fuller use of existing resources.
10. Vertical integration that is, ability to access a resource, both forward and backward.
11. Strategy of sequence that is, what activities to be performed first and how fast. Thus, product specification must precede cost estimation etc.
12. Resource limitations, be they human, physical or financial.
13. The right time to act and to make a change.

Question 18: Discuss in what sense Government as a segment of the environment may be regarded both as an aid and as an impediment to business.

Answer:

It is convenient to divide the role of government into two categories:

(i) Government acting as an aid and

(ii) Government acting as impediment to business. Infact, the government may simultaneously be performing both these aforesaid acts.

(i) Government acting as an aid to business:

Government can aid business by-

- Setting interest and exchange rates
- Providing education and training through govt. institutions or through grants to firms.
- Protecting intellectual /physical property through legislations
- Economic planning at key industry areas
- Giving tax/other incentives to industries and providing subsidies to the threatened industry, erection of tariff barriers against foreign products, imposition of quotas against foreign goods, etc.
- Imposing import tariffs to curb foreign business entries.
- Government assistance in start -up business. In many regions of high unemployment, government provide special concessions and assistance to start-up new businesses through different schemes. A similar situation arises in backward or non-industry areas, where government may provide special facilities or concessions are given for setting up new industries.
- Government as an excellent customer.
- Government as a sustainer of R & D.
- Government as aid to controlling wage cost through adopting appropriate policies.
- Government as provider of new business opportunities like favouring privatisation of new industries.

(ii) Government as impediment to business:

Government can act as an impediment by:

- Creating procedural regulations that are difficult to comply with
- By increasing its intervention in society through legislations and regulations detrimental to the industries
- Distorting markets by indirect taxation
- Discretionary production licenses
- Changing government policies in response to political pressures

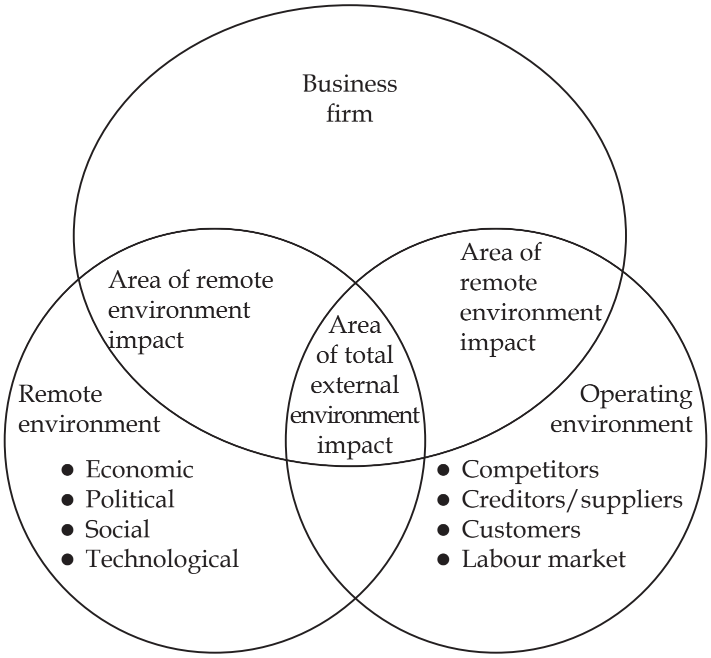
- Imposing restrictions such as monopoly controls, quota fixations etc. ,
- Putting short-term political advantages before long-term national benefits
- As a protector of the environment, government may curb activities believed to be causing pollution thru a spate of legislations
- As a guarantor of health and safety to workers, government may through various acts and legislations, increase the cost of production to the company
- Many governments have legislation to protect the consumer -against unscrupulous business practices. It may involve insistence of honest labelling of goods, contents of advertising, standardisation of contents in pharmaceutical and food products and price regulation in case of utility companies. The more extensive these laws are, the more hostile the business tends to become toward these.

Question 19: Explain the importance of environment analysis in Strategic Management.
Answer:

Environmental Analysis: External and often largely uncontrollable factors influence a firm's choice of direction and action, and ultimately, its organisational structure and internal processes. These factors, which constitute the external environment, can be divided into:

- Remote environment (It is composed of a set of forces that originate beyond the operating situation of the firm).
- Operating environment (involves factors in the immediate competitive situation that provide many of the challenges a particular firm faces in attempting to attract needed resources or in striving to profitability market its goods and services).

Firm's external environment:



Remote environment: Economic considerations refer to the nature and direction of the economy in which the business operates. E.g. Availability of credit, interest rates, rates of inflation, growth trends of GNP etc.

Political: The direction and stability of political factors is a major consideration for managers in formulating company strategy. Political constraints are placed on each company through.

E.g.: Fair trade decisions, Tax programs, Minimum wage legislation, Pricing and pollution policies, Laws aimed at protecting the consumer and the environment etc.

Social: Social considerations involve the beliefs, values, attitudes, opinions, life styles of those in a firm's external environment, as developed from their cultural, demographic, religions, educational.

Technological: To avoid obsolescence and prompt innovation, a firm must be aware of technological changes that might influence its industry.

E.g.: Technological innovation, forecasting, manufacturing and marketing techniques.

Operating Environment: Competitive position: By assessing its competitive position, a business improves its chances of, designing strategies that optimise environmental opportunities.

In constructing a competitor's profile, the following situational factors to be considered:

- Market share
- Breadth of product line
- Effectiveness of sole distribution
- Price competitiveness
- Advertising and promotional effectiveness
- Financial position
- Product quality
- R & D position
- Caliber of personnel
- General image

Suppliers and Creditors: Dependable relationships between a business, firm and its suppliers and creditors are essential to the company's long term survival and growth (supplier's financial support, services, and materials) (Quick delivery, liberal, credit terms etc.).

Customer Profiles: In developing a profile of present and prospective customers, managers are better able to plan the strategic operations of the firm, anticipate changes the size of markets, and allocate resources supporting forecast shifts in demand patterns.

Four principal types of information are useful in constructing a customer profile:

- Geographic: (Areas) - Region
- Demography: (Sex, Age, marital status, income, occupation religion, race, nationality).

- Psychographic: (Customer personality & life style are often better predictors of purchasing behaviour)
- Compulsiveness, Autonomy, leadership, Ambitionness, Authoritarianism etc.)

  Coco-cola, catch the wave
- Buyer Behaviour: Usage rate, Readiness stage, Benefits sought, Brand loyalty etc.

Labour Market (Personnel):

The ability to attract and hold capable employers is a prerequisite for a firm's success. Three factors most affect a firm's access to needed personnel:

- Reputation as an employer
- Local employment rates : (Absorption)
- Availability - Ready availability of needed knowledge and skills.

Thus, Designing opportunistic strategies is based on the conviction that a company is able to anticipate future business conditions will improve its performance and profitability.

Question 20: Explain the linkage between environmental analysis and strategic management.

Answer:

Environmental analysis has three basic goals. First, the analysis should provide an understanding of current and potential changes taking place in the environment. It is important that one must be aware of the existing environment. At the same time one must have a long term perspective too. Second, environmental analysis should provide inputs for strategic decision making. Mere collection of data is not enough. The information collected must be used in strategic decision making.

Third, environmental analysis should facilitate and foster strategic thinking in organisations - typically a rich source of ideas and understanding of the context within which a firm operates. It should challenge the current wisdom by bringing fresh view points into the organisation.

To be specific, the benefits of environmental study are as follows:

(a) Development of broad strategies and long-term policies of the firm.

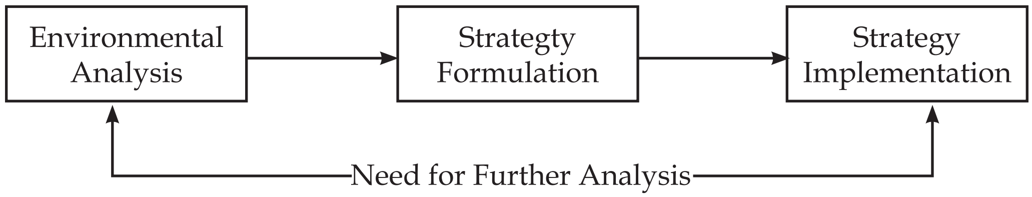
(b) Development of action plans to deal with technological advancements.

(c) To foresee the impact of socio-economic changes at the national and international levels on the firm's stability.

(d) Analysis of competitor's strategies and formulation of effective counter measures.

(e) To keep one self dynamic.

The following figure shows the linkage between environmental analysis and strategic management.



Question 21: What is 'synergy'? Explain its significance in strategy making.

Answer:

'Synergy' is a measure of the firm's ability to make good on a new product - market entry. Usually it is explained by the term "two plus two equals five". Synergistic advantages emerge because of operating economies which can be achieved through the elimination of duplicate facilities and consolidation of marketing, purchasing and other operations.

Synergy is the powerful ally of international strategic planning and must receive special attention of top management before making any decision regarding new product market entry or acquisition of a new firm in host country. The whole concept of synergy is based on the promise that the compatibility of the existing product - market with the new product market will help an organisation to achieve its objective much more profitably than that achieved by firms independently.

Synergies invariably result in more exports, with the transnational source, finished products and components from its Indian operation. Analysis of synergistic effects of alternatives is very useful because of their far - reaching consequences. The major thrust of the analysis is on the measurement of synergistic effects upon the operations of the organisation. This effect can be measured in terms of cost economies to the organisation from a joint operation or in terms of increase in net revenue for a given level of investment or in terms of decreased investment requirements for a given level of earnings. According to Ansoff, synergistic effects should be measured in terms of start-up economies and operating economies. Structure must follow synergy. This calls for willingness and dynamism on the part of the management of the acquiring firm to adjust themselves in consonance with the changing situations. However, in the real world this is not usually found because of apathy of most of the managers particularly those brought up in internally oriented skills and those who are conservative and believe in maintaining the status quo to go for any change from the present product market complexion.

Question 22: Explain the functions of a strategy.

Answer:

The basic advantage of strategy is that it provides a tool with which a firm can overcome difficulties and subdue competition. This is because strategy performs the following functions:

1. Strategy furnishes the management with a perspective whereby the latter gives equal importance to present and future opportunities and problems, and endeavours to exploit the opportunities and confront the problems effectively. The management has not only to

state the purpose and objectives of the firm but also the means by which the objectives are to be reached.

2. Strategy offers a way to thinking, a discipline and a technique to manage changes. The management is totally prepared to anticipate, respond and influence the firm's destiny regardless of the developments taking place in the business world. By constant surveillance of various external forces and a through capability analysis, the management can discern the new opportunities to be exploited and impending threats to be minimised, and modify or revise the existing product-market strategy.

   The major thrust of corporate strategy is on predetermination what must be done in advance of taking any action. This enables the management to formulate the firm's future through innovation and creativity and take advantage of favourable conditions.

3. Strategy provides a dual approach to problem solving: (i) exploration of the most effective means to overcome difficulties and face competition; and (ii) the deployment of limited resources among critical activities with the intention of maximising profits. It furnishes the most scientific technique with which the management can make investment decisions in order to achieve the objective of maximum return with minimum loss.

4. Another function of strategy is that it provides the right direction in which the firm should progress. It provides a broad framework within which the firm's operations should be planned and controlled. In the absence of strategy, the management does not have rules to search for new opportunities, both inside and outside the firm. Internally, for instance, the research and development department has no guidelines for its contribution towards diversification. Similarly, without strategy the external acquisition department lacks focus. Thus, the firm as a whole either passively waits for opportunities come by a 'back shot' search technique.

5. Finally, strategy focuses attention upon changes in the organisational set-up, administration of organisational processes affecting behaviour and the development of effective personal leadership. Successful implementation of strategy requires the top management to shape the formal structure of the organisation, its formal relationships and processes of motivation and control, bearing in mind the nature of corporate strategy. He must bring about the commitment to the organisational goals and policies of all those executives who are assigned responsibilities for activating the strategic plans.

Question 23: Define Strategic Management. Explain the critical areas of strategic management.

Answer:

"Strategic management is defined as the set of decisions and actions resulting in formulation and implementation of strategies designed to achieve the objectives of an organisation".

It is also known as Strategic Planning.

Critical Areas of Strategic Management:

- Determine the mission of the company.
- Developing a company profile that reflects internal conditions and capabilities.

- Assessment of the company's external environment in terms of both competitive and general contextual factors.
- Analysis of possible options uncovered in the matching of the company profile with the external mission.
- Identifying the desired options uncovered when possibilities are considered in light of the company mission.
- Strategic choice of a particular set of long term objectives and grand strategies needed to achieve the desired options.
- Development of annual objectives and short term strategies compatible with long-term objectives and grand strategies.
- Implementing strategic choice decisions based on budgeted resource allocations and emphasising the matching of tasks, people, structures, technologies, and reward-systems.
- Review and evaluation of the success of the strategic process to serve as a basis for control and as an input for future decision making.

As these nine areas indicate, strategic management involves the planning, directing organising, and controlling of the strategy related decisions and actions of the business.

Dimensions of Strategic Decisions:

Strategic issues have six identifiable dimensions:

1. Strategic issues require top management decisions.
2. Strategic issues involve the allocation of large amounts of company resources.
3. Strategic issues are likely to have a significant impact on the long term prosperity of the firm.
4. Strategic issues are future oriented. (Strategic decisions are based on what managers anticipate or forecast rather than on what they know).
5. Strategic issues usually have major multifunctional or multi business consequences, (customer mix, competitive emphasis, organisational structure etc.)
6. Strategic issues necessitate considering factors in a firm's external environment.

(Strategic managers look beyond the limits of the firm's own operations. They must consider what relevant, other, (competitors, customers, suppliers, creditors, Govt. etc.)).

Three levels of strategy:

- Corporate Level: (BODs, CE & AOs) They are responsible for the financial performance of the organisation. (Corporate image and social responsibility) - (Corporate officers set the objectives and formulate strategies).
- Business level: (Business Managers) They translate the objectives and strategies into concrete functional objectives and strategies for individual business divisions.

- Business level strategic managers must determine the basis on which a company can compete in the selected product market area.

Functional level:

Managers of the product, geographic, and functional areas. Their responsibility is to develop annual objectives and short term strategies in such areas as production, operations, and research and development, finance, accounting, marketing and human relations.

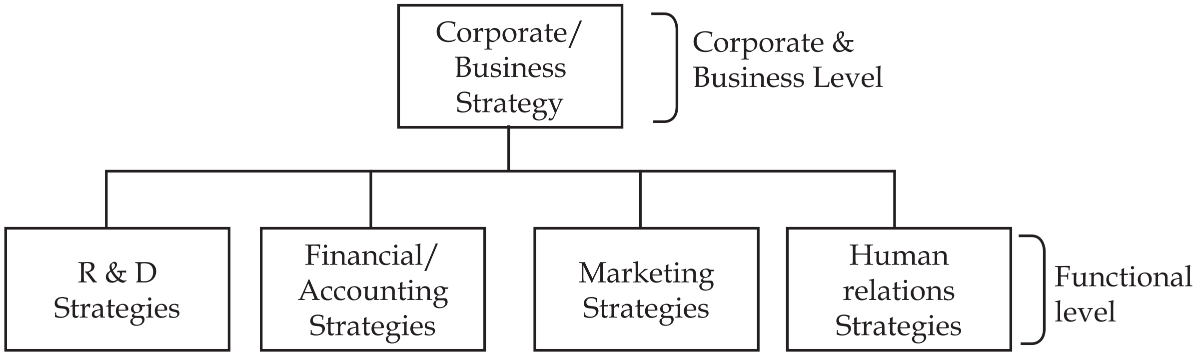
Their responsibility is to implement company's strategic plans.

While the corporate and business level managers concentrate on 'doing right things', managers at the functional level must stress "doing things right".

Figure: Alternative Strategic management structures:

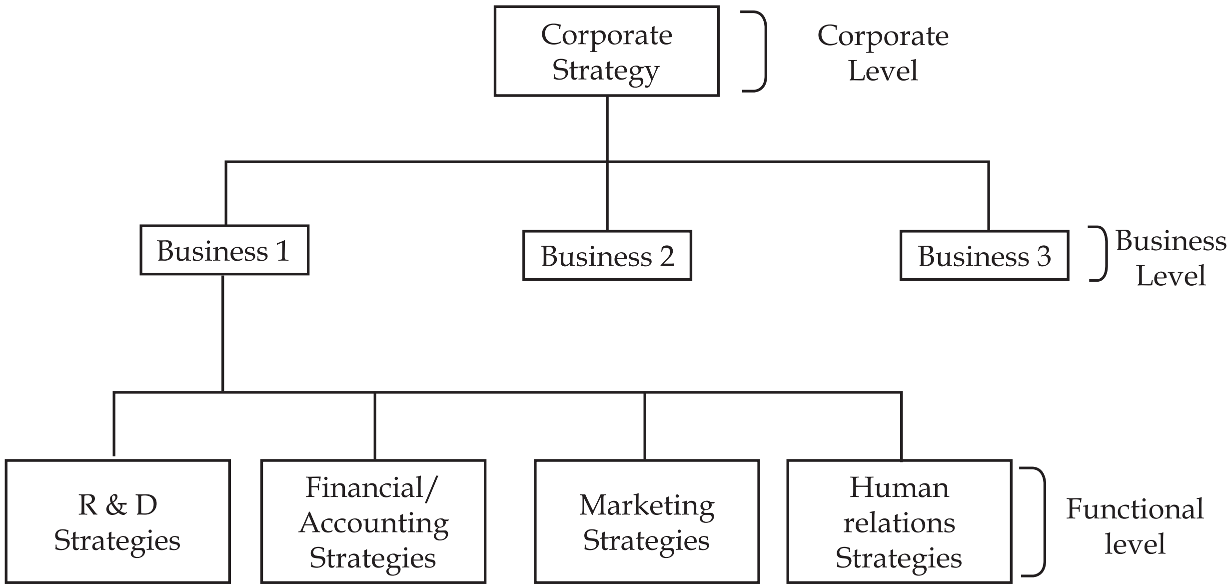
Alternative 1:

Single business firms



Alternative 2:

Multiple-business firms



Question 24: What is the relationship between strategy and structure?

Answer:

Strategy & Structure: Successful implementation of strategy depends upon mainly the appropriateness of the organisation structure.

Though strategy and structure interactive and interrelated, if has been often observed that structure follows strategy. Since structure is a tool to realise the aims of strategy, it helps people to pull together in the performance of their diverse tasks to accomplish these aims.

The structure should change in accordance with changes in size, geographic spread, technologies, and strategies of an organisation.

The importance organisational structures are:

- Tall, Flat Structure
- Formal & Informal
- Bureaucratic
- Matrix (Violation of one man - one boss)

There is nothing like the 'best' or ideal structure. The best organisation structure is the one that best fits the overall situation. [The structure (what type of) depends upon the nature, stage of growth, extensiveness of operations, needs for strategic controls etc.]

Question 25: Explain how strategies are formulated?

Answer:

Strategy Formulation:

Process: The following are the steps involved in the strategy formulation.

1. **Defining the Company Mission:**
    - Mission, Basic product/service, primary market, principal technology, company goals, survival, growth, profitability, company philosophy, public image etc.
2. **Assessing the External Environment:**
    - Remote and operating environment.
3. **Industry Analysis:**
    - How competitive forces shape strategy?
    - Threat of Entry; Powerful suppliers and Buyers.
    - Substitute products etc.
4. **Evaluating the Multinational environment:**
    - Why companies internationalise?
    - Complexity of the Multinational environment.
        (i) Control problems of the multinational firm

(ii) Multinational strategic planning

(iii) Multi domestic industries and Global industries

5. **Environmental Forecasting:**
   - Selection of critical environmental variables
   - Selection of sources of significant environmental information
   - Evaluate forecasting techniques
   - Integrate forecast results into the strategies management process
   - Monitor the critical aspects of managing forecasts.

6. **Company profile: International Analysis of the firm:**
   - Development of the company profile.
   - Identification of strategic internal factors
   - Evaluation of strategic internal factors

7. **Formulating long-term objectives and grand strategies:**

   Long term objectives:
   - Profitability
   - Productivity
   - Competitive position
   - Employee development
   - Employee relations
   - Technological leadership
   - Public responsibility

   Qualities of long term objectives:
   - Acceptable
   - Flexible
   - Measurable
   - Motivating
   - Understandable Suitable

Grand Strategies: Master/business strategies, intended to provide basic direction for strategic activities.

Various types of grand strategies:

(a) Concentration (on current business) (increasing of present products in present markets).

(b) Market development (selling present products in new markets)

(c) Product Development (developing new product for present markets)

Specific options under the grand strategies of concentration market development and product development.

(i) Concentration:

(a) Increasing present customers rate of usage:

- Increasing the size of purchase
- Advertising other uses
- Giving price incentives for increased usage.

(b) Attracting competitors' customers:

- Establishing sharper brand differentiation
- Increasing promotional effort
- Initiating price cuts

(c) Attracting nonusers to buy the product

- Inducing trial use through sampling, price, incentives and so on.
- Pricing up or down Advertising new uses

(ii) Market Development:

(a) Opening additional geographical markets

- Regional expansion
- National expansion
- International expansion

(b) Attracting other market segments:

- Developing product versions to appeal to other segments
- Entering other channels of distribution
- Advertising in other media.

(iii) Product Development:

(a) Developing new product features:

Adopt (to other ideas, developments) Modify; (change colour, shape, form, sound); Magnify (stronger, longer, thicker, extra value); Minify (smaller, shorter, and lighter)

- Substitute (other ingredients, process, power)
- Rearrange (other patterns, layout, sequence, components)
- Reverse (inside out)

Combine (blend, combine units, purposes, appeals, ideas)

(b) **Developing quality variations**

(c) **Developing additional models and sizes**

8. **Strategic Analysis and Choice:**
   - SWOT Analysis
   - Grand strategy selection
   - Behavioural considerations affecting strategic choice
   - Role of past strategy
   - Degree of firm's external dependence
   - Attitudes towards risk
   - Internal political considerations
   - Timing considerations
   - Competitive reaction

Question 26: Distinguish between 'Strategy' and 'Policy'.

Answer:

Strategy: Strategy refers to the determination of the purpose or mission and the basic long-term objectives of an enterprise, and the adoption of courses of action and allocation of resources necessary to achieve these aims. Therefore, objectives are a part of strategy formulation.

Policy: Policies are general statements or understandings that guide managers thinking in decision making. They ensure that decisions fall within certain boundaries. They usually do not require action but are intended to guide managers in their commitment to the decision they ultimately make. The essence of policy is discretion. Strategy, on the other hand, concerns the direction in which human and material resources will be applied in order to increase the chance of achieving selected objectives.

Certain major policies and strategies may be essentially the same. A policy of developing only through retailers may be an essential element of a company's strategy for new product development or marketing. One company may have a policy of growth through the acquisition of other companies, while another may have a policy of growing only by expanding present markets and products. While these are policies, they are also essential elements of major strategies. Perhaps one way to draw a meaningful distinction is to say that policies will guide a manager's thinking in decision - making if a decision is to be made while a strategy implies the commitment of resources in a give direction.

Question 27: Explain the significance of Strategy Evaluation?

Answer:

Evaluation of strategy of an enterprise is as important as strategy formulation because it provides an insight into the efficacy and effectiveness of the overall plan as well as sub-plans in attaining the desired results. It also enables the management to judge the suitability of the on-going strategy in changing socio-economic, political and technological developments and corporate conditions and points out to the need for modification in strategy in order to seize emerging opportunities and minimise new threats.

On the basis of periodic strategy evaluation, the central management can determine precisely whether programmes are being carried out in such a way that corporate objectives will be attained satisfactorily.

Strategy evaluation also influences the behaviour of events and ensures that they conform to plans. It serves the 'steering function' - to steer the organisation and the various sub-systems within it on the right track and to negotiate their way through a turbulent environment. It aims at promoting integration between short-range and long-range plans and between the enterprise and the environment.

Strategy evaluation serves as a valuable instrument for the purpose of achieving stability and continuity on the one hand and adaptation and adjustment on the other. Organisational stability is sought through appraisal of operational policies and procedures. This ensures the steady state of the organisation to establish itself, to derive and consolidate the gains from resources already committed, to preserve the system's vitality and viability. Periodic appraisal of strategy provides an opportunity to the management to make requisite adjustments in objectives, strategies and policies in tune with the dynamics of the external environment.

Finally, strategy evaluation can help the management in making effective use of scarce and valuable resources of the enterprise. It strives for minimising the variability in the deployment of resources so that the intended goals are achieved with the least cost and few untoward consequences.

Question 28: What are the problems of strategy evaluation?

Answer:

Task of strategy evaluation suffers from the problems arising out of misinterpretation of environmental forces and corporate resources. The evaluator may not always be correct when he questions the validity of the on-going strategy. This is because of the fact that determination of opportunities and threats is often of a function the perception and the attitude of the person making such exercise as it is of the factor itself. For instance, a dynamic and enterprising planner may perceive abundant opportunities emerging due to economic and technological developments and formulate expansion strategy. This approach may not be appreciated by an evaluator with a conservative attitude and closed cognitive style that holds the view that the enterprise should continue to maintain its present product-market posture owing to disquieting political developments.

Inaccurate assessment of financial, marketing, managerial and other resources of the enterprise and existence of synergistic benefits poses another obstacle to the appraisal of strategy. Thus, for instance, a corporate planner chooses a diversification strategy because in his view the firm has adequate financial and managerial resources to support this plan. But the evaluator questions the utility of such a strategy because he doubts the skill and competence of the senior executives of the firm.

Another obstacle that is inherent in strategy appraisal is identification, evaluation and choice of strategic alternatives. In the real world, it has been noted that some organisations without making independent appraisal of opportunities choose a course of action because others in the same line of business have done so. This type of approach renders the product-market strategy weak.

Another source of difficulty involved in appraisal of strategy is misinterpretation of current results. Generally, the central chief executive, without digger deep into the problem, regards the current strategy as unsound if the performance has not been satisfactory and directs the corporate planner to re-examine it. In the same vein, he labels the strategy as sound because of the excellent operating results. But such type of hurried judgment may, at times, be erroneous. Poor results may have been due to improper execution of strategy or outstanding profits were due to certain other factors such as war and product rationing. The management swayed by good results may not take serious note of implications of impending environmental changes and accordingly remain indifferent to any modification in the current plan for the future.

Question 29: 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 mangers 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 a transitional period during which existing concepts and methods are discarded, new ones are tried and accepted, and the newly structured organisation put into operation.

Question 30: Discuss the steps involved in Strategy Implementation.

Answer:

Strategy Implementation: The following steps involved in the strategy implementation.

(i) Operationalising the Strategy: (throughout the organisation)

Important tools to accomplish this:

(a) Annual objectives guide implementation by translating long-term objectives into current targets. (Coordination).

(b) Functional Strategies are derived from business strategy and provide specific, immediate direction to key functional areas within the business in terms of what must be done to implement the strategy.

(c) Policies provide another means of directing and controlling decisions and actions at the operating levels of the firm in a manner consistent with business and functional strategies. Effective policies channel actions, behaviour, decisions, and practices to promote strategic accomplishment.

(ii) Institutionalising the strategy:

* Structural alternatives
  - simple, functional, divisional, matrix
* Dimensions of leadership (in implementation)

Key considerations in managerial assignment to implement strategy:

Advantages	Disadvantages
Already know key people, practices and conditions	Less adaptable to major strategic changes because of knowledge, attitudes and values.
Personal qualities better known and understand by associates	Past commitments may hamper hard decisions required in executing a new strategy.
Have established relationships with peers, subordinates, suppliers and buyers etc.	Less ability to become inspired and credibly convey the need for change.
- Symbolises organisational commitment to individual careers.	
Outsider may already believe in and have 'lived' the new strategy.	Often costly.
- Outsider is unencumbered by internal commitments to people.	- Suitable candidates may not be available always, leading to compromise choices.
- Outsider comes to the new assignment with heightened commitment and enthusiasm.	- Uncertainty in selecting, the right person.
Bringing an outsider can send powerful signals throughout the organisation that change is expected.	The 'morale' costs when an outsider takes a job several insiders wanted.

* Influence of organisation culture on organisational life.

(iii) Strategic control Guiding and Evaluating the strategy:

* Establishing Strategic Controls

(Strategic controls are intended to steer the company towards its long-term strategic direction).

Four basic types of strategic control:

(a) Promise Control:	Designed to check systematically and continuously whether or not the premises set during the planning and implementation process are still valid.
(b) Implementation Control:	Designed to assess 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.
(c) Strategic Surveillance:	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.
(d) Special Alert Control:	It is the need to thoroughly and often rapidly, reconsiders the firm's basic strategy based on a sudden, unexpected event.

Question 31: Why Environmental Scanning? Explain in detail.

Answer:

Environmental scanning also referred as the basic monitoring system, is the process of monitoring economic, competitive, technological, socio-cultural, demographic and political setting to determine opportunities for and threats to the firm. Such an analysis involves information compiling, processing and forecasting the above conditions.

Scanning of environmental forces is a stupendous task in view of their rapidly changing character. This is much more different in the case of international environment which is highly complex, turbulent and tumultuous. Even then this exercise is undertaken by every firm and more so by a multinational firm if it has to survive successfully and grow amidst highly volatile and dynamic environment. Failure to monitor and evaluate the external environment in today's world can have serious and a very negative consequence.

A multinational firm can set its future directions and targets of performance and formulate the most suitable strategy only when it has been able to visualise and perceive the opportunities and constrain in store for it. Visualisation and perception of business opportunities and threats arising out of developments inside and outside the country are, therefore essential for comprehensive environmental scanning because both the favourable and unfavorable components are inherent in the overall environment.

The environment may offer major profit opportunities due to anticipated economic, socio-political and industrial trends and new opportunities in the market/product/customer segments which the company can readily exploit particularly in the case of technological advances. In the same vein, an economic downturn, an adverse social or political condition, structural changes in an industry, market decline or product obsolescence, competitive threats and, above all, tight financial market can pose considerable treats that greatly limit a company's range of choices.

The entire environmental frame work and its component parts, are dynamic and the pace of change is tremendous and such as change affects the market for the firm's present products, the prospects for future and market choices. The environmental changes may threat on the established strategies and call upon the management to be alert to the possibility that the opportunity they have seized will soon expire. They may also provide new opportunities in terms of new market needs which the management can satisfy. No international firm can remain oblivious to these environmental developments which are relevant to its own sphere of operation. It has not to adjust itself in consonance with environmental changes. In order to respond the environment, the management should attempt to predict changes in different environmental forces and discern the opportunities and threats emanating from changes in the environment. It is inevitable because it takes sometime for the enterprise to bring about necessary changes in the organisation. The more energy in international firm devotes to environmental appraisal, the greater is the capacity to survive.

Environmental appraisal enables the firm to get clear idea about the existing competitors, their current operations and future plans. This is inevitable if the firm has to formulate strategy to counteract the competitors' moves. If the competitor is on something, it needs to be investigated, otherwise the competitor's move could lead to his pulling ahead, growing faster and becoming more profitable. Assessment of the foreign competitive situation also is important while considering any foreign environment. It will always be in the interest of the international firm to ascertain how many local rivals are there and how good they are, if the rivals are very efficient and their products excellent and their marketing superb, then the situation is much different than if there are no competitors, or if the firms in the country are inefficient. A multinational firm scanning alternative possibilities might well avoid a country, at least temporarily that offers strong domestic or other foreign competition. This is especially true if the market is relatively small or saturated.

Environment appraisal enables the management to predict future development to make the invisible more visible and, thus, lessen the uncertainty about the future in the face of spectacular, powerful and rapid environmental changes. Those who foresee the critical changes that affect the firm will have a far better chance of being successful than those who will not be able to do so.

Thus, the management has to search the environment to determine which factors pose threat to the firm's present product-market strategy and accomplishment of objectives and which environment forces present opportunities for greater accomplishment of objectives by adjusting the firm's current strategy. No organisation can afford to ignore changes in technology, competitive environment, government policy or changes in social values. If it does not react to the demands of the environment by changing its strategy, it is counting decline or extinction.

Input-output relationship between a firm and environment also necessitates environmental scanning. A firm, in order to function, must produce various inputs as human, capital, managerial, and technical from the environment. These inputs are then converted into goods and services and made available to those living in the environment. Thus, firm's operations regarding acquisition of quantum and kinds of input and distribution of output are subject to environmental influences.

The management must also scan the environment of home as well as host countries so as to fund out what are the diverse claims and expectations of different sections of the society which the firm has to fulfill in order to be socially acceptable. These claims need to be accorded due weight age while formulating overall as well as subsidiary level objectives, policies and strategies.

While scanning environment the management must remember that such an appraisal facilitates spotting of opportunities at the level of an industry rather than at firms or products level. As a result of this aggregation, management decision loses the sharpness needed for choosing a particular product-market. Furthermore, environmental analysis fails to answer whether the desired economic and technological potential existing within a particular industry will be available to the firm. The prospects in an industry as a whole are not necessarily the same for an individual firm particularly when the total industry capacity substantially exceeds the demand. Along with this, the determination of opportunities or threats is often as much a function of the perception and the attitude of the management as it is of the factor itself. For example, there are two factors, viz., increased government interference and competition increasingly centered on technical specification of the control system as well as the machine. To the management wedded to a philosophy of no government intervention of any type, both factors appear to be a threat. However, to the management with less rigid attitudes a great opportunity is opened up in terms of a chance to break into an existing competitor's historical preserve by product innovation for which the government subsidises part of the best and also instigates the risk through adverse orders for prototypes or trail in factories. Thus, both factors seem equally valid and yet the same basic factors are merely viewed with different attitudes. To the enterprising arrangement, all changes offer new opportunities and the change to generate new alternatives for an existing business.

Question 32: 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 a structural analysis of industries. According to this analysis, which has gained great popularity, the state of competition in an industry depends on 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 on 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 or experience curve, favourable access to 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 are 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 an 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 utilisation 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 norms.

(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 profitability 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, or (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 more 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 or 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.

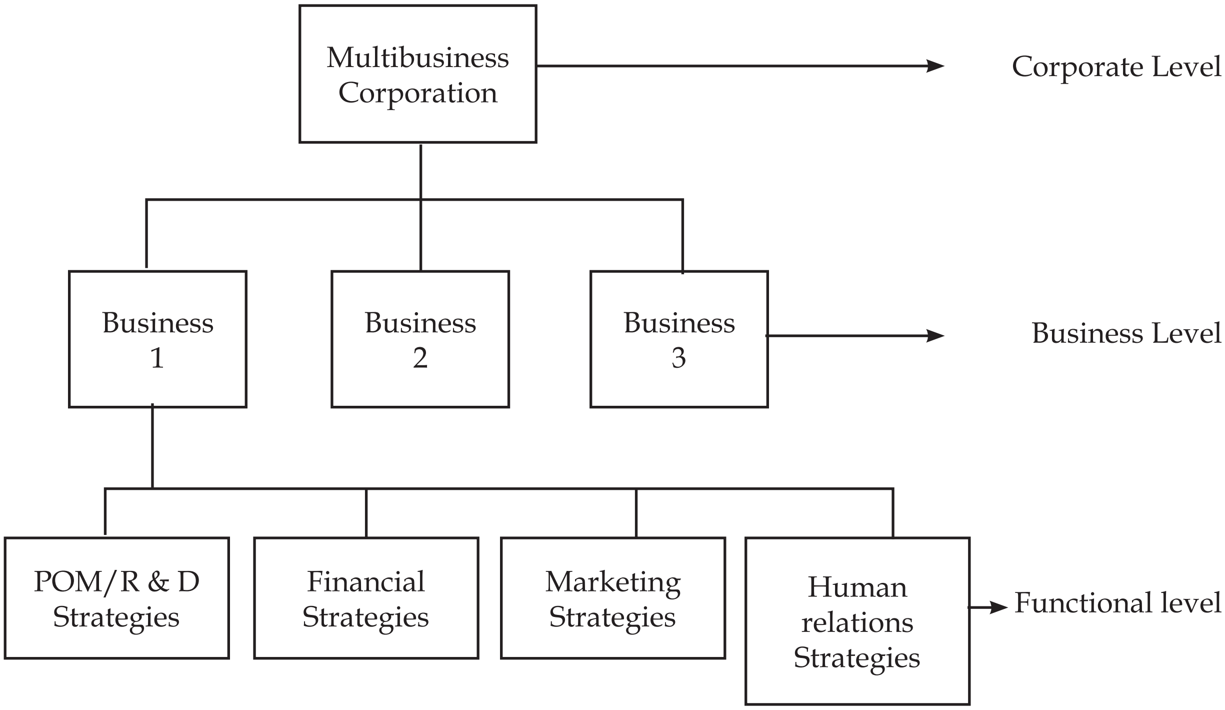
Structural Analysis and Competitive Strategy: The purpose of the structural analysis is to diagnose the competitive forces and to identify the strengths' to help formulate an effective competitive strategy that "takes offensive or defensive action in order to create a defendable position against the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

Question 33: What do you mean by Corporate Level Strategy?

Explain the environmental impact on it.

Answer: This strategy is formulated by top management to oversee the interests and operations of an organisation made up of more than one line of business. The major questions at this level are: What kinds of business should the company is engaged in? What are the goals and expectations for each business? How should resources be allocated to reach these goals?



Three Levels of strategy

In formulating corporate-level strategy, Peter Drucker suggests, corporations need to decide where they want to be in eight areas, market standing, innovation, productivity, physical and financial resources, profitability, managerial performance and development, worker performance and attitudes, and public responsibility.

Environmental Impact on Corporate Level Strategy:

At the corporate level strategy, environmental impact on three key issues are significant (i) patterns of diversification, (ii) portfolio planning and (iii) risk return trade-offs.

Patterns of Diversification: In diversifying, there are two models a company can follow internal and external. Firms choosing the internal model stress the development of new products and services through research and development efforts within the organisations. Conversely, companies diversifying externally focus on making acquisitions.

Environment influences patterns of diversification in at least three ways. First, firms differ in the synergies they try to exploit across their businesses. These synergies could be upset or enhanced by macro environmental changes. Second, different patterns of diversification manifest different vulnerabilities. Macro environmental changes may amplify these vulnerabilities. Third, macro environmental trends may open up or close out existing patterns of diversification. This is particularly so when the pattern of diversification is not conglomerate.

Vulnerabilities in Diversification Patterns –

Patterns of diversification	Vulnerability
Horizontal diversification	All businesses share the general economic environment
Vertical integration	Markets
Technology-related concentric Diversification	Key technology synergy
Conglomerate diversification	Society and general economy.

Port-Folio Planning: With regard to portfolio planning (the type of businesses a corporate entity must have), two strategic issues are relevant. First, the composition of the firm's collection of businesses (or "portfolio") must be determined. This involves the question of whether the firm should follow a conglomerate, concentric, vertical, or mixed pattern of diversification. It also raises the question of what businesses to add to the portfolio.

Ten Options for a Corporation:

In deciding on a corporate strategy, a company has basically ten options:

1. **Concentration on a Single Business:** The Company concentrates on a single product, service, market, or technology. Indian Airlines, for example, operates aircraft for the benefit of domestic passengers and so is the case with Air India which files aircraft across the global. Similarly, life Insurance Corporation concentrates in life business and so does the Indian Railways which operate railways.

2. **Vertical Integration:** This is the strategy of a company moving backward or forward, or both, along the channels of supply and distribution. The takeover of Parle by Coca-Cola is an example for vertical integration.

3. **Concentric Diversification:** Under this strategy, the company moves into new but related lines of business. There is a governing common thread that guides the company's acquisition and internal development policy. This thread may consist of technology, product similarity, or other valid reasons. The takeover of Tomco along with its subsidiaries by Levers is an example for concentric strategy. The subsidiaries are: Tata Vashishti Detergents (a joint venture with Maharastra Petrochemicals), Industrial Perfumes, International Fisheries, Kalyani Soap Industries (a joint venture with the West Bengal Government), and Tata Oil Clorox.

4. **Conglomerate Diversification:** This is unrelated diversification. Here, the constraints on the company's strategy are merely whether a business meets the minimum standard of expected profitability. J.K. group of companies belong to this category.

5. **Joint Venture:** Joint venture is a capital sharing arrangement between an MNC and a local company (or even a foreign government) or another MNC. Each partner holds shares in the subsidiary and shares the profits in relation to its ownership share. By following a joint venture route, MNCs can spread a given amount of investment across more locations and there by minimise risks.

   Most MNCs operating in our country have joint ventures with local outfits. Thus, we have Procter and Gamble having joint ventures with Godrej. Similarly, Maruti is jointly owned by Suzuki of Japan and the Government of India.

6. **Retrenchment:** This is a common short-run strategy that some companies adopt during periods of poor economic performance. At the corporate level, it can assume two variations. The first involves stringent across the board cost cutting to improve efficiency. Ceat Ltd., for example, has resorted to cost cutting and financial restructuring to restore healthy bottom line. The second demands the selective pruning or revamping of the weakest, product or division. Hiving off Tomco by Tatas to Levers is a case to the point.

7. **Divestiture:** This is another limited strategy that involves either selling off parts of a company to another firm or "spinning off" financially and managerially independent companies. Such a policy is generally followed to reverse past mistakes. Sale of oral hygiene business by Ciba-Geigy is an example for the first variation of divestiture. For second is the example of Eicher group which has six independent units. They are Eacher Tractors Ltd., Eicher Motors Ltd., Royal Enfield Motors Ltd., Eicher International Ltd., Eicher Span Financial Services, and Eicher Consultancy Services.

8. **Liquidation:** This involves closing down the business for ever. Liquidation strategy is resorted to when all efforts to retrieve to a sick company have failed to yield results. During 1993 alone the BIFR recommended closure of as may as 262 sick companies.

9. **Reorganisation under BIFR Scheme:** Sick companies are referred to the Board for Industrial of Financial Reconstruction (BIFR) under the provisions of the Sick Industrial Companies (Special Provisions) Act, 1985. The Board prepares a scheme of rehabilitation if a sick unit is retrievable. Otherwise the Board recommends its closure. During 1993 alone as may as 415 schemes of rehabilitations were prepared and implemented by the Board.

10. **Combination Strategies:** The preceding nine strategies are not mutually exclusive. They can be combined in almost any number of variations. Thus, conglomerates often shed their less profitable businesses. Single businesses diversify and large companies set up joint ventures. In today's competitive environment many companies are pursuing strategies that combine retrenchment and divestiture with concentric diversification. The second key issue concerns how resources are to be allocated among the several businesses in the portfolio. An analytical frame work called portfolio analysis has been developed to help corporate management address and structure the issue.

    Prominent portfolio planning models available are the G.E. Model, BCG Model, Mckinsey Model and the one developed by Arthur D. Little, Inc. Although all these differ in detail, they all basically follow a similar methodology. They all require the identification of strategic business units (SBUs), the positioning of SBUs on a matrix, and the application of a particular resource strategy for each SBU, depending on its placement on the matrix.

    Macro environmental trends have important implications for portfolio planning. Typical portfolio planning focuses on competitive advantages within an existing industry, constrained by the internal financial resources of the firm. Environmental analysis is also particularly important for planning potential future portfolios. The specific businesses to be targeted need to be considered in the light of macro environmental forecasts and predictions.

    Risk-return Trade offs: Political, economic, technological, and demographic shifts influence the returns and risks of existing and planned portfolios.

Question 34: 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 an 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 no 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 a 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.

Question 35: Discuss how competitive forces shape strategy?

Answer:

The essence of strategy formulation is coping with competition. Yet it is easy to view competition too narrowly and too pessimistically. While one sometimes hears executives complaining to the contrary, intense competition in an industry is neither coincidence nor bad luck.

Moreover, in the fight for market share, competition is not manifested only in the other players. Rather, competition in an industry is rooted in its underlying economics, and competitive forces exist that go well beyond the established combinations in a particular industry. Customers, suppliers, potential entrants, and substitute products are all competitors that may be more or less prominent or active depending on the industry.

The state of competition in an industry depends on five basic forces, which are diagrammed in figure. The collective strength of these forces determines the ultimate profit potential of an industry. It ranges from intense in industries like tires, metal cans, and steel, where no company earns spectacular returns on investment, to mild in industries like oil-field services and equipment, soft drinks, and toiletries, where there is room for quite high returns.

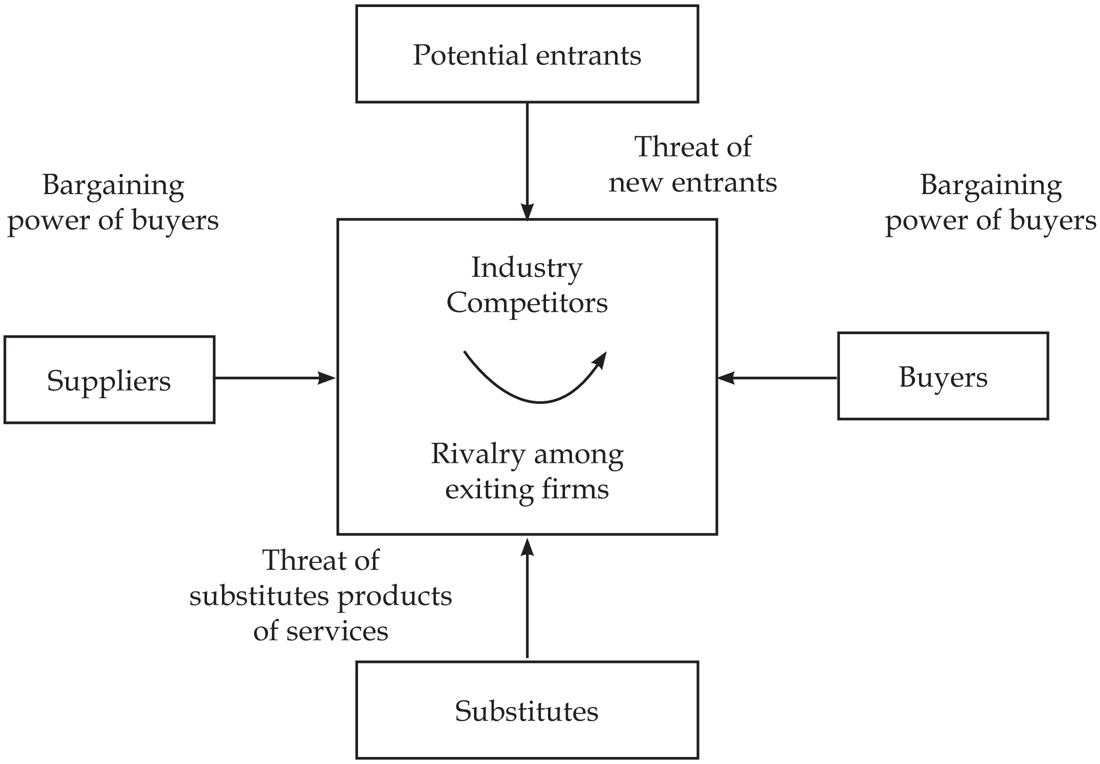
In the economists "perfectly competitive" industry, jockeying for position is unbridled and entry to the industry very easy. This kind of industry structure, of course, offers the worst prospect for long-run profitability. The weaker the forces collectively, however, the greater the opportunity for superior performance.

Whatever their collective strength, the corporate strategist's goal is to find a position in the industry where his or her company can best defend itself against these forces or can influence them in its favour. The collective strength of the forces may be painfully apparent to all the antagonists, but to cope with them, the strategist must delve below the surface and analyse the sources of competition. For example, what makes the industry vulnerable to entry? What determines the bargaining power of suppliers?

Knowledge of these underlying sources of competitive pressure provides the groundwork for a strategic agenda of action. They highlight the critical strengths and weaknesses of the company, animate the positioning of the company in its industry, clarify the areas where strategic changes may yield the greatest payoff, and highlight the places where industry trends promise to hold the greatest significance as either opportunities or threats.

Understanding these sources also proves to be of help in considering areas for diversification.

Forces driving Industry competition



Contending Forces: The strongest competitive force or forces determine the profitability of an industry and so are of greatest importance in strategy formulation. For example, even a company with a strong position in an industry unthreatened by potential entrants will earn low returns if it faces a superior or a lower cost substitute product as the leading manufacturers of vacuum tubes and coffee percolators have learned to their sorrow. In such a situation, coping with the substitute product becomes the number one strategic priority.

Different forces take on prominence, of course, in shaping competition in each industry. In the ocean going tanker industry the key force is probably the buyers (the major oil companies), while in tires it is powerful OEM buyers coupled with tough competitors. In the steel industry the key forces are foreign competitors and substitute materials.

Every industry has an underlying structure, or a set of fundamental economic and technical characteristics, that gives rise to these competitive forces. The strategist, wanting to position his company to cope best with its industry environment or to influence that environment in the company's favour, must learn what makes the environment tick.

This view of competition pertains equally to industries dealing in services and to those selling products. To avoid monotony in this article, I refer to both products and services as "products". The same general principles apply to all types of business.

A few characteristics are critical to the strength of each competitive force.

Threat of Entry: New entrants to an industry bring new capacity, the desire to gain market share, and often substantial resources. Companies diversifying through acquisition into the industry from other markets often leverage their resources to cause a shape-up, as Philip Morris did with Miller beer.

The seriousness of the threat of entry depends on the barriers present and on the reaction from existing competitors that the entrant can expect. If barriers to entry are high and a newcomer can expect sharp retaliation from the entrenched competitors, obviously he will not pose a serious threat of entering.

There are six major sources of barriers to entry:

1. **Economies of Scale:** These economies determine entry by forcing the aspirant either to come in on a large scale or to accept a cost disadvantage. Scale economies in production, research, marketing, and service are probably the key barriers to entry in the mainframe computer industry, as Xerox and GE sadly discovered. Economies of scale can also act as hurdles in distribution, utilisation of the sales force, financing and nearly any other part of a business.

2. **Product Differentiation:** Brand identification creates a barrier by forcing entrants to spend heavily to overcome customer loyalty. Advertising, customer service, being first in the industry, and product differences are among the factors brand identification. It is perhaps the most important thing is soft drinks, over-the-counter drugs, cosmetics, investment banking, and public accounting. To create high fences around their business, brewer's couple brand identification with economies of scale in production, distribution, and marketing.

3. **Capital Requirements:** The need to invest large financial resources in order to compete creates a barrier to entry, particularly if the capital is required for unrecoverable expenditures in up-front advertising or R & D. Capital is necessary not only for fixed facilities but also for customer credit, inventories, and-absorbing start-up losses. While major corporations have the financial resources to invade almost any industry, the huge capital requirements in certain fields, such as computer manufacturing and mineral extraction, limit the pool of likely entrants.

4. **Cost Disadvantages Independent of Size:** Entrenched companies may have cost advantages not available to potential rivals, no matter what their size and attainable economies of scale. These advantages can stem from the effect of the learning curve (and of its first cousin, the experience curve), proprietary technology, access to the best raw materials sources, assets purchased at preinflation prices, government subsidies, or favourable locations. Sometimes cost advantages are legally enforceable, as they are through patents.

5. **Access to Distribution Channels:** The new boy on the block must, of course, secure distribution of his product or service. A new food product, for example, must displace

others from the supermarket shelf via price breaks, promotions, intense selling efforts, or some other means. The more limited the wholesale or retail channels are and the more that existing competitors have these tied up, obviously the tougher that entry into the industry will be. Sometimes this barrier is so high that, to surmount it, a new contestant must create its own distribution channels, as Timex did in the watch industry in the 1950s.

6. **Government Policy:** The government can limit or even foreclose entry to industries with such controls as license requirements and limits on access to raw materials. Regulated industries like trucking, liquor retailing, and freight forwarding are noticeable examples, more subtle government restrictions operate in fields like ski-area development and coal mining. The government also can play a major indirect role by affecting entry barriers through controls such as air and water pollution standards and safety regulations.

The potential rival's expectations about the reaction of existing competitors also will influence its decision on whether to enter. The company is likely to have second thoughts if incumbents have previously lashed out at new entrants or if.

The incumbents possess substantial resources to fight back, including excess cash and unused borrowing power, productive capacity, or clout with distribution channels and customers.

The incumbents seem likely to cut prices because of a desire to keep market shares or because of industry wide excess capacity.

Industry growth is slow, affecting its ability to absorb the new arrival and probably causing the financial performance of all the parties involved to decline.

Question 36: State the key internal factors in various functional areas, which have potential strengths and weaknesses.

Answer:

Key Internal Factors:

Potential strengths and weaknesses Marketing:

- Firm's products/services- breadth of product line.
- Concentration of sales in a few products or to a few customers.
- Ability to gather needed information about markets.
- Market share or submarket shares.
- Product/service mix and expansion potential life cycle of key products, profit/sales balance in product/service.
- Channels of distribution number, coverage, and control.
- Effective sales organisation, knowledge of customer needs.
- Product/service image, reputation, and quality.
- Imaginative, efficient, and effective sales promotion and advertising.
- Pricing strategy and pricing flexibility.

- Procedures for digesting market feedback and developing new products, services, or markets. After-sale service and follow-up.
- Good will/brand loyalty.

Finance and Accounting:

- Ability to raise short-term capital.
- Ability to raise long-term capital, debt/equity,
- Corporate-level resources (multi business firm).
- Cost of capital relative to industry and competitors.
- Tax considerations.
- Relations with owners, investors, and stockholders.
- Leverage position capacity to utilise alternative financial strategies, such as lease or sale and leaseback.
- Cost of entry and barriers to entry.
- Price earning ratio.
- Working capital, flexibility of capital structure.
- Effective cost control, ability to reduce cost.
- Financial size.
- Efficient and effective accounting system for cost, budget, and profit planning.

Production/Operations/Technical

- Raw materials cost and availability, supplier relationships.
- Inventory control system, inventory turnover.
- Location of facilities, layout and utilisation of facilities.
- Economies of scale.
- Technical efficiency of facilities and utilisation of capacity.
- Effective use of subcontracting.
- Degree of vertical integration, value added and profit margin.
- Efficiency and cost/benefit of equipment.
- Effective operation control procedures, design, scheduling, purchasing, quality control, and efficiency.
- Costs and technological competencies relative to industry and competitors.
- Research and development/technology/innovation.
- Patents, trademarks, and similar legal protection.

Personnel:

- Management personnel.
- Employees' skill and morale.
- Labour relations costs compared to industry and competition.
- Efficient and effective personnel policies.
- Effective use of incentives to motivate performance.
- Ability to level peaks and valleys of employment.
- Employee turnover and absenteeism.
- Specialised skills.
- Experience.

Organisation of General Management:

- Organisational structure.
- Firm's image and prestige.
- Firm's record for achieving objectives.
- Organisation of communication system.
- Overall organisational control system (effectiveness and utilisation).
- Organisational climate, culture.
- Use of systematic procedures and techniques in decision making.
- Top management skill, capabilities, and interest. Strategic planning system. Intraorganisational synergy (multibusiness firms).

Question 37: Discuss the roles of Different Strategists.

Answer:

The term strategist refers to those who are involved in strategy formulation. In other words, this section answers the question who formulates strategies?

In large organisations, board of directors, general managers, and corporate planning staff (if there is such a division/cell) and, in some cases, external consultants may play a role in strategic planning.

Board of Directors: The board of directors plays an important role in corporate strategy making. The ultimate legal authority in business is that of the board of directors. Boards are held responsible to the stockholders for the following duties: ensuring the continuity of management (replacing or retiring managers), protecting the use of stockholders' resources, ensuring that managers take prudent actions regarding corporate objectives, approving major financial and operational decisions of the managers, representing the company with other organisations and bodies in society; maintaining, revising and enforcing the corporate charter and by laws.

The Board does not directly formulate the strategy, but it can and should play an important role in strategic management by causing the formulation of the corporate plan, evaluating it, reviewing it, evaluating its implementation and by its power to appoint or remove the chief executive officer (CEO). Kenneth Andrews observes: “A responsible and effective board should require of its management a unique and durable corporate strategy, review it periodically for its validity, use it as a reference point for all other board decisions, and share with management the risks associated with its adoption”.

When the board of directors is an inside board (i.e., majority of the members consists of persons holding management positions in the company), inside members may directly involve in strategy formulation by the virtue of the management positions they hold. When the board is an outside one (i.e., majority of the members do not hold management positions in the company) and the outsiders are capable persons, the evaluations, reviews and directions could be more independent objective and meaningful. However, outside board could sometimes cause conflicts also.

According to Dr. A.S. Ganguly, Chairman, ICI India Ltd., “the Board, as a whole, has the responsibility to initiate discussion, agree and underwrite the corporation’s strategic plans”. The Board has the collective responsibility to ensure its implementation through agreed operational plans. Individual Executive Directors are responsible and accountable to meet the targets for specific business under their control.

However, it is generally acknowledged that the Boards of many Indian companies are not effective. Here is the case of a well known company, for example, The Glaxo India Ltd. had a Board consisting of several non-executive and executive members. Board meetings did not usually focus much on the performance of the business or its new investments, but dealt with a number of formal legal and accounting matters. Some of the non-executives had been on the Board for over a decade with the resultant natural tendency to resist change and defend the past. The executive directors as individuals did not have much independence of views as the tradition of the company was that they toed the line laid down by the Managing Director in charge, as people do in any gentlemen’s club.

Therefore, one of the first steps was to change the functioning and the composition of the Board by arranging for the older non-executives to retire and to replace them by younger non-executives with experience in finance and marketing.

It is very essential that on any company’s Board there should be some independent, professionally qualified non-executive Directors. At the same time there should be a regular retirement policy for nonexecutive directors with a clear understanding of their period for which they are appointed, so that there is no misunderstanding when the time comes of them to step down. This is an essential part of Corporate Governance.

Sometimes it is very difficult for a Chief Executive who has been steeped in the tradition of company and had been involved in many of its investments which are not performing to accept the need to change or to extricate from the past. There are loyalties and sentiments to be overcome, especially if the CEO is a sensitive individual. A change could become necessary even at that level in order to facilitate the process of change.

Looking back perhaps the most important change in the company was this change in the composition and quality of the Board. It is not easy to change a Board and it takes time but if a business has to be rejuvenated the first place to start is at the Board level. Whether it is a company or a nation the quality of leadership has the single largest impact on its performance.

The draft Code on desirable Corporate Governance formulated by Confederation of Indian Industry (CII), has laid down, inter alia, the following principles.

- The full board, which should be single tired, should meet at intervals of two months, and at least six times a year.
- The non-executive directors should comprise at least 30 percent of the board if one of them is the chairman.
- The non-executive directors should comprise at least 50 percent of the board if the chairman and the managing director is the same person.
- No individual should be a director on the boards of more than 10 companies at any given time.
- Non-executive directors should be active, have defined responsibilities, and be conversant with P & L accounts.
- Non-executive directors should be paid commissions for their professional inputs besides their sitting fees.
- Directors who have not been present for at least 50 percent of board meetings should not be re-appointed.
- The board should be informed of operating plans and budgets, long-term plans, quarterly divisional results, and internal audit reports.
- Details of defaults, payments for intangibles, foreign exchange exposure, and managers' remuneration should be reported to the board.
- An audit committee, comprising at least three non-executive directors, should be set up and given access to all financial information.

General Manager: The role of General Managers (GM) in strategic management is clear from the fact that strategic management is a general management function. The General Managers are the top executives of the enterprise and SBUs who are responsible for the survival and success of the enterprise.

The GM is the entrepreneur sets goals), strategist (plans), organisation builder (organisers), leader (directs), and chief implementer controls). The task is to lead the firm or SBU through uncharted territory in less than-certain circumstances.

The most important GM, obviously, is the CEO. As George Steiner rightly points out, "there can and will be no effective formal strategic planning in an organisation in which the chief executive does not give it firm support and make sure that others in the organisation understand his depth of commitment".

Corporate Planners: Large organisations may establish a corporate planning division or cell. It is a staff function and these staff personnel are known as corporate planners.

Functions and responsibilities of the corporate planning staff include:

1. Keeping track of the latest developments in the field of strategic management and disseminating such information to the strategists.
2. Supplying data inputs and analytical support needed for strategic management.
3. Environmental analysis.
4. Identifying new business opportunities.
5. Helping to establish a planning system.
6. Formulating guidelines for preparing plans.
7. Coordinating divisional plans.
8. Assisting to evaluate and control strategies.

Strategic Management Consultants:

Some organisations, particularly those which do not have a corporate planning staff, make use of the services of strategic management consultant. Several Indian companies have sought the services of such consultants like Mc Kinsey, Anderson Consulting Arthur D Little, Arthreya, Tata Consultancy etc.

Question 38: How Grand Strategies are formulated? Briefly explain the principal Grand Strategies.

Answer:

Grand Strategies: Despite variations in implementing the strategic management approach, designers of planning systems generally agree about the critical role of grand strategies. Grand strategies, which are often called master or business strategies, are intended to provide basic direction for strategic actions. Thus, they are seen as the basis of coordinated and sustained efforts directed toward achieving long-term business objectives.

As theoretically and conceptually attractive as the idea of grand strategies has proved to be, two problems have limited use of this approach in practice. First, decision makers often do not recognise the range of alternative grand strategies available. Strategic managers tend to build incrementally from the status quo. This often unnecessarily limits their search for ways to improve corporate performance. Other executives have simply never considered the options available as attractive grand strategies.

Second, strategic decision makers may generate lists of promising grand strategies but lack a logical and systematic approach to selecting an alternative.

Grand strategies indicate how long-range objectives will be achieved. Thus, a grand strategy can be defined as a comprehensive general approach that guides major actions.

Any one of the 12 principal grand strategies could serve as the basis for achieving major long-term objectives of a single business concentration, market development, product development, innovation, horizontal integration, vertical integration, joint venture, concentric diversification, conglomerate diversification, retrenchment/turnaround, divestiture, and liquidation. When a company is involved with multiple industries, businesses, product lines, or customer groups as many firms are several grand strategies are usually combined. However, for clarity, each of these grand strategies is described independently and clearly with examples to indicate some of their relative strengths and weaknesses.

(i) Concentration: The most common grand strategy is concentration on the current business. The firm directs its resources to the profitable growth of a single product, in a single market, and with a single technology. Some of America's largest and most successful companies have traditionally adopted the concentration approach. Examples include W.K. Kellogg and Gerber Foods, which are known for their product, Shaklee, which concentrates on geographic expansion, and Lincoln Electric, which bases its growth on technological advances.

The reasons for selecting a concentration grand strategy are easy to understand. Concentration is typically lowest in risk and in additional resources required. It is also based on the known competencies of the firm. On the negative side, for most companies concentration tends to result in steady but slow increases in growth and profitability and a narrow range of investment options.

Further, because of their narrow base of competition, concentrated firms are especially susceptible to performance variations resulting from industry trends.

Concentration strategies succeed for so many businesses including the vast majority of smaller firms because of the advantages of business level specialisation. By concentrating on one product, in one market, and with one technology, a firm can gain competitive advantages over its more diversified competitors in production skill, marketing know-how, customer sensitivity, and reputation in the marketplace.

A grand strategy of concentration allows for a considerable range of action. Broadly speaking, the business can attempt to capture a larger market share by increasing present customer's rate of usage, by attracting competitors' customers, or by interesting nonusers in the product or service. In turn, each of these actions suggests a more specific set of alternatives.

When strategic managers forecast that the combination of their current products and their markets will not provide the basis for achieving the company mission, they have two options that involve moderate cost and-risk market development and product development.

(ii) Market Development: Market Development commonly ranks second only to concentration as the least costly and least risky of the 12 grand strategies. It consists of marketing present products, often with only cosmetic modifications, to customers in related market areas by adding different channels of distribution or by changing the content of advertising or the promotional media. Thus, businesses that open branch offices in new cities, states, or countries are practicing market development. Likewise, companies that switch from advertising in trade publications to newspapers or add jobbers to supplement their mail order sales efforts are using a market development approach.

(iii) Product Development: Product development involves substantial modification of existing products or creation of new but related items that can be marketed to current customers through established channels. The product development strategy is often adopted either to prolong the life cycle of current products or to take advantage of favourable reputation and brand name. The idea is to attract satisfied customers to new products as a result of their positive experience with the company's initial offering. Thus, a revised edition of a college textbook, a new car style, and a second formula of shampoo for oily hair each represents a product development strategy.

(iv) **Innovation:** In many industries it is increasingly risky not to innovate. Consumer as well as industrial markets have come to expect periodic changes and improvements in the products offered. As a result, some businesses find it profitable to base their grand strategy on innovation. They seek to reap the initially high profits associated with customer acceptance of a new or greatly improved product. Then, rather than face stiffening competition as the basis of profitability shifts from innovation to production or marketing competence, they move on to search for other original or novel ideas. The underlying philosophy of a grand strategy of innovation is creating a new product life cycle, thereby making any similar existing products obsolete.

(v) **Horizontal Integration:** When the long-term strategy of a firm is based on growth through the acquisition of one or more similar businesses operating at the same stage of the production marketing chain, its grand strategy is called horizontal integration. Such acquisitions provide access to new markets for the acquiring firm and eliminate competitors. For example, Warner-Lambert Pharmaceutical Company's acquisition of Parke Davis reduced competition in the ethical drugs field for Chilcott Laboratories, a company Warner-Lambert had previously acquired.

(vi) **Vertical Integration:** When the grand strategy of a firm involves the acquisition of businesses that either supplies the firm with inputs (such as raw materials) or serve, as a customer for the firm's outputs (such as warehouses for finished products), vertical integration is involved. For example, if a shirt manufacturer acquires a textile producer by purchasing its common stock, buying its assets, or through an exchange of ownership interests the strategy is a vertical integration. In this case it is a backward vertical integration since the business acquired operates at an earlier stage of the production/marketing process. If the shirt manufacturer had merged with a clothing store, it would have been an example of forward vertical integration the acquisition of a business nearer to the ultimate consumer.

(vii) **Joint Venture:** Occasionally two or more capable companies lack a necessary component for success in a particular competitive environment. For example, no single petroleum firm controlled sufficient resources to construct the Alaskan pipeline. Nor was any single firm capable of processing and marketing the volume of oil that would flow through the pipeline. The solution was a set of joint ventures.

(viii) **Concentric Diversification:** Grand strategies involving diversification represent distinctive departures from a firm's existing base of operations, typically the acquisition or internal generation (spin-off) a separate business with synergistic possibilities counterbalancing the two businesses strengths and weaknesses. For example, Head initially sought to diversify into summer sporting goods and clothing to offset the seasonality of its snow business. However, diversifications are occasionally undertaken as unrelated investments because of their otherwise minimal resource demands and high profit potential.

(ix) Conglomerate Diversification: Occasionally a firm, particularly a very large one, plans to acquire a business because it represents the most promising investment opportunity available. This type of grand strategy is commonly known as conglomerate diversification. The principal and often sole concern of the acquiring firm is the profit pattern of the venture. There is little concern given to creating product/market synergy with existing businesses, unlike the approach taken in concentric diversification. Financial Synergy is what is sought by conglomerate diversifies such as ITT, Textron, American Brands, Litton, U.S. Industries, Fuqua, and I.C. Industries. For example, they may seek a balance in their portfolios between current businesses with cyclical sales and acquired businesses with counter cyclical sales, between high cash low opportunity and low-cash/high opportunity businesses, or between debt free and highly leveraged businesses.

The principal difference between the two types of diversification is that concentric acquisitions emphasise some commonality in markets, products, or technology, whereas conglomerate acquisitions are based principally on profit considerations.

(x) Retrenchment/Turnaround: For any of a large number of reasons a business can find itself with declining profits. Economic recessions, production inefficiencies, and innovative break through by competitors are only three causes. In many cases strategic managers believe the firm can survive and eventually recover if a concerted effort is made over a period of a few years to fortify basic distinctive competencies. This type of grand strategy is known as retrenchment.

It is typically accomplished in one of two ways, employed singly or in combination:

- **Cost reduction:** Examples include decreasing the work force through employee attrition, leasing rather than purchasing equipment, extending the life of machinery, and eliminating elaborate promotional activities.

- **Asset reduction:** Examples include the sale of land, buildings, and equipment not essential to the basic activity of the business, and elimination of "perks" like the company aeroplane and executive cars. If these initial approaches fail to achieve the required reductions, more drastic action may be necessary. It is sometimes essential to lay off employees, drop items from a production line, and even eliminate low-margin customers.

Since the underlying purpose of retrenchment is to reverse current negative trends, the method is often referred to as a turnaround strategy. Interestingly, the turnaround most commonly associated with this approach is in management positions. In a study of 58 large firms, researchers Schendel, Patton, and Riggs found that turnaround was almost always associated with changes in top management. Bringing in new managers was believed to introduce needed new perspectives of the firm's situation, to raise employee morale, and to facilitate drastic actions, such as deep budgetary cuts in established programs.

(xi) Divestiture: A divestiture strategy involves the sale of a business or a major business component. When retrenchment fails to accomplish the desired turnaround, strategic managers often decide to sell the business. However, because the intent is to find a buyer willing to pay a premium above the value of fixed assets for a going concern, the term marketing for sale is more appropriate. Prospective buyers must be convinced that because of their skills and resources, or the synergy with their existing businesses, they will be able to profit from the acquisition.

The reasons for divestiture vary. Often they arise because of partial mismatches between the acquired business and the parent corporation. Some of the mismatched parts cannot be integrated into the corporation's mainstream and thus must be spun off. A second reason is corporation financial needs. Sometimes the cash flow or financial stability of the corporation as a whole can be greatly improved if businesses with high market value can be sacrificed. A third, less frequent reason for divestiture is government antitrust action when a corporation is believed to monopolise or unfairly dominate a particular market.

Although examples of grand strategies of divestiture are numerous, an outstanding example in the last decade is Chrysler Corporation, which in quick succession divested itself of several major businesses to protect its mission as a domestic automobile manufacturer. Among major Chrysler sales were its Air tempt air conditioning business to Fedders and its automotive subsidiaries in France, Spain, and England to Peugeot Citroen. These divestitures yielded Chrysler a total of almost $500 million in cash, notes, and stock and, thus, in the relatively short term, improved its financial stability. Other corporations that have recently pursued this type of grand strategy include Esmark, which divested Swift and Company, and White Motors, which divested White Farm.

(xii) Liquidation: When the grand strategy is that of liquidation, the business is typically sold in parts, only occasionally as a whole, but for its tangible asset value and not as a going concern. In selecting liquidation, owners and strategic managers of a business are admitting failure and recognise that this action is likely to result in great hardships to themselves and their employees. For these reasons liquidation is usually seen as the least attractive of all grand strategies. However, as a long-term strategy it minimises the loss to all stakeholders of the firm. Usually faced with bankruptcy, the liquidating business tries to develop a planned and orderly system that will result in the greatest possible return and cash conversion as the business slowly relinquishes its market share.

Planned liquidation can be worthwhile. For example, the Columbia Corporation, a $130 million diversified firm, liquidated its assets for more cash per share than the market value of its stock.

Question 39: What is strategic control? Explain the basic types of strategic control.

Answer:

A strategy is selected and implemented over time so as to effectively position and guide a firm within an often rapidly changing environment. Strategies are forward looking, designed to be accomplished several years into the future, and based on management assumptions about numerous events that have not yet occurred.

How should managers undertake controlling a strategy? Traditional approaches to control seek to compare actual results against a standard. The work is done; the manager evaluates the work, and uses the evaluation as input to control future efforts. While this approach has its place, it is inappropriate as a means to control a strategy. Waiting until a strategy has been fully executed often involves five or more years, during which many changes occur that have major ramifications for the ultimate success of the strategy. Consequently, customary control concepts and approaches must be adjusted or replaced in favour of strategic controls that recognise the unique control needs of long-term strategies.

Strategic control is concerned with tracking the strategy as it is being implemented, detecting problems or changes in underlying premises, and making necessary adjustments. In contrast to post action control, strategic control is concerned with controlling and guiding efforts on behalf of the strategy as action is taking place and while the end result is still several years into the future. Managers responsible for a strategy and its success are typically concerned with two sets of questions:

1. Are we moving in the proper direction? Are key things falling into place? Are our assumptions about major trends and changes correct? Are the critical things we need to do being done? Do we need to adjust or abort this strategy?
2. How are we performing? Are we meeting objectives and schedules? How are costs, revenues, and cash flows matching projections? Do we need to make operational changes?

Strategic controls, augmented by certain operational controls, are designed to answer these questions. Reward systems play a key role in directing strategy implementation and motivating strategic control.

Establishing Strategic Controls: Control of strategy can be characterised as a form of "steering control". Ordinarily, a significant time span occurs between initial implementation of a strategy and achievement of its intended results. During that time, numerous projects are undertaken, investments are made, and actions are undertaken to implement the new strategy. Also during that time, both the environmental situation and the firm's internal situation are developing and evolving. Strategic controls are necessary to steer the firm through these events. They must provide the basis for correcting the actions and directions of the firm in implementing its strategy as developments and changes in its environmental and internal situations take place.

Prudential Insurance Company provides a useful example of the proactive, steering nature of strategic control. Several years ago, Prudential committed to a long-term market development strategy wherein it would seek to attain the top position in the life insurance industry by differentiating its level of service from other competitors in the industry. Prudential decided to establish regional home offices, thus achieving a differential service advantage. Exercising strategic control, Prudential managers used the experience at the first regional offices to reproject overall expenses and income associated with this strategy. In fact, the predicted expenses were so high that the location and original schedule for converting other regions had to be modified. Conversion of corporate headquarters was sharply revised on the basis of other early feedback. Thus the steering control (or strategic control) exercised by Prudential managers significantly altered the strategy long before the total plan was in place. In this case, major objectives remained in place while changes were made in the strategy in other cases, strategic controls may initiate changes in objectives as well.

The four basic types of strategic control are:

1. Premise control.
2. Implementation control.
3. Strategic surveillance.
4. Special alert control.

The nature of these four strategic controls is shown in the figure next page.

Premise Control:

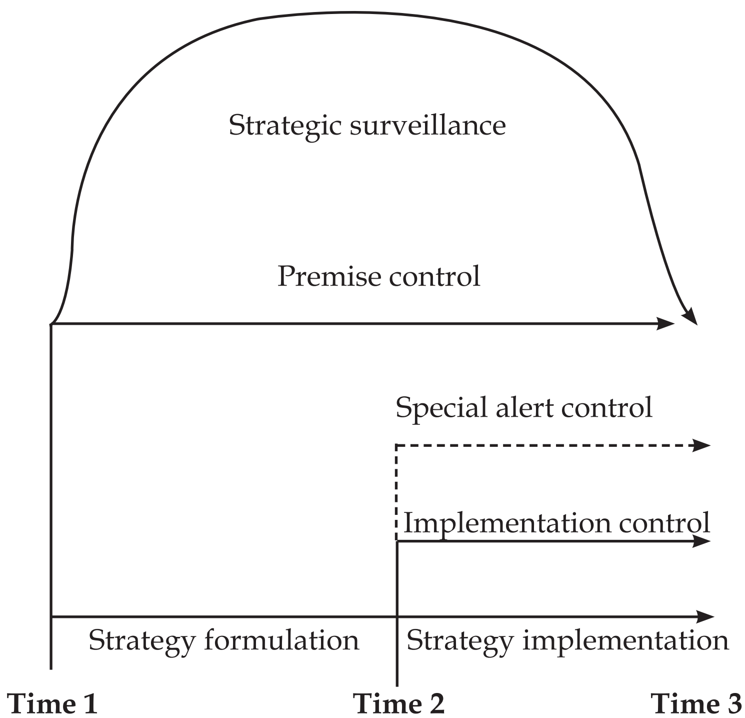
Every strategy is based on assumed or predicted conditions. These assumptions or predictions are planning premises; a firm's strategy is designed around these predicted conditions. Premise control is designed to check systematically and continuously whether or not the premises set during the planning and implementation process are still valid. If a vital premise is not longer valid, then the strategy may have to be changed. The sooner an invalid premise can be recognised and revised, the better the chances that an acceptable shift in the strategy can be devised.

What Premises should be monitored? Premises are primarily concerned with two types of factors environmental and industry. They are described below:

Environmental Factors: A company has little or no control over environmental factors, but these factors exercise considerable influence over the success of the strategy. Inflation, technology, interest rates, regulation, and demographic/ social changes are examples of such factors. Strategies are usually based on key premises about these factors.

Industry Factors: These factors affect the performance of companies in a given industry. They differ among industries, and a company should be aware of the factors that influence success in its particular industry. Competitors, suppliers, substitutes, and barriers to entry are a few such factors about which strategic assumptions are made.

Premises, some major and some minor, are often made about numerous environmental and industry variables. To attempt to track every premise may be unnecessarily expensive and time-consuming. Therefore, managers must select those premises and variables that (a) are likely to change and (b) would have a major impact on the company and its strategy if they did.



Four Types of Strategic control

How is Premise Controls Enacted?

The key premises should be identified during the planning process. The premises should be recorded, and responsibility for monitoring them should be assigned to the persons or departments who are qualified sources of information. For example, the sales force may be a valuable source for monitoring the expected price policy of major competitors, while the finance department might monitor interest rate trends. All premises should not require the same amount of effort, and, again, emphasis should be placed on key success premises so as to avoid information overload. Premises should be updated (new predictions) based on updated information. Finally, key areas within the company or key aspects of the strategy that the predicted changes may significantly impact should be preidentified so that adjustments necessitated by a revised premise can be determined and initiated. For example, senior marketing executives should be alerted about changes in competitors' pricing policies in order to determine if revised pricing, product repositioning, or other strategy adjustments are necessary.

Question 40: 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 assess 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 a source of information from which managers can obtain feedback that helps determine whether the overall strategy is progressing as 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 a 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 as 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 an 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 are concerned with "steering" the company's future direction. Both are needed to manage the strategic process effectively.

Question 41: What is SWOT Analysis? Give a brief illustrative list of strengths and weaknesses of different areas.

Answer:

SWOT Analysis: SWOT analysis is one of the prime and primary steps in strategic management. Terms such as WOTS - up analysis, SCOT (strengths, constraints, opportunities and threats), internal analysis (analysis of strengths and weakness of the firm), external analysis (analysis of environmental threats and opportunities), ETOP (environment threats and opportunities profile), EFE (external factor evaluation) Matrix, IFE (internal factor evaluation) Matrix etc. are also used in this context (in the case of IFE/EFE matrix, the key internal/external are identified, they are assigned weight ages and weighted scores are obtained by multiplying the weights with the respective ratings).

Strengths and internal competencies of a firm, particularly in comparison with that of its competitors. Strengths may encompass the company image, brand image, business synergies, and functional areas such as marketing, finance, personnel, production and R&D.

Weaknesses are those factors which tend to decrease the competencies of the firm, particularly in comparison with its competitors. Such weaknesses may includes poor product quality, obsolete technology, high production costs, lack of R&D back up, poor distribution infrastructure, poor financial position, weak management, etc.

The following tables provide a brief illustrative list of strengths and weaknesses of different areas:

Table 1: Strengths and Weaknesses

Strengths	Weaknesses
Marketing	
Strong brand image Strong distribution network Deep product mix Efficient and motivated sales force High quality product	Poor brand image Weak distribution Narrow product mix Poor sales force Poor product quality
Production	
Economies of scale State of the art technology Efficient input sourcing Efficient inventory management Strong R&D support	High cost due to small size Obsolete technology Inefficient input sourcing Poor inventory management No R&D support
Finance	
Comfortable debt-equity ratio Large internal accruals High dividends and market capitalisation High credit rating	Lop-sided capital structure Very high interest payments Poor reserves Low credit rating Poor receivables management
Human Resource	
Qualified and experienced human resource Motivated human resource Good industrial relations Good human resource management	Redundant human resource Excess manpower Poor morale Poor industrial relations Poor human resource management
Management	
Efficient Board of Directors Efficient and motivated managers	Inefficient Board of Directors Unhealthy conflict between member of Board Conflict between members of Board and top managers Inefficient managers

Table 2: Opportunities and Threats

Opportunities	Threats
Regulatory/Political	
Delicensing	Delicensing
Dereservations	Dereservations
MRTPA relaxations	MRTPA relaxations
Import liberalisation	Import liberalisation
Price decontrol	
Liberalisation of foreign investment and technology policy	Liberalisation of foreign investment and technology policy
Capital market reforms	Political instability
Economics	
Boom	Recession
Steady and fast increase in income	Economic instability
Social/Demographic	
Favourable change in consumer attitude	Unfavourable change in consumer attitude
Increasing population	Stagnating/declining population
Change in age composition of population	Change in age composition of population
Growth of consumerism	Growth of consumerism
Growth of environmentalism	Growth of environmentalism

In table 1 several factors figure under opportunities as well as threats. This is because what is an opportunity for some firms is a threat for some others. For example, Delicensing is an opportunity for many firms to enter new business or to expand existing business but it poses a threat to existing firms who were enjoying the benefits of a protected market. Similarly, while import liberalisation is a threat to import competing industries, it is an opportunity for some other firms to obtain materials/technology cheaply.

A SWOT analysis of the Modi Xerox, made in the early 1990s, is given below. The company has repositioned itself from just a copier to a document company and reformulated its corporate mission statement as "to develop, manufacture, service and finance a complete range of document processing products and services to help our customers to make their office more productive".

Table 3: SWOT Analysis of Modi Xerox

Strengths	Weaknesses
Strong brand name	More expensive than the competitors
Strong market presence	Small product range
Access to technology	Low productivity by international standards.
Quality of trained & skilled manpower	Inadequate investment on information software systems & debase
Motivated sales force & excellent market coverage	
Opportunities	**Threats**
Large and growing market	Fierce international competition (expected)
Easy access to the Xerox technology	Priced down, costs up
Advantages of synergies in the product range.	High personnel attraction rates

Question 42: Write a note on Tows Matrix.

Answer: The TOWS Matrix, is an important strategy formulation matching tool. The TOWS Matrix postulates the following four alternatives strategies.

WT Strategy: The WT or the mini-mini strategy seeks to minimise the weaknesses and threats. Some of the weakness may be overcome or minimised. For example, managerial weakness may be solved by change of managerial personnel, training, etc. weakness due to excess manpower may be addressed to by restructuring and retirement schemes. External threat may be met by strategic alliance, or other type's joint ventures. In some cases an unprofitable business that cannot be revived may be given up.

Tows Matrix

	Internal Factors	
Internal Factors / External Factors	Internal Strengths (S)	Internal Weakness (W) ....
External Opportunities (O)	SO (Maxi - Maxi) Strategy (maximise strengths and opportunities)	WO (Mini-Maxi) Strategy (minimise weakness and maximise opportunities)
External Threats (T)	ST (Maxi - Maxi) Strategy (maximise strengths and minimise threats)	WT (Mini - Mini) Strategy (minimise weaknesses and threats)

WO Strategy: The WO or mini-maxi-strategy aims at minimising the weaknesses and maximising the opportunities. For example, for a textile machinery manufacturer in India the main weaknesses were dependence on foreign firms for technology and the long time taken to execute an order. The solutions are to give thrust to R&D to develop technology and measures to reduce the time lag so as to be is a better position to exploit to the maximum the growing demand.

ST Strategy: The ST or maxi-mini strategy attempts to use the organisations strengths to deal with the environment threats. For example, a company may use its technological, financial and marketing strengths to combat a new competition. For example, Hindustan Lever has been employing this strategy to fight the increasing competition from companies like P&G, Nirma etc.

SO Strategy: The SO or maxi-maxi strategy, which is the most desirable and advantages strategy, seeks to mass up a firm's strengths to exploit the opportunities. For instance, Hindustan Lever has been augmenting its strengths (by measures such as the merger of BBLIL into HLL and takeover of firms in the food business) to exploit the growing potential of the food business.

Question 43: What should be the Strategic Planning period for an organisation?

Answer:

The planning period should be the appropriate period of time which meets planning requirements and enables the decision making and/or control 'processes to be most effectively exercised. For example, the appropriate planning period for a firm of aircraft manufacturers will be much longer than the planning period for a firm of book publishers, which in turn will probably be longer than the planning period for a firm of fashion garment manufacturers.

Question 44 : (a) What should characterise objectives?

(b) List four possible financial objectives that a firm might pursue.

(c) What are the drawbacks to use the ROI as a primary objective?

(d) Which type of company is likely to have growth as its primary objective?

(e) List the main stakeholder groups.

Answer:

(a) Many organisations set their objectives in order to implement the corporate mission. Many objectives are:

- Specific
- Measurable
- Attainable
- Result oriented
- Time-bound

However, not all goals can be measured, or can ever be attained completely. Customer satisfaction is a goal, but satisfying customer and ensuring that they remain satisfied is a continuous process that does not stop when one target has been reached.

(b) The primary objective for a company will be a financial objective based on shareholders wealth, but there are different ways of expressing such an objective in quantitative terms for practical purpose. Various financial objectives would include the following:

- Profitability
- Return on Investment or Return on capital employed
- Share price, earnings per share, dividends
- Growth
- Several of these objectives simultaneously.

(c) Some companies use an accounting ROI as a primary objective but there are drawbacks to its uses.

- Capital employed is notoriously suspect as a financial measure, since a book value in the balance sheet will probably bear little or no comparison with the true value - net replacement cost, gross replacement cost, net realisable value or economic value of the asset.
- If ROI were used, there would be some difficulty in balancing short-term results against long-term requirements.
- The choice of ROI as an objective also ignores the risk of investments. High risk projects might promise a high return if they succeed, but it may be safer to opt for a project with a lower return but a greater guarantee of success.

(d) Growth is likely to be a prime objective for the following types of company:

- Smaller companies since these will usually have greater potential for significant rates of growth.
- Larger companies which are seeking to achieve a size which will enable them to compete with other multinationals in world markets.

(e) There are three broad types of stakeholders in an organisation, as follows:

- Internal stakeholders (employees, management)
- Connected stakeholders (shareholders, customers, suppliers' financiers)
- External stakeholders (the community, government, pressure groups)

Question 45: Describe briefly the Grand strategy Alternatives.

Answer:

There are four grand strategies: Stability, expansion, retrenchment and combination. These are options for the pace -or level of efforts in the current business definition or for changing the business definition. Following exhibit shows a matrix of these basic options with some representative examples of approaches for carrying out the strategy. That is, the firm may decide to change its business definition by expanding or retrenchment of the scope of its products, markets or functions. If it chooses, to maintain its definition, it still may alter its strategy by changing the pace of effort within the stable business definition in order to become more efficient or effective in the way it carries out the mission. Of course, combinations of options are possible at the same time or over time. Combinations include simultaneous activities across several cells or sequential options in these cells over time.

Basic grand strategy alternatives

		Products	Markets	Functions
Change	Expand	Add new times	Find new users or territories	Forward vertical integration
Business Definition	Retrench	Drop old times	Drop distribution channels	Become captive company
Stable Definitions		Maintains	Maintain	Maintain
	Expand	Find new users	Increase Market share (penetrate)	Increase plant capacity
Face Changes	Retrench	Decrease product Development	Reduce Market Share	Decrease Process R&D
	Stable	Make packing changes	Maintain Share	Maintain production Efficiency

Question 46: 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.

Question 47: How would you classify strategic alternatives based on growth? Discuss specific contributions if any, in this respect.

Answer:

Based on the desired rate of growth the various alternatives provided are:

- internal expansion (adding more capacity)
- internal stability (by augmenting resources)
- internal retrenchment (manpower or assets)
- external retrenchment (by disposing company-owned outlets)
- external expansion through mergers
- A combination of the above strategies.

Strategic alternatives could also be classified into the following categories:

- Stable growth strategies
- Profit strategies
- Stable growth as pause strategies
- Sustainable growth strategies.

The first alternative is useful when a firm purchases its original objective or objectives similar to the original one, or when the focus of its main strategic decision is on the incremental improvement of functional performance In this case achievement level is fixed on the basis of past performance connected for known rate of inflation. The underlying premises in this case are:

- a reasonably stable environment, and
- management not being in favour of undertaking high degree of risk though it is not risk-averse.

Modi Xerox since its inception has followed a stable growth strategy in India. It has concentrated on a narrow range of products and quality aspect of after-sales service.

The second alternative is followed when the main aim of the strategic business unit is to generate surplus. In the process other objectives may be sacrificed. This aspect may get considerable importance during the phase of recession.

The stable growth alternative applies in those situations where a firm deliberately slows down to improve efficiency. Such behaviour is observed among organisations who find it difficult to manage growth. This difficulty is usually experienced by organisations of small to medium size. But, unmanageable growth has been experienced by large organisations too. A very large number of television manufacturers in India are forced to control their growth in spite of large market opportunities that exist before them. Since most of the TV manufacturers are small or medium sized firms lacking substantial resources, they follow a stable growth strategy by focussing their efforts in certain geographical markets and around few products.

The sustainable growth alternative includes a modified incremental growth to take one of the unfavourable external conditions. These include:

(1) Internal growth strategies, consisting of:
   - Concentric diversification
   - Conglomerate diversification

(2) External growth strategies consisting of:
   - Mergers
   - Joint ventures.

(3) Liquidation.

Concentric growth is an alternative where the firm goes into business which are related to the existing ones, say from manufacture of spare parts for passenger cars to manufacture of spare parts for tractors. This is an example of product related concentric growth. An example of customer related concentric growth is when a firm producing farm equipment decides to enter the business of chemical fertilisers.

Under the growth alternatives of conglomerate diversification, a firm may acquire another firm which has surplus cash even though there may be nothing in common with the existing business. The RPG enterprises have pursued this alternative within the scope of its limited resources.

Merger is an alternative where two firms join. There are different objectives of mergers including the need to tide over the financial crisis. In actual practice, it is difficult to draw a distinction between mergers and acquisitions. Strictly speaking the case of mergers, the existing companies lose their identity and a new company is formed, while in the case of acquisition, it is the purchase of a company by another company. Madura Coats is a company born out of the merger- of Madura Mills and Coats India Limited in early seventies. At times, it is profitable to diversify through mergers. Joint venture is an alternative which can meet a number of needs such as rapid rate of growth desired by a firm, maintaining the risk within reasonable limit, and to tide over the constraint of resources. Thus, a firm having constraint of production capacity can have a joint venture with a firm having surplus production capacity.

Liquidation indicates a situation where the firm finds the business unattractive. There may be a dearth of people who have interest in the proposition. Neither the employees nor do outside parties find it an attractive proposition to be revived. Obsolete equipment is the usual cause. Disinvestment may be considered attractive when the present worth of expected earnings is less than its present worth.

Question 48: What are the “key success factors” in the organisational context? How would you determine them? Compare and contrast different types of standards which can be used for evaluation and control of strategy.

Answer: Key variables, key success factors or critical success factors are most important for a successful strategy. A typical list of such factors for a business organisation is shown below:-

Marketing	Production	Assets Management	Personnel
Sales order book position, market share, gross margin or repeat orders	Capacity utilisation, cost of production, timely deliveries.	Inventory turnover, Sundry debtors, Return on investment	Employee turnover, absenteeism, man days lost in strikes

It must be noted that the key variables for designing the system of evaluation and control differ from business (and thus organisation) to business (organisation). Also in a large multi-business organisation, they may vary from one organisation unit/ level to another.

This is particularly true in the Indian context where unrelated business strategies are not necessarily unsuccessful or uncommon. A company may be in textile and pharmaceutical business simultaneously as also in vegetable oils and computers. The environment permits that it is therefore all the more necessary to avoid getting bogged down with a standard of uniform set of key variables for all the organisations. Knowledge of key characteristics of industry in which the business falls is thus imperative and useful for identifying key success factors. Some of the key variables on the other hand will emerge from the company’s functional strategies. For instance, if a company has proposed aggressive strategies, the number of new products introduced in a period will be a key success factor. The guidelines for identifying key variables have been provided as below:

- Is it important in explaining the success or failure of the organisation?
- Is it volatile and can change quickly, often for reasons not controllable by the managers?

- Is it significant enough to require prompt action when a change occurs?
- Is it not easy to predict changes in key variables?
- Can the variable be measured, either directly or via a surrogate?

For instance, customer satisfaction cannot be measure, but its surrogate, number of sales returns can be a key variable.

Having identified the measures relevant for assessing the success of the strategy, the next important issue is to set the standards against which actual performance is to be measured. The standards of performance could be any of the following three types.

(a) Historical standards. In this type of standards, comparison of present performance is made with the past performance. Though simplest, this type does not take into account the changes in environmental conditions between the two periods. Moreover, the prior-period performance itself may not have been acceptable. It also could be misleading in the formative years when the numerator (previous year's figures) is small.

(b) Industry standards. In this type of standards, the comparison of a firm's performance is made against similar other firms in the industry. The difficulty here is that all the firms may not be exactly the same for purposes of comparison.

(c) Present Standards. The goals/targets are decided by the firm's management to be achieved in a particular period. Present standards convey the aspiration levels and take into account environmental conditions, if properly derived. These are more realistic and also consider the organisation's capacity to achieve them. These, however, require tremendous analysis. Absence of such analysis may lead to shocking results. However, for a company developing a conscious strategy, present standards provide the best alternative.

Question 49: Dramatic cost advantages can emerge from finding innovative ways to restructure processes and tasks, cut frills and provide the basics more economically.

(a) List the primary ways by which companies can achieve a cost advantage by reconfiguring their value chains.

(b) Explain the way a cost leadership strategy can help a firm in handling the five competitive forces.

(c) Identify the elements in the marketing mix that would be particularly relevant to a manufacturer of domestic washing machine.

Answer (a):

Cost advantages by reconfiguring value chains:

Dramatic cost advantages can emerge form finding innovative ways to restructure processes and tasks, cut out frills, and provide the basics more economically. The primary ways companies can achieve a cost advantage by reconfiguring their value chains include:

- Simplifying the product design
- Stripping away the extras and offering only a basic, non-frills product or service, thereby cutting out activities and cost associated with multiple features and potions.

- Re-engineering core business processes to cut out needless work step, and low-value added activities.
- Shifting to a simpler, less capital-intensive or more streamlined technological process.
- Finding ways to bypass the use of high-cost raw materials or component parts.
- Using direct-to-end-user sales and marketing approaches that cut out large costs and margins of wholesalers and retailers.
- Relocating facilities closer to suppliers, customers or both to curtail inbound & outbound logistical costs.
- Achieving a more economical degree of forward or backward vertical integration, relative to competitors.
- Dropping the something for everyone approach and focussing on a limited product/ service to meet a special, but important, need of the target buyer, thereby eliminating activities and costs associated with numerous product versions.

Answer (b):

Cost leadership strategy in handling five competitive forces:

Being the low-cost provider in an industry, a firm can provide some attractive defences against the five competitive forces:

- In meeting the challenges of rival competitors, the low cost firm is in the bet position to compete offensively on the basis of price, to defend against price war conditions, to use the appeal of lower price to grab sales (and market share) from rivals, and to earn above-average profits (based on bigger profit margins or greater sales volume). Low cost is a powerful defence in markets where price competition thrives.
- In defending against the power of buyers, low costs provide a company with partial profit margin proaction since powerful customers are rarely able to bargain price down past the survival level of the next most cost-efficient seller.
- In countering the bargaining leverage of suppliers, the low-cost producer is more insulated than competitors from powerful suppliers if the primary source of its cost advantage in greater internal efficiency.
- As regards potential entrants, the low-cost leader can use price-cutting to make it harder for a new rival to win customers; the pricing power of the low-cost provider acts as a barrier for new entrants.
- In competing against substitutes, a low-cost leader is better positioned to use low prices as a defence against companies trying to gain market inroads with a substitute product or service.

Answer (c):

Elements in the Marketing Mix: A manufacturer of domestic washing machine is a supplier of consumer durables to the consumer market. Here, the marketing mix has to be consumer-oriented, so that the main principles behind the marketing mix and the smaller sales mix must be such that the arrangement and the allocation of resources maximise returns per unit of outlay washing machines are bought for use, and also for personal satisfaction, and individual buyers purchase them in single units.

- **Product:** With a consumer capital good like a washing machine, the product itself will be important. The consumer will want quality, a wider variety of features and a well-known name with good reliable service backup and guarantees. Packing may be important, but technological specifications will certainly be. Under Place, ready availability, good service cover and prompt delivery will be important.
- **Promotion:** An individual buys washing machine infrequently (e.g. motor car). So, promotion is necessary. The customer will look at all promotional literatures, want demonstration and possibly consult an adviser.
- **Price:** It is an expensive product. Price discounts, trade-in allowances and bonuses will be important Credit terms and payment periods will also be important.

Question 50: "An organisation can choose from a wide variety of grand strategies such as Stability Strategies, Growth Strategies, Retrenchment Strategies and Combination Strategies". Explain these strategies and highlight the conditions under which each one is the most appropriate.

Answer: Four grand strategies: stability, growth, retrenchment and combination are opinions for the pace or level of efforts in the current business definition or for changing the business definition.

Stability: A stability strategy is a strategy that a firm pursues when -

- It continues to serve the public in the same product or services, market and function sector as defined in its business definition or in very similar sectors.
- Its main strategic decisions focus on incremental improvement of functional performance.
- Stability strategies are implemented by 'steady as it goes' approaches to decisions. Few major functional changes are made in the product or service line, markets or functions. In an effective stability strategy, a company will concentrate its resources where it presently has or can rapidly develop a meaningful competitive advantage in the narrowest possible product - market- function scope consistent with its resources and market requirement.

Growth: A growth strategy is a strategy that a firm pursues when -

- It serves the public in additional product or service sector or adds markets or functions to its definition.
- It focuses its strategic decisions on major increases on major increases in the pace of activity within its present business definition.

A firm implements this strategy by redefining the business- either adding to the scope of activity or substantially increasing the efforts of the current business. Growth is usually thought of as 'the way' to improve performance. An increase in assets or sizes is thought by many to yield growth in profit or ROI. Several studies support this proposition. But the opinions and research of others suggest that short-run inefficiencies often result.

Retrenchment: A retrenchment strategy is pursued by a firm when -

- It sees the desirability of or necessity for reducing its product or service lines, markets of functions.
- It focuses its strategic decisions on functional improvement through the reduction of activities in units with negative cash flows.
- A firm can redefine its business by divesting itself of a major product line or an SBU. It could abandon some market territories. A firm could also reduce its functions. Of course, the ultimate redefinition is total liquidation.

Combination: A combination strategy is a strategy that a firm pursues when -

- Its main strategic decision focus on the conscious use of several grand strategies at the same time (simultaneously) in several SBUs of the company.
- It plans to use several grand strategies at different future times (sequentially).

With combination strategy, the decision makers consciously apply several grand strategies to different parts of the firm or to different future periods. The logical possibilities for a simultaneous approach are stability in some areas, growth in others; stability in some areas, retrenchment in others; retrenchment in some areas, expansion in others; and all three grand strategies in different areas of the company.

Question 51: What do you understand by "Corporate Reconstructing"? Specify and discuss about Corporate Level Restructuring Strategies.

Answer: Corporate restructuring refers to the process by means of which a firm makes an assessment and evaluation of itself at a point of time and refocuses itself to specific tasks of performance for improvements. It looks upon every activity as a green field project and question the firm's basic premise in order to engineer radical change rather than aim for just incremental gains. The concept is sometimes referred to as business process re-engineering as it involves consideration of at least: business portfolio revaluation; financial engineering; and organisational redesign.

Corporate level restructuring strategies can be thought of from two aspects: hardware and software.

Hardware restructuring involves redefining and/or modifying the structure of the organisation so as to make it more efficient in decision-making, responsiveness and intra-organisational communication etc. Some suggested strategies are:

- Identification of core competency and portfolio pruning
- Flattening of organisational layer
- Downsising
- Creation of self directed teams
- Benchmarking.

Software restructuring involves cultural and process changes required to create collaborative environment for a firm's growth. Suggested steps are:

- Business strategy communication
- Co-ordination
- Trust
- Stretch
- Empowering people
- Industry foresight
- Training.

Question 52: "Differentiation Strategy is not without pitfalls". — Identify the common pitfalls.

Answer: The essence of diversification is to be unique with features that are of value to the customers. It is concerned with a company's positioning within a market or a segment in relation to the various product characteristics that influence customer choice. However, the common pitfalls are:-

- Over differentiating, so that price is too high relative to competitors, or product quality or service levels exceed buyer's need.
- Attempting to charge too high a premium price.
- Ignoring the need to signal value and depending only on intrinsic product attributes to achieve differentiation.
- Not understanding or identifying what buyers consider as value.
- Trying to differentiate on the basis of something that does not lower a buyer's cost, as perceived by a buyer.

Question 53: Many Organisations prefer to grow through new green field projects. Some of them are keen on takeovers while many feel expansion is the best way. Some others are of the view that strategic alliances would serve the purpose of growth. Give examples of each approach and indicate the conditions under which they may be productive and profitable.

Answer: It will be appropriate to say that the Indian industry is undergoing a process of restructuring, in order to gain competitive strength both in domestic as well as in export markets. The said restructuring is taking place through various means, i.e. takeovers, expansions, strategic alliances etc. for the purpose of growth. When growth occurs, it may be due to one or more of the following reasons i.e. expanding market, entry into new areas to escape a mature or decline market, expansion because of superior market performance or expansion to capitalise on a new marketing opportunity.

Takeover means acquisition of a certain block of equity capital of a company which enables the acquirer to exercise control over the affairs of the company. In theory, the acquirer must buy more than 50% of the paid up equity of the acquired company to enjoy complete control. In practice however, effective control may be exercised with a smaller shareholding, because the remaining shareholders scattered and ill-organised, are not likely to challenge the control of acquirer. Sometimes the acquirer may have tacit support of the financial institutions, banks, mutual funds, having sizeable holding in the company's capital. The main objective of a takeover bid is to obtain legal control of the company. The company taken over remains in existence as a separate entity unless a merger takes place. It may broadly be classified into three categories:

(i) **Horizontal:** It takes place between two companies which are essentially operating in the same market. Their products may or may not be identical. For example, the merger of Tata Oil Mills Company Ltd. (TOMCO) with Hindusthan Lever Limited (HLL) is a horizontal one. Both the companies have similar products. A TV manufacturer taking over washing manufacturing company, will also be a horizontal one, because both the companies are in the market for consumer durables.

(ii) **Vertical:** It is one in which the company expands backwards by takeover of a company supplying raw materials or expands forward in the direction of the ultimate consumer. For example, the merger of Reliance Petrochemicals Ltd. (RPCL) with Reliance Ltd. (RIL) is a vertical merger; with backward linkage as far as RIL concerned.

(iii) **Conglomerate:** In this type, the concerned companies are in totally unrelated lines of business, come together with the expectation to bring about stability of income and profits. For example, Mohta Steel Industries Ltd. merged with Vardhaman Spinning Mills Ltd.

Following advantages accrue to the companies which come together through acquisition or through different strategic alliances:

(a) Economies of scale: When two or more companies come together the larger volume of operations of the combined entity results in various economies of scale. These economics arise because of more intensive utilisation of combined production capacities, distribution channels, research and development facilities, data processing system, reduction of overhead etc.

(b) Synergy: A term used to identify the conditions where the combined effect of the two or more courses of action is greater than the sum of the individual parties.

(c) Tax savings: If a healthy company acquires a sick unit through merger, it can avail of Income-tax benefit u/s 72A of the Income-tax Act.

(d) As a growth and diversification strategy: Growth and diversification are very important corporate objectives. If a firm has decided to enter or expand in a particular industry, acquisition or strategic alliance with another firm in that industry, rather than dependence on internal expansion, may offer several strategic advantages. They are:

   - As a preventive move, it can prevent a competitor from establishing a similar position in that industry.
   - It offers s special timing advantage by enabling a firm to leap-frog several stages in the process of expansion.
   - It may entail less risk and even less cost.
   - In saturated market, simultaneous expansion and replacement makes sense than creation of additional capacities.

(e) Deployment of surplus funds: A company having surplus funds to invest may deploy profitably in another company, starved of the same.

(f) Avoiding unhealthy competition: It may enable companies to avoid unhealthy competition in a situation where there are too many players aiming at a limited market. This type of take-over/merger/alliance are possible only if they do not violate the provisions of MRTP. For example, VIP Industries took-over Universal Luggage.

(g) Acquisition of Patent, brand Name etc.: It might be relatively easy way to acquire valuable patent rights, technical know-how, established brand name, etc.

(h) Higher debt capacity: A company could enhance its borrowing capacity. A higher debt capacity means greater tax advantages and that higher value of the firm.

(i) Reduction in floatation cost: When two firms merge, they save on floatation cost of future equity, preference and debenture issues.

(j) Lower rate of borrowing: The consequence of larger size and grater earning stability, as many financial experts argue, is to reduce the cost of borrowing. For example, the creditors are protected by both the firms. This additional protection reduces the cost of capital.

However, with the recent liberalisation, business groups may like to rationalise their port-folio of industrial units. Under the pressure of increasing competition, the Indian conglomerates are realising the need to focus on core competencies. They are also realising the importance of strategic withdrawal from certain areas. For example, Tatas are expanding their steel manufacturing capacity at TISCO or vehicle manufacturing capacity, at TELCO. At the same time, they have disposed of TOMCO. On the contrary, HLL, free from the shackles of FERA, has taken over the same to make use of the additional soap manufacturing capacity, available with TOMCO.

Question 54: Sustainable growth opportunities include "Internal Growth Strategies", "External Growth Strategies" and "Liquidation"- Discuss.

Answer: Sustainable growth strategy is the strategy to keep up the growth of an organisation. The primary aims of a business are survival and success. A company might seek to grow organically by developing its own product-market mix or go for diversification.

Product-market strategy for growth may take one or more of the following types:-

(i) Internal growth strategies —

a) Horizontal integration, e.g. a milk producer acquires a bakery.

b) Vertical integration, e.g. when a manufacturer establishes a door to door selling operation.

c) Concentric diversification, e.g. a firm manufacturing oils goes into producing both salt and body lotion.

d) Conglomerate diversification, e.g. ITC diversifying into hotel business.

a and b classes as related diversification i.e. diversification into related products or markets, while c and d are classed as unrelated diversification.

(ii) External growth strategies —

Mergers and acquisitions: A merger is the joining of two separate companies to form a single company, e.g. Madura Coats and Coats India Limited merged to become Madura Coats Ltd. An acquisition is the purchase of a controlling interest in another company, e.g. acquisition of Brooke Bonds by Hindusthan Levers Limited.

Mergers and acquisitions meet such needs as quick entry into a new market, obtaining ownership of established brand name, access to financial resources and marketing infrastructure, elimination of competition and acquisition of new technology.

Joint Venture: In this case, two firms join together to undertake a venture. Joint venture can meet a number of needs such as rapid rate of growth desired by the firm, maintaining the risk within reasonable limit and tiding over the constraint of resources.

Thus, we see an MNC (multinational company) entering into a joint venture with a firm of repute in India.

(iii) Liquidation: Liquidation indicates a situation where the firm finds the business unattractive. It is a de-growth strategy. A company might decide to concentrate on its 'core' business and sell off fringe activities, or to sell off subsidiaries continually making losses or whose growth prospects are not good or to sell off a subsidiary at a profit, perhaps as a means of thwarting a takeover bid.

Question 55: (a) Discuss how a firm can create and sustain 'Competitive Advantage'.

(b) Successful pursuit of competitive advantage requires an understanding of the 'industrial value chain'. — Discuss.

Answer (a) Competitive advantage is creating better value for the customers of an organisation for the same or lower cost than that of its competitors or creating equivalent Value for it customers for the lower cost than that of its competitors. The difference between what a customer receives (customer's realisation) and what the customer gives up (customer's sacrifice) is the customer's value what a customer receives is called 'total product'. The total product is the complete range of tangible and intangible benefits that a customer receives from a purchased product.

According to Porter, there are two generic strategies capable of producing a sustainable competitive advantage, viz., (i) a low-cost strategy (cost leadership), and (ii) a differentiation strategy.

A low-cost strategy aims at providing the same or better value to the customers of an organisation at a low cost than its competitors. If one defines customer value as the difference between realisation and sacrifice, a low-cost-strategy tries to increase customers' value by minimising the sacrifice of the customers. On the other hand, a differentiation strategy strives to increase the customers' value by increasing what the customers receive. Providing something to the customers that is not provided by the competitors creates competitive advantage. The product characteristic(s) must be such that it/they set the product different from that of the organisation's competitors. To be of value, the customers should appreciate that same variation has been made in the product/service. Furthermore, the value added to the customers by differentiation must exceed the organisation's costs of providing the difference (variation). If the customers appreciate the variation made and if the value added to the customers exceed the cost of providing the difference, then a competitive advantage has been accomplished.

Answer (b) Industrial value chain is the linked set of value-creating activities right from the basic raw materials to the disposal of the finished product/service by the end-use customers. That apart, in order to create and sustain a competitive advantage, an organisation must understand the entire value chain and not just the portion in which it operates. Breaking down the value chain into its strategically relevant activities is basic to successful implementation of cost leadership and differentiation strategies. A value chain framework is a must for understanding an organisation's strategically-important activities. Basic to a value-chain framework is the recognition that there exists complex linkages and interrelationship among activities both internal and external to the organisation. Internal linkages are, relationships among the activities that are performed within an organisation's portion (sphere of activities) of the value chain. On the other hand, external linkages describe the relationships among the organisation's value chain activities that are performed with respect to its suppliers and customers.

To gainfully exploit an organisation's internal and external linkages, one must identify the organisation's activities and select those that can be used to create and sustain a competitive advantage. This process of selection requires knowledge of the cost and value of each activity.

Question 56: (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.

Answer (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?

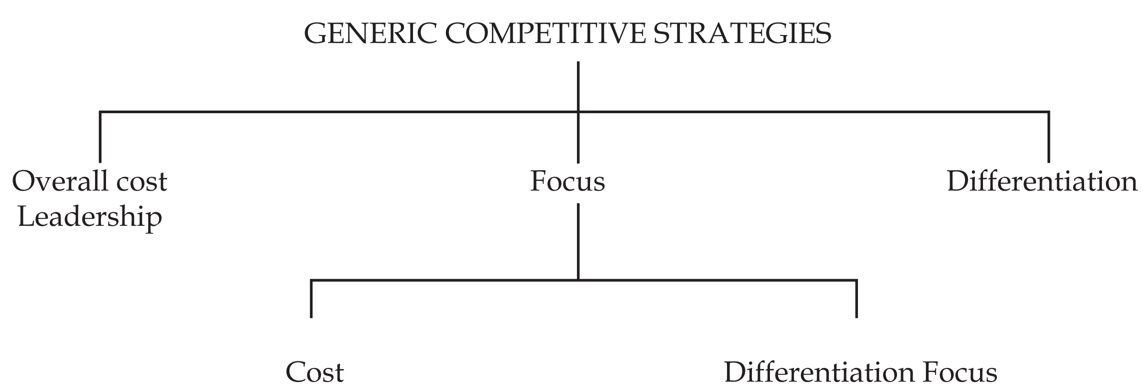
One cannot have simple tests of soundness of a corporate strategy. However, an analytical look at any company's strategy against several criteria (the list given above is only indicative but not exhaustive) will give the concerned person(s) an idea about the quality of strategy and its implications.

Question 57: Explain the concept of 'value-chain' and discuss the advantages of value-chain analysis to-any organisation.

Answer:

Porter points out that a firm's value chain is an important determinant of competitive advantage. Value is the amount buyers are willing to pay for what a firm provides them. The total revenue reflects the value. Creating value for buyers that exceeds the cost of doing so is the goal of any generic strategy.

Porter has identified, at the broadest level, three internally consistent generic strategies (which can be used singly or in combination) for creating a defendable position in the long run and outperforming competitors in an industry.



Overall cost leadership: The strategy of cost leadership is to become the lowest cost producer in the industry through a set of functional policies aimed at this basic objective.

Differentiation: In this strategy a firm seeks to be unique in its industry along some dimensions that are widely valued by key buyers. It selects one or more at tributes that many buyers in an industry perceive as important and uniquely positions itself.

Focus: This strategy rests on the choice of narrow competitive scope within an industry which the focuser can serve better than the competitors. This strategy has two variants -

Cost focus: where a firm seeks cost advantage in its target segment, and

Differentiation focus: where a firm seeks differentiation in its target segment.

The value chain displays total value and consists of value activities and margin. Value activities are the physically and technologically distinct activities a firm performs.

There are, broadly, two types of value activities, viz., Primary activities and support activities.

Primary activities include:

(i) Inbound logistics (activities associated with receiving, storing and disseminating inputs to products);

(ii) Operations (processing activities);

(iii) Marketing and sales,

(iv) Services.

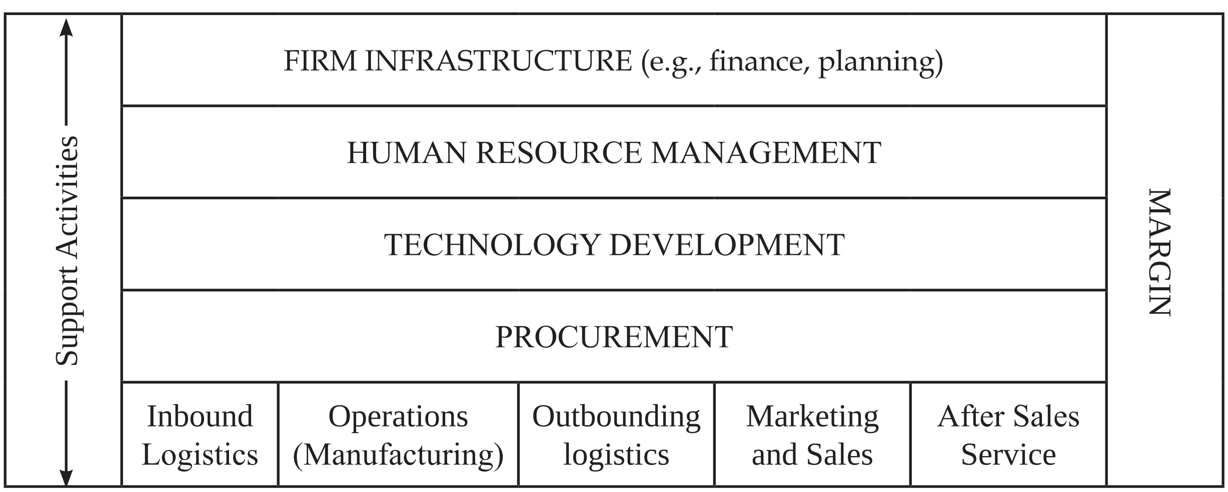
Support activities include:

(i) Procurement (purchasing of inputs);

(ii) Technology development;

(iii) Human resource management;

(iv) Firm infrastructure (includes general management, planning, finance, accounting, legal and government affairs and quality management).



Firms create value for their customers through performing activities mentioned in the value chain above. To gain competitive advantage over its rivals, a firm must either provide comparable buyer value by performing the activities more efficiently than its competitors (cost leadership) or perform activities in a unique way that creates greater buyer value and command a premium price (differentiation). Firms gain competitive advantage from conceiving of new ways to conduct activities, employing new procedures, new technologies or different inputs. However, a firm is more than the sum of its activities. A firm's value chain is an interdependent system of network of activities, connected by linkages. Linkages occur when the way in which one activity is performed affects the cost or effectiveness of other activities. Linkages often create trade-off in performing different activities which must be optimised, e.g. a more costly product design can reduce after-sales service costs.

Careful management of linkage can be a decisive source of competitive advantage. Gaining competitive advantage requires that a firm's value chain is managed as system rather than a collection of separate parts. Reconfiguring the value chain, by relocating, reordering, regrouping or even eliminating the activities is often at the root of a major improvement in competitive position.

A company's value chain for competing in a particular industry is embedded in a larger stream of activities that is called the value system. This includes the value chains of suppliers, distribution channels and the buyers. A firm should strive to understand not only its own value chain activities but also of the competitors', distributors' and suppliers. Ultimately, firm gains competitive advantage by performing strategically important activities more cheaply or better than its rivals.

Question 58: (a) Describe the strategic approaches to acquisition.

(b) How would you classify strategic alternatives based on risk? Discuss specific contributions, if any, in this respect with some Indian examples.

(c) Discuss Strategic alliances. What are its advantages & disadvantages?

Answer (a):

Acquisition "Play"	Strategy to Achieve Performance Premium
1. Acquire synergistic product market position	Achieve scale economies of distribution, production or technology.
2. Acquire position in key international markets	Achieve scale economies for global production and technology investments.
3. Acquire a "beach head" in an emerging high growth market	Anticipate high leverage business growth equations by identifying market forcing functions.
4. Acquire a portfolio of minority investments	Apply pressure for improved short-term earnings and sell stock. Gain improved information on future potential.
5. Acquire a company with under-utilised financial strengths	Use borrowing capacity or other financial strengths (e.g. unabsorbed tax losses) to achieve the immediate performance premium.

Acquisition "Play"	Strategy to Achieve Performance Premium
6. Acquire an underskilled company in a related industry	Apply superior marketing technology or production expertise to enhance the competitive position and performance of the acquisition candidate.
7. Acquire an under-exploited physical asset	Anticipate shortages and price increases in the physical assets' value. Investment to exploit the resources, using distribution capacity.
8. Acquire an under-valued corporate portfolio	Apply more aggressive portfolio management to restructure resources allocation and upgrade results.

Answer (b): From the point of view of an organisation, strategic alternatives may be clarified on the basic of degree of risk involved. Thus they 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 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 wish 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.

Vertical integration:

This can assume two forms: backward and forward. Integration means in-house production of critical inputs for the main business or going in for marketing of products by opening retail outlets. 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 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, machine tools, casting and fabrication etc. Hindusthan Lever has pursued a strategy of vertical integration for soaps and toiletries businesses. It has also followed diversification in basic chemicals. Some business houses have gone in for large scale diversification e.g. TATAS, BIRLAS, THAPARS, and ITC etc.

Answer (c):

Strategic alliances are distinguished from joint ventures because the companies involved do not take an equity position in one another. In many instances, strategic alliances are partnerships that exist for a defined period during which partners contribute their skills and expertise to a cooperative project. For example, one partner provides manufacturing capabilities while a second partner provides marketing expertise. Many times, such alliances are undertaken because the partners want to develop in-house capabilities to supplant the partner when the contractual arrangement between them reaches its termination date. Such relationships are tricky because, in a sense, the partners are attempting to "steal" each other's know-how.

In other instances, strategic alliances are synonymous with licensing agreements. Licensing involves the transfer of some industrial property right from the U.S. licensor to a motivated licensee in a foreign country. Most tend to be patents, trademarks, or technical know-how that is granted to the licensee for a specified time in return for a royalty and for avoiding tariffs or import quotas. Bell South and U.S. West, with various marketing and service competitive advantages valuable to Europe, have extended a number of licenses to create personal computer network in the United Kingdom (U.K.).

Advantages:

1. **Leverages several firms' core competencies.**

   This allows alliance members to be more competitive in seeking certain project work or input.

2. **Limits capital investment.**

   One partner firm does not have to have all the resources necessary to do the work of the alliance.

3. **Is flexible.**

   Alliances allows a firm to be involved yet continue to pursue its other, "regular" business opportunities.

4. **Leads to networking and relationship building.**

   Alliances get companies together, sometimes even competitors. They allow key players to build relationships that are valuable, even if the present alliance doesn't "plan out". Alliance partners learn more about each others' capabilities and gain advantage or benefit from referrals and other similar behaviours, creating win—win situations.

Objective Major Questions

1. **Assess and value partner knowledge**

   ➢ What were the strategic objectives in forming the alliance?

- What are the core competencies of our alliance partner?
- What specific knowledge does the partner have that could enhance our competitive strategy?

2. **Determine knowledge accessibility**
   - How have key alliance responsibilities been allocated to the partners?
   - Which partner controls key managerial responsibilities?
   - Does the alliance agreement specify restrictions on our access to the alliance operations?
3. **Evaluate knowledge tacitness and ease of transfer**
   - Is our learning objective focused on explicit operational knowledge?
   - Where in the alliance does the knowledge reside?
   - What we are trying to learn and how we can use the knowledge?
4. **Establish knowledge connections between the alliance and the partner**
   - Are parent managers in regular contact with senior alliance managers?
   - Has the alliance been incorporated into parent strategic plans?
   - What is the level of trust between parent and alliance managers?
5. **Draw on existing knowledge to facilitate learning**
   - In the learning process, have efforts been made to involve managers with prior experience in either/both alliance management and partnerties
   - Are experiences with other alliances being used as the basis for managing the current alliance?
6. **Ensure that partner and alliance managerial cultures are in alignment**
   - Is the alliance viewed as a threat or an asset by parent managers?
   - In the parent, is there agreement on the strategic rationale for the alliance?
   - In the alliance, do managers understand the importance of the parent's learning objective?

Disadvantages:

1. **Can result in loss of control.** A firm in an alliance by definition cedes ultimate control to the broader alliance for the undertaking for which the alliance is formed. This can prove problematic if the alliance doesn't work out as planned—or is not well planned.
2. **Can be hard to establish good management control of the project-loss of operational control.** Where multiple firms have interrelated responsibilities for a sizable joint project, it should not be difficult to imagine problems arising as the players go about implementing a major project as in the example of EDS and its Dutch and British partners in the Atlas Consortium. It requires good up-front planning and use of inter company project team groups early on in the bidding process.

3. **Can distract a participating company: S-management and key players.** One strategic alliance can consume the majority attention of key players essential to the overall success of the home company. Whether because of their technical skills, managerial skills, key roles all three, the potential for lost focus or time to devote to key responsibilities exists.

4. **Raises issues of control of proprietary information and intellectual property.** Where technology development is the focus of the alliance, or maybe part of it, firms partnered together may also compete in other circumstances. Or they may have the potential to do so. So partnering together gives each the opportunity to learn much more about the other, their contacts, capabilities and unique skills or trade secrets.

   Strategic alliances have proven a very popular mechanism for many companies seeking to become more agile competitors in today's dynamic global economy. They have proven a major way for small companies to become involved with large players to the benefit of both-allowing the smaller player to grow in a way that builds its future survival possibilities and the larger player to tap expertise and knowledge it can no longer afford to retain or develop in-house.

Question 59: Michael Porter suggests that there are three generic strategies for creating and sustaining superior performance. Describe each of these strategies and indicate how each will result in competitive advantage. Illustrate your answer with some Indian examples.

Answer (a): Three generic strategies are:

(i) Overall Cost leadership: A cost leadership strategy seeks to achieve the position of lowest-cost producer in the industry. The competitive advantage that results from producing at the lowest cost is that the manufacturer can compete on price with every other, producer in the industry and can earn the highest unit profits. Bajaj Auto Limited and TELCO appear to be following this strategy.

(ii) Differentiation: A differentiation strategy attempts to make the product in terms of attributes which are desirable to the customer, including customer service. The assumption is that competitive advantage can be gained through the particular characteristics of a firm's products. With a successful differentiation strategy, loyalty to the firm's products will build up and customers are not so price- sensitive. The firm can then sell its products, at prices that are higher than the least-cost producer in the market. Bata Shoes, OTIS elevators, Chiragh-Din-Shirts are some examples.

(iii) Focus: A focus strategy is based on segmenting the market and targeting particular segments instead of trying to serve the entire market with a single product. Genteel, a liquid detergent for expensive clothes by Swastik and Ponds Talcum Powder are some handy examples for this strategy.

The competitive advantage which results is that the firm is thus able to serve its narrow strategic target more effectively and efficiently than competitors who are competing more broadly. As a result the firm achieves either differentiation from better meeting the needs of the particular target, or lower costs in serving this target, or both.

Questions 60: (a) What is the emphasis of which is usually called an 'Operating Turnaround Strategy'? What are the major approaches for such strategy? Why such strategy may be called for?

(b) Explain when vertical integration occurs. What are the purposes and the disadvantages of vertical integration?

Answer (a): The emphasis is on improving internal efficiency. The environmental conditions leading to turnaround strategies usually include recessions or depressions in the economy as a whole or in industries, the firm does business in.

The major approaches include:

(1) Reducing costs — e.g. lay off, voluntary retrenchments, trimming of travelling expenses of the executives, using less costly stationery etc.

(2) Increasing revenues — e.g. better investment of cash and current assets, tighter inventory, better collection of debtors, effective advertising etc.

(3) Reducing assets — e.g. selling out equipments no longer needed or those needed to implement expansion that now appears unrealistic.

(4) Reorganising product and/or markets to achieve greater a efficiency — it may be called for if many or most of the following conditions are present:

- the unit's product is In a stable or declining market.
- the unit does not provide sales stability or prestige for the firm
- the unit's market share is small and it would be too costly to increase that share
- the unit does not contribute a large percentage to total sales.
- the corporation has better uses for its funds
- the decline in sales will be more rapid than the reduction in corporate support
- the price or availability of raw materials presents problem.

Answer (b):

Vertical integration is a strategy which expands or contracts the business definition primarily in terms of functions performed. As a firm takes some input and transforms it into output, it adds value in the form of utility to a buyer of its output. There are two kinds of vertical integration. A backward integration is associated with strategies affecting the supply of a firm's input (towards raw material stage). Forward integration refers to moves altering the nature of the distribution of the firm's output (toward end users). Note that, expansion or retrenchment is possible. The firm can add or subtract functions. Vertical integration is the primary form of a make or buy decision.

Examples:

- Indian Oil could integrate forward if it decided to sell its entire output of petrol/diesel through its own service stations instead of most of it through distributors.

- A soft drink manufacturer can vertically integrate backward when it bought its flavour supplier and the mango groves, which provided the raw materials for the flavour company and the soft drink manufacturer.
- A new company may be formed through a backward vertical integration strategy when several suppliers of sarees were merged to produce most of their output for a big supplier. Instead of producing and distributing, they retrenched out the distribution function, letting the big supplier to market the product.

Disadvantages come in the form of increasing dependence on one industry or the risk of possible monopoly restrictions violations. Recognise that, expanding forward or backward could result in the addition of new markets for product, and the firm may compete with former distributors or suppliers.

Question 61: What is conglomerate diversification? Explain with suitable examples when conglomerate diversification would be a particularly good strategy to pursue.

Answer:

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

In Conglomerate diversification, a company moves or diversifies into product areas, which are not related to the existing product to each other by common technology or markets etc. The products manufactured by a company which has gone into unrelated diversification usually belong to different industry or market groups. This may be accomplished by setting up new projects from grass- root level, or through mergers or takeovers of running businesses. Under Conglomerate diversification, new unrelated products are added by acquiring new products. Further under Conglomerate diversification, a firm may acquire another firm, which has surplus cash even though there may be nothing in common with the existing business. The growth of ICICI, a development bank, into a financial conglomerate is a recent history.

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

(i) to achieve a growth rate higher than what can be realised through expansion,

(ii) to make better use of financial resources with retained profits exceeding immediate investment needs,

(iii) to avail of potential opportunities of profitable investments,

(iv) to achieve distinct competitive advantage and broader stability,

(v) to spread the risk or gain increased stability,

(vi) to improve the price-earnings- ratio and bring about a higher market price of shares.

Many of these objectives of conglomerate diversification can be and are actually realised by external development through acquisition and merger.

Examples of Conglomerate diversification: India has taken place in companies Like Godrej, Reliance Industries, Hindustan Machine Tools Ltd., etc.

Conglomerate diversification is a good strategy where

(i) Basic industry is experiencing declining annual sales and profits.

(ii) An organisation has capital and managerial talent required to compete in a new industry.

(iii) There is some synergy between existing and proposed new areas of business (ITC in apparel/Agri-business).

(iv) Acquire an unrelated business which offers attractive investment opportunity (e.g. Kingfisher Airlines).

(v) Existing business is continuous threat of saturated demand. (Generic chemicals, Cigarette, and phone etc. business).

(vi) When an organisation is subjected to environmental safety or pollution control or anti trust law.

Question 62: How can the business-level strategies of "Cost Leadership" and "Differentiation" be used to position the firm relative to the five forces of competition in a way that permits the earning of above average returns.

Answer:

Cost leadership strategy emphasises efficiency. By producing high volumes of standardised products, the firm hopes to take advantage of economies of scale and experience curve effects. The product is often a basic no-frills product that is produced at a relatively low cost and made available to a large customer base. Maintaining this strategy requires a continuous search for cost reduction in all aspects of the business. The associated distribution strategy is to obtain the most extensive distribution possible. Promotional, strategy often involves trying to make a virtue out of low cost product features.

To be successful, this strategy usually requires a considerable market share advantage or preferential access to raw materials, components, labour, or some other important input. Without one or more of these advantages, the strategy can easily be imitated by competitors. Successful implementation also benefits from:

- process engineering skills o products designed for ease of manufacture o sustained access to inexpensive capital
- close supervision of labour
- tight cost control
- Incentives based on quantitative targets.

Differentiation involves creating a product that is perceived as unique. The unique features or benefits should provide superior value for the customer if this strategy is to be successful. Because in the eyes of the customers the product has no rival, the price elasticity of demand is low and customers are likely to be more brand loyal. This sort of market condition can provide considerable insulation from competition. However, there are usually additional costs associated with the differentiating product features and this could require a premium pricing strategy.

To maintain this strategy the firm should have:

- strong research and development skill
- strong product engineering skill
- strong creativity skill
- good cooperation with distribution channel
- strong marketing skill
- incentives based on subjective measures
- be able to communicate the importance of the differentiating product
- characteristics
- continuous improvement and innovation o attract highly skilled, creative people

Question 63: 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.

<u>Important benchmarking processes used in strategy implementation.</u>

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.

Question 64: What is competitor analysis?

Answer:

Competitor analysis is necessary for formulating right strategies and determining the right positioning for the firm in the industry.

Competitor analysis seeks to find answers to certain basic questions such as:

(i) Who are the competitors of the firm?

(ii) What are the current strategies of the competitors?

(iii) What are their future goals and likely strategies?

(iv) What drives the competitors?

(v) Where is the competitor vulnerable?

How are the competitors likely to respond to the strategies of others?

Porter has suggested a framework for competitor analysis, consisting of four diagnostic components, viz., future goals, current strategy, assumptions and capabilities.

As Porter observes, "its goals, assumptions, and current strategy will influence the likelihood, timing, nature, and intensity of competitor's reactions. Its strengths and weaknesses will determine its ability to initiate or react to strategic moves and to deal with environmental or industry events that occur".

Competitor Response Profile:

An analysis of these components will help to formulate what Porter calls competitor's profile, i.e., answers to critical questions such as: What moves or developments will provoke the competitor and how is the competitor likely to respond or retaliate?

The competitor response profile seeks to predict the competitor's offensive moves and defensive capabilities.

Future Goals:

An Analysis of these components will help to formulate what Porter calls competitor's response profile, i.e., answers to critical questions such as: What moves or developments will provoke the competitor and how is the competitor likely to respond or retaliate?

The competitor response profile seeks to predict the competitor's offensive moves and defensive, capabilities.

Future Goals:

Analysis of future goals would be helpful to identify the attitude and behaviour of the competitor and likely strategies. As Porter observes, "a knowledge of goals will allow predictions about whether or not each competitor is satisfied with its present position and financial results, and thereby, how likely that competitor is to change strategy and the vigour with which it will react to outside events or to moves by other firms"?

Knowledge of competitor's goals may help to predict its reactions to strategic changes. Goals of both the business unit and corporate parent need to be examined.

In 1996, the CEO of ICI had revealed that it wanted to increase the contribution of its Asian operations from 15 percent to 25 percent of the total and earmarked 800 million pounds for investment in Asia, including 200 million for India. It was believed that a part of it would go for acquisitions. Similarly, the CEO of Hindustan Lever revealed the intention to raise the company's contribution to the Unilever's global turnover from about 5 percent to 10 percent within a decade. Falling in line with the parent's portfolio strategy, HLL identified the processed food business is a major thrust area. It was, clear that the HLL would go for massive capacity expansion, including M & A.

Assumptions:

It is critical to understand:

- The competitor's assumptions about itself.
- The competitor's assumptions about the industry and the other companies in it.

A firm may perceive itself as a socially conscious organisation, the industry leader, quality conscious firm, highly ethical etc. Such assumptions will, obviously, guide the way the firm behaves, including reactions to competitors' moves.

A firm would also have assumptions about the industry and competitors like the industry prospects; competitors' goals, capabilities and weaknesses; competitors' possible behaviours and reactions etc.

The strategies and moves of a firm will be influenced by the above two assumptions. The assumptions may or may not be correct.

Current Strategy: Identification of the current strategies of the competitors is a very important component of competitor's analysis. "A competitor's strategy is most usefully through of as its key operating policies in each functional area of the business and how it seeks to inter relate the functions".

Capabilities: The ability of a firm to accomplish its goals and to respond to competitor's moves depends on its strengths and weaknesses. Analysis of the strengths and weaknesses of the competitors is, therefore, very important.

Question 65: Explain various Strategic Alternatives.

Answer:

Mainly there are three 'Strategic Alternatives'. They are:

(i) Stability Strategy

(ii) Growth Strategy, and

(iii) Retrenchment Strategy.

(i) Stability Strategy: Stability strategy refers to strategy of status quo in which the present course of business is maintained. It is regarded as a no growth strategy. This does not mean that stability strategy does not provide for any improvement in the personnel level performance. A firm is said to have adopted option of stability strategy if:

- It decides to serve the same class of customers with the same products;
- It continues to pursue the same objectives, adjusting the level of achievement by about the current annual growth rate;
- Its strategic thrust is one incremental improvement of functional performances; and
- It concentrates its resources is the narrowest possible product - market scope for developing a meaningful competitive advantage.

(ii) Growth Strategy: A growth strategy is one that an enterprise pursues when it increases its level of objectives upward in a significant increment much higher than extrapolation of its past achievement level. Thus, growth contemplated in growth strategy is different from normal expansion which an enterprise can achieve through its normal learning curve.

Basic Growth Strategies/Approaches

Approaches	Element	Scope	Chief Means
Intensive Expansion	Product lines market	Within Industry	- Market Penetration, Market Development Product Development
Integration	Product Market business area	All – inclusive	- Backward Integration, Forward Integration, Harizontal Integration
Diversification	Business area	Within and outside industry	- Concentric, Horizontal, Conglomerate, Diversification.

(iii) Retrenchment Strategy: At times international business enterprises experience problems of business decline and perceive threats to their survival. The only alternative available before management to handle such problems effectively is retrenchment strategy. The development and management of this strategy is much more difficult and cumbersome as compared to that of growth strategy because options are limited and action is restricted particularly when the firm is caught in a precarious conditions. Retrenchment strategy calls for immediate action to affect temporary business contraction while planning for gradual recovery. Its basic thrust is one functional improvement particularly through reduction of costs, reduction of number of functions and reduction of number of the products and markets. Through these steps retrenchment strategy seeks to achieve the immediate goal of reducing sales/ profit threat, the intermediate goal of making a step-by-step profit improvement and the ultimate goal of recovery.

There are three phases of a well-conceived retrenchment strategy, namely, the contracting phase, the consolidation phase and the recovery phase.

The contracting phase of retrenchment is characterised by reduction in personnel administrative and functional costs. During the consolidation phase retrenchment strategy lays stress on profit improvement and management audit programmes. The retrenchment strategy during the recovery phase places greater emphasis on the offensive approach instead of the defensive approach. Market intensification is a major part of this approach.

Question 66: Explain the variants of Retrenchment Strategy?

Answer:

There are three major variants of retrenchment strategy.

They are: Turn-around strategy, Survival strategy, and Liquidation strategy

(a) Turn - around strategy:

When an enterprise has been suffering business losses for a long period of time because of continued decline in sales, it takes recourse to turn-around strategy to arrest and reverse the declining performance of the business. A turn around strategy with its basic philosophy of hold the present business and cut the costs is an extreme step which stops just short of selling the liberation or degenerating into insolvency. Such a course of action should be resorted to only when the business is worth saving. It is, therefore, necessary to determine the firm's future earning power and compare the same with the estimated liquidation value. If the firm's future earning power is higher than the liquidation value, it will be worthwhile to continue the operation of the firm.

A turn around strategy calls for strong managerial action to restore profit and rebuild morale. Before developing the turn - around strategy, decision has to be taken as to who should direct the turn-around operation. In other words, should the existing top management be continued or should a new one be brought in from outside. Such a decision has to be taken by the BODs. Once this decision is taken, the BODs and the Chairman jointly formulate objectives of the operation.

(b) Survival strategy: When a firm's business has reached the stage of extinction, it focuses all its energy on the search of a survival strategy. Six danger signs of a company in need of help are losing money (negative profit), shortage of cash, losing market share, deteriorating physical facilities, departing of personnel and low morale among those remaining. Most kinds of the business trouble that can threaten a firm seriously will externally be manifested in a cash flow problem. Survival drives have psychological, sociological and systematic roots. These reflect individual drives for personal security, tribal interdependence, allegiance of social groups and dynamic inertia of complex organisations to continue functioning as they are. There are three approaches to survival strategy. They are: Management Restructuring, Divestment and Restructuring Business.

(c) Liquidation Strategy: This is usually the strategy of last resort. Liquidation of the present business enterprise is the ultimate retrenchment. Liquidation strategy is the decision to sell off or close down a firm. Such a decision is taken under the following circumstances.

- When the business condition of a firm is perilous and there is no hope of recovering from the present crisis.
- At times, the managers may feel the business is at its peak but the future is uncertain and the firm is unable to see any direction in which it can enter and operate.
- A firm may be suffering from a business crisis and it may not have adequate resources to get out of the present crisis.
- When a firm has been facing very badly in the past few years and has consequently suffered considerable losses and some other firm offers to buy it for tax consideration or any other reason.
- Sometimes, a firm may be offered a price higher than its real worth and the management may be tempted to sell off the business, particularly when it is found that there are suitable alternative investments or business where the sale proceeds could be gainfully employed.

Question 67: How do you make Strategic Financial Decisions?

Answer:

Making Strategic Decisions: Financial strategy defines the use of financial resources to implement corporate strategy and outlines courses of action. It enables the finance manager to develop, to specify the optimal deployment of such resources towards the achievement of financial and corporate objectives under varied strategic situations. Thus, financial strategy has three major dimensions - investment, financing and dividend. These strategic decisions must be made within the parameters of corporate purpose and mission and objective of maximisation of the firm's value. We shall now discuss in brief, how the finance manager takes various financial decisions.

Investment Strategy: Investment strategy is the vital aspect of financial strategy. Since funds involve cost and are available in limited quantity their proper utilisation is necessary to help the firm to attain its objectives. This calls for making prudent decisions regarding total amount of assets to be held in the enterprise, make-up of these assets and business risk complexion of the firm as perceived by investors. Investment decisions consist of decisions regarding capital expenditure products and current assets.

Financing Strategy: An important task of the central manager is to see that the capital necessary to execute the corporate strategy is provided at a reasonable cost and with minimum risk. In financing strategy, the finance manager has to decide about the optimal financing mix or make up of capitalisation in order to maximise earning per share and so also market value of shares. This involves a detailed examination of some of the following vital factors:

- What sources of long-term funds should be tapped and in what proportion?
- To what extent should long-term debt be resorted?
- Should the firm take resource to lease financing?
- Should the firm employ trade credit as a means of financing and if yes, to what extent?

Dividend Strategy: Dividend strategy sets out the direction regarding distribution of the firm's profits. This is probably the most important single area of decision making for the finance manager. Action taken by the management in this area affects growth rate of the firm. An erroneous divided decision may land the firm in a financial predicament and the capital structure of the firm may become unbalanced. Progress of the firm may be crippled owing to dearth of resources resulting in fall in earnings per share. Stock market is likely to react to this development and share prices tend to sag leading to decline in total value of the firm. Extreme care and prudence on the part of the management are, therefore, extremely desirable.

Question 68: What are the steps involved in formulating diversification strategy?

Answer:

The following steps are entailed in the development of diversification strategy:

Awareness of Diversification Opportunity: This is the first step of diversification strategy. Top managers generally become aware of or sense a need for diversification planning when they find inconsistencies between the enterprise's current position and its objectives based on some perception of its future environment. A firm is assumed to have a level of performance - in Ansoff s case based on rate of return on capital invested - and if it now appears that this cannot be achieved on the basis of existing activities, then the firm has two options. The first is to accept a lowered target; the second is to assess the gap and then to proceed to cover this by changed tactics in existing activities and markets, and also by diversification. Thus, the trigger for diversification operates when there is a threat of under-achievement. Diversification strategy may, at times, be pursued in order to avoid current instability in sales and profits. Sometimes, the need to achieve higher utilisation of resources motivates the management to diversify the current product-market combinations of the firm.

Once the rationale of the diversification move has been established, the next issue before the management is to delineate the major areas for diversification. This requires penetrating search of new business opportunities which are usually derived from market needs. These needs change due to technological, economic, political and social developments and variations in attitudes and preferences of customers. Thus, diversification must start in the business environment, with special attention to any observable novel trends and exceptional growth areas.

A detailed environmental appraisal may result in a number of diversification opportunities which may be closely related to the firm's present technology, ethos and market contact or which may be sharply divergent. Thus, a firm may have before it a large number of options clustering around vertical diversification, horizontal diversification, concentric and conglomerate diversification.

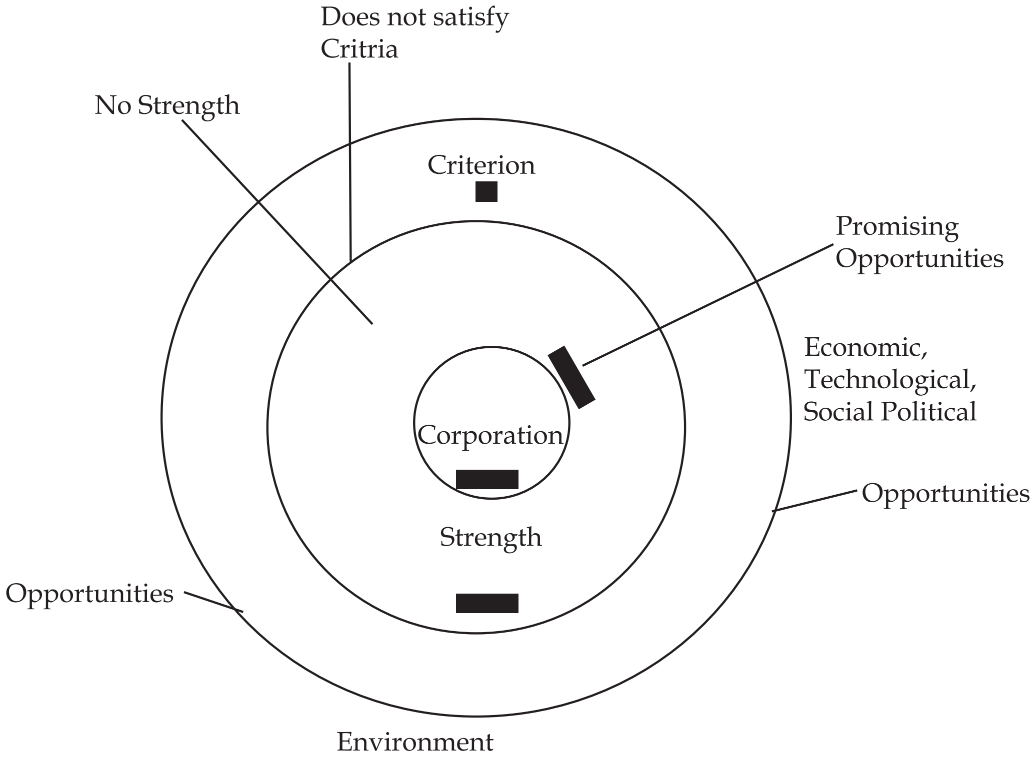
Selecting the Most Promising Opportunities: For selecting the most promising diversification opportunities, top managers must examine first of all the product life cycle. Diversification into an already mature market will hold very limited promise of success because of the already depressed profit margins and the vigorous defence of the market shares held by the already established firms. Furthermore, certain criteria will have to be established so as to screen identified alternatives and select a handful of the most promising portfolios. One such criterion could be entry into a new market, whether at home or abroad. An enterprise considering diversification into a new product line must prognosticate the potential value of that market, opportunity for the company's product taking into account design, performance, price, availability, etc. and the cost of the minimum scale of entry that appears necessary if any impact is to be made. Critical mass is another important criterion which aids in limiting a large number of options to a handful of the most promising ones. Thus, alternatives promising larger than critical mass are picked up for further feasibility testing. The management must also determine the maximum investment for purposeful entry and maximum time needed from the decision stage to the first order.

Profitability is another important condition which a diversification opportunity must fulfill. Besides, there are some other criteria such as acceptable geographical markets, allowable kinds and volume of needed R and D, acceptable license arrangements, maximum allowable influence on physical environment, and maximum numbers of skilled workers to be needed and minimum estimated time for product line to reach maturity. Once the opportunities have been selected, it may also be desirable to place weights on the more significant factors.

Feasibility Testing of Chosen Opportunities: Once a handful of diversification opportunities are chosen, their feasibility study must be made in detail. Feasibility test of alternatives is done by matching their resource requirements with the resources available with the enterprise. Such a study will decide in what direction the contemplated product-market posture will diversify - internal development or acquisition. Strategic requirements of each move should be compared with the existing financial, technological, marketing and managerial resources of the firm. In general, preconditions for any type of diversification are solid financial situation, flexible ownership structure, rich marketing experience and good customer relations in given areas, production flexibility in some plants, well developed management systems of certain kinds, experienced R and D personnel in special sciences, availability of raw materials at cheaper rate, transportation facilities, etc.

Thus, the choice of any diversification move must be made taking into consideration its strategic requirements and strengths. Consideration of synergistic factor further helps in making a useful choice. An alternative promising greater scope of synergistic advantage has an edge over others. Thus, vertical and horizontal types of diversification will have synergistic advantages since the enterprise continues to sell through established marketing channels and hence should be preferred to conglomerate diversification. However, it must be noted that both vertical and horizontal diversification contribute little toward improvement of stability of the enterprise. A firm planning to diversify its current operations for the sake of minimisation of instability in its operations will be committing a folly in choosing either of the two. Vertical diversification is very sensitive to instabilities and will offer less assurance of flexibility. In fact, by putting more eggs into the same end-product basket, vertical diversification increases the firm’s dependence on a particular segment of economic demand. Thus, both vertical and horizontal diversification vectors offer only a limited potential for objectives. Their contribution to flexibility and stability objectives is limited. They will be making useful contribution to the profitability objective if the present economic environment of the firm is healthy and growing.

As regards the concentric and conglomerate diversification, both have the potential for meeting all of the objectives of the firms if the firm has the requisite resources. However, a concentric path, which is comparable to a conglomerate diversification in economic prospects and flexibility, will usually be more profitable and less risky because of synergy. While this is true that conglomerate diversification does not offer any synergistic advantage, a well-planned and developed conglomerate strategy does have a sense of direction expressed through competitive advantage, product-market scope and objectives.



Selection of Promising diversification opportunities

The above process of selection of promising opportunities has been exhibited in above figure. In this figure an attempt has been made to portray the interplay between new business opportunities, corporate strengths and diversification criteria.

Since the above strategic decision is being made under the conditions of partial ignorance, a risk analysis must be made, particularly for the one involving large investment. For each of the strategic variables (total market potential within chosen geographic area, the market share, net price per unit, raw marketing cost per unit, production cost per unit, marketing cost per unit, total overhead and total investments) uncertainty ranges are estimated on the basis of the best judgment available, and probabilities are assigned to each range on a subjective basis. Different opportunities, of course, result in differing profitability ranges. The most probable centre value is then calculated for each of them. The one promising the highest profitability value is chosen.

Question 69: How do you formulate an acquisition strategy?

Answer:

In recent years the tendency to grow through acquisition has assumed enormous significance in the business world. Acquisition ranging from licensing to purchase of another firm has come to be recognised as better means to accomplish growth and profitability objectives of the company than internal development which may involve addition of new products or major organisational changes to provide for new skills and completeness. Financial, risk and timing are some of the major factors that favour the move for acquisition instead of internal development. Growth by way of internal development entails start-up costs on product development and introduction, and acquisition of new facilities and skills. These costs may be less if a company acquires another. However, it is argued that acquisition pays for the start-up costs as well as premiums as a compensation for the risks assumed by the seller in developing the property and the competences being sold. This makes acquisition costlier than internal development. However, this is not necessarily the case in risky issues. In such a case, the company might take over another enterprise by an exchange of stock and not worry for poor public response to security issues.

Acquisition is not a simple task. It has to be carried out with extreme care on a planned basis by a task force created in the form of a large and complete department equipped with functional specialists. If this is not done properly there will be a dip in the performance of the organisation resulting in a downward share price spiral. Broadly speaking, acquisition strategy should be developed along the following lines:

Laying Down Objectives and Criteria: Any company embarking upon a strategy of expansion through an acquisition policy must lay down acquisition objectives and criteria. These criteria sum up the acquisition requirements including the type of organisation to be acquired and the type of efforts required in the process. Laying down the corporate objectives and the acquisition criteria ensure that resources are not dissipated on an acquisition when these might more profitably be used to expand existing business activities.

Assessing Corporate Competence: A detailed study of the company's own capabilities should form an integral part of acquisition planning. Such a study is done to make sure that it possesses the necessary competence to carry out the acquisition programme successfully. Once the corporate strengths have been underpinned the management should appoint an ad hoc task force with a member of the top management team to head this body and functional executives as its members to carry out the pre-acquisition analysis, negotiate with the prospective firm, integrate the companies and monitor acquisition results.

Locating Companies to Acquire: With carefully spelt out acquisition objectives, strategies and screening criteria, a company may not face any problem in finding the right organisation. For performing this task, the acquiring company must take into consideration economic, legal and other factors. For instance, it may be useful to ascertain what the potential firm can do for the organisation which it can not do on its own, what the organisation can do for the potential firm which it can not do itself, what direct and tangible benefits or improvements result from acquiring the potential firm and what is the intangible value of these savings to the organisation. In the same vein, legal procedures involved in acquisition must be gone through in detail. Managerial implication of takeover strategy should also be examined.

An enormous amount of information pertaining to the above aspects gathered over a period of time is indispensable to a company with an active continuous acquisition programme. The desired information collected in conjunction with banks, financial institutions, stock brokers and consultants help in locating particular concerns which might fit the needs of the acquiring company.

Question 70: 'Retrenchment Strategy has different forms.' Explain.

Answer: There are three major variants of retrenchment strategy.

They are:

(a) Turn-around strategy,

(b) Survival strategy, and

(c) Liquidation strategy

(a) Turn - around strategy: When an enterprise has been suffering business losses for a long period of time because of continued decline in sales, it takes recourse to turn-around strategy to arrest and reverse the declining performance of the business. A turn around strategy with its basic philosophy of hold the present business and cut the costs is an extreme step which stops just short of selling the hyberation or degenerating into insolvency. Such a course of action should be resorted to only when the business is worth saving. It is, therefore, necessary to determine the firm's future earning power and compare the same with the estimated liquidation value. If the firm's future earning power is higher than the liquidation value, it will be worthwhile to continue the operation of the firm.

A turn around strategy calls for strong managerial action to restore profit and rebuild morale. Before developing the turn - around strategy, decision has to be taken as to who should direct the turn-around operation. In other words, should the existing top management be continued or should a new one be brought in from outside. Such a decision has to be taken by the BODs. Once this decision is taken, the BODs and the Chairman jointly formulate objectives of the operation.

(b) Survival strategy: When a firm's business has reached the stage of extinction, it focuses all its energy on the search of a survival strategy. Six danger signs of a company in need of help are losing money (negative profit), shortage of cash, losing market share, deteriorating physical facilities, departing of personnel and low morale among those remaining. Most kinds of the business trouble that can threaten a firm seriously will externally be manifested in a cash flow problem. Survival drives have psychological, sociological and systematic roots. These reflect individual drives for personal security, tribal interdependence, and allegiance of social groups and dynamic inertia of complex organisations to continue functioning as they are.

There are three approaches to survival strategy. They are: Management Restructuring, Divestment and Restructuring Business.

(c) Liquidation Strategy: This is usually the strategy of last resort. Liquidation of the present business enterprise is the ultimate retrenchment. Liquidation strategy is the decision to sell off or close down a firm. Such a decision is taken under the following circumstances.

(a) When the business condition of a firm is perilous and there is no hope of recovering from the present crisis.

(b) At times, the managers may feel the business is at its peak but the future is uncertain and the firm is unable to see any direction in which it can enter and operate.

(c) A firm may be suffering from a business crisis and it may not have adequate resources to get out of the present crisis.

(d) When a firm has been facing very badly in the past few years and has consequently suffered considerable losses and some other firm offers to buy it for tax consideration or any other reason.

(e) Sometimes, a firm may be offered a price higher than its real worth and the management may be tempted to sell off the business, particularly when it is found that there are suitable alternative investments or business where the sale proceeds could be gainfully employed.

Question 71: Examine the role of Mergers and Acquisitions in the transformation of industrial structure.

Answer:

Mergers and acquisition (M&As) have played a great role in the transformation of the industrial structure of the advanced economies. It is pointed out that about two-thirds of the large public corporations in the U.S.A. have had at least one case of merger in their history and that the acquisition oriented conglomerates experienced super fast growth in sales, profits and assets. Mergers represent resource allocation and reallocation processes in the economy with firms responding to new investment and profit opportunities arising out of changes in economic conditions and technological innovations impacting industries. While the first wave of M&As represented mostly horizontal mergers, the second wave predominated by vertical (both forward and backward) integration.

M&As in India: Mergers and acquisitions have played an important role in the transformation of the industrial sector of India since the Second World War period. The economic and political conditions during the Second World War and post war periods gave rise to a spate of acquisitions and mergers.

Large number of M&As occurred in industries like jute, cotton textiles, sugar, insurance, banking and electricity, and tea plantations. The liberalisation ushered in 1991 very significantly charged the scene. Following the liberalisation of the regulations on growth and M&As (Delicensing, dereservations, MRTPA relaxations, liberalisation of policy towards foreign capital and technology), the M&A mania has bitten corporate India making the 1990s a decade of structural transformation of the industrial sector.

The total number of mergers and acquisitions which India witnessed during the entire decade of 1980s was only 84 (32 mergers and 52 takeovers), but in 1993 alone there were 114 M&As and there ware much higher levels of M&A activities if the following years. M&As have significantly contributed to the growth of a number of companies/business groups. There is a clear trend towards merger. This applies to green field enterprises and acquired firms. Brooke Bond and Lipton were merged 11.09.93 and the merged entity, Brooke Bond Lipton were merged in 01.09.93 and the merged entity, Brooke Bond Lipton India Ltd. (BBLIL), merged into Hindustan Lever in 1996. The Pharmaceutical firms of the Ajay Piramal group (Nicholas Piramal India Ltd.,

Piramal Healthcare Ltd. into which the group company Sumitra Pharma was merged earlier Healthcare Ltd. into which the group company Sumitra Pharma was merged earlier-and Boehringer Mannheim India Ltd.) merged. Similarly, the four bulk drug and formulation companies of the Natco group have merged. The Nirma group companies have merged into Nirma Ltd. Consumer durables groups like BPL, Videocon and Onida have also undertaken merger of various group companies. These are but just some examples of the merger trend that has enveloped the Indian corporate sector.

Reasons for M&A:

There are a number of reasons for or advantages of M&A.

M&A and Growth-Gap Filling: One important objective of M&A is to fill the growth-gap, i.e., the gap between the company's sales potential and its current actual performance. The four important components of growth-gap are the following.

1. Product Line Gap
2. Distribution Gap
3. Usage Gap
4. Competitive Gap

Theories are a number of theories of mergers and other forms of asset redeployment. They seek to explain the reasons for/benefits of mergers and other forms of asset redeployment. Weston et. al. have categorised these theories as shown in following:

1. Efficiency Theories:
   - Differential managerial efficiency
   - Inefficient management
   - Operating Synergy
   - Pure diversification
   - Strategic realignment to changing environment
2. Agency problems and managerialism
3. Market power
4. Taxes

5. Redistribution

Operating economies of scale is the desire to protect the interests of the managers and employees who are at greater risk if the single industry in which attempt to adapt to the changing environment makes the response quick and is believed to be less risky fraction of the ownership shares of a firm. Tax effects are also advocated as an important reason for mergers. According to the redistribution hypothesis, M&A increases value to shareholders at the expense of other stakeholders in the firm, like bondholders, government (in the case of tax savings) and organised labour.

Management of M&A:

Management of M&A involves the following important phases.

1. Determination of the strategic of M&A.
2. Screening, evaluation and choice of candidates for M&A.
3. Determination of acquisition strategy.
4. Post-acquisition integration.

The first important step in the management of M&A is the determination of the strategic purpose of merger/acquisition. Is the objective to gain an entry into the market? Is it to strengthen the competitive position or to gain market leadership? Is it to acquire technology? Is it for achieving economies of scale or advantages of synergy? Is it to deepen/ or widen product mix? Is it to strengthen the distribution in bound or outbound logistics?

Strategic Considerations in M&A:

1. Fit with Mission and Strategy
2. Fit with Portfolio Strategy
3. Competitive Impact
4. Scale Economies and Synergy
5. Pre-emptive Motive
6. Comparison with establishment of New Unit
7. Long-term Financial Considerations
8. Tax Shields
9. Strengthening Ownership Control and Guarding against Acquisition

Screening, Evaluation and Choice:

Having considered the strategic issues and determined the strategic purpose of acquisition, a company can move on to the next stage, that is choice of the eligible candidate for acquisition. This involves a screening and evaluation of the possible firms. The purpose of screening is to eliminate firms which do not satisfy certain set criteria. For example, firms above a certain size in value, or firms which are too small, may not suit the resources or purpose of the company. Other criteria used at the screening stage may involve market share, product mix, market coverage, international business etc. Screening facilitates short listing of companies for detailed analysis.

Important criteria used for evaluation include the following:

1. Earnings Potential
2. Value of Company
3. Market Position
4. Capital requirement
5. Condition of Plant and Machinery
6. Quality of Management Team
7. Human Resources

Acquisition Strategy: Once a firm is identified for acquisition, the company has to determine acquisition strategy. The strategy will depend, on the particular case ad situation. For example, if the management of the target company is unwilling for the company to be taken over, it cannot be a friendly one. In several cases, a company may be on the look out for buyers and the seller may have certain specific considerations, besides the price. Both strategy and tactics are required to deal with takeover cases.

The team typically includes the CEO, a senior finance executive, and a legal expert. It should also have an investment or merchant banker with takeover experience. And increasingly, media experts are becoming key members of such teams, to make sure that public and minority shareholder opinion do not turn against the takeover try, and also to use the media to discourage other bidders.

Sometimes a company enters into a lease agreement with potential take-over firms-as HLL did in the case of Sunrise Industries and Union Home products - which enable the company to more closely assess the viability of the units.

There are also cases of companies entering into Management Contracts, managing the firm for some period and then taking over as done by companies like Tate Tea in the case of some tea plantations in Sri Lanka.

Post Merger Integration: Post merger/acquisition integration of the firms is a crucial task to be accomplished for effective performance. There are several aspects of the integration. The organisational culture of the companies may be different. Some times there may be differences in the policies, procedures and styles. Functional facilities and activities will have to be aligned and coordinated.

Emotional integration of personnel of the organisations is another aspect. Some of the important areas of post merger/acquisition integration are the following.

1. Procedural Integration
2. Physical Integration
3. Managerial and Socio cultural Integration

Pitfalls in M&A:

Many M & As have failed to produce the expected results; several of them have been disastrous. There are many downside risks or pitfalls in M&A. The common ones are the following.

1. Over pricing
2. Hidden Liabilities

Defence Strategies:

There are several defence strategies which companies may employ against hostile takeover attempts. Important strategies are the following:

1. Pacman Defence
2. Swallowing Poison Pill
3. Disposing off Crow Jewels
4. Management Buy-Out
5. Operation Gray or White Knight
6. Golden Parachutes

Question 72: What is Turnaround Management? Explain the elements in Turnaround Management.

Answer:

Turnaround Management: Turn-around management refers to the management measures which reverse the negative trends in the performance indicators of the company. In other words, turnaround management refers to the management measures which turn a sick company back to a healthy one or those measures which reverse the deteriorating trends of the performance indicators such as falling market share, sales (in constant rupees), and worsening debt-equity ratio.

Turn-around Management Factors: Management Factor: Managerial inefficiency is the root cause of the problems in a number of cases. Therefore, improvement of the management becomes a prerequisite. The new CEO should streamline things and in many cases will have to change the organisational culture.

(i) Human Resource Factor: In many of the companies which are in very bad shape, the human resource is redundant, demoralised and surplus. The surplus manpower should be got rid of morale should be restored and the quality of the manpower should be improved through training and recruitment of competent people for the key positions, if needed.

(ii) Production Facilities: Modernisation and other improvements of plant, equipments etc., are also often an important part of the turnaround management.

(iii) Finance Management: Arranging additional finance, financial discipline, financial restructuring (described under Business Reorganisation).

(iv) Product Mix Modification: A number of turnaround management cases involve modification of the product mix. Unprofitable products may have to be dropped and new products may have to be introduced.

(v) Marketing Strategy: An appropriate marketing strategy could help improve such cases.

(vi) Miscellaneous: Liquidation of assets, which are not in use.

Elements in Turnaround Management:

From case studies of turnaround management often companies, Khandwalla has identified the following ten elements of a successful turnaround strategy.

1. Change in top management
2. Initial credibility building actions
3. Neutralising external pressures
4. Initial control
5. Identifying quick pay off activities
6. Quick cost reductions
7. Revenue generation
8. Asset liquidation for generating cash
9. Mobilisation of the organisation
10. Better internal coordination

Question 73: Distinguish between Horizontal and Vertical Integration.

Answer:

Horizontal and a vertical integration help management to realise economies of scale, to have a strong influence on the market and to face competition with confidence. Peter Drucker lays great emphasis on the right size of business as a measure for the viability and growth of a firm and this means elimination of wrong size through by achieving horizontal and vertical integration. Without economical operation, it is difficult to achieve the long-term competitive survival goal. Hence, the role of economies of large-scale. Backward integration is concerned with economy in regard to a reliable supply of inputs at cheap prices. Forward integration, on the other hand, has to do with cutting down the marketing cost by eliminating certain channels of marketing and allocating capital resources more profitably and effectively in the face of competition.

Diversification becomes necessary when there is market saturation, when competitive pressure is high, when product lines become obsolete, or when further expansion is not permitted by the government; when higher profits and growth are expected from an alternative business. When risks have to be spread (riot to keep all the eggs in the same basket), when instantaneous profit can be made, and when executives feel bored in doing the same business again and again.

Diversification can move along with what is called the "common thread" which has been emphasised Say Prof. Ansoff and Drucker. It involves a "strategic fit" in the sense that the new business should fit the present one in terms of technology as well as products, what Prof. Thompson calls "moving into closely related products" for example, a bakery firm moving into the biscuit business; building on the company's technology, synthetic fibers firm moving into the biscuit business; building on the company's technology, synthetic fibers firm moving into carpets; utilising the company's by-products or raw materials for by-products-timber into plywood and so on. The strategic fit would also enable the company to utilise its sales force more effectively and build up its brand names and goodwill. Innumerable such examples, namely, are provided by such companies as Procter and Gamble, and Look heed. This is what may be called "concentric diversification," which has certain inherent virtues.

Thomson bases his analysis on Drucker's theme, and points out: "Extend technological diversification is becoming outmoded as a viable strategy precisely because the prolific branching out of technology eventually dilutes what once was its clear advantage". He quotes the example of Sony and Texas Instruments which branched out of their original technology into many lines. Whereas GEC and Westinghouse divested themselves of a number of consumer and industrial products in which electricity was incidental. The American Biltrite Rubber Co., Dow Chemicals, Eastman Kodak, General Motors, B. F. Goodrich, Johnson & Johnson, Minnesota Mining and Manufacturing have resumed "concentric diversification".

Conglomerate diversification, however, has not been successful in a majority of cases, because lack of "strategic fit" or "common thread technology". For a few years, a conglomerate may achieve higher profits, later, however, when it comes up against all kinds of complex problems, the management decides to divest itself of certain business by selling out. As a matter of fact, conglomerates were unable to manage unrelated business during the period of depression or recession.

Financial synergism promotes losses in the end. Therefore, what is needed is a strategic fit or distinctive competence. However, it is wrong to make blanket criticism against conglomerate. The pros and cons of what kind of and how much, diversification an organisation should embark upon to get the best results for its distinctive competence are differently from case to case. A logical plan for an organisation's management is to begin its evaluation with a consideration of "what is the best diversification it needs to attain its goals, accomplish its mission and still remain competitive and prosperous". At the other extreme, the management is equally obliged to examine the question: "What is the utmost in diversification that can manage, given the capacity it adds to our organisation?" In all likelihood, the optimal answer lies in between. After deciding what to include and what to exclude, the next step is to make the diversification strategy specific enough to define the role of each line of business within the total organisation.

It is, therefore, clear that almost all leading authorities are opposed to haphazard, loose and jungle-type of conglomerate diversification in American industry. There are several cases of companies which embarked upon such a strategy in the 1960s sold away certain unrelated business in order to achieve competitive excellence for differential advantage. Indian companies which are conglomerates, should learn from the American experience, if they want to avoid sickness. Doing ventures are a method of having a holding company whereby unrelated business can be brought under economic fits.

Innovative strategy is new and different business, because the existing business product, market and technology are susceptible to sudden changes, and higher profits may be expected to accrue from innovation. It involves a huge investment, risk and entrepreneurship. If it is managed well, it can increase profits substantially (the Xerox machines). However, it has to be related to the product-line and product-mix policy and various aspects of launching a new product.

The retrenchment strategy involves cutting book on personnel, inventory, replacement of machinery, closing uneconomic plants and pruning the product-line of unprofitable items in order to reduce cost. Retrenchment is merely a reaction to adverse environment.

Divesture strategy involves the selling out of those lines of business which cannot be managed efficiently and effectively. Generally, unsuccessful lines of business should be got rid of quickly and without hesitation. To drag on their production for years will lead to a cut in profits. But sometimes, instead of selling, the management may keep a hold on it by organising a holding company.

Liquidation is the last alternative strategy when there is no hope of the survival of the unsuccessful unit. But it entails unemployment and loss of output. However, where there is no hope of survival of the unity it is better to liquidate it.

Strategic planning is never static. It is dynamic. Flexibility has to be built into it.

After identifying the strategic choice, the next step is to evaluate it in terms of profits, synergy effect and growth. Here, a great deal of objective analysis has to be undertaken; and profit rates, market share and growth must be based on productivity and no on physical growth.

Rothschild an executive of GEC pinpoints the relationship between functional areas and overall strategy in these words. "The best investment and management strategy in the world is of little use unless each function of the business designs and executive programme that are consistent with the strategies selected Management cannot assume that its engineering, manufacturing or marketing executives will stop what they are doing and automatically design programmes that closely fit the management's chosen strategy. This is even more vitally important if you intend to segment your business and to adopt different strategies for each segment. Functional managers and organisations will continue to repeat their past performance and will not think about changing unless they are given guidelines and direction".

Rothschild discusses functional areas like engineering and manufacturing in terms of standardisation, simplification, design, quality, facilities and equipment, technical talent, beginning with basic research and moving through application research, advanced engineering and design engineering, capacity requirement, flexibility of production system, productivity, low cost material and logistics.

Marketing strategy must fit the manufacturing strategy.

Corporate strategy aims at influencing the market size (or market share) and the growth rate of the market; and therefore attention must be focussed not only on engineering and manufacturing efficiency, but on satisfying customer needs and wants. Mere economical cost by itself is of little relevance. The primary aim is customer satisfaction and the manufacturing system must be designed and revised constantly so as to meet the ultimate aim of the business. That is why Rothschild assigns a greater role to marketing and environment analysis in his design of strategic planning, while playing on the competitors' weakness. An evaluation of environmental changes, capitalising on them, the unique unchallenged strength of the company in terms of a new market and new product must be built. The very uniqueness should be the foundation of future strategy. The market position, technological position, product position, financial position and overall production must be very strong in comparison with those aspects of the competitors' "rate of return" and "corporate growth rates," for these are the best criteria of assessing strategic alternatives.

Question 74: How the various potential candidates for mergers/acquisitions are valued in the context of the corporate strategy by the acquirer?

Answer: Mergers and acquisitions involve share stocks of different companies and their exchange for suitable consideration. Acquiring the shares of another company entitles one to get the dividend accruing on the same, or the capital gains by selling the shares when the prices are higher than what was paid for. Value of the shares/stocks of a company is determined by factors such as:

- Present dividend returns
- Likely future returns
- Risk of these future returns
- Present profitability
- Potential growth rate.

Thus, the valuation for the merger and acquisition involves evaluation of the associated risks and the potential growth rate of the firm and its earnings. The valuation procedure follows a rigorous analysis similar to the one followed for other capital budgeting decisions.

Valuation by P/E ratio:

The P/E ratio is defined as:

$$\frac{\text{Market price per share}}{\text{Net earnings after tax per share}}$$

Thus, if market price of a share is Rs. 40 and earnings per share is Rs. 2, then the P/E ratio is 20. In other words, this company would have to sustain profit at this level for 20 years to pay back its current share price. Of course, generally an investor would not wait this long to recover his cost. The investment is made either with the hope that the company would grow faster, or that when the price of the share rises beyond Rs. 40, the investor would sell shares for some capital gains. When the P/E ratio is reversed, it gives the Earnings Yield. In the above example, the earning yield is 5% after tax. This is how considering the risk of investment in shares, and the risk-free returns available from bank deposits.

The different values of P/E ratio for different companies are attributed to the differences in:

- Growth rate of company,
- Risk associated with the investment
- Competition and environment of the industry

The industrial sector to which a company belongs plays an important role in the value of a company and its shares. Certain sectors have shorter business cycles and more uniform earnings compared to other sectors. The essential consumer products e.g. soaps, detergents, oil, etc. have steady returns on investments compared to the heavy engineering equipment manufacturer. The fortunes of the latter are intimately linked to the upswing growth phases of the economy only. Thus, the P/E ratio for a company is a simplified tool for assigning value to a company. This must be viewed along with other underlying factors such as the growth prospects, risks associated with the company and the business sector, and the present earning position of the company.

Earnings per share: Another way of looking at the potential acquisition is to compare the earnings per share of the acquirer, the company to be acquired and the two together. If the market price of a share is Rs.100 and its P/E ratio is approximately 25 then its earning per share is Rs. 4. However, the value is a static measure of the performance of the acquisition. The earnings of the company can move upward or downward depending on the action taken by the company. To grasp this, one is to look at the major sources and uses of funds given in the balance sheet and profit and loss account. P/ E ratio or earnings per share alone indicate very little and must be checked side by side with the Balance Sheet and Profit and Loss Account of the firm. This together should be viewed to develop a scenario on how the company is running at present and how it can be run better after the acquisition. A typical financial analysis to facilitate such building up of scenario, would involve the following steps:

Divest loss making operations: The first action that the acquirer considers while acquiring another company is to see if there is any loss making operation within the organisation. By divesting the loss making subsidiary, the acquirer reduces the cash drain in the form of losses, and generates some liquid funds for running the profitable part of the organisation. The additional funds so generated help to reduce the bank borrowings or may be invested in good marketable securities for additional income. One hopes that these unwanted assets can be disposed of at their book values at least.

Use ratio analysis: The performance of the company and efficiency of its various operations can be judged by calculating various key ratios, e.g. current ratio. The current ratio for the company should be compared with the industry average to check, if it is on the higher side. A high current ratio should lead one to go through the individual components of current assets and current liabilities.

Reduce current assets: Under current assets, often there is a high level of stocks and excess money blocked with the debtors. The stock level should be compared with the industry average, and then it should be estimated how much of it can be reduced, for instance, a high level of 8 months of stocks can be reduced to a 6 months level. Funds corresponding to stock level of 2 months would be released for better deployment of funds elsewhere. Similarly, average age of debtors should be compared with the average age of debtors for the acquiring company. If the acquirer's debtors' age is lower, consider how the acquirer's credit controls can be used to reduce the average age of debtors. For instance, if the average age can be reduced even by 25%, then this would give additional funds for current use.

Reduce current liability: The funds released from stocks and debtors are than ploughed back into the firm, and correspondingly some liabilities in the form of say, bank overdraft etc. can be reduced to save on their respective interest charges.

Revise Balance Sheet and Profit and Loss Account: On the basis of the actions sustained above, revised Balance Sheet and Profit and Loss Account are developed. The new net earnings per share are calculated, which will be far better than the earlier value of earnings per share, of the target company. Thus, the acquirer is able to derive savings and higher profits which presumably the target company had not foreseen.

Incorporate growth and expectation rates: In the context of P/E ratio we presumed that it would stay constant before and after acquisition. On the other hand, the reality speaks otherwise. The very fact that the P/E ratio of different companies varies, implies that the investors associate their investments in different companies with different risks. Thus, the mergers and acquisitions must be valued on the basis of the likely growth rates of the different companies when run independently, and compared with their combined performance. Acquisition involves generally paying a premium over and above their current market prices to the shareholders of the acquired company. Thus the number of shares in the combined company would be different from (and less than) the simple sum of the number of shares in the two companies. Furthermore, the growth rate of a high-growth company is bound to fall with the acquisition of the low growth company. Thus, initially for the acquirer, the earnings per share may seem to improve over their earlier operations with the acquisitions. Similarly, the shareholders of the acquired company also gain by their over-capitalisations of shares. But it is generally seen that because of the difference in the growth rates of the acquirer and the acquired companies, the growth rate of the combined company is lower than that of the acquiring company. At some stage in future, the earnings per share of the combined operations fall below, what would have been the earnings per share of the acquirer's operations alone? As the investment in that of the acquirer, a merger or acquisition is considered profitable if the returns on investment for the acquirer company are higher than their investment. The two streams are compared in terms of their present values.

The above method has been criticised for the fact that it is based on reported earnings rather than actual cash streams in the form of actual dividends paid to the shareholders. To that extent the market can be deceived by manipulating the reported earnings.

Market value of Assets: This is another way of judging an acquisition. The current market value of the used assets of the target company if traded in the market are a good measure of their worth. However, the market may perceive an asset to be in a different use than the one for which the company is using it. Land and buildings are the fixed assets of the company which provide productive industrial operations, but they may have a much higher market value specially if they are located conveniently near a growing urban centre. In such a situation, the company must also incorporate the cost of conversion of the assets to the proposed new use and check whether the concerned governing agencies would allow such conversion.

Replacement value of Assets: Another way of evaluating the worth of the assets of a company is by evaluating the written down replacement value of the assets. This takes into account the usage of the assets and their remaining useful economic life. The written down replacement value of an asset is calculated as:

$$\left[1- \frac{\text{Age of Assets}}{\text{Total economic life}}\right] \times \text{Current cost of asset.}$$

Here, the current cost of an asset is determined by market price of the asset if replaced now. Replacement cost is better than the historical cost, particularly in an inflationary economy, where the price of assets is rising steadily. Furthermore, the price of the assets also increases if these assets are in general being used more profitably. On the other hand, if these assets are not so profitable in use, their prices get depressed or else the asset replacement will not take place.

However in this analysis, the economic life of the asset has to be estimated and sometimes due to the technological achievements the assets available in the market are markedly different from the ones originally installed by the company a few years ago. Most of the currently available assets incorporate computers in them and more automatic/with flexible manufacturing features. The replacement value of assets is compared with the other option for the firm to invest in new assets.

Thus a merger/acquisition can be valued in different ways to compare the cost with the potential benefit. The benefit accruing with the future earnings is discounted to the present values, while the costs are determined by market value or the written down value of the concerned assets.

Question 75: To get a bird's-eye view of an organisation's operations is the purpose of the value chain model of corporate activities, developed by Porter of the way in which firms organise and perform activities.

Required:

(a) A brief examination of some of the elements of value chain model;

(b) A brief discussion on how value chain analysis can contribute to the strategic analysis of costs.

Answer:

(a) Activities are the means by which a firm creates value in its products. (They are sometimes referred to as value activities). Activities incur costs, and, in combination with other activities, provide a product or service which earns revenue. Firms create value for their buyers by performing these activities.

Porter (in Competitive Advantage) analysed the various activities of an organisation into a value chain. This is a mode of value activities and the relationships between them. Here is a diagram of the value chain (figure in the next page) :—

Let us examine some of these elements in turn.

Primary activities are those directly related with production, sales, marketing, delivery and services. The diagram shows five primary activities.

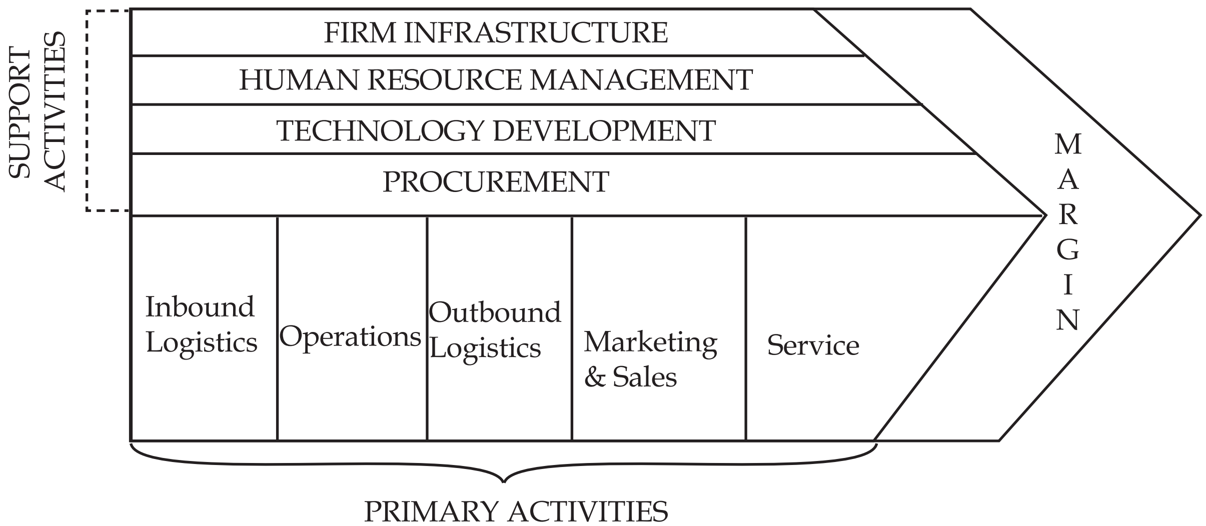
(i) Inbound logistics are those activities involved with receiving, handling and storing inputs to the production system. It thus includes warehousing, transport, stock control and so forth.

(ii) Operations are those activities which convert inputs into final product.

(iii) Outbound logistics are those activities relating to storing the product and its distribution to customers.

(iv) Marketing and sales are those activities that relate to informing customers about the product, persuading them to buy it and enabling them to do so. This includes advertising, promotion and so forth.

(v) After sales service. For many companies there are activities such as installing products, repairing them, providing spare parts and so forth.



Support activities are those which provide purchased inputs, human resources, technology and infrastructural functions to support the primary activities. Support activities include the following.

(i) Procurement reports to those activities which acquire the resource inputs to the primary activities.

(ii) Technology development. These activities are related to both product design and to improving processes and/or resource utilisation.

(iii) Human resource management is the activities of recruiting, training, developing and rewarding people.

(iv) Firm infrastructure. The system of planning, finance, quality control are activities which Porter believes are crucially important to an organisation's strategic capability in all primary activities.

Furthermore, in addition to the categories described above Porter identifies three other ways of categorising activities.

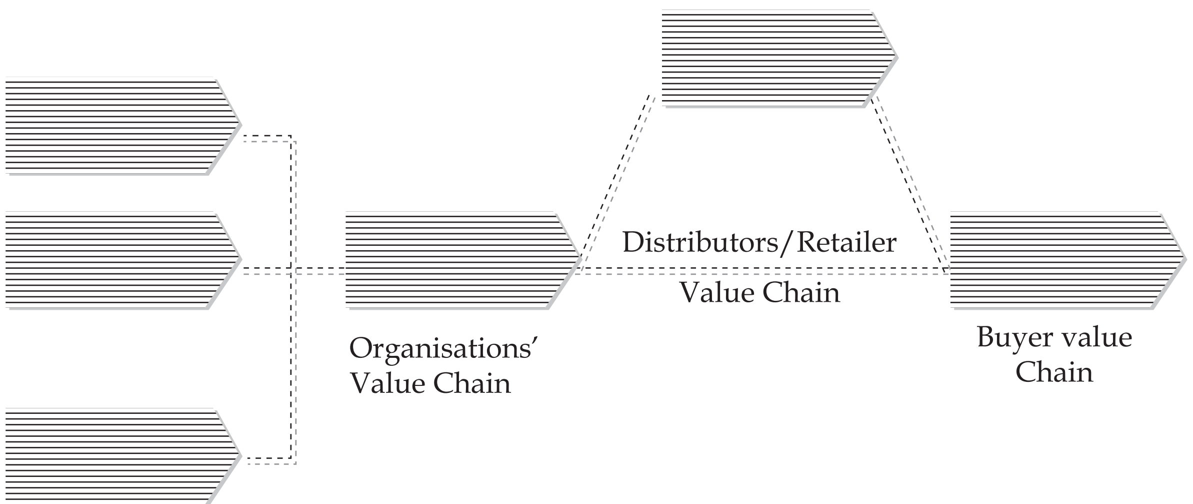
(i) Direct activities are concerned with adding value to inputs,

(ii) Indirect activities enable direct activities to be performed.

(iii) Quality Assurance. This type of activity monitors the quality of other activities and includes:

- Inspection
- Review
- Audit

Linkages connect the interdependent elements of the value chain together. They occur when the element of the value chain affects the cost or effectiveness of another. The value chain contains an element for margin. This is the excess of the amount that the customer is prepared to pay over the cost of the resource inputs and value activities. Firms can gain competitive advantage by concerning of new ways to conduct activities, employing new procedure, implementing new technologies or using different inputs and by exploiting linkage effectively.



A company's value chain is not bounded by a company's borders. It is connected to what Porter describes as a value system.

As well as managing its own value chain, a firm can secure competitive advantage by managing the linkages with its suppliers and customers. A company can create competitive advantage by making best use of these links and this means considering the value chains of these supplies and customers.

A value chain is also a model for analysing a firm's competitors, and also further on in the planning process for designing strategies. A firm's value chain is not always easy to identify nor are the linkages between the different elements. However, it is an important analytical tool, because it helps people:

- to see the business as a whole;
- to identify potential sources of competitive advantage.

(b) The value chain models are the process by which organisation convert inputs into outputs. If the purpose of this process is the creation of value, then the accountant can contribute to the strategic analysis of costs. However, Porter has said, while systems do certain useful data for cost analysis, they often get in the way of strategic cost analysis. Although many accounting reports contain a value added statement frequently, such statements:

- are little more that an analysis of sales revenue less purchases.
- ignore how value is created, including :
- linkages within the firm
- other elements within the value system involving outsiders.

A summary of the failure of traditional cost systems is outlined in the table below.

	Traditional Costing Systems	**Value Chain Cost analysis**
Focus	• Manufacturing operations	• Customers • Value perceptions
Cost Object	• Products. • Functions • Expense heads	• Value-creating activities • Product attributes
Organisational Focus (SBUs)	• Cost and responsibility centre	• Strategic Business units • Value-creating activities
Linkages	• Largely ignores • Cost allocations and transfer prices used to reflect interdependencies	• Recognised and maximises
Cost drivers	• Simple volume measures	• Strategic Decisions
Accuracy	• High Apparent precision	• Low precision • Indicative answers

What might influence the cost of the value chain?

(i) Structural cost drives are major strategic choices made by the firm which determine its underlying cost base.

These include the following:

- Scale of operations, capacity etc, giving rise to economies of scale or otherwise.
- Scope: to what extent is the firm vertically integrated?
- Experience: has the firm climbed the learning curve?
- Technology used in the value chain.
- Complexity and breadth of product range.

(ii) Management issues which influence how well a firm manages the value chain in operation terms, include:

- Capacity utilisation
- Product and process design.

- Continued learning opportunities offered by TQM and continuous improvement programmes.
- How well external linkages are exploited.

Firms may create a more outward-looking focus in their costing system as follows:

(i) Most products are a collection of benefits, which is why customer buys them. Ultimately, the provision of customer benefits is the real cost driver of the business, and it

			⇦	Cost driver A	⇦	A	
Input Cost	⇦	Activities	⇦	Cost driver B	⇦	B	Customer benefit sought
			⇦	Cost driver C	⇦	C	

should be possible to work backwards, as it were, from the customer benefits to the underlying costs.

(ii) For different products, it should be possible to identify the:

- Customer's perception of the value of the benefit.
- The cost of providing the benefit.

This is a sort of cost/benefit analysis. Those benefits which are least costly to provide should be offered first of all.

For the accountant, a problem with this approach is:

- A lack of precision in the data;
- The inevitable subjectivity in deciding what customer's value as a benefit.

Question 76: Benchmarking exercise is based on "best practices" and not on "best Performances" Discuss.

Answer:

Benchmarking exercise is based on "best practices" and not on "best performances". For practices connote 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 why? In tracking the practices of other companies, Benchmarking of the process of measuring the company against the products, practices, and services of some of its most efficient global competitors is the ideal way. For example, when Xerox was in the comeback trail in the last lap of 20th century, it decided to institute a policy of benchmarking as a means of identifying ways to improve the efficiency of its operations.

Xerox benchmarked L.L.Bean for distribution procedures, Deere & Company for central computer operations, Procter & Gamble for marketing and Florida Power & Light for total quality management processes. By the early 1990s, Xerox was benchmarking more than 200 functions against comparable areas in other companies. This process helped Xerox dramatically to improve the efficiency of its operations.

Types of benchmarking are given below:

- Strategic benchmarking: This aims at enhancing a 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.
- Competitive benchmarking: This is confined to the area relating to the performance characteristics of the company's key products and services. So competitive bench marking will involve the best practices of the companies in the same sector.
- Process benchmarking: This is attempted to improve specific key activities and operations culminating into processes with the help of best practice organisations that are engaged in similar activities and services.
- 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.
- 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 with in the company.

Question 77: 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

Question 78: "The condition wherein the whole is greater than the sum of its parts; in a synergistic merger, the post merger value exceeds the sum of the separate companies' pre merger values" Prove.

Answer:

Under 'synergy', the combined value of a firm is much greater than the value of individual firms. The phenomenon of synergy arises due to economies of scale of operation. Besides, the combined mega features such as enhanced managerial capabilities, creativity, innovativeness, R & D and market coverage capacity. Due to the complementary nature of resources and skills a widened horizon of opportunities are also responsible for synergy on a merger situation. For example, Madura bank had very big network compared to ICICI. Bank of Madura had one of the lowest costs of deposit and capital adequacy ratio was very high.

ICICI had ICICI had latest technology to be implemented and subsidiaries overseas but had no significant network in India. So, ICICI and Madura bank came together and there has been a dramatic improvement post merger due to synergy.

Question 79: "Takeover usually takes the form of 'hostile' or 'forced' or 'unwilling' acquisition and acquisition happens at the instance and the willing ness of the company management and the shareholders" Do you agree?

Answer:

Yes, it is for this reason that acquisition is generally referred to as 'friendly takeover'. An example of acquisition is Aditya Birla group, a leading conglomerate in India with substantial interest in textiles and cement, apart form other things, took over from L & T its cement business on a friendly takeover. Similar such transaction was that ORBI Tech by Polaris Software. On the other hand, the acquisition of Raasi Cement by India Cements earlier was a hostile takeover by the India Cements Group. Further, the term takeover is often used to denote the hostile nature of acquisition, where there is an element of resistance and opposition to the takeover bid.

Question 80: (a) What are the strategies adopted to combat hostile takeover?

(b) "Growth through concentric diversification into a related industry may be a very appropriate corporate strategy" Comment.

(c) "Complementary mergers may result in each firm filling in the missing pieces of their firm with pieces from other firm" Comment.

Answer (a)

A target company which faces the threat of a hostile takeover, would adopt the following Strategies:

Poison pill tactics: This strategy aims at initiating action against the predator by destroying the attractiveness of the firm. The following are few methods:

The acquiring company may issue substantial amount of convertible debentures to its existing shareholders which would make it difficult for the potential acquirer as there is a danger of considerable increase in the voting power of the company.

- ➢ The target firm either sells or mortgages or leases or otherwise disposes off some of its precious assets.
- ➢ The target firm can defend itself from the onslaught of the potential bidder is to dispose of its liquidity by acquiring some asset or other firm.
- ➢ The target grants its employees stock options that immediately vest if the company is taken over. This is intended to give employees an incentive to continue working for the target company at least until a merger is completed instead of looking for a new job as soon as takeover discussions begin. However, with the release of the "golden handcuffs", many discontented employees may quit immediately after they've cashed in their stock options. The poison pill may create an exodus of talented employees. In many high-tech businesses, attrition of talented human resources often means an empty shell is left behind for the new owner.
- ➢ The target company issues rights to existing shareholders to acquire a large number of new securities, usually common stock or preferred stock. These new rights usually allow holders (other than an acquirer) to convert the right into a large number of common shares if anyone acquires more than a set amount of the target's stock (typically 10-20%). This immediately dilutes the percentage of the target owned by the acquirer, and makes it more expensive to acquire control of the target.

Green mail tactics: The target firm can purchase its own stocks at a premium to avert a takeover bid. The incentive is offered by management of the target company to the potential bidder for not pursuing the takeover bid.

White Knight tactics: The target company's management may seek out a friendlier potential acquiring company who could offer a higher offer price which would eventually drive away the original bidder. The purpose of 'white knight strategy' is to seek to find a bidder. The objective is to make the takeover exercise as much unviable and unprofitable as possible for the original bidder. Such a strategy will help get the target firm a better deal. There are cases where a white knight has later been aggressive with the target company and consummated the deal at better terms.

Golden Parachutes tactics: Adopted by the target company by offering hefty compensations to its managers if they manage to get ousted due to takeover; this is pursued to reduce their resistance to takeover. This was also mentioned among one of the strategies of poison pill. This is mainly initiated because soft target firms who are managed by professional managers may fear shifting of loyalty by professional managers and to avoid any such attempts set up golden parachutes so that predators may not have incentive to deal with the agents for consummating the deal.

Divestiture tactics: Whereby target the company arranges to divest or spin off some of its businesses in the form of an independent, subsidiary company thus reducing the attractiveness of the existing business to the predator. This clearly changes the valuation of the company and many a times the multiples of valuation for multi divisional businesses would encourage such moves by target companies.

Crown Jewel tactics: Whereby the target company arranges to sell its crown jewel namely highly profitable part of the business or ones which market values better in order to dissuade the predator. However, such strategic initiative requires clear understanding of predators target businesses and valuation guidelines to be effective.

Legal tactics: A target firm can forestall the possible takeover bid through legal mode. It takes the form of 'legal strategy' for guarding against hostile takeovers. In this case, it is possible for the target firm to move a court of law for obtaining injunction against the offer. For this purpose, relevant provisions exist in the Securities Contracts (Regulations) Act, 1956 and the Companies Act, 1956. This strategy is resorted to either to block or delay the tender offer in circumstances where the shares are lodged for the transfer by the bidder. SEBI has come with clear guidelines to discourage hostile takeovers in India.

Answer (b)

While this statement may look relevant on the face of it, this can be applied only when a firm has a strong competitive position but industry attractiveness is low. For example, Murugappa group's E.I.D. Parry India Ltd., for example, has diversified both internally and externally out of the unpredictable sugar business into a series of related businesses run by the parent company.

The related diversification internally took the form of diversifying sugar division into alcohol and confectionary to add profitability to the unpredictable sugar business. Again the fertiliser activity of EID parry group in the form of production of fertiliser mixtures, ammonium phosphate sulphate and super phosphate was integrated externally with Coromandal fertilisers of which E.I.D. Parry India is a major share holder.

Answer (c)

A merger of a firm with strong R & D unit would help to improve new product development while with a firm with a strong distribution network, may benefit better distribution. For example, Dr. Reddy's went for acquisitions of R&D units to strengthen their exploration for new molecules to shorten the product development time horizon. Coca Cola when entered into India, took over the distribution systems of Parle and this saved them both efforts and time to develop distribution network.

Question 81: 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.

Question 82: 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 organisations 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 bottom line. 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 organisation change those business processes that are fundamental to the success of the organisation.

Question 83: Discuss DMAIC (define measure, analyse, improve, control) Six Sigma Approach

Answer:

The DMAIC- Six Sigma Approach:

Define

- Project definition
- Project charter
- Gathering voice of the customer
- Translating customer needs into specific requirements

Measure

- Process mapping (as-is process)

- Data attributes (continuous vs. discrete)
- Measurement system analysis
- Gauge repeatability and reproducibility
- Measuring process capability
- Calculating process sigma level
- Visually displaying baseline performance

Analyse

- Visually displaying data (histogram, run chart, pareto chart, scatter diagram)
- Value-added analysis
- Cause and effect analysis
- Verification of root causes
- Determining opportunity (defects and financial) for improvement
- Project chart review and revision
- Translating customer needs into specific requirements

Improve

- Brainstorming
- Quality function deployment (house of quality)
- Failure modes and effects analysis (FMEA)
- Piloting your solution
- Implementation planning
- Culture modification planning for your organisation

Control

- Statistical process control (SPC) overview
- Developing a process control plan
- Documenting the process

Question 84: Discuss 'globalisation' as an important strategic global business trend.

Answer:

Government of different countries has been taking various measures to improve their economic competitiveness and to protect their other economic and non-economic interests. In this connection, globlisation has emerged as one of the important strategic global business trends. The political and economic changes in the erstwhile socialist countries and the substantial liberalisation of multinational trade and investment have strengthened the forces of globalisation. Companies are becoming more globalised in their production, marketing and other functions.

Globalisation in a true sense is a way of corporate life necessitated, facilitated and nourished by the transnationalisation of the world economy and developed by corporate strategies. Globalisation is an attitude of mind-it is a mind-set which views the entire world as a single market so that the corporate strategy is based on the dynamics of the global business environment. International marketing or international investment does not amount to Globalisation unless-it is result of such a global orientation. Companies which have adopted a global outlook stop thinking of themselves as national marketers who venture abroad and start thinking of themselves as global marketers. The top management and staff are involved in the planning of world-wide manufacturing facilities, marketing policies, financial flows and logistical systems. The global operating units report directly to the chief executive or executive committee, not to the head of the international division. Executives are trained in worldwide operations, not just domestic or international. Management is recruited from many countries, components and supplies are purchased where they can be obtained at the least cost, and investments are made where the anticipated returns are the greatest. A truly global corporation views the entire world as a single market - it does not differentiate between domestic market and foreign markets. A global corporation develops a genuine equidistance of perspective, i.e., managers, with a truly global orientation, consciously try to set plans and build organisations as if they view all key customers equidistant from the corporate centre.

In essence, globalisation encompasses the following:

(i) Doing or planning to expand, business globally;

(ii) Giving up the distinction between the domestic market and foreign markets & developing a global outlook of the business;

(iii) Locating the production and other physical facilities on a consideration of the global business dynamics, irrespective of national considerations;

(iv) Basing product development and production planning on the global market considerations;

(v) Global sourcing of factors of production, i.e., raw materials, components, machinery/ technology, finance, etc., are obtained from the best source anywhere in the world;

(vi) Global orientation of organisational structure and management culture.

Normally, a firm passes through different stages of development before it becomes a truly global corporation. Typically, a domestic firm starts its international business by exporting. Later, it may establish joint ventures or subsidiaries abroad. From an international firm it may then develop into a multinational firm and finally into a global-one.

Broadly speaking, there are five different stages in the development of a firm into a global corporation. The first stage is the arm's length service activity of an essentially domestic company which moves into the new markets overseas by linking up local dealers and distributors. In stage two, the company takes over these activities on its own. In the third stage, the home based company begins to carry out it own manufacturing, marketing and sales in the key foreign markets. In stage four, the company moves to a full insider position in these markets, supported by a complete business system including R & D and engineering. Still, the headquarters mentality continues to dominate and different local operations are linked, their relation to each other established by their relation to the centre. In the final stage, the company moves towards a genuinely global mode of operations. A company's ability to serve local customers in markets around the globe in ways that are truly responsive to their needs as well as to the global character of its industry depends on its ability to strike a new organisational balance. What is called for is global localisation - a new orientation that simultaneously looks in both directions. Getting to the final stage, however, means venturing on to new grounds altogether. To make this organisational transition, a company denationalises its operations and create a system of values shared by corporate managers around the globe to replace the glue a nation-based orientation once provided. Today's global corporations are nationality less because consumers have become less nationalistic. True global corporations serve the interests of customers, not governments. They do not exploit local situations and then repatriate all the profits back home, leaving each local area poorer for their having been there. They invest, they train, pay taxes, they build up infrastructure and they provide good value to customers in all the countries where they do business.

The globalisation trend will become stronger. Many multinational corporations will transform themselves into global corporation. They will strive to enhance their competitiveness by tapping the scope for globalisation in sourcing, manufacturing and marketing. For them, domestic operations account for only a small part of the total revenue/profit. In a truly multi-national enterprise, not only will the sales revenue be generated from many markets but also product development and other operations will be organised multinationally.

According to Porter, a global approach to strategy involves a number of elements. First, it clearly means selling world-wide, not just home market. International sales are viewed not as incremental business but as integral strategy. The firm builds an international brand name and establishes international marketing channels it controls. Second, a global strategy involves locating activities in other nations in order to capture local advantages, offset particular disadvantages, or to facilitate a local market penetration. Third and most importantly, a global strategy involves coordinating and integrating activities on a world-wide basis in order to gain economies of scale or learning, enjoys the benefits of a consistent brand reputation, and serve international buyers. Simply operating internationally does not equate to a global strategy unless this sort of integration and co-operation takes place. Advantages drawn from the global network add to home-based advantages and make them more substainable. Porter argues that a company must move towards a global strategy as soon as its resources and competitive position allow if it is competing in a global industry. A high domestic, cost of capital, high domestic factor costs, and strong currency are no excuses in global competition. Yet, competing internationally is not a substitute for improvement and innovation at home.

Drucker says, most people think of giant companies when they hear the word 'translational'. But increasingly, medium and even small businesses operate in the world economy rather than in one or two countries. It is actually easier for the medium and even for the small companies to operate without much regard for national boundaries.

Certain significant developments in the context of globalisation are discussed separately, in brief, below.

Sourcing: A growing trend and an important aspect of globalisation are global-sourcing, i.e. procuring the various raw materials, components, etc., from the lowest cost source available anywhere in the world. The growth of multinational sub-contracting is an obvious indication of the growth of global sourcing. An important corollary of the global sourcing is the disintegration and hollowing of firms, i.e., tasks which were routinely done inside most firms are now subcontracted to outsiders - small and large, domestic and foreign. The world sourcing market is estimated at about a third of the total world exports. Many South-East Asian countries have taken advantage of the growing global sourcing, contributing significantly to their economic development and export earnings.

Joint Ventures: There have also been substantial increases in joint ventures of different types. The economic reforms in the centrally planned economies and policy liberalisations in other countries have given a tremendous boost to joint venturing.

Mergers and Acquisitions (M & A): There has been a spurt in the cross-border M. & As. Although diversification has been a strong motivation for M & As in respect of many companies, a number of other factors like technical, strategic and financial advantages, political reasons and the fear of growing protectionism have also been behind the M & As surge. M & As provides certain specific advantage like instant access to markets and distribution network and access to new technology or patent right.

Strategic Alliance: A new wave of competitive strategy has been sweeping across the international business horizon, known by such names as entente, strategic alliance, coalition, etc. This strategy seeks to enhance the long-term competitive advantage of the firm by forming alliances with its competitors existing or potential in critical areas instead of competing with others. Strategic alliances, which enable companies to increase resource productivity and profitability by avoiding unnecessary fragmentation of resources and duplication of investment and effort, are growing in popularity and are very conspicuous in the industries which are characterised by high fixed costs in R & D and manufacturing and/or high and fast changing technology. In a changeable world of rapidly globalising markets and industries — a world of converging consumer tastes, rapidly spreading technology, escalating fixed costs and growing protectionism - strategic alliance is an essential tool for serving customers. Globalisation mandates such alliances and makes them absolutely essential to strategy.

Question 85: Differentiate: (a) Products & Brands; (b) Futurology & Future Research; (c) Conglomerates and Diversified Majors; (d) Above-the-line & Below-the-line Advertising.

Answer (a):

Products & Brands: A product can be defined as something which is offered to a market in order to satisfy customer needs in some way: it is a package of benefits. A brand, on the other hand, is rather different: it is a name, term or symbol or design or combination of them which is intended to signify the goods and services of one seller or group of sellers and to differentiate them from those of competitors. For examples, denim jeans, the product, underpin a number of brands, e.g. Wrangler, Lee, and New Port. These brand names do not only apply to jeans and can be found also on shirts.

Sometimes, it has been argued that products have life cycles whereas brands do not. But, this statement is a false dichotomy. This model applies to some products but not to all. On the other hand, some products do not have a life cycle, although some stages of the life cycle model still apply. With brands, the situation is equally ambivalent. Some brands appear immortal, despite the changes in the products they support. On the other hand, some brands do die, if they are not properly supported.

Answer (b):

Futurology & Future Research: Futurology is the visions of the future as presented by futurologists. Some futurologists develop an original well thought-out system, often connected with philosophy. These views can be very penetrating and stimulating. They are not usually limited to the near future or one single sector of society. The aim of the qualified futurologist resembles that of philosopher he wishes primarily to make the developments in society clear by describing them in a particular manner. Sometimes a secondary aim is to warn against undesirable situations or to describe a possible development towards a desirable situation. If one can be thankful for these futurologists who broaden our vision and make us conscious of possible futures; we can indeed little value those who flippantly produce forecast, that are not founded on a thoroughly tested thought model or on systematic research. The aim of systematic future research is of a totally different nature. It is concerned with the use of presently available -concrete data to make statements about possible concrete developments in support of long-term policy forming and decision making of target groups. This is based on the simple fact that much of the information on how the future will be is already available.

Answer(c):

Conglomerates and diversified majors: A Conglomerate is a firm which has at least five or six divisions, which sell different products principally to market, rather than to each other. Conglomerates diversified quickly, primarily through mergers, and usually into product or service lines, unrelated to their prior business.

A diversified major is a firm which developed their diversification over a long period of time primarily through internal expansion into products or services related to their prior business.

The conglomerate management style is different. Their central offices are much smaller than those of diversified majors.

Usually they have no staff officials (e.g. for R & D). They tend to place most major operating decisions at decentralised divisional levels. This is often because the central office has no one expert in making operating decisions in that business. Thus, division managers are autonomous as long as divisions 'deliver'. Diversified majors have better opportunities for synergy than conglomerates.

Answer (d):

Above-the-line & Below-the-line Advertising: Above-the-line advertising is in its normal or popular sense — e.g. T.V. or radio commercials, poster ads, newspaper and magazine advertisement. Below-the-line advertising is the sales promotion activities — i.e. 'non-media' advertising. Though, to a large extent, advertising and sales promotion are complementary and sales promotion is used often as a means of reinforcement for bringing a media campaign closer to the customer, a distinction is often sought to be made between them. Advertising is effective product positioning through u.s.p. It is, therefore, commonly associated with mass media. The general role of sales promotion is persuasive communication. Basically, the task of sales promotion comprises stimulating customer buying and distribution effectiveness. Accordingly, sales promotion is short-term more specific and focussed and talked about including immediate purchase.

Question 86: Illustrate the following concepts:(a) Core competence; (b) Functional vs. Martix form of organisation;(c) Cost leadership vs. Cost reduction; (d)Vision vs. Strategic intent.

Answer:

(a) **Core Competence:** Prahlad and Hamel, in impressing the importance of invisible resources in global competition, have introduced the impressive concept of core competency. Core competencies are the collective learning in organisations, especially on how to coordinate diverse production skills and integrate multiple streams of technologies. The philosophy behind the concept is simple and can be linked to a tree. The diversified corporation is a large tree. The trunk and major limbs is core products, the smaller branches are business units; the leaves, flowers and fruits are end products. The root system that provides nourishment, sustenance and stability is the core competency. It thus involves not only harmonising streams of technology but is also about the organisation of work and delivery of value. The force of core competency is felt as decisively in services as in manufacturing.

It is also communication, involvement, and a deep commitment to working across organisational boundaries. The skills that together constitute core competency must coalesce around individuals whose efforts are not narrowly focused that they cannot recognise the opportunities for blending their functional expertise with that of others in new and interesting ways. Because core competency does not diminish with use, it needs sustenance and nurturing on a long- term basis suitably backed by appropriate vision on the part of the top management.

(b) **Functional vs. Matrix form of organisation:** Functional form refers to specific duty, activities like marketing, procurement, personnel etc. Matrix form refers to cross-functional. It is the ultimate liaison device. By using a matrix structure the organisation avoids choosing one basis of grouping over another; instead, it chooses both. In consequence the matrix structure sacrifices the principle of unity of command.

(c) **Cost leadership vs. Cost reduction:** Cost is the greatest and the most enduring competitive advantage for the long-term success of any product or service. Cost leadership, i.e. enjoying the lowest costs often translates into market leadership, allowing a company to dictate terms in the market place. There are five major variables which influence cost leadership. They are: output level, factor prices, factor productivity, technology and size of the unit. Obviously, the cost tends to be the lowest for a firm with; the highest output levels; the lowest factor prices; the highest factor productivity; the right and relevant technology; and an economically optimum size.

No cost is at a level that it cannot be cut and reduced. Cost cutting and reduction is an important exercise which should be periodically undertaken in every enterprise. The areas of cost reduction can be classified as: raw material and inventory costs; manufacturing costs; labour costs; finance costs; marketing costs; R&D costs; general administrative costs. However, these areas are a brief outline only. Many more operational areas of cost reduction can be identified. Cost reduction is not a one-shot exercise. One should keep at it continually and vigourously, practically, all the time. Otherwise, costs have a natural tendency to rise. On their own, they will never come down. One must continually push them down. Believe that cost can always be cut. They must be cut.

Once one acquire cost leaders-hip, one's survival in the market place is better assured. Try competing with Bajaj Auto in scooters, with Raymonds is worsted suiting, then one will know what it means to be a market leader through cost leadership. The task is formidable.

(d) Vision vs. Strategic intent: A vision, which is our preference for how it should be identified, provides an organisation with a forward looking, idealised image of itself and its uniqueness. Visions can appear to be soft and non managerial. Because of this, having a dream or vision for an organisation sometimes can bring discomfort both to the visionary or visionaries and those vision impacts. Nevertheless, regardless of what it is called a purpose, a goal, a personal agenda, a legacy, or a vision or dream - the positive consequences of having one is clear. It provides members of the organisation with a view of the future that can be shared, a clear sense of direction, a mobilisation of energy, and a sense of being engaged in something important. Strategic intent has a shorter perspective with an emotional content. Sometimes strategic intent of an organisation forms the major slogan of an organisation. Since such slogans are mission based, if and when environment compulsions make a company change its set mission, its slogan should similarly be changed.

Question 87: Briefly explain the Arthur D. Little's Life Cycle/Portfolio Matrix, along with the diagram.

Answer:

Arther D. Little (ADL) presents a twenty-cell matrix identified by the competitive position of a business and its industry maturity. Competitive position is approximated by market share, share movement, technology, breadth of the product line, and special market advantage, and industry maturity is measured by considering industry growth, rate of technological change, stability of shares, and customer switching. Again, weights must be defined to calculate the matrix position of a particular business. The matrix location of each unit can then be used to formulate a natural strategy to accomplish the business goals of the firm. The model is as shown below.

In it market situation is described in four stages-from embryonic to ageing. The competitive situation is shown in five categories ranging from weak to dominant.

	Embryonic	Growth	Mature	Ageing
Dominant	Fast growth, Start up	Fast growth, attain cost Leadership, Renew, Defend Position	Defend position attain cost leadership, Renew, fast growth	Defend position focus, renew, and grow with industry.
Strong Competitive Position	Start up, differentiate, fast growth,	Fast growth, renew, focus, differentiate	Attain cost leadership, renew, focus, Differentiate, growth with industry.	Find niche, hold niche, hang on, grow with industry, Harvest
Favourable	Start up, Differentiate, focus, fast growth	Differentiate focus, catch up, growth with industry	Harvest find niche, hang on, hold niche, renew, turnaround, differentiate, focus, and grow with industry.	Retrench turnaround
Tenable	Start up, Grow with Industry, Focus.	Harvest, catch up, hold niche, Hang on, find niche, Turnaround, Focus, and grow with industry.	harvest, turnaround, find niche, retrench	Divest, retrench
Weak	Find niche, Catch up, Grow with Industry.	Turnaround, retrench.	Withdraw Divest	Withdraw

The purpose of the matrix is to establish the appropriateness of a particular strategy in relation to these two dimensions. The position within the life cycle and the company is determined in relation to eight external factors' or disciplines of the evolutionary stage of the industry. These are: market growth rate, growth potential, breadth of product line, number of competitors, spread of market share among the competitors, customer loyalty, entry barriers, and technology. It is the balance of these factors, which determine the Lifecycle.

The competitive position of the organisation within its industry can be established by looking at all characteristics of each category. Thus a dominant position usually results from quasi-monopoly. Strong organisations are those that can follow strategies of their own choice without too much concern for the competitors etc.

Question 88: State the basic marketing objectives and discuss how such objectives can be achieved.

Answer:

Three basic marketing objectives can be clearly identified:

- To enlarge the market
- To increase market share
- To improve profitability

A number of distinct strategies may be identified for achieving these objectives. To enlarge the market:

(i) By innovation or product development

- Through improving existing products or line to increase use;
- Through developing new products or lines,

(ii) By innovation or market development

- Through development of present end use markets;
- Through discovery of new end use markets.

To increase market share:

(i) By emphasising product development & product improvement for competitive advantage.

- Through product performance.
- Through product quality
- Through product features

(ii) By emphasising persuasion efforts for competitive advantage.

- Through sales and distribution
- Through advertisement and sales promotion

(iii) By emphasising customer service activities for competitive advantage.

- Through ready availability, order handling and delivery service.
- Through credit and collection policies
- Through after sales service

To improve profitability:

(i) By emphasising sales volume for profit leverage

- Through strengthened sales and distribution efforts
- Through strengthened advertisement and sales promotion effort

(ii) By emphasising elimination of unprofitable activities

- Through pruned product and lines
- Through pruned sales coverage and distribution
- Through pruned customer service

(iii) By emphasising price improvement

- Through leadership in initiating necessary price increases
- Through price improvement gained by differentiation

(iv) By emphasising cost reduction

- Through improved effectiveness

Question 89: What do you understand by "Segmentation"? What are the criteria for effective segmentation? What are its benefits?

Answer:

Market segmentation is the division of a market into fairly homogenous subsets where each subset can be chosen, reached and served by its own tailored marketing mix. Each such homogenous subset is made up of people with approximately similar needs and aspirations which distinguish them from other subsets. Segmentation applies to the personal customer market and the business market.

The criteria for effective segmentation are: measurability; accessibility; action ability; substantiality. There are benefits to both the organisation and to its customers.

(i) The firm can choose segments with greater profit potential. No firm has unlimited resources and must concentrate their use to promising segments. Segmentation allows tailoring of all the elements and sub elements of marketing mix.

- Products and services themselves may be fine-tuned to the segment. The costs involved in product testing/ development can be reduced by concentrating on specified segments only.
- The firm can consider differential pricing. Lower unit costs can be achieved.
- The four promotional sub-elements can likewise be better directed towards the direct segment.
- Facilities can be located and furnished in accordance with the exigencies of the segments.
- Managerial and staff training can be more specific, rapid and effective.
- The firm also benefits because it forces itself to look at not only the present situation but also the future.

(ii) Customers benefit from segmentation by being offered those products and services which they are seeking at prices pitched at their level, and their products and services can be packaged in the combination of interest to the segment.

Question 90: (a) Discuss the principal elements of "Marketing Mix" and identify those elements that would be particularly relevant to a manufacturer of heavy commercial vehicles.

(b) In making a choice of a Pricing Strategy or Strategies, the Marketing Manager needs to assess the firm's position relative to certain factors. Prepare a Questionnaire highlighting the major factors and assessment criteria against each factor.

Answer (a):

Marketing mix refers to the apportionment of effort, the combination, designing and integration of the elements of marketing into a programme or mix which, on the basis of an appraisal of the market forces-will best achieve the objectives of an enterprise at a given time. Kotler defines the marketing mix as the set of controllable variables and their levels that the firm uses to influence the target market. Such variables are: Product, place, price and promotion. In addition, for service there are three extra P's, People, processes and physical evidence.

A manufacturer of heavy commercial vehicles produces for the industrial market. Here the purchase is made by a professional buyer who buys for use and not personal satisfaction. Under the 4P's obviously quality, features, opinions, style and sizes will be important characteristics for the product. Packaging will be irrelevant.

- The place may be important for service back up while promotion will depend on trade advertising, technical publicity and reports, service back up and the personal selling. Price will again be important, although more in the context of value for money. Tatas do not claim to be the cheapest, but they emphasis on quality, reliability and long term. Credit terms may be important although this may be dealt with separately. Discounts and allowances will be important.

Answer (b):

Questionnaire on factors influencing pricing decisions.

The company:

- What is the price range of products?
- What are the risk levels of each alternative price?
- Is the company price leader or follower?

Competitors:

- Have the competitor's pricing strategies affected the company's sales volume and profit position?

Customers:

- What is the effect of price on purchase decision?
- Whether the customers are too much price sensitive or not?

Market:

- Are there any substitutes for the product?
- What are the company's market share/projected market size/expected growth at varied prices?

Middleman:

- Are channels available to put the desired strategy into practice?
- What profits would be passed along to middleman?

Environment/Government:

- What regulations and legislations can affect the company's pricing strategy?
- What are the current and projected economic condition, inflation, interest rate? International environment:
- Foreign exchange rate?
- Market structure?
- Market operating cost?
- Channels?
- Barriers to trade-quotas and tariffs, promotions? etc.

Question 91: Demand forecasting can be done using (i) Delphi technique, (ii) Time-series analysis and (iii) Regression analysis.

Highlight the strengths of these techniques and also indicate the situations where these techniques would be relevant. (Use hypothetical figures in support of your answer, if required.)

Answer:

(i) **Delphi technique:** The Delphi technique is a method of expert opinion from a large group of people in a systematic way. It is mainly required in any long term technological forecasting at macro level. This technique is a modification of the panel or committee approach, while it eliminates some of the disadvantages, of the classical committee. In the Delphi:

- Direct interaction is avoided by using a programmed sequential questionnaires of three or four rounds;
- The expert is not called to defend his publicly expressed opinion, and anonymity of individual forecasters is maintained;
- Subordinates do not have to differ with senior executives face to face;
- The final result is a statistical group response;
- Results are based on interactions combined controlled feed back.

(ii) **Time series:** This is a short term sales forecasting tool, useful only as a micro tool at the level of company product. The basis of such analysts is that the future value is a recombination of its past performance, at least into near-term future, by decomposition into the components of trend, cycle, season and erratic events.

(iii) **Regression:** In this analysis also the past observations are described as a function of time and identified pattern is then used to forecast ahead. This method is often used for long-term forecasting. Being cause and effect models, it can only be used at the level of the industry. However, it is too easy and therefore encourages thoughtlessness; particularly in the long-term, why should a curve depending only on time provide a suitable description of the distant future?

Question 92: Market share is one of the primary determinants of business profitability; other things being equal, businesses with a larger share of a market are more profitable than their smaller-share competitors. An important reason for the increase in profitability with market-share is that large-share companies usually have lower costs. The lower costs are due in part to the economies of scale, and also to the experience effect. Explain these two concepts and indicate how they are relevant in planning strategies.

Answer:

Economies of scale are often described as "increasing return to stale". Very large plants cost less per unit of production to build and are often more efficient than smaller ones. The following - are some of the principal economies of scale:

(i) Economies in the use of the factors of production. To produce a large output at a lower cost per unit of production than a smaller output clearly means the total cost must increase less than proportionately to output.

(ii) Economies are administration. The cost of administration will decrease with increasing output.

(iii) Marketing economics. A large firm enjoys economics in both buying and selling.

(iv) Other economies of large scale include availability of easy finance and also due to better research and welfare facilities.

Experiences Effect: Although the term learning effects and experience effects are often used interchangeably, they can and should be distinguished. Learning effects typically refer in a narrow way to labour costs alone, as they reflect short term cost reductions achieved through learning by doing and the rate of change of direct labour costs with respect to cumulative output was seen to be negative. On the other hand, experience effect refers to the reduction in total costs achieved over the total life of a product. Both are measured by total accumulated output to date. But, learning and experience curves differ in respect of the range of costs covered; the range of output during which the reduction in costs supposedly take place; and causes of cost reduction. Learning by doing is then seen to be something that not only affects assembly operators, but everyone involved in an organisation — all who should improve the performance of their roles through experience.

The experience curves is based on the postulate that the length of time required to complete a task is inversely related to the number of times the task is performed — or, more specifically, that the total unit costs, in real terms of producing, distributing and marketing a particular item decline by a fixed percentage (usually 10 to 30%) each time of cumulative number of unit produced is doubled. This is just a fancy way of saying that practice makes perfect.

However, when these effects have a pronounced impact on total costs, significant cost advantages over competitors can usually be obtained by acquiring greater experience. Since, experience and size are closely related to market share, being the market leader or having a large share is usually advantageous in such circumstances.

Question 93: Distinguish the following statements:

(a) "Delphi can never be useful as a sales forecasting tool though it may be a reasonably good tool for demand estimating".

(b) "Regression may be appropriate at the aggregate level of an industry but it may not be so at the level of a company".

Answer:

(a) The Delphi Technique is a method of obtaining expert opinion from a large group of people in a systematic way. This has three attributes: anonymity, feed back and group response. The final result is a statistical group response. Thus, being a subjective judgement in nature, Delphi Technique fails to treat the future as deterministic. Accordingly, Delphi can never be useful as a sales forecasting tool, because of the fact that, sales forecast is specific to a company and we are talking about brand specific products. However, it may be a reasonably good tool for demand estimation, as such estimation is generic and at the level of industry.

(b) Regression is a trend extrapolation technique and basically encompass that the future value is only an extension of the past performances, at least into near-term future. The past observations are described as a function of time and the identified pattern is then used to forecast ahead. Therefore, it encourages thoughtlessness; particularly in the long-term as to why should a curve depending only on time provide a suitable description of the distant future. Accordingly, though it may be taken as appropriate at the aggregate level of an industry to some extent, it may not be so at the level of a company, wherein much more specific data is demanding, to search through other techniques.

Question 94: (a) Highlight the similarity and difference between sales promotion and advertising.

(b) Suggest a market research framework to evaluate the effectiveness of an advertising campaign covering print media alone, (Use hypothetical figures if necessary).

Answer (a):

Advertising and sales promotion are primarily oriented towards influencing the buying decisions of the customers. Some of their objectives could be:

Introducing new products, penetrating new markets, increasing the share of market, building up a corporate image, reaching customers inaccessible to salesmen, educating consumers, etc.

Though, to a large extent, advertising and sales promotion are complementary and sales promotion is often used as a means of reinforcement for bringing a media campaign closer to the customer, a distinction is often sought to be made between them. Advertising is effective product positioning though U.S.P. It is therefore commonly associated with the mass-media. The general role of sales promotion is persuasive communication. Basically, the task of sales promotion comprises stimulating customer buying and distribution effectiveness. Accordingly, sales promotion is short-term, more specific and focussed and talks about including immediate purchase.

Answer (b):

There cannot be just one criterion for measuring the effectiveness of advertising, since advertising has various objectives, calling for different techniques for testing the fulfillment for each. So, because of a large number of complex and interdependent variables, the results obtained by applying a specific technique to test the fulfillment or otherwise of a specific objective, may not be reliable under all situations.

More often than not, sales are considered to be the most obvious test for measuring advertising effectiveness. But such measurement maybe vitiated by various factors and cannot be considered an infallible guide to measure advertisement effectiveness. Such factors are:

(i) Advertisement is only a part of the total marketing effort, the result of which is reflected through sales.

(ii) Similarly it will be difficult to segregate the effect of advertising on sales due to changing economic conditions.

(iii) The time-lag between advertisement and buyers' response to it is almost impossible to determine.

(iv) Measurement of indirect effect of advertising is almost impossible.

(v) The result of one particular company's advertising campaign might be nullified or enhanced, depending on the extent and skill of the competitor's marketing efforts. However, some broad ideas can be formed and approximate results can be arrived at by such a test.

A summary of several methods developed and published for "Measuring Advertising Results" are as follows:

(i) Measuring awareness: This is the simplest and most superficial. This is intended to assessed knowledge without reference to source. There are four ways of doing this, viz., YES/NO questions; open-end questions; checklist questions; and rating-scales.

(ii) Measuring re-calls: There are two basic ways; viz., un-aided recall and aided recall.

(iii) Measuring attitude: The various methods used are direct questions, rating scale, check-lists, semantic differential test and partially structured interviews.

(iv) Psychological Measurement: To explore the pre-conscious and unconscious levels of mind.

(v) Sort-and-Count Measurement: To request prospective buyers to ask for information, samples etc.

(vi) Measuring usage: By consumer interviews etc.

The methods given above cannot be used to develop an acceptable basis of financial measurement of advertising effectiveness. There is no such simple procedure to measure whether the money spent on advertisement as well as on sales on promotion has gone down the drain or has given back some return to the company. Attempts are being made by various companies and advertising experts to develop some acceptable method or approach. These methods or approaches are usually not published but adopted for the own use of the companies concerned.

(Accordingly, one could develop any proposal depending on the above discussion to objectify the areas to be covered to evaluate the effectiveness of advertising campaign of his choice).

Question 95: Technology forecasting is a crucial input in strategy formulation. Suggest the best method to forecast the technological changes with reasons and explain the method.

Answer:

In the case of forecasting the technological changes, reliable data needed for one of the quantitative technique is not available. As such, the estimation is generic and is a subjective judgement, to be drawn through a process of statistical group response. Thus, for any long term technological forecasting at macro level, the Delphi technique is the best suitable method of obtaining expert opinion from a large group of people in a systematic way.

This technique has three attributes: anonymity, feed back and group response. The final result is a statistical group response. This technique being a modification of the panel or committee approach, eliminates some of the disadvantages of classical committee.

Question 96: "Advertising is used to build brand loyalty and sales promotion is used to break brand loyalty". Discuss with example.

Answer:

Sellers generally use inventive-type promotions to attract new tiers, to reward loyal customers and to increase the repurchase rates of occasional users. New tiers are of three types - users of another brand in the same category, users in other categories and frequent brand switchers. Sales promotion often attracts the brand switchers, as they are primarily looking for low price, good value or premiums. Accordingly, sales promotion cause brand - quality - image dilution and decreasing brand loyalty. Advertising on the other hand, appears to be capable of increasing the "prime franchise" of a brand.

Question 97: Discuss how (i) Porter's model of generic strategies and (ii) Ansoff's (product-market expansion) matrix can be used by a business organisation to generate strategies, clearly mentioning their limitations.

Answer:

Competitive Advantage

Competitive Scope

	Low cost	Differentiation
Board target	Cost leadership	Differentiation
Narrow target	(a) Cost focus	(b) Differentiation

Porter's Model of generic strategies

Competitive scope refers to whether the organisation chooses to target the entire market or whether it chooses to concentrate on a more narrowly defined segment. Competitive advantage refers to the route taken to serve the market or market segment.

(i) A firm pursuing a cost leadership strategy aims to be the lowest cost producer in the market as a whole or, in the case of a cost focus strategy, in a market segment. Cost leaders cannot be undercut on price and enjoy higher profitability.

(ii) Not every firm can be a cost leader and many choose to use differentiation, which is the exploitation of unique aspect or features of the product in the market as a whole or in a segment of it (differentiation focus).

Porter argues that firms must choose between these strategies and a firm that may struck in the middle is doomed.

(i) The choice of generic strategy is likely to be a long-term one. A firm cannot realistically pursue cost leadership one year and differentiation in the next year.

(ii) Also, most firms employ some form of market segmentation and the model cannot identify which segments the firm should pursue if it follows a focus strategy.

(iii) The model can highlight confusions in the firm's existing strategy if it is applied to current competitive situation of the firm.

Product / Market	Present	New
Present	1. Market Penetration	3. Product/Service development
New	2. Market Development	4. Diversification

Ansoffs (Product-Market) Expansion Matrix

The Ansoff Matrix identifies four different kinds of product market strategy that the existing organisation can pursue, depending on whether the firm concentrates on existing products and/or markets or embarks upon new ventures.

Market penetration involves trying to milk more from existing products and existing markets. If the market as a whole is growing, this might appear a fairly low-risk strategy to adopt. Where the market is stagnant, market penetration might involve increasing market share at the expense of other products.

Market development uses existing products in new markets. Exporting is, perhaps, an example of this strategy. This might be attractive if the firm has to achieve high sales volume to utilise capacity effectively.

Product development involves offering new products to existing markets. Firms with an expensive distribution network may choose this strategy to make most effective use of it by marketing more products through.

Diversification involves moving into new market(s) with new products. However, this need not always be as risky as it sounds, especially if the products and/or markets have some similarities to existing ones. Conglomerate diversification can sometimes be justified on the existence of synergies.

The Ansoff Matrix is a framework for discussing alternative directions. The managers can take decisions using it as a tool.

(i) As suggested, market penetration may not be possible if the markets are mature; only - examination of the specifics will identify which is the best approach.

(ii) Obviously, it is too general on its own to suggest which market should be targeted. Limitations of the above models: All models are abstractions and simplifications of real-life situations and it is best to consider them as aids to creative thought rather than scientific laws or axioms which must be followed without question.

Porter's Model of Generic Strategy: Porter's statement that no firm can pursue a struck in the middle strategy is not entirely borne out by the facts. Indeed, a variety of approaches can be adopted to price and the differentiating product features. Some seem to prosper quite successfully. Firms do strive for cost leadership and differentiation at the same time.

Cost leadership:

(i) Cost refers to internal measures, rather than the market demand. It can be used to gain market share; but it is the market share which is important.

(ii) If cost leadership applies across the whole industry, only one firm will pursue this strategy successfully.

(iii) Having low costs does not mean one has to charge lower prices or compete on price. A cost leader can choose to invest higher margins in R and D or marketing. Being a cost leader arguably gives producers more freedom to choose other competitive strategies. Competitive advantage can only be achieved in terms of a product (or service) which is seen by a user to have an advantage. Its cost base is relevant only in so far as it may provide a means of enhancing that output in some way.

(iv) Low costs give more opportunity to differentiate the product.

(v) Low costs also enable one to serve many segments, i.e. to pursue a focus strategy for many segments.

Differentiation: Porter assumes that a differentiated product will always be sold at a higher price. However, a differentiated product may be sold at the same price as competing products in order to increase market share. Differentiation can be achieved by keeping costs down; the savings can be reinvested in unique product features.

Two other points can be mentioned.—

(i) The object of differentiation: The firm must discover who are its competitors, whether they serve other market segments and if they compete on the same basis.

(ii) The sources of differentiation: This can include all aspects of the marketing mix, not only the product, e.g., restaurants aim to create an atmosphere as well serving food of good quality.

Focus probably has fewer conceptual difficulties as it ties in very neatly with ideas of market segmentation. In practice, most companies pursue this strategy to some extent by designing products/services to meet the needs of particular target markets.

Ansoff s (Product-Market) Expansion Matrix:

(i) As discussed earlier, this Matrix is only a framework for identifying product-market opportunities and does not provide any criterion for choice. There is nothing to stop firm carrying out all four strategies simultaneously provided, it has the resources. A firm can pursue a penetration strategy in its-existing markets as well diversifying into new ones.

(ii) The scope of this Matrix is limited and there are various strategic developments not covered in the Matrix. New technology and manufacturing technologies and manufacturing techniques can also alter the dynamics of the market.

(iii) It does not address the degree of change in each product-market area.

(iv) This Matrix does not identify the role of profit.

(v) Withdrawing from a market or product is not offered as an Option.

Question 98: (a) Write a critical note on the Profit Impact on Marketing Strategies (PIMS).

(b) Examine the degree to which the three concepts: positioning, product differentiation and market segmentation relate with each other.

Answer (a):

PIMS analysis attempts to establish the profitability (i.e., return on capital) of various marketing strategies. PIMS researchers, based on their analysis of database of, at least, 3000 firms, believe that 70% of the relative profit performance of an organisation, when compared to similar business, derives from the areas of competitive strength, market attractiveness and productivity.

A research study in the USA found that there was a positive correlation between market share and return on investment so that companies with higher market share earned high returns. Three possible reasons were put forward for this correlation.

(i) Economies of scale: It enables a market leader to produce at lower unit costs than competitors and so make bigger profits.

(ii) Bargaining power: A strong position in the market gives a firm greater strength in its dealings with both buyers a suppliers.

(iii) Quality of management: Market leaders often seem to be run by managers of a high calibre.

However, low market share does inevitably mean poor returns. If this were so, small firm would always make low returns and this is simply not true. A company can prosper with a low market share in the following ways:—

- ✓ Market segmentation : New market segments might be a small proportion of the total market, but profitable ;
- ✓ Emphasising product quality and charging higher prices;
- ✓ Wanting to stay small and consciously avoiding growth;
- ✓ Cost control.

Businesses can also earn good profits with a low market share in a low growth market in the following circumstances:

- ✓ The market is stable;
- ✓ Product innovations are rare;
- ✓ Most products are standardised;
- ✓ Companies produce supplies or components for industrial customers and have built up a close working relationship with these customers;
- ✓ Repeat buying is frequent;
- ✓ The value added to sales ratio is high.

Finally, some firms are prepared to sacrifice profitability for market share over a period of time. Some Japanese firms were willing to charge low prices to buy market share and totally weaken the competitors whose products were not as deep.

There are practical difficulties with PIMS research which might raise questions about the usefulness. These are as follows:-

- ✓ Identifying each market segments properly - an up-market producer is in a different market segment than to a down-market cheap goods producer and it would be wrong to classify them as competitors in the same market.
- ✓ Measuring the actual size of the market and so the company's own market share in proportional terms.
- ✓ Establishing what returns are available from a particular market share.
- ✓ It has also been argued that PIMS analysis is more relevant to industrial goods markets, where the correlation between high market share and high returns is not so strong.

Answer (b):

(1) Positioning creates product differentiation. Positioning creates a position, a place for your brand in the mind of your prospect. Your prospect is going to recognise your brand in the basis of the position you create for it in his mind. He is going to distinguish your brand on the basis of this position. Your prospect is going to distinguish your brand from the other competing brands on the basis of the position each one of them has in his mind. In other words, your prospect is differentiating brands on the basis of positions. We therefore say, Positioning creates differentiation.

In the Salora Commercial, an angel answered your questions, "sound as clear as a Salora TV" — "picture as sharp as Salora TV".

The positioning strategy for Salora TV was creating a position on the basis of sound and picture- to make you differentiate your brand of TV on the basis of position.

But was the Salora TV, the only TV, that had a clear sound and sharp picture? Certainly not. But probably Salora TV was the first TV to forcefully build that position.

What should be understood is that while the manufacturer/ the agencies has identified that position, should be built on the basis of sound and picture. The creativity people have added immense creativity to the positioning idea to make the commercial stand out.

(2) Product differentiation helps positioning. Product differentiation can be created in a research development laboratory. You can have a well differentiated product from the works, but if communication does not work for it, you can have an undifferentiated position or may be no position at all in the mind of your prospects.

(3) When you talk to a group - it becomes a segment. Every communication/advertising has to address a segment. Naturally when you have to communicate with a group of prospects a segment, you have to get into their minds to know how they perceive you. Your competition and your messages. Segment is not a component of position; segment is what you are communicating with using a powerful and scientific positioning approach.

(4) Intensity increases with narrow targets — Segmentation and fragmentation. If you were to address to only women for a product, you can show the advantages she can drive out of your product, you are taking to her — only. If you were to address men and women for a product you have to be careful at least to avoid highlighting something for women which can put your men customers off. Thus, in a very competitive situation, the only way to win perhaps to narrow down your focus to create a distinct position — a separate position perhaps for a narrowed down target.

(5) Same product can be positioned differently for different segments. Milkmaid from Nestle was been targeted at different segments at different times. Without changing the product and the pack, an advertisement have established communication with different segment by using the positioning concept. They have created different positions in the mind of prospects for their product through positioning and repositioning the product.

   - At one point of time milkmaid was positioned as creamer, for tea and coffee by using the headline: "Rich and Creamy" makes the tasty different MILKMAID. They have shown a cup of tea and a mug of coffee in the advertisement.
   - Milkmaid, at another point of time was positioned as a substitute of milk.
   - It was also positioned as a topper, on fruits and puddings with the head lines "Top it with milkmaid" and in the bottom they wrote RICH and CREAMY milk-maid, ended with the words, makes the tasty difference.
   - In the advertisements that followed the above they pronounce the use of milkmaid in sweet dishes. Through the advertisement they are enhancing the position of milkmaid by successful repositioning.

(6) Rematching product to position. Suppose you are about to lunch a new brand of bath soap and your research reveals that you can comfortably curve out a niche amongst the middle class urban women in the age group of 25-30 years, who are very sensitive about their skin. You want to position soap as "which keeps the skin young". You might like to turn back to your R & D team asking them to add something in the soap, which can reinforce your position. You may also ask your packaging people to match your position. Rematching product to a position is good marketing.

(7) You need a new position — when you invade into another product category to expand your market. We would like to draw you at the advertisement of Lakme Winter Care Lotion. The headlines of the- advertisement reads- "Read this and discover why you will never use cold cream again". It carries on to say- New Winter Care Lotion. The non-greasy way to fight winter dryness and it ends saying, "so much more than cold cream".

What are they doing through this advertisement, through this communication? They are trying to reposition the Lakme winter care lotion as a better alternative to cold cream. They are invading into the cold cream to expand their market.

(8) Market position to segment. Sometimes your product does well in a segment for which it was originally not meant or not conceived for. If this happens, you need to reinforce this through good positioning. You will like to create or strengthen the position in the mind of the prospect. You may recall the launch of Maruti Van (as it was originally positioned). This vehicle was initially positioned and advertised as a van. It was a product developed to compete with the vans, the Standard and the Bajaj. However, it was found that it was being bought as a substitute for a car and thus it was actually competing with the Amby and the Fiat. Maruti Udyog responded to this position, customers gave in their mind to their van. They renamed the product as Omni and repositioned it as the most specious car on the Indian roads.

When you want to move in on a new idea, you heed to relate it with something that is already in the mind. Creating something altogether new in the human is very difficult, if not possible. When the first car was developed, it was called "The Horseless Carriage". Could they have not simply called it car? The answer is they could have. But then imagine the effort that must have gone in explaining as to what a car is. In advertising terms, it would have required a heavy budget along with the confusions it would have created. They would have had to beat around the bush and would have again gone back to relate it to a carriage. Thus, when you want to move something new in the human mind, do not forget to relate it, to something that is already there.

Question 99: Define 'marketing research' and explain its scope.

Answer:

Marketing research: The sources of marketing data will vary from organisation to organisation, but are both internal and external, including information provided by marketing research. Marketing Research has been defined by the Chartered Institute of Marketing as the 'objective gathering, recording and analysing of all factors about problems relating to the transfer and sales of goods and services from producer to consumer or user'. Within this definition, there are a few points to note:

(i) Marketing research should provide a regular information system for control decisions by marketing and senior management people.

(ii) Marketing research is concerned with all types of customers and users, not just the household consumers.

(iii) Marketing research provides information which enables managers to make decisions about the marketing mix — product, place, price and promotion. It is not simply market research.

(iv) Information is only worth obtaining if it has a purpose and a value. The scope of marketing research may be listed as follows:

(i) Market research

It is only one aspect of marketing research. Marketing research is the investigation of the marketing activities of a company, i.e., the entire marketing mix, and should look into how far all these activities are consumer-oriented and should recommend how they car be planned in the future in order to sustain profits and customer demand.

- analysis of the market potential for existing products
- forecasting likely demand for new products
- sales forecasting for all products
- study of market trends
- study of the characteristics of the market
- analysis of the market share.

(ii) Product research

- customer acceptance of proposed new products
- comparative studies between competitive products
- studies into packaging and design
- forecasting new uses of existing products
- test marketing
- research-into development of a product line.

(iii) Price research

- analysis of elasticity of demand
- analysis of costs and contribution of profit margins
- the effect of changes in credit policy on demand
- customer perceptions of price
- sales promotion research
- motivation research for advertising effectiveness
- analysing the effectiveness of advertising on sales demand
- analysing the effectiveness of individual aspects of advertising
- establishing the sales territories
- analysing the effectiveness of salesmen
- analysing the effectiveness of other sales promotion methods.

(v) Distribution research

- the location and design of distribution centres
- the analysis of packaging and transportation
- dealer's supply requirements
- dealer's advertising requirements
- the cost of different methods of transportation and warehousing.

Question 100: Discuss the ways of strengthening an organisation's position relative to that of its competitors.

Answer:

Ohmae suggested four ways of strengthening a company's position relative to that of its competitors. These are:—

(i) identify functional differentiation (key factors of success),

(ii) exploit competitors' weakness (relative superiority);

(iii) ask why-why (aggressive initiatives);

(iv) maximise user's benefits (strategic degree of freedom)

(i) Focusing on key factors of success:

Ohmae suggested that in the event of limited resources, it may be wise to concentrate on key functional or operating areas that are determinant of success for a particular business. This calls for identifying the key factors for success in a given industry. There are two approaches to identify the key factors of success. The first is to direct the market as imaginatively as possible to identify the key segments; the other is to discover what distinguishes successful companies from loosers and then to analyse the differences between them.

The key factors of success of different industries may live in different functions, areas, distribution channels and so on. These can be identified along the various functional activities of business starting from raw materials to customer servicing. Business history indicates that the most effective short cut to major success appears to be to jump quickly on the top by concentrating major resources early on a single strategically significant function, become really good and competitive at it and then move to consolidate a lead in the other functions by using the profit structure that the early top status has made possible. All of to-day's industry leaders without exception began by bold deployment of strategies based on key factors of success.

(ii) Building on relative superiority: A firm can compare its products with that of its competitors in order to identify the product superiority. Operation 'tear down' to compare each and every component in an assembled product like automobiles is commonly used to identify the area of strengths and weaknesses.

(iii) Pursing aggressive initiatives: A third alternative route to gain competitive advantages to initiate an aggressive search for improvements is to relentlessly challenge the prevailing assumptions with a single question 'why' till major breakthroughs are achieved. In some business situations a statement appears when the older key factors of success no longer hold any competitive advantages. This approach has enabled excellent breakthroughs in products, processes and services. As Ohmae suggests, the results of this kind of change in the direction of strategic thinking can be spectacular. The basis of such approach is always to confront what is taken for granted in an industry or business with the simple question 'why'?

(iv) Exploiting the strategic degree of freedom: This is the last route, suggested by Ohmae, to superior competitive performance. There can be situations when due to operational and resource constraints, there may be limited scope for improvements in a given key factor of success. The concept of strategic Degree of Freedom helps in tackling such situations to maintain the edge.

Porter has suggested a three-generic strategic framework. One may like to compare Porter's suggestions with four alternative routes suggested by Ohmae. According to Porter, there are three potentially successful generic strategic approaches to cope with the five competitive forces as well as to gain competitive advantage.

These are –

- overall cost leadership.
- differentiation
- focus

	Strategic Advantage	
Industry circle strategic target	Differentiation	Overall Cost Leadership
Particular segment only	Focus	
	Uniqueness Percival by the customer	Low cost Position

Overall cost leadership: A cost leadership strategy seeks to achieve the position of lowest-cost producer in the industry. The competitive advantage that results from producing the lowest cost is that the manufacturer can compete on price with every other producer in the industry and can earn the highest unit profit.

Differentiation: A differentiation strategy attempts to make the product unique in terms of attributes which are derivable to the customer, including customer service.

The assumption is that competitive advantage can be gained through the particular characteristics of a firm's products. With a successful differentiation strategy, loyalty to the firm's products will build up and customers are not so price-sensitive. The firm can then sell its products at prices that are higher than the low-cost producers in the market.

Focus: A focus strategy is based on segmenting the market and targeting particular segments instead of trying to serve the entire market with a single product. It has been described as a 'pistol' approach as distinct from a 'shotgun' approach.

The competitive advantage which results is that the firm is thus able to serve its narrow strategic target more effectively and efficiently than competitors who are competing more broadly. As a result, the firm achieves either differentiation from better meeting the needs of the particular target or lower cost in serving this target or both.

Question 101: The true nature of marketing today is not serving the customer; it is outwitting & outfitting your competitors. It is a war, where the enemy is the competition and the customer is the ground to be won. To fight this war, there are four ways viz., Defensive Warfare, Offensive Warfare, Flanking Warfare & Guerrilla Warfare.

Do you agree with the above statement? Briefly explain the four ways as stated above.

Answer:

Marketing Warfare: It is true that the marketing War can be fought today by following the principles of Defensive Warfare, offensive Warfare, Flanking Warfare and Guerrilla Warfare. A brief Notes on each of the aforesaid ways is given below:

The Defensive Warfare: This is essential recommended for market leaders it aims at protecting against regulatory provisions, industrial licensing restrictions etc. A leader has to spend more time in safeguarding its interests against Government, Social and Public Environment rather than the immediate next competitor. Thus for Companies like TELCO, Hindustan Lever, Bajaj Auto etc. the major worry may be the interference with the Government. At the same time, a leader cannot afford to overlook the moves of the competitors. A leader should also be able to attack itself. The three principles of defensive warfare are:

- Only the market leader should consider playing defence,
- The best defensive strategy is the courage to attack yourself, and
- Strong competitive moves should always be blocked.

The Offensive Warfare: Offensive warfare is almost like a mirror image of the defensive warfare. Organisations occupying number two position in the industry are suggested to follow the Offensive Strategy by identifying a weakness in leader's strength and attacking at the point. Thus, very high prices of steel tubes of Tata Steel gave an opportunity to other pipe manufacturers like Zenith Tubes, Gujarat Steel Tubes and the like to capture sizable market at lower prices.

The principles of offensive warfare are:

- The main consideration is the strength of the leader's position,
- Find the weakness in the leader's strength and attack at the point,
- Launch the attack on as narrow as front as possible.

The Flanking Warfare: Flanking is the most innovative form of marketing warfare. Over the years, most of the biggest marketing successes have been flanking moves. It is recommended to firms with limited resources. These firms can not afford to flight the large firms holding number one or two position on the same battle ground. The entry of 'promise toothpaste with clove oil clout' is an example of flanking warfare. Flanking can be achieved in any manner such as flanking with low price, flanking with small size, flanking with large size, flanking with distribution, flanking with product form etc.

One can see a parallel between a market-cutting a niche and flanking. Basically they mean the same thing, i.e. creating a distinctive position for itself and avoiding any head collision with the leaders.

The principles of flanking warfare are:

- A good flanking move must be made in an uncontested area,
- Tactical surprise ought to be an important element of the plan,
- The pursuit is just as critical as the attack itself.

The Guerrilla Warfare: The last form is the guerrilla warfare. Most of the players in a marketing war would be fighting in the market place like the guerrillas. Smaller companies can be highly successful as long they do not try to emulate the giants in their field. Like flanking form, there can be many guerrillas; like Geographic guerrillas, Demographic guerrillas, Industry guerrillas, product guerrillas and High End guerrillas. In each state, one will find both local make suitcase and other luggage items along with the well known national brands.

Local brands of rubber and plastic chappals are the example of low price end guerrillas.

"Chirag Din" shirts, "Metro Shoes" (Both Mumbai based) are some examples of high price end form of guerrilla warfare.

The principles of guerrilla warfare are:

(i) find segment of the market small enough to defend

(ii) no matter how successful you become, never act like the leader

(iii) be prepared to buy out at a moment's notice.

Question 102: Explain the GE Multifactor Portfolio Matrix with suitable examples.

Answer: The GE Multifactor Portfolio Matrix, also known as Business Attractiveness Screen, developed in the 1970s by the General Electric of USA, is a three by three matrix which rates each SBU against two critical variables, viz., industry attractiveness and business strength. The vertical axis in the following figure indicates industry attractiveness and the horizontal axis shows the business strength in the industry. Each dimension is a composite measure of several components factors. One superiority of the GE matrix over the BCG matrix , thus, is that while the BCG matrix bases industry attractiveness on a single variable (industry growth rate), in the GE matrix industry attractiveness is measured by a number of factors like size of market, market growth rate, industry profitability, competitive intensity, technological requirement etc. Similarly, the business strength is rated considering a number of factors such as market share, market share growth rate, profitability, distribution efficiency, brand image etc.

Kotler observes that those factors (market attractiveness and business strength) "make excellent marketing sense for rating a business. Companies will be successful to the extent that they go into attractive markets and possess the required business strengths to succeed tin those markets. If one or the other is missing, the business will be produce outstanding results. Neither a strong company operating in an unattractive market nor a weak company operating in an attractive market will do very well".

Each of the dimensions (industry attractiveness and business strength) is classified into three categories of high (strong), medium, and low (weak), thus creating nine cells. This is another refinement of the four-cell BCG matrix.

Every factor on each of the dimensions is assigned a weight. The choice of the factors and the weights assigned to the factors may vary from business unit to business unit. For example, the relative importance of technology, brand image, distribution efficiency, after-sales service, pricing etc. may vary from industry to industry.

The choice of factors determining the industry attractiveness and business strength and the determination of weights are very critical in this analysis. Therefore, they often involve a lot of research.

Table 1 gives a hypothetical illustration of rating of industry attractiveness and business strength. Each factor is assigned a weight. Each factor is also rated on a 10 point scale. Rating of 1 to 4 considered as low: 4 to 7 medium and 7 to 10 high.

In the hypothetical case illustrated in Tables 1 and 2, the total score for market attractiveness is 6.75 and for business strength is 7.55 out of the maximum possible score of 10 for each. In other words, the industry attractiveness is medium and the business strength is high.

All the businesses of a company are shown in the following figure. The size of the circles represents the size of the relevant markets (not the size of the company's business as in the BCG matrix). The company's market share in each of the business is represented by the shaded area.

The position of the business in the matrix would suggest the appropriate strategy for the business. There are three possible strategies. Along the lower left to upper right diagonal (cell G,E and C) representing SBUs which are medium in overall attractiveness, selective investment may be appropriate, (i.e., investment based on their potential, and within each selected business, selecting skill areas, products and functions in which marginal investments are likely to yield the highest returns.)

The three cells below the diagonal (H,I,F) represent SBUs that are low in overall attractiveness. The appropriate strategy for them would be harvesting or divesting. The three cells .at the upper left (A.B.D) indicates SBUs that are high in overall attractiveness. There are businesses in which company should invest farther and grow.

Table 1: Industry Attractiveness

Factors	Weights	Rationing (1-10)	Value
Availability of inputs	0.20	7	1.40
Overall market size	0.15	8	1.20
Annual growth rate of market	0.15	6	0.90
Profitability	0.15	7	1.05
Competitive intensity	0.15	6	0.90
Technological requirements	0.10	7	0.70
Capacity utilisation	0.10	6	0.60
Total	1.00		6.75

Table 2: Business Strength

Factors	Weights	Rating (1-10)	Value
Market Share	0.15	5	0.75
Market share growth rate	0.20	7	1.40
Brand image	0.05	8	0.40
After sales service	0.05	7	0.35
Pricing	0.10	7	0.70
Distribution capacity	0.10	9	0.90
Capacity utilisation	0.10	9	0.90
Product quality	0.10	8	0.80
Technology	0.15	9	1.35
Total	1.00		7.55

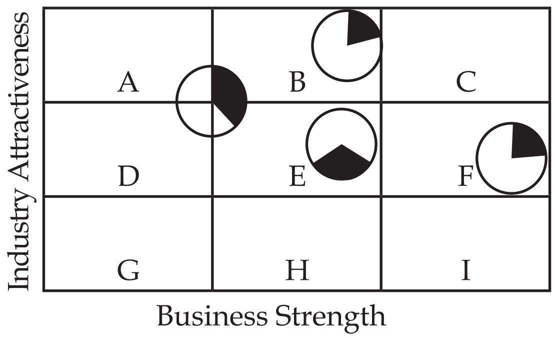


Fig. Nine-cell GE Matrix

Question 103: Suggest a framework to evaluate the effectiveness of advertisement.

Answer:

There cannot be just one criterion for measuring the Effectiveness of Advertising since advertising has various objectives, calling for different techniques for testing the fulfilment for each. So, because of a large number of complex and interdependent variables, the results obtained by applying a specific technique to test the fulfilment or otherwise of a specific objective, may not be reliable under all situations.

More often than not, sales are considered to be the most obvious test for measuring advertising effectiveness. But such measurement may be vitiated by various factors and cannot be considered an infallible guide to measure advertisement effectiveness. Such factors are:

(i) Advertisement is only a part of the total marketing effort, the result of which is reflected through sales.

(ii) Similarly it will be difficult to segregate the effect of advertising on sales due to changing economic conditions.

(iii) The time-lag between advertisement and buyers response to it is almost impossible to determine.

(iv) Measurement of indirect effect of advertising is almost impossible.

(v) The result of one particular company's advertising campaign might be nullified or enhanced, depending on the extent and skill of the competitor's marketing efforts.

However, some broad ideas can be formed and approximate results can be arrived at by such a test. A summary of several methods developed and published for "Measuring advertising Results" are as follows:

(i) Measuring awareness: This is the simplest and most superficial. This is intended to assess knowledge without reference to source. There are four ways of ding this viz. YES/NO Questions; Open-ended questions; checklist questions and rating-scales.

(ii) Measuring re-calls: There are two basic ways: viz., unaided recall and aided recall.

(iii) Measuring attitude: The various methods used are direct questions, rating scale, check-lists, semantic differential test and partially structured interviews.

(iv) Psychological Measurement: To explore the pre-conscious and unconscious levels of mind.

(v) Sort-and-Count Measurement: To request prospective buyers to ask for information, samples, etc.

(vi) Measuring usage: By consumer interviews, etc.

The methods given above cannot be used to develop an acceptable basis of financial measurement of advertising effectiveness. There is no such simple procedure to measure whether the money sport on advertisement as well as on sales promotion has gone down the drain or has given back some return to the company. Attempts are being made by various companies and advertising experts to develop some acceptable method or approach. These methods or approaches are usually not published but adopted for the own use of the companies concerned.

Question 104: A Corporate Strategic Analyst uses (a) Sensitivity Analysis; and (b) Simulation, to understand the long-term financial impact on the organisation. Fortunately or unfortunately, he is not getting a conclusive answer, but two different answers. As a student of strategic management, please help him to resolve this conflict by highlighting the suitability's and the pros and cons of these two methods.

Answer:

Sensitivity analysis in a method of systematically determining the effect which, different values of decision parameters (i.e. the key variables in a decision model) will have on the decision criteria (i.e. the ultimate expected output). In building up a decision model, estimates are made of the various relevant factors, all of which are subject to variations and each such variation will have an impact on the final expected outcome of the decision. The impact of each variation will, however, be different and some of the estimated factors would be more sensitive to the variation than others. By bringing out the effects of each variation separately on the output, the method of sensitivity analysis determines the answer to "what if" problems. Sensitivity analysis would assist the management in finding out the impacts of all possible variations and would take care of the sensitive areas. A decision problem would usually consist of unnumerable key variables built into complex mathematical model. But with availability of facility of computer the working out of sensitivity analysis can be applied to all mathematical models for analysing the risk in short term decision opportunities. If an exercise has to be meaningful to provide a reliable basis for decision making the dangers of risk and uncertainty must be reduced to the minimum, if not eliminated. It is, therefore, necessary to undertake a systematic exercise in sensitivity analysis. Sensitivity analysis is an useful technique for incorporating the assessment of risk during strategy evolution. For example, the key assumptions underlying a strategy might be that

- there will be a 5% growth in market demand
- there will be no industrial unrest in the company
- there will be 90% capacity utilisation

In his case the sensitivity analysis would aim to find out the effect on performance in case

(a) market demand grow by 2% instead;

(b) market demand grow by 10% instead; and

(c) likelihood of lessar capacity utilisatioin.

Thus sensitivity analysis would help the management to develop a clear picture of the risks of making a particular strategic decisions.

Simulation is a method of solving decision making problem by designing, constructing and manipulating a model of the real system. It is useful technique to solve a business problem when many values of the variables are not known or partly known in advance and these is no easy way to find these values. It is a quantitative technique that uses a computerised symbolic model to represent actual decision making under an certainty.

The limitations of Simulation Technique are:

- The simulation technique does not generate optimal solutions to problems like other quantitative techniques. It is a trial and error approach that may provide different solutions in repeated runs.
- It is often a long and complicated process.
- Simulation technique by itself do not generate a solution but it would indicate a way of evaluating solution
- Some situations are not amenable to simulation.
- Simulated results are not precise and at time it is not possible to assess the extent of error in simulated solution

Question 105: (a) Development of appropriate pricing strategies, especially from a long term point of view, is a must for the survival and growth of any enterprise. Discuss.

(b) There are seven questions to be considered, before arriving at the right price. What are they?

Answer (a):

(a) The task involved has two aspects, viz. an understanding of price, a buyer is willing or is prepared to pay and setting detailed objectives of the firm underlying its proposed pricing plan. The price that a buyer is prepared to pay will depend on various factors like:

(i) value of goods to buyer;

(ii) ability to deploy funds for the purpose;

(iii) price charged by competition. In certain circumstances, the product will be faced with a "backward learning" demand curve, indicating that more will be bought at a higher price than a lower price. This, in turn, may be due to snob appeal, fear of scarcity, psychological value added to the product etc.

Now, regarding the second aspect, viz. objectives, and the age old profit maximisation objective suffers from a host of definitional and conceptual imprecision, as well as practical difficulties. In fact, pricing can be a key to achieving far broader corporate objectives than those implied in the limited commercial concept of profit. Some of these objectives are: earning a target return on investment, achieving or sustaining a certain level of marketing share, ensuring planned level of economic production/operations etc.

Only upon a clear understanding of the various issues involved in both the aspects stated above, would it be necessary to design a price strategy for each product and each significant market segment separately for adoption in the short-run and in the long-run. Examples of some of the more common price strategies are:

(i) penetrating pricing;

(ii) price-setting;

(iii) skimming the cream;

(iv) marginal pricing.

It may be mentioned in this context that there should be some variation in pricing strategies by products or service types. In the consumer group field, for example, pricing is the most powerful weapon in the hands of a marketing manager, but in industrial marketing, it may not be a so powerful tool. In the professional service sector, members usually do not knowingly compete with each other on professional charges.

Answer (b):

They are:

- Is your pricing decision in consonance with the overall marketing strategy?
- Does it have a clear mandate and agreement among the different functions such as sales, brand management, manufacturing, procurement and finance?
- Have you assessed what value customers place on your product or service?
- Have you accounted for the fact that different customer groups value the same product differently?
- Have you assessed your customer's price sensitivity?
- Have you factored the fallouts of your competitor's retaliatory actions?

Question 106: (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.

Answer (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.

(v) 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.

Question 107: Why distribution function is referred as the most crucial part of Marketing Management? Also, discuss the various factors influencing logistic choice.

Answer:

Peter Drucker has described distribution as industry's Dark Continent. Distribution or placement is the most crucial part and an important function of marketing. Between the producer or manufacturer and the consumer or the end user there are a number of intermediaries or middlemen who ensure a smooth flow of goods and services. They are commonly called distribution channels. Place as an element in the marketing mix is largely concerned with the selection of distribution channels and with the physical distribution of goods. The distribution of goods from the producer to the end user varies according to the nature of goods.

While the increasing distribution costs have been causing concern to many marketing executives and have also affected the consumer by way of increased prices, systematic efforts towards containing these costs are practically absent in India. One reason for this could be that the executives are not aware of the interplay of the complex factors in the logistics of distribution and constantly they are unable to maneuver or manipulate these factors.

Various important duties performed by distribution are *inter alia*:

- Bringing buyers and sellers into contact;
- Offering a sufficient choice of goods to meet the needs of buyers;
- Persuading customers to develop a favourable opinion of a particular product;
- Storage and transportation of goods from the manufacturing point to the consumption point;
- Maintaining an adequate level of sales;
- Maintaining an acceptable price;
- Providing appropriate services (e.g. credit, finance, after sales-services, customer-servicing, complaint-handling etc.
- Market intelligence and feedback collection;

The first task of the distribution channel management is to develop a pathway or team/network of merchants and agents business institutions for the flow of goods and services from the point of production to the point of use. The actual movement and handling of goods with value addition is the second task of the channel operations (logistics) In its original use, logistics was a military term referring to a complete system of moving, supplying and quartering troops. Businessmen broadened logistics to include any type of transportation and storage. Marketers applied the term to mean the physical handling of products. They also began employing the term physical distribution in place of logistics. General factors affecting logistics choice are:

- Need for specialists- for private logistics, it cannot find/arrange /afford better use of public ware houses and carriers that are specialists.
- Capital- must be sufficient to start and manage private logistics effectively.
- Control- assurance that the logistics is performed as desired and results into quick and safe deliveries. Nothing like private, if one can afford.
- Manageable preference.
- Operating cost
- Product
- Customer characteristics - desire for speed and services; tolerance for delays; incorrect shipments, damage etc.

Question 108: Why is branding used as a strategic weapon of product planning? In what ways may a firm pursue a branding and positioning strategy? Describe with examples.

Answer:

Branding removes anonymity and gives identification to a company and its goods and services. According to Kotler, brand is a name, term, sign, symbol or design or combination of them, intended to identify the goods and services of one seller or group of sellers and to differentiate them from those of competitors. The reasons for branding are:

- It is a form of product differentiation which makes customers readily identify the goods or services and thereby helps to create a customer loyalty to the brand.
- The more a product is similar to competing goods, the more branding is necessary to create a separate product identity.
- Branding leads to a more ready acceptance of a manufacturer's goods by wholesalers or retailers.
- It facilitates self-selection of goods in self-service stores and also makes it easier for a manufacturer to obtain display space in stores and shops.
- It reduces the importance of price differentials between goods.
- Brand loyalty in customers gives a manufacturer more control over marketing strategy and his choice of channels of distribution.
- Other products can be introduced into brand range on the articles already known to the customer, i.e. brand ex-tension.
- It ceases the task of personal selling.
- It is supposed to convey psychic benefits to the customer.

Positioning through branding strategies might be summarised as:-

Branding Strategy	Description	Implies	Example
Individual name	Stand alone product	Unique	Bold, Tide
Family Branding	The power of the family name to intro-duce and market new products	Image of the family brand across a range of products. These might be : (i) Blanket family brand; (ii) Separate family names; or iii) Trade name with an individual product-	(i) Tata (ii) Levis for clothing's, e. g. shirts, pants, (iii) Tata-Sumo, Kellogg's Corn Flakes.
Brand Extension	New flavours, size, etc.	High consumer loyalty to existing brand.	Flury's confectionery to ice cream.
Multi-branding	Different names for similar goods serving similar consumer tastes.	Consumer make random purchases across brands.	HLL's different brands of soap products.

Question 109: "In the 'maturity stage' of Product life cycle the market becomes saturated, price competition intensifies, and the rate of sales growth slows down. Suggest strategic choices in such a stage of the PLC.

Answer: PLC - Maturity stage: In order to face the situations characterised by the maturity stage of PLC, alternative marketing and distribution strategies listed below are suggested.

(1) Intensive promotion by means of–
- brand-stressing advertising;
- more attractive design and functional packaging;
- more after-sales service;
- heavier point of sale effort; and
- increase in sales promotion expenditure to hold customer loyalty.

(2) Trading down through —
- introduction of low-priced models of an established product;
- price-cutting of the entire product line and keeping prices close to private levels; and
- entering a 'fighting brand' on the market at a lower price to avoid killing of an established premium brand.

(3) Trading up (strategy opposite to item 2) through
- improvement of quality/appearances, etc.;
- use of prestige packages;
- price increase to cream market levels (in order to increase market penetration/ earn more margin on possibly lower sales/keep greater differentiation over competitive products)

(4) Proliferation, exclusive or radical, by
- more designs/ varieties;
- more exclusive and innovative features;
- creating radical/ distinct package designs; and
- more options.

(5) Increase of product availability and point-of-sale service through more distribution outlets/ dealers/service centres, etc.

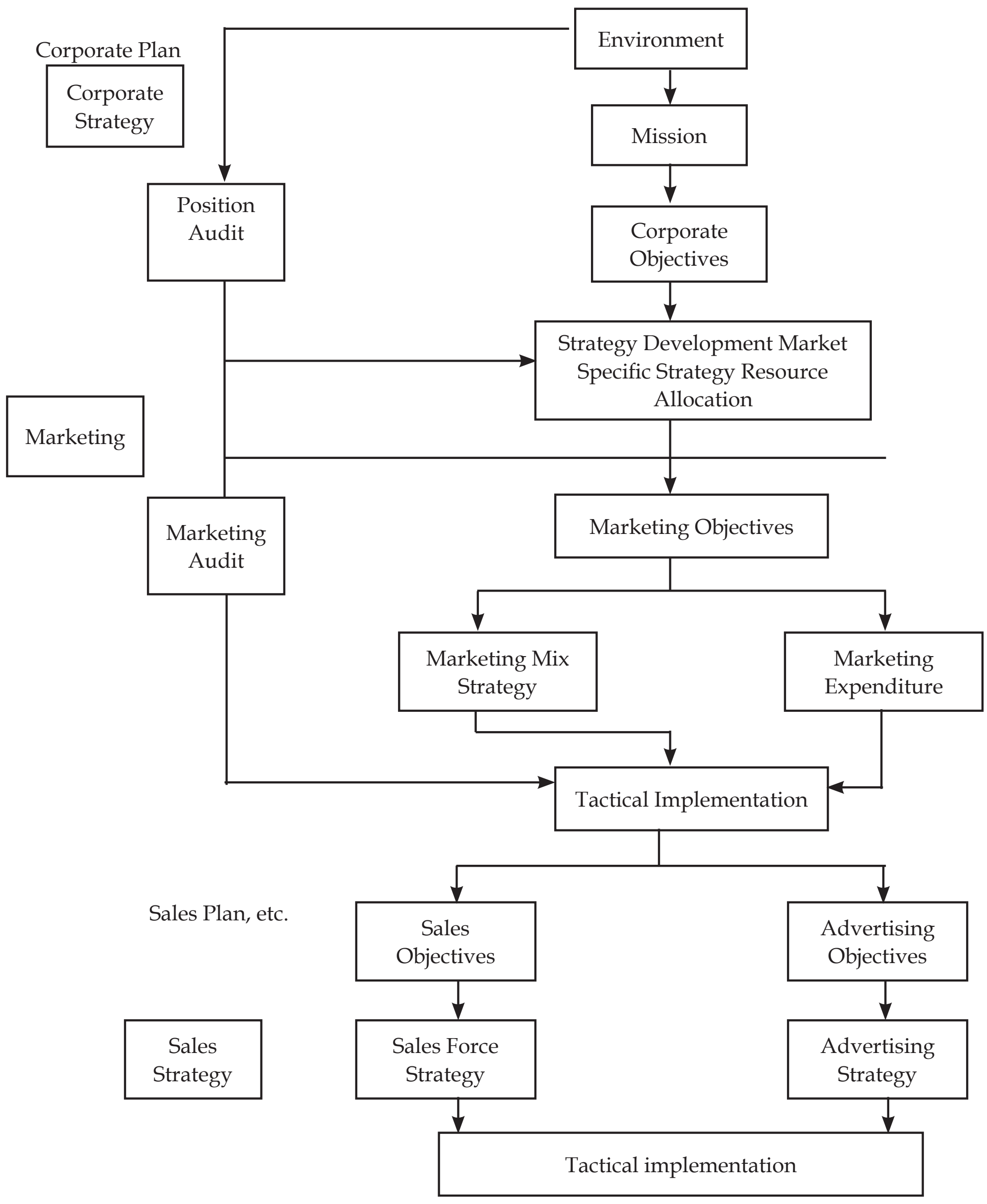
Question 110: What do you understand by Marketing Strategy? What distinguishes marketing strategy from Marketing Tactics? Show how marketing strategy fits with Corporate Strategy and sales strategy.

Answer:

First Part: Basically, marketing strategy is the formula for achieving marketing success in business. In the commercial world, "it is the plan for getting the best return from resources, the selection of the kind of business to engage in and the scheme for obtaining a favourable position in the business field. It is the arrangement for dealing with the ever-changing outer world. It is the understanding of the peculiar quality of an industry area and the programme for matching with it". Thus, this strategy requires a thorough understanding of the perspective of the market, an appreciation of the optimism of the industry and its special characteristics, and an analysis of the prospects of the environmental background into which the business structure and its marketing efforts fit. Second Part: Marketing strategy is a long-range operational planning of a firm, whereas Marketing tactics is a short-range exercise. The functions and functioning of the basics of market positioning, product positioning, marketing mix, market entry, etc. constitute the marketing strategy. On (he other hand, 4-Ps of marketing (Product, Place, Price, Promotion) are addressed in marketing tactics.

Third Part: Marketing Strategy vis-à-vis Corporate Strategy and Sales strategy.

This relationship can be best explained by the diagram below:



Question 111: The sequence of strategies suggested by Ansoff is industry specific. Develop this sequence for two diverse industries like Insurance and Colour TVs keeping in mind the Indian market.

Answer:

The Ansoff's Matrix identifies 4 different kinds of Product market strategy that an Industry should adopt. These are Market Penetration, Market development, Product development and Diversification.

Market penetration involves trying to milk more from the existing products and existing markets. If the market as a whole is growing, this might appear a fairly low risk strategy to adopt. Where the market is stagnant, market penetration might involve market share at the expense of other players in the field.

Market Development uses existing products in new markets. This strategy might be attractive if the unit has to achieve high sales volumes-to utilise capacity efficiently. Product Development involves offering new products to the existing markets.

Diversification involves moving into new market with new product.

Ansoff model is a framework for discussing alternative directions. It is a model for identifying for product-market opportunities. There is no criterion for any choice amongst the strategies suggested by Ansoff. There is nothing to stop a company carrying out all the four strategies simultaneously, provided it has the resources. For example, a firm can pursue simultaneously a penetrating strategy in its existing markets as well as diversifying into new ones.

Insurance Sector: Insurance Sector is a on-going growing industry. Hitherto 'Life insurance Corporation of India' (LIC) had been monopolising this sector. But under the changed scenario, following liberalisation & Globalisation, a number of new players have come in and are posing a real threat to the Industry's Leader viz., LIC.

Further the market size of this Industry is very huge. There is lot of scope to develop many new products. The market is at a developing stage, with the Industry spreading out mostly across the urban and middle class income group.

The sequence of strategies as suggested by Ansoff for the Insurance Sector should be-

- Product Development
- Market Development
- Penetration and finally
- Diversification.

Product Development: Product Development involves offering new products to the existing markets. The scope for Product Development in this sector is tremendous and this should be accorded the top most priority. A lot of new ideas are fast filtering into our country from different countries abroad.

LIC should offer attractive new policies to its existing millions of clientele and thereby retain its number uno status.

Market Development: Market Development is taking place because of the huge market size and the unawareness of people across the country, especially in rural areas about the product.

Market penetration: We are already noticing the huge market penetration that is taking place in the Insurance Sector. Market players are slashing the premium and are making attractive offers-specially to the rural folk by undertaking big publicity campaigns.

Diversification: Insurance biggies like Pru ICICI, Bajaj Aliianz , who are the two top private sector players have already diversified into new areas like Mutual Fund etc.

To sum up, Ansoffs model has a lot of relevance for the Insurance Sector. All the strategies., as suggested by Ansoff, are being put into play, as per the sequence suggested above.

Colour TV industry:

Colour TV came into the market for the first time during The Asian Games, 1984. Before that only Black and White TVs were only available. In the language of Strategic Management, we can say that the product 'Black& white TVs' were in the Maturity Phase of Product Life Cycle, whereas the Colour TVs had just been only in the 'Introduction ' Phase.

The sequence of strategies as suggested by Ansoff for the Colour TV Industry should be-The sequence of strategies as suggested by Ansoff for the Insurance Sector should be-

- Market Development
- Penetration
- Product Development and
- Diversification.

Market Development: The Market Development for the Colour TVs industry has been growing exponentially in view of a no. of new TV channels that are entering the Indian market specialising in different areas like Sports channel, Entertainment channel etc. With the introduction of some populist measures taken by some state Government in the south, by distributing TV s for the poor and the under-privileged communities the market has suddenly got 'heated up'. Due to the stiff competition, the prices have also tumbled down for a Colour TV. The market for Black& White TV has almost come to a 'Zero' level. Every one are now going crazy for a Colour TV.

Market penetration: Market Penetration is going on at a feverish pitch, due to the emerging new technology like LCD, Plasma etc.

Product Development: Product Development has assumed a special significance for the Colour TV industry. There is a huge stress on quality. The final result as a consequence is a squeeze on profit margin, due to market penetration.

Diversification: Diversification to other areas related to shopping goods are taking place. Many players are moving into new products like Home Theatres, Refrigerators etc.

Summing up, Ansoffs-model has a lot of relevance for the Colour TV industry. All the strategies, as suggested by Ansoff, are being put into play, as per the sequence suggested above.

Question 112: (a) State the methods of generating new product ideas.

(b) State the basic requirements of a new product development and strategy.

Answer (a):

The methods of generating new product ideas are as listed below.

Origin/ Source	Popular Methods.
Customers	Survey, Focus Group
Competitors	Systematic Comparison, Benchmarking, Developments in similar industries.
Distributors	Suggestions and their feedback about present products.
Creative techniques	Brain Storming, Customer constraints and usage surveys.
Laboratories	Scientific Journals, Product testing.

Answer (b):

The basic requirements or steps of new product development are:

- Exploration
- Screening
- Business Analysis
- Development
- Testing
- Commercial Production.

The pre-requisites for new product development are:

- Competent R&D,
- Competent engineering/design
- Acceptance of challenges
- After-sales services.

For a new product strategy, the basic requirements are:

- Customer acceptance
- Satisfactory performance
- Economic production
- Packaging and
- After-sales service.

Question 113: Bring out the difference between 'Marketing' and Societal Marketing' concepts. Why is the latter so important?

Answer:

The marketing concept is a business philosophy that believes that the customer's satisfaction is the reason for the business's existence. The marketing concept holds that achieving organisational goals depends on the needs and aspirations of the target consumers and delivering the desired satisfactions more effectively and efficiently than competitors do.

The marketing concept starts with a well-defined target market, focuses attention on understanding those customers' needs, coordinates all the marketing efforts by creating long-term customer relationships based on customer value and satisfaction. Under such marketing concept, companies produce what consumers want, thereby satisfying consumers and making profits.

The societal marketing concept holds that a company should make good marketing decisions by considering consumers' wants, the company's requirements, and society's long-term interests. It is closely linked with the principles of Corporate Social Responsibility and of Sustainable Development.

The concept has an emphasis on social responsibility and suggests that for a company to focus on exchange relationship with customers might not be in order to sustain long-term success. Rather, marketing strategy should deliver value to customers in a way that maintains or improves both the consumer's and the society's well-being.

The societal marketing concept holds that the organisation should determine the needs and interests of target markets. It should then deliver the desired satisfactions more effectively and efficiently than competitors in a way that improves the consumer's and the society's well-being.

Importance of societal marketing concept:

The societal marketing concept is a new marketing philosophy. It is important because it not only encompasses all activities that ensures delivery of what the customers want, but also ensures that the rights of the society are not infringed while delivering to customers who form a particular segment of society.

Most companies recognise that socially responsible activities improve their image among customers, stockholders, the financial community, and other relevant publics. Ethical and socially responsible practices are simply good business, resulting not only in favourable image, but ultimately in increased sales.

The societal marketing concept Questions whether the pure marketing concept is adequate in an age of environmental problems, resource shortages, worldwide economic problems and neglected social services. It asks if the firm that senses, serves and satisfies individual wants is always doing what's best for consumers and society in the long run.

According to the societal marketing concept, the pure Marketing concept overlooks possible conflicts between short-run consumer wants and long-run consumer welfare.

Question 114: (a) Discuss the role of Product development as a part of an overall marketing strategy.

(b) Explain why a direct relationship between the cost of production and selling price may be inappropriate as a pricing strategy.

Answer (a):

Product development involves an organisation seeking to create new products to replace existing ones. The new products may be completely new or revised versions of existing ones.

Within a marketing strategy, a company's competitive posture is determined by its overall product-market mix and product development strategy is a part of this. Many firms attempt to have a combination of current and new products for survival and growth.

The strategies of market penetration, market development and diversification are also coordinated with the strategy of product development. For an overall marketing strategy, a company will attempt a mixture of these strategies.

As a part of an overall marketing strategy, product development performs the following roles:

- Replacement of products, which are in the maturity of PLC.
- Risk reduction thru5 production of a range of products.
- Brand extension
- New markets' entry, etc.

Answer (b):

This relationship between the cost of production and selling price is technically termed as cost plus pricing policy. Such a policy is inappropriate for the following reasons:

- This policy fails to recognise that -
- Sales demand is determined by sales price and
- Profit-maximising price is not directly related to the cost of the product
- Product cost computation is a subjective exercise as arbitrary cost apportionments decisions are in practice.
- A firm having spare capacity might be interested to accept marginal business but this policy leads to high prices for losing potential customers.
- This policy could lead to an upward spiral of price increases if it is regularly.
- In the early stage of PLC, unit cost of a product is high. This may not sufficient demand for achieving the desired market share.

Question 115: (a) "Risk Management Strategies are seven fold". Identify them and briefly discuss any three of them.

(b) How is insurance premium is computed for a particular product and what is the role of management accountant in this exercise?

Answer (a):

Risk Management strategies are seven-fold and they are:

- Avoid Risk
- Reduce Risk
- Retain Risk
- Combine Risk
- Transfer Risk
- Share Risk and.
- Hedge Risk.

A brief on the first three Risk Management Strategies is as below:

(i) Avoid Risk: This is prevention and a proven strategy. This strategy results in complete elimination of exposure to loss due to a specific risk. It may involve avoidance of an activity, which is risky. This strategy can be approached in two ways:

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

Discontinuance of an activity to avoid risk: Abandoning a project to avoid risk midway is a decision sometimes taken while handling the project.

(ii) Reducing Risk: This strategy 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 (e.g. Burglar Alarm) and
- Loss Control (e.g. Using Fire Extinguisher)

(iii) Retain Risk: Risk Retention is adopted when Risk 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 occurs when the organisation is unaware of the risk and faces it when it comes up.

Answer (b):

The process of determining or fixing the rates of premium for a particular product is known as 'Pricing'. Traditionally, premiums have been calculated based on tariffs set by the IRDA i.e., the Insurance Regulatory and Development Authority. The rates are derived, based on various factors like- past loss ratio, location of the asset, type of asset, as well as exposure to the risks. Rate is the pricing factor upon which the premium is based. For example- car insurance policies are priced, based upon several factors like-make& model of the car, the age of the driver, purpose for which the car is used, location where the vehicle is kept, etc.

Premium is calculated using the formula

Premium = Annual Rate × Sum Insured

The annual rate is usually given per thousand Sum Insured.

Traditionally, for motor insurance, the parameters that are used to price a policy have been - model of the car, age of the driver, location of the car, purpose for which the car is being driven, etc.

The industry will eventually move from price rating to risk rating. The pricing for individuals will be based on their track record. For e.g., for 'own damage' in a car insurance policy, the pricing parameters will be the model of the car, driver's age, engine capacity, etc.

Management Accountant has a very important role to play in the subject issue of' computation of Insurance premium'. The issue is in the nature of' pricing of any product'. Management Accountant needs to break up' Insurance Premium' into four parts:

- Cost of payment for losses;
- Cost of operation and maintenance of insurance pool;
- Reserve for contingencies;
- Return on Investment.

The calculation of Insurance, in case of Life Insurance, is a very complicated exercise, as the variables involved are too many. Some of these are:

- Factors aggravating mortality rates- like smoking, drinking and other habits,
- Age of the insured,
- Occupational hazards, etc. ,

This computation is normally done through 'Actuaries' involving mortality rates. Premium rate is often referred to as rate/unit of exposure. Further the gross insurance premium is made up of a pure premium cover to the expected loss and a loading to cover the cost of doing the business.

Question 116: (a) Describe 'Asset-Liability Mode' and its utility for managing liquidity risk and exchange rate risk.

(b) Explain the concept of 'Risk Pooling' and Diversification of Risk?

Answer (a):

Asset-liability Management Model: Asset-liability Management Model involves matching of the assets and the liabilities, by which a prudent management of an investment portfolio can be properly taken care of. Asset-liability management is defined as "maximising the risk adjusted returns to shareholders over the long run". It is also defined as management of total balance sheet in terms of size and quality (composition of assets and liabilities).

Liquidity risk management through Asset-Liability Management: It is difficult to measure liquidity risk as it entails expected likely inflow of deposits, loan dispersals, changes in competitive environment, etc. The most commonly used techniques for measurement of liquidity risks is the gap analysis.

The Assets and Liabilities are arranged according to their maturity pattern in time brackets. The gap is the difference between the maturing assets to the maturing liabilities. A positive gap indicates that maturities of assets are higher than those of liabilities. A negative gap indicates that some rearrangement of funds will have to be done during that time bracket. It can be from sale of assets or issue of new liabilities or rolling over existing liabilities.

Exchange Rate Risk Management through Asset-Liability Management: At a particular exchange rate, assets and liabilities of a financial institution match exactly. As the exchange rate fluctuates, this balance-gets disturbed. A simple solution to correct this risk is to match assets and liabilities of the same currency. Many financial institutions do not have foreign exchange exposure, as all their assets and liabilities are in rupee currency. The risk of foreign exchange borrowings of these institutions is passed on to the lenders through dollar denominator loans. The uncovered loans are hedged at the time of contacting them through forward covers for the entire amount.

Answer (b):

Concept of Risk Pooling: The concept of pooling risk is the process of identification of separate risks and put them ail 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, Transit Insurance is taken for transporting the various plant and machinery from the manufacturers to the project site. The materials are then received at the site and stored until erection. Storage Insurance will cover the risk during the storage. During erection of different plant & machinery, risks due to mechanical, electrical etc., are covered through Erection Insurance. The erected plant & machinery is then tested and trial runs are taken for guarantee purposes on continuous run, as per the contract. The risk covered during this period is covered as risks for commercial run. All these risks put together is called pooling. This single pooled policy has a risk value and premium payable and the conditions attached thereto by both the insurer and the insured to carry out those obligations are clearly spelled out in the policy documents.

Diversification of risk: This involves identifying both the systematic and the unsystematic risks. Systematic risk is inherent and is peculiar to the type of the business/firm and can be reduced or diversified through functional level strategy. The unsystematic risk is external to the organisation and is 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.

Question 117: (a) Explain how the uses of different Forecasting Models assist in taking management decisions. What are the various criteria used in selecting a forecasting method?

(b) Describe e-business as defined in Judy Strauss and Raymond Frost's E-marketing model.

Answer (a):

Uses of different Forecasting Models assist in taking management decisions:

Forecasting models happens to be important constituents of the category of decision support system models. These are extremely helpful in transforming user inputs into useful information. Planning for the future is the essence of any business. Businesses need estimates of future values of business variables. Commodities industry needs forecasts of supply, sales and demand for production, planning, sales, marketing and financial decisions.

Some businesses need forecasts of monetary variables e.g., costs or price. Financial institutions face the need to forecast volatility in stock prices. There are macro economic factors that have, to be predicted for policy-making decisions in Governments. The list is endless and forecasting is a key 'decision-making practice' in most organisations.

Forecasting models are needed to develop strategic plans for long range perspectives. Forecasting models are of 4 types, as listed below:

I. Qualitative Models:

- Delphi model- Collects and analyses panel of expert opinions.
- Historic data- Develop analogies to the past data.
- Normal group technique-participative group process.

II. Naive (Time Series) Quantitative Models:

- Simple average- Averages past data to project the future based on that average.
- Exponential smoothing-Weighs differently earlier forecasts and the recent one to project into the future.

III. Causal Quantitative Model:

- Regression analysis- defines functional relationships among variables as to whether it is linear or non-linear.
- Economic Modelling: offers an overall forecast for a variable like Gross National Product (GNP)

IV. Combination of monetary & physical projections.

- Marketing projections- Monetary by region, product and product group.
- Economic projections- Monetary by region, industry and broad product group.
- Historical projections- In units, monetary by product and product group.
- Demand forecast-In units by product and product group for operations management and monetary for sales and financial planning (a combinations of a, b, and c).

Various criteria used in selecting a forecasting method:

Managers are often confronted with the problem of preparing forecasts for which sourcing of data becomes a difficult problem and the decisions regarding selection of the method of forecast with the available data. Following are some of the factors that would influence the criteria for selecting a forecasting method:

- Quantum of data-maximum/minimum no. of observations, peaks and troughs, weightages, seasonal data etc.
- Pattern of data-stationary, trend, seasonality, complexity, cyclic etc.
- Time horizon-short, medium and long.
- Preparation time-short, medium and long.
- Type of skills required- no sophistication, moderate sophistication or high sophistication.

Answer (b):

Judy Strauss and Raymond Frost's E-marketing model:

Judy Strauss and Raymond Frost's E-marketing model defines E-Business as a continuous Optimisation of a firms business through digital technology.

EB=EC + BI+ CRM + SCM + ERP

Where EB is the Electronic Business,

EC is Electronic Commerce,

BI is Business Intelligence,

CRM is Customer Relationship Management,

SCM is Supply Chain Management and

ERP is Enterprise Resource Planning.

EC uses digital technologies to enable buying/selling, BI uses digital technologies for collecting primary/secondary information. CRM is the strategy to satisfy customers and build long lasting relationships on the basis of high interaction with customers. This high interaction has been enabled through web conferences. SCM relates-to delivery of products efficiently and effectively both by the vendors to the manufacturers and manufacturers to the distributors/ customers. The high interaction with-vendors and customers has been possible through EDI (electronic data interface), paperless transactions. ERP has helped optimisation of business processes and lowering costs. Order entry and purchasing, invoicing and inventory control have been speeded up and also optimised through MRP, JIT, Kanban, etc., using digital technologies.

Question 118: Discuss the techniques of competence analysis.

Answer:

Five widely used techniques of analysing the competence of an organisation and determining its strengths and weaknesses are:

(i) Financial Analysis, (ii) Market Research, (iii) Opinion Survey, (iv) Factor Rating, and (v) Equilibrium Approach

(i) Financial Analysis: Financial analysis is the process of determining the financial strengths and weaknesses of the company by establishing a strategic relationship between the components of balance sheet and profit and loss statement and other operative data.

A number of techniques are used to make a financial analysis of a firm. Some of the important techniques are: Common Size Statements, Ratio Analysis, Funds Flow Analysis, Break - Even Analysis.

With the help of financial analysis one can assess not only the financial position of a firm but also its managerial ability to utilise funds efficiently. But it does not provide any idea about the image of the company's product or the product life.

(ii) Market Research: Market research method is employed as a supplement to financial analysis wherein opinions of leading customers, top executives of leading organisation and scientists who are capable of evaluating technological capabilities and trends and obtained by seeking interviews with them. Through market research brings out the effectiveness of an organisation in terms of product life and product technology.

(iii) Opinion Survey: In this method, opinions of key executives about the way the various factors influence the working of the enterprise are sought. On the basis of these opinions, various factors can be grouped into favourable contributing factors and unfavourable contributing factors. However, the analyst must use the information supplied by executives carefully because of their prejudices. It will be more useful if the group discussion method is followed to gather information.

(iv) Factor Rating: In this method various factors affecting the capability of an organisation are rated in terms of their influence on financial, marketing and operations management of the firm.

(v) Equilibrium Approach: This is a very useful technique of analysing corporate ability. In this approach, key areas are identified and managers of the firm are invited across a wide front to discern various factors contributing positively as well as negatively to each of the critical result areas and consider them together to arrive at a particular conclusion.

Question 119: How do you evaluate Portfolio models?

Answer:

The benefits produced by the portfolio models have been succinctly adumbrated by Kotler: "The models have helped managers to think more futuristically and strategically, to understand the economics of their businesses better to improve the quality of their plans, to improve communication between business and corporate management, to pinpoint information gaps and important issues, and to eliminate weaker businesses and strengthen their investment in more promising businesses".

It must at the same time be noted that there models have their own limitations.

The fact that the BCG model bases market attractiveness entirely on growth rate and business strength entirely market share limits its relevance.

The relevance of the GE model depends on the appropriateness of the selection of factors and their weights determining market attractiveness and business strength. Similarly, the accuracy of the rating is a critical factor. There is scope for biases to creep in.

One of the limitations of the BCG matrix lies in categorising the dimensions of industry growth rate and market share that vary along a continuum; having only information that is contained in actual market share numbers. Moreover, without huge amounts of comparative and historical statistics, the cut off points between high and low tend to be arbitrary.

These matrices be used very carefully, with full understanding of the underlying assumptions. If products are differentiated, if SBUs share costs, or if product lines cannot be divided into reasonable number of SBUs, the matrices may not produce good alternatives. Portfolio models should be viewed as one tool for generating strategic alternatives, but choice should be tempered by managerial judgment not by mechanical application of planning matrices. If these models are not used cautiously, they may lead the company to place too much emphasis on market-share growth and entry into high-growth business, to the neglect of managing the current business well.

Another important problem is that these models fail to delineate the synergies between two or more businesses, which mean that making decisions for one business at a time might be risky. There is a danger of terminating a loosing business unit that actually provides an essential core competence needed by several other business units.

Despite these limitations, the portfolio models have improved the analytical and strategic capabilities of managers and permitted them to make tough decisions on a more data-oriented and hard-nosed basis than mere impressions would permit.

Question 120: Critically examine the BCG Matrix for the evaluation of Business Portfolio. Explain the weaknesses of the method.

Answer:

The Boston Consulting Group (BCG) model, popularly known as the BCG Matrix and Growth-Share Matrix, is based on two variables, viz., the rate of growth of the product-market and the market share in that market held by the first relative to its competitors.

The market growth rate is an indicator of the attractiveness of the industry and the relative market share is an indicator of the strength of the firm in that industry relative to its competitors.

In the following figure, the vertical axis measures the annual growth rate of the market and the horizontal axis shows the relative market share of the firm. Each of these dimensions is divided into two categories of high and low, making up a matrix of four cells. These four cells are described below.

High Growth - Low Market Share: Products in this cell are in fast growing markets but their relative market shares are low. They are, therefore, aptly described as question marks - the company confronts the critical question of whether to make further investments in these businesses to build up market share or to divest and get out.

A question mark may call for heavy investment and other capabilities to increase its market share and become a star. If the company has the strength to increase its market share, the right strategy would be to build, i.e., to build up the market shares so that the question mark becomes a star. Achievement of this strategy may even necessitate foregoing short-term profits.

If the company does not have the strength to build up a question mark to a star or if the resources can be put to better use elsewhere, divestment may be an appropriate strategy.

A company which is in a number of businesses may have several question marks (in the figure there are three). Some of these may be right for building up and it may be prudent to drop some. In some cases where a company has a number of question marks, it may face resource crunch to build up all these business.

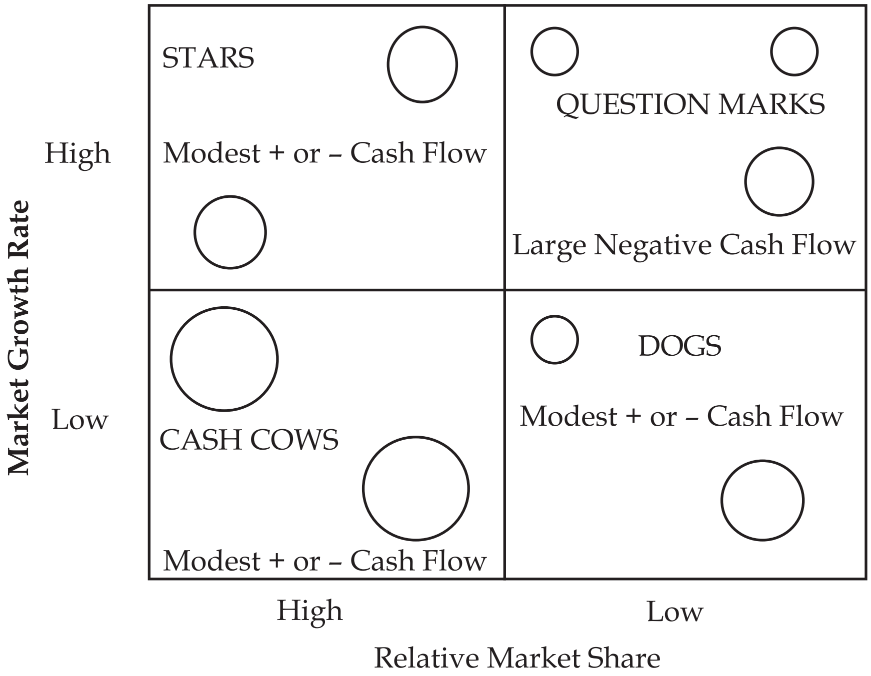
If a company has a number of question marks, it does not necessarily mean that it will have to build up some and drop others. In some cases the right strategy could be to build all. The other extreme could also be true in some cases. There could also be cases of the sole question mark a company has to be dropped. Further, it also does not mean that all question marks which cannot be built up should be dropped. There could be products in high growth markets with low market share, capable of making net cash flows without requiring any significant additional investment.

High Growth- High Market Share: Products in this cell are called stars. They are promising products because they have a relatively high market share and the market is growing fast. Stars are usually profitable and would be the future cash cows. Many stars call for substantial investment to maintain their market share in the fast growing market. This may necessitate reinvestment of internal accruals and sourcing external funds. Several stars, therefore, may not produce cash flow for the company until the market matures and the stars become cash cows.

In the figure, there are two stars. The appropriate strategy for stars often is to hold, i.e., to maintain the market share which usually requires, as indicated above, large investments to increase supply and to fight competition.

Low Growth - High Market Share: As the market matures or when the market growth rate becomes low the stars would become cash cows. Cash cows are, thus, high market share business in slow growth industries. Being in slow growth industries, they do not normally require significant reinvestment. Cash cows generate lot of cash which may be used to finance the development of other businesses of the company like stars and question marks. A company which does not have cash cows would find it difficult to develop its business.

The strategy often employed in respect of weak cash cows (i.e., those which do not have a long term prospects) is to harvest, i.e., to increase the short-term cash flow regardless of the long term effects. In case of strong cash cows (i.e., those with long-term prospects), some reinvestment may be required to keep them in good for harvesting for long.



BCG Matrix

Low Growth - Low Market Share:

Businesses with low market share in low growth industries are described as dogs.

Dogs may produce low profits or loss. If a dog does not generate satisfactory return and if there is no chance of improving it, one may be tempted to advocate divestment. However, in several cases dogs may be retained in the portfolio due to several reasons. In some cases dogs may be providing crucial inputs to stars. Some dog product may have to be retained to complete the product range and provide a credible presence in the market. They may be held for defensive reasons - to keep competitors out. Sometimes dogs may be retained due to reasons like goodwill, sentimental factors etc.

A dog may be harvested before liquidation.

As time passes, SBUs may change their position in the growth share matrix. Successful SBUs have a life cycle. They start as question marks, become stars, then cash cows, and finally dogs towards the end of their life cycle. For this reason, companies should examine not only the current positions of their businesses in the growth-share matrix (as in a snapshot) but also their moving positions (as in a motion picture). Each business should be reviewed as to where it was in past years, and where it will probably move in future years. If the expected trajectory of a given business is not satisfactory, the company should ask its business's manager to propose a new strategy and the likely resulting trajectory. Thus, the growth-share matrix becomes a planning framework for the strategic planners at company headquarters. They use it to try to asses each business and-assign the most reasonable objective.

The Weaknesses of B.C.G. Matrix: The criticism of the GSM approach tends to focus on its oversimplified and some what misleading representation of possible strategy position.

(i) This approach to strategy development encourages the use of general rather than specific criteria,

(ii) It implies assumptions about mechanism of corporate financing and market behaviour that are either unnecessary or false.

(iii) The GSM also ends to overlook other important strategic factors that are a function of the external competitive environments. For example, technological change, barriers to entry, social, legal, political and environmental pressure, unions and related human factors, elasticity of demand and the cynical nature of sales.

(iv) The application of the GSM to strategic decision-making is in the manner of the diagnostic rather than a prescriptive aid in the instances where observed cash flow pattern do not confirm with those on which the four product market categories are based. This commonly occurs where changes in product market strategies have short term transient effects on cash flow.

Question 121: Examine the recent trends in Portfolio Strategy.

Answer:

For some time now, there has been a trend all over the developed world to reduce the breadth of the portfolio and towards greater focus. The concept of core competence has greatly influenced this trend. For example, Glaxo Holding (UK) divested its milk based products and decided to concentrate on prescription drugs. The Anglo-Dutch multinational Unilever gave up its peripheral businesses, packing and transportation. The Pearsons Group (UK) which has a host of businesses decided to focus on the media and entertainment found its performance decline, divested most of the diverse businesses to concentrate on its core business, telecommunications. There are but a few examples of unbundling of the portfolios.

The case focussing: Mr. T. Thomas, Chairman, Glaxo India Ltd., in his speech in one of the Annual General Meetings of the company has very lucidly and succinctly described the rational of focus and vision in business. The nine factors elaborated by him are the following:

- **Specialised Knowledge and Management Skills:** In the increasingly globalising markets characterised by growing competition, a firm needs high quality management that has an adequate depth of specialised knowledge and skills in that specific industry. If attention, skills and other resources are dissipated over a very diverse portfolio it will be very difficult to gain competitive advantage.
- **Adequate Concentration of Investment:** To compete successfully globally, and even domestically, massive investments are required in fixed assets, market place and R & D so that the scale of investments in individual global products groups has reached such proportions that firms have to concentrate their investment in a select number of areas.
- **Market Dominance:** By concentrating resources in one business or in a few select areas of business, a company can gain dominance nationally and globally in those areas. In a properly managed company the profit margins will be higher with higher volumes and market share.

- **Stronger Intra-Business Links:** A strong intra-business link (marketing - R & D link, for example), necessary for success in a highly competitive industry, is possible only if a company focuses itself on select areas of business.
- **Greater Commitment of Managers:** In a high diversified business, managerial efficiency and commitment suffer because of movement of managers across business and differing fortunes and prestiges of businesses. In a more focused firm, the management will be more uniformly committed to each part of a more cohesive business, thereby ensuring its success and growth.
- **Minimising Errors of Judgment:** In a diversified business the top management will find it increasingly difficult to understand each of the individual business and, and therefore, may make errors of commission and omission with regard to judgment of competition and the market place.
- **Avoiding Central Bureaucracy:** A highly diversified company tends to have a central bureaucracy which acts as a link between the management, its central supporting groups (operational and functional) and the corresponding people in each individual business group and location. This central bureaucracy often tends to distort efficient decision making process, besides adding unproductive costs. By focusing on select business segments, the linkage between top management and operations will be more direct and the organisation will be leaner and more agile and far more efficiently responsive to change without the hindrance of a central bureaucracy.
- **Realising the Full Potential of Each Business:** When several businesses are clubbed together in a large diversified group, the real potential of some of the business may not be full realised. Focus would help realise such potential as has been proven by companies like Glaxo, ICI and ITC.
- **Parent/Subsidiary Harmonisation:** When the parent company becomes a focused one, it would be appropriate for the subsidiary to fall in line and harmonise objectives and strategy for better results as has been done by Glaxo India.

Question 122: Discuss on the Product Life Cycle, its uses in the strategic planning and also on the criticism of the Product Life Cycle concept.

Answer:

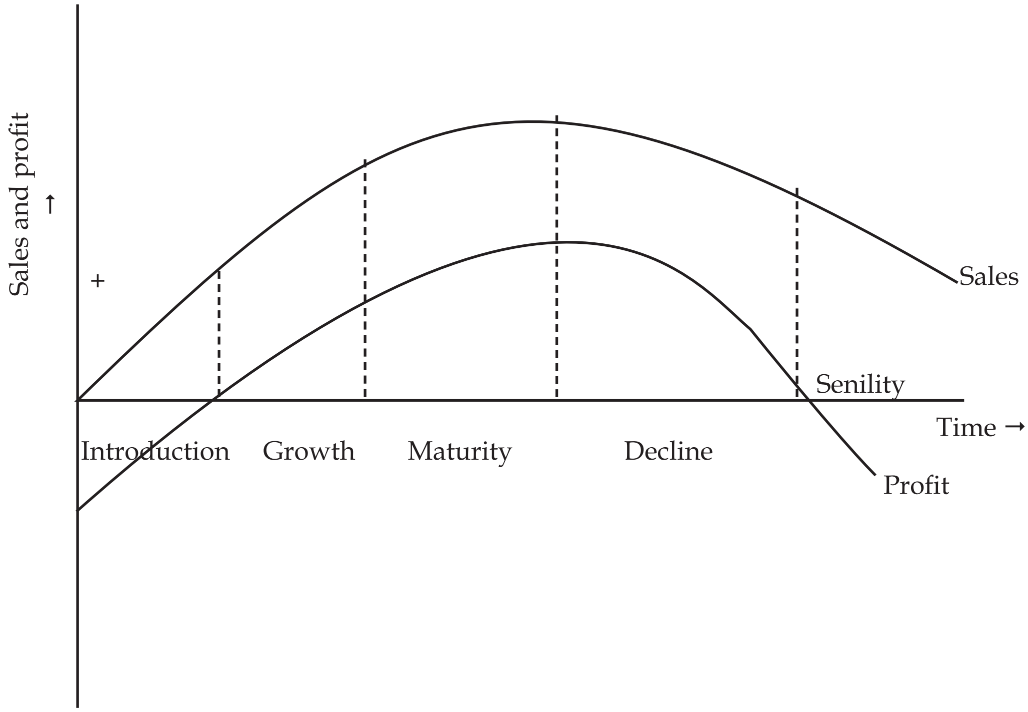
From the firm's point of view, a way of stabilising its risk/return profile is to provide a number of different products, which have different financial and marketing characteristics. This mirrors an investor's concern to reach a desired trade-off between risk and return. The profitability and sales of a product can be expected to change over time. The product life cycle is an attempt to recognise distinct stages in a product's sales history. Marketing managers distinguish between the following:

(a) Product class: This is a broad category of product e.g. cars, washing machine, also referred to as the generic product.

(b) Product form: Within a product class there are different forms that the product can take. For example, front loading automatic washing machine.

(c) The particular type of the product form: This is sometimes referred to as brand, but one must be careful how one uses this word.

The product life cycle applies in differing degrees to each of the three cases. A product-class may have a long maturity stage, and a particular make or brand might have an erratic life cycle or not. Product forms however tend to conform to the classic life cycle pattern, commonly described by a curve as follows:-



(Characteristics of introduction, growth, etc. should be discussed briefly hereinafter)

Brands or individual makes of a product might have a shorter life cycle than product form, although the same pattern applies to many of these too. However, a brand can take on a life independent of the type of product form sold.

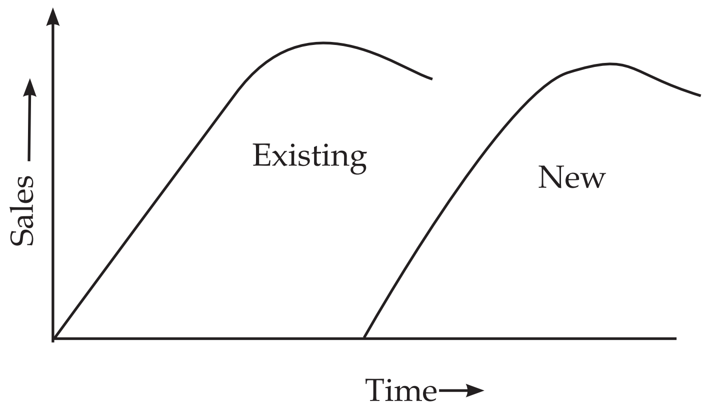
A company selling a range of products must try to look into the longer term; beyond the immediate budget period, and estimate how much each of its products is likely to contribute towards sales revenue and profitability. It is therefore necessary to make an assessment of the following:

- The stage of its life cycle that any product has reached.
- Allowing for the price changes, other marketing strategies, cost control and product modifications for how much longer will be able to contribute significantly to profits and sales.

Another aspect of product life cycle analysis is new product development and strategic planners must consider the following:

- How urgent is the need to innovate, and how much will have to be spent on R & D to develop new products in time?
- Capital expenditure and cash flow.

It is essential that firms plan their portfolio of products to ensure that new products are generating positive cash flows before existing earners enter the decline stage.



In this situation, the company is likely to experience cash flow problems.

By considering the product life cycle of the existing product, when planning the timing for launch of a new product, cash flow problems can be avoided.

It is perhaps easy enough to accept that products have a life cycle, but it is not so easy to sort out how far through its life a product is, and what its expected future life might be.

There ought to be a regular review of existing product, as a part of marketing management responsibilities.

Information should be obtained about the likely future of each product and sources of such information might be as follows.

(i) An analysis of past sales and profit trends,

(ii) The history of other products,

(iii) Market research,

(iv) If possible, an analysis of competitors.

Estimate of future life and profitability should be discussed with any experts available to give advice. Once the assignments have been made, decisions must be taken about what to do with each product. The choices are as follows:-

(i) Continue selling the product, with no foreseeable intention yet of stopping production.

(ii) Initiate action to prolong a product's life, perhaps by product modification, advertising more, by trying to cut costs or raise prices etc.

(iii) Plan to stop producing the product and either to replace it with new ones in the same line or to diversify with new product-market areas.

Costs might be cut by improving the productivity of the workforce or by redesigning the product slightly, perhaps as a result of a value analysis study.

There are some legitimate criticisms of the product life cycle concept as a practical tool in strategic planning.

(i) How can marketing managers or other managers recognise just where a product stands in its life cycle?

(ii) The traditional curve of a product life cycle does not always occur in practice.

(iii) Strategic decisions can change a product's life cycle, for example by redesigning a product in the market; its life can be extended.

(iv) Competition varies in different industries, and the strategic implications of the product life cycle will vary according to the nature of the competition.

The product life cycle also suggests several areas of risk.

(i) Once the product has taken off, more companies will be encouraged to enter the market it has created. There is a risk of overcapacity. Consequently there may be a shakeout period, of takeovers and rationalisation, to bring capacity into line with demand.

(ii) The risk profile also changes at later levels in the life cycle. Substitute products can erode demand.

Question 123: According to the Growth Share Matrix (GSM), a firm has four basic product market strategies that it can adopt in pursuit of its objectives: investment (Question Mark); maintenance (Star); harvesting (Cash Cow); Withdrawal (Dog). Indicate briefly the important characteristics of each of these strategies along with the relationship between the stage of evolution of a product-market segment and its GSM classification.

Answer:

GROWTH-SHARE MATRIX GUIDELINES

Strategic Management Guidelines

Question Mark (uncertain new products at the introductory stage of their evolution)	Question marks are managed to gain market share and strengthen their competitive position. To do so considerable investment is needed since rapid market growth occurs and cash generation is low as a result of low market share.
	The initial step of the success sequence occurs when a Question Mark becomes a star because of the market share gain. However, if growth slows and competitive position is still weak, a Question Mark becomes a Dog. Where Star potential is not evident divestment is recommended.

Star (Products experiencing rapidly growing demand, and rapid growth in the firm's capacity to manufacture and distribute them)	Market growth is rapid. Shakeouts will occur as firms jostle for competitive position. Large cash hbalances are generated but heavy investment is required to maintain market share growth and consolidate competitive position. Low margins may be essential to deter competition, but longer-term prospects improve as growth slows, when large cash returns should be obtained. If investment is cut back during growth to gain cash returns in the short/medium term the Disaster sequence occurs, a Star becoming a Dog.
Cash Cow (Products with a large share of mature market)	A Star becomes a Cash Cow as market growth slows during maturity. Investment requirements are low and limited to those needed to reduce costs and maintain marketing leverage. Large cash surpluses are generated. Market positions become entrenched as the 3 or 4 dominating competitors consolidate their position of strength. Cash cows are managed for cash. As a market contracts during decline because of e.g. product substitution, a cash cow becomes a Dog.
Dogs (Product with a low share of a declining market)	Dogs have relatively weak competitive positions in low-growth and mature markets. In most cases they have little potential for gaining market share and are not very profitable. However, where it is possible to obtain a relatively strong competitive position in a market segment a modest cash return may be generated (cash Dog). Liquidation of Dog products (SBU) is usually recommended.

Question 124: It has been argued that products have life cycles whereas brands do not.

Required:

(a) Discuss the validity of the above argument.

(b) Explain the role of brands in the construction of barriers to entry,

(c) Recommend some suitable financial criteria which could be used, at the different stages of the product life cycle, for the purposes of financial control.

Answer (a):

A product can be defined as something which is offered to a market in order to satisfy customer needs in some way; it is a package of benefits. A brand on the other hand, is rather different: it is a name, term or symbol or design or combination of them which is intended to signify the goods or services of one seller or group of sellers and to differentiate them from those of competitors. For example, denim jeans, the product, underpin a number of brands, such as Levis, Wrangler, Lee.

Product life cycles: The life cycle model suggests that a product goes through distinct phases, with different financial and marketing characteristics. The phases are development, launch, growth, maturity and decline. This model applies to some products but not for all. The same customer need for black and white TVs have by and large given way to colour. On the other hand, some products do not have a life cycle. Denim jeans show no signs of fading away, nor does toothpaste, although some stages of the life-cycle model still apply.

Brand life cycle: With brands, the situation is equally ambivalent. Some brands appear immortal, despite the changes in the products they support. This is because they are adequately supported. On the other hand, some brands do or die, if they are not properly supported by advertising and promotion. The statement is thus a false dichotomy. The life cycle model is a tool for marketing managers, not a scientific prediction. What drives both products and brands is customer needs.

Answer (b):

A barrier to 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:

(i) Product differentiation: Porter discusses two criteria; Brand image is built up through advertising and other special features and reflects both use and signalling criteria.

(ii) 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, producer quality etc.

(iii) 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 to 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.

(iv) With some brands, there are also quite high switching costs, which is why may people are unwilling to change bank accounts because of the inconvenience of so doing.

(v) 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.

Answer (c):

Financial criteria for assessing different stages of the product life cycle. As each stage of the life cycle involves different risks and has different financial characteristics, no one measure is suitable throughout. The table below offers a summary.

	Launch	**Growth**	**Maturity**	**Decline**
Characteristics	High business risk. Negative net cash flow. DCF evaluation for overall investments.	High business risk, neutral net cash flow.	Medium business risk. Positive cash flow.	Low risk. Neutral - positive cash flow.
Critical success factors	Increasing time to launch.	Market share growth. Sustaining competitive advantage.	Contribution per unit of limiting factor; Customer retention.	Timely exit.
Information needs	Market research into size and demand.	Market growth, share. Diminishing returns. Competitor marketing strategies.	Comparative competitor costs, Limiting factors.	Rate of decline; best time to leave; reliable value of assets.
Financial controls	Strategic milestones, Physical evaluation. Mainly non-financial measures owing to volatility.	DCF. Market share, Marketing objectives.	ROI, Profit margin, Maintaining market share.	Free cash flow (for elsewhere).

Question 125: Define marketing research and explain its scope.

Answer:

The sources of marketing data will vary from organisation to organisation, but are both internal and external, including information provided by marketing research. Marketing research has been defined by the Chartered Institute of Marketing as the "objective gathering, recording and analysing of all factors about problems relating to the transfer and sales of goods and services from producer to consumer or user". Within this definition, there are a few points to note:

- Marketing research should provide a regular information system and control decisions by marketing and senior management.
- Marketing Research is concerned with all types of customers and user, not just the household consumer.

- Marketing research provides information which enables managers to make decisions about the marketing mix - product, place, price and promotion. It is not simply market research.
- Information is only worth obtaining if it has a purpose and a value.

The scope of marketing research may be listed as follows:

(a) Market research is only on aspect of marketing research. Marketing research is the investigation of the marketing activities of a company, i.e. the entire marketing mix - and should look into how far all these activities are consumer-oriented and should recommend how they can be planned in the future in order to sustain profits and customer demand.

- analysis of the market potential for existing products
- forecasting likely demand for new products
- sales forecasting for all products study of market trends
- study of the characteristics of the market
- analysis of market share.

(b) Product research.

- customer acceptance of proposed new products
- comparative studies between competitive products
- studies in to packaging and design
- forecasting new uses of existing products
- test marketing
- research into development of a product line.

(c) Price research

- analysis of elasticity of demand
- analysis of costs and contribution or profit margins
- the effect of changes in credit policy on demand
- customer perceptions of prices.

(d) Sales promotion research.

- motivation research for advertising effectiveness
- analysing the effectiveness of advertising on sales demand
- analysing the effectiveness of individual aspects of advertising
- establishing sales territories
- analysing the effectiveness of salesmen
- analysing the effectiveness of other sales promotion methods.

(e) Distribution research.

- the location and design of distribution centres
- the analysis of packaging for transportation
- dealer supply requirements
- dealer advertising requirements
- the cost of different methods of transportation and warehousing.

Question 126: Discuss on new Product Pricing.

Answer:

There are three elements in the pricing decision for a new product.

- getting the product accepted
- maintaining a market share in the face of competition
- making a profit from the product.

When a firm launches a new product on to the market, it must decide on a pricing policy which lies between the two extremes of market penetration and market skimming.

Market penetration pricing is a policy of low prices when the product is first launched in order to gain sufficient penetration into the market. It is therefore a policy of sacrificing short-term profits in the interests of long-term profits. The circumstances which favour a penetration policy are as follows:—

- The firm wishes to discourage rivals from entering the market.
- The firm wishes to shorten the initial period of the product's life cycle, in order to enter the growth and maturity stages as quickly as possible.
- A firm might therefore deliberately build excess production capacity and set its prices very low; as demands build up, the spare capacity will be used up gradually, and unit cost will fall; the firm might even reduce prices further as unit costs fall.
- In this way, early year losses will enable the firm to dominate the market and have the lowest costs.

Market skimming. The aim of market skimming is to gain high unit profits very early on in the product's life.

(a) The firm charges high prices when a product is first launched.

(b) The firm spends heavily on advertising to win customers.

(c) As the product moves into the later stages of its life cycle progressively lower prices will be charged. The profitable cream is thus skimmed off in progressive stages until sales can only be sustained at lower prices.

(d) Conditions which are suitable for such a policy are as follows:

- Where the product is new and different, so that customers are prepared to pay high prices so as to be 'one up' on other people who do not own one.
- Where demand elasticity is unknown. It is better to start by charging high prices and the reducing them if the demand for product turns out to be price elastic.
- High initial prices might not be profit-maximising in the long run, but they generate high initial cash flow. A firm with liquidity problems may prefer market-skimming.
- Skimming may also enable the form to identify different market segments for the product, each prepared to pay progressively lower prices. If product differentiation can be introduced, it may be possible to continue to sell at higher prices to some market segments.

(e) The firm may lower its prices in order to attract more price-elastic segments of the market; however, these price reductions will be gradual.

Introductory offers may be used to attract an initial customer interest. Introductory offers are temporary price reductions, after which the price is raised to its normal commercial rate.

Question 127: What are channels of distribution?

What factors would govern your choice of distribution in the competitive structure of an industry?

Answer:

The term channels of distribution refer to the marketing institutions through which goods or services are transferred from the original producers to the ultimate customers. Channels of distribution include the following:

(i) Retailers, who may be classified by -

- type of goods sold
- type of service
- size
- location

Although the retailer may sell the goods acquired, the retailer is also a customer, as the retailer hopes to make a profit from distributors.

(ii) Wholesalers, many of them specialising in particular products. Most wholesalers deal in consumer goods, but some specialise in industrial goods.

(iii) Distributors and dealers. Organisations which contracts to buy a manufacturer's goods. and sell them to customers.

(iv) Agents. Agents differ from distributors in the following way:

- Distributors buy the manufacturer's goods and resell them at a profit.

- Agents do not purchase the manufacturer's goods, but earn a commission on whatever sales they make.

(v) Franchisees.

(vi) Multiple stores, which buy goods for retailing direct from the producers, many of them even under their own label.

(vii) Direct selling, also an aspect of promotion.

The reasons for direct distribution, perhaps with a dedicated sales force, might be as follows.

- The need to demonstrate a technical product.
- Wholesalers and retailers will try to sell all the products they handle, and will not favour one manufacturer's products. Even dealers are sometimes lethargic in trying to sell their products.
- An inability to persuade intermediaries to accept products.
- High intermediary profit margins affecting the final sale prices to customers.
- A small market with only a few target customers may make direct selling cheap.
- As a means of maintaining good relations with end customers and obtaining feed back.

The reasons against direct distribution and in favour of using intermediaries are as follows :

- A lack of financial resources.
- Financial resources may be available but can be employed more profitably elsewhere.
- A lack of a sufficiently wide assortment of products to sell.
- A wide geographical market area makes the costs of direct selling very high.

It is important to consider who has the greatest power in a distribution channel and is therefore able to exert greatest influence over the activities of other members of the channel. Monitoring the balance of power is a vital component in marketing information system. The shift in the balance of power has two consequences:

- Large multiples are able to dictate product specifications, and drive much harder bargains on matters of price and delivery.
- The large multiple's won-labels brands are increasingly the major competition against branded goods.

The significance of this is that retailers are themselves customers. In other words, this is a key feature of the organisation's competitive environment. The bargaining power of customers, as one of the competitive forces, has therefore increased, as well as the threat of substitutes, because:

- Retailers are customers;

- Retailers can offer their own substitute products to the end consumers.

Question 128: Due diligence is applied more to confirm the initial offer rather than to withdraw. Is it true?

Answer:

Due Diligence is the most important aspect in doing a merger and takeover deal. During the process of takeover, the predator and the target extend a lot of information on an informal mode and predator's deal progress is based on a number of assumptions and data inputs are primarily from public source and competitive intelligence. The process of due diligence gives the predator the authority to validate the Homework of the Deal. Hence the management gives a lot of importance for this activity during the transaction.

While doing the due diligence the focus would be to assert whether the deal is worth the bill.

When someone triggers such a thought, the following aspects would prop up:

1. Confirmation of the strategy and feasibility of the target's business
2. Verifying operations and assets and liabilities are as represented
3. Develop and evaluate opportunities to best fit the target with the buyer
4. Cultural fit
5. Understanding the seller's financial and legal structure

The buyer must go with the spirit of confirming the value of the deal agreed to at the earlier stage and if corrections required, one must ascertain the same. Then the buyer must probably see how value generating activities could be driven on the post deal stage. If the buyer goes with the intention of finding gaps, probably the whole process may destabilise. There may not be perfect information sharing or mapping at Letter of intent stage.

Question 129: "Agricultural sector is poised for a second green revolution during the eleventh five year plan period" Comment.

Answer:

Agriculture sector has remained a problem area and there has been a deceleration in its growth.

To arrest this trend and reverse the deceleration number of policy inputs has been made. A National Rain fed Area Authority (NRAA) has been created in November 2006 to support up gradation and management of dry land and rain fed agriculture. The authority would coordinate all schemes relating to watershed development and other aspects of land use. The accelerated irrigation benefit programme is also being revamped to repair, renovate and restore water bodies in various states. For improved productivity in the agricultural sector an action plan has been formulated product specific. Like the green revolution of 1960's another revolution is on the threshold. The 11th plan will give special emphasis to agriculture to reorient and rejuvenate this sector to meet the needs of the farmers. The credit flow to the agricultural sector has exceeded the target for the third consecutive year. However, doubts are being expressed about the efficacy of the delivery systems and the improvement of this system is the urgent need. The National Agricultural Insurance Scheme (NAIS) and the National Rural Employment Guarantee Scheme

(NREGS) are two important schemes, which have been implemented recently. These have been extended to more number of villages, so that the under employment in agriculture sector is mitigated and business risk in agricultural farming due to natural calamities are also taken care of Dr. M.S. Swaminathan committee has identified insurance as a panacea for the above liabilities and the possible steps can be:

- Recognising agriculture as an "open roof" industry and bringing in concepts of industrial liability insurances
- Pre-harvest hedging
- Cross dimensional liability coverage for inability
- Linking of life assurances of farming community with their property and casualty insurances

Question 130: Growth of infrastructure has lagged behind and may assume serious proportions during the eleventh five year plan. How does the government of India plan to meet this challenge?

Answer:

The growth of infrastructure has lagged behind and may assume serious proportions. So, the government has been actively pursuing public private partnership (PPP) to bridge the deficit in the infrastructure. Under the overall guidance of the committee of infrastructure headed by the Prime Minister, the PPP programme formulation and implementation are being closely monitored by the relevant ministry / departments. An appraisal mechanism has been laid down and PPP appraisal committee has been given a mandate and guidelines for drawing up time frame for according approvals to proposals in a speedy manner. PPP projects normally involve long term contracts between the government and private parties detailing the rights and obligations of both the contracting parties. Government has decided to develop standardised frameworks based on due diligence and agreements will follow international practices. They will also create a framework with a right matrix of risk allocation, obligations and returns.

Planning commission has also issued model concession agreement (MCA) for ports, state highways and operation maintenance agreements for highways. To promote PPP programme all state governments and central ministries are setting up PPP cell with a senior level office as a nodal officer. Technical assistance has been obtained from Asian Development Bank (ADB) including hiring of consultants and training of personnel.

Question 131: What are the types of forecasting? Identify the models.

Answer:

Forecasting models are of four types:

1. Qualitative models
    - Delphi model – Collects and analyses panel of experts opinions
    - Historic data – Develop analogies to the past through judgment
    - Nominal group technique – Participative group process with forced voting

2. Naive (time series) quantitative models

   - Simple average – Averages past data to project the future based on that average
   - Exponential smoothing – Weights differently earlier forecasts and the recent to project into the future

3. Causal quantitative model

   - Regression analysis – Defines functional relationships among variables as to whether it is linear or non-linear
   - Economic modeling – Offers an overall forecast for a variable like Gross National Product (GNP)

4. Combination of monetary and physical projections

   - Marketing projections – Monetary by region, product and product group
   - Economic projections – Monetary by region, industry and broad product category
   - Historical demand projections – In units, monetary by product and product group
   - Demand forecast – In units by product and product group for operations management and monetary for sales and financial planning. (This is a combination of a, b and c)

Question 132: What are the various decision analysis models?

Explain influence diagrams.

Answer:

There are three types of decision analysis models:

- Analytical hierarchical process
- Decision trees
- Influence diagrams

Influence diagrams:

Another important decision analysis tools are known as an influence diagram. It offers a graphical presentation of decision situation expressing the exact nature of relationships between the variables. Bodily (1985) developed certain conventions for influence diagrams.

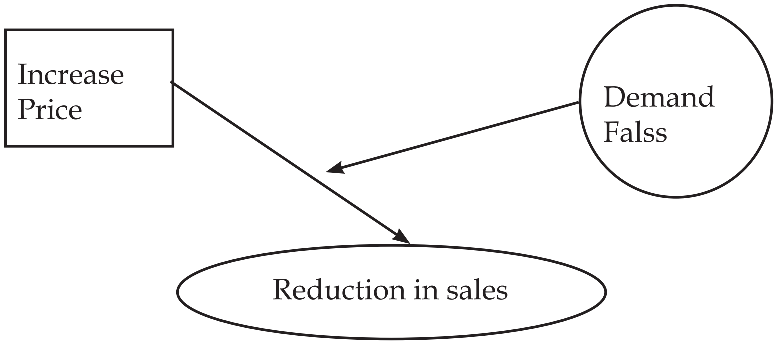
They are:

- A rectangle is a decision variable
- A circle is an uncontrollable or intermediate variable
- An oval is a result or outcome variable

These three types of variable are connected with arrows that indicate the direction of influence.

Arrows can be one way or two ways.

Influence diagram simplified:



Question 133: What advantages does the GE matrix model have over the BCG matrix?

Answer: The GE Business Screen:

The GE Business Screen is an advanced portfolio matrix developed by General Electric for its use in determining which SBUs or major products to keep in GE's portfolio and which to delete. The GE matrix can also be used to evaluate possible acquisitions, mergers, and/or new product development.

The GE matrix eliminates the majority of the inherent weaknesses of the BCG matrix by employing composite measures of business strengths and industry attractiveness. With the GE matrix, a strategist may plot a business in any of nine positions, as opposed to the BCG's four positions. GE's matrix also includes a corresponding increase in the number of advisable strategies identified. The GE matrix consists of nine cells of different colours that indicate appropriate strategies for different businesses or products. The vertical axis represents industry attractiveness while the horizontal axis represents the strength of the business or product. Both axes have high, medium, and low locations.

Within the GE matrix, there are three grids labelled G, R, and Y. If a firm or product under analysis falls in an intersection within Grid G, or a "green" cell, then an invest-and-grow strategy should be used. An organisation or product falling in an intersection within Grid R, or a "red" cell, should either (1) be harvested and ultimately divested or (2) employ a retrenchment and turnaround strategy, curtail or reduce investment in the business, and extract as much as possible before the business is divested. Grid Y portrays a firm that intersects in a "yellow" cell, where the firm or product has low business strengths but high industry attractiveness. Here, the organisation should employ a selectivity/earnings strategy. If this demonstrates good earning potential for the business, it should received an invest-and-grow strategy and be monitored continually. If it does not prove worthwhile, it should be divested.

Business strength (controllable dimensions):

The ability of the company to compete effectively in its industry or market includes knowledge about industry, customers, market share, financial performance, quality of its marketing personnel, and production capacity.

Market or industry attractiveness (uncontrollable dimension):

These include market growth rate, competitive industry factors, legal constraints, plus opportunities and threats from the SBU's external environment.

G = High Priority for Investment
Y = Moderate Priority for Investment
R = Low Priority for Investment

G	G	Y	High
G	Y	R	Moderate
Y	R	R	Low
High	Medium	Low	

The GE model has several advantages over the BCG matrix.

First, it allows for intermediate rankings between high and low. Second, it incorporates a variety of strategically relevant variables. Third, it emphasises channeling corporate resources to those businesses that combine market attractiveness with business strength.

The GE model shares some weaknesses with the BCG model.

It yields only general prescriptions as opposed to specific strategies. Although a strategy such as "hold and maintain" may be useful as a starting point, specific approaches to implement the strategy remain wide open. Further, the model fails to show when businesses are about to emerge as winners because the product is entering the takeoff stage. It is therefore recommended to utilise more than one model to overcome some of these problems.

Using one model might help managers to solve a particular problem but overlook other possibilities.

Question 134: What are the different policies taken by the Government of India to improve the productivity and competitiveness of the Indian economy?

Answer:

Proactive policy measures taken by the Government of India to improve the productivity and competitiveness of the Indian economy enunciated in the various sectors of the economy – real, fiscal, external, monetary and financial.

(i) Real sector policies:

- **Agriculture and allied activities:** Agricultural sector has remained a problem area and there has been a declaration in its growth. To arrest this trend and reverse the deceleration, number of policy inputs has been made. A National Rain Fed Area Authority (NRAA) has been created in November 2006 to support up-gradation and management of dry land and rain fed agriculture. The authority would coordinate all schemes relating to watershed development and other aspects of land use. The accelerated irrigation benefit programme is also being revamped to repair, renovate and restore water bodies in various states. The National Agriculture Insurance Scheme (NAIS) and the National Rural Employment Guarantee Scheme (NREGS) are two important schemes which have been implemented. These have been extended to more number of villages, so that the under employment in agriculture sector is mitigated and business risk in agricultural farming due to natural calamities are also taken care of.

- **Manufacturing and infrastructure policies:** If the increased activity in the manufacturing sector since 2003-2004 has to be sustained focus on upgrading the infrastructure facilities in the country is the need of the hour. Up gradation of human skills, work on golden quadrilateral, introduction of public private partnership model, increase in the power production capacity, etc, have already been identified as the areas which need robust growth in the immediate future. Spiraling of crude oil prices has had a deleterious impact on production and logistics costs through higher fuel costs. Alternatives to fossil fuel are being looked into. Wind energy is being harnessed increasingly apart from utilising the large coal reserves available in our country. The credible alternative of producing nuclear power is one of the salient government policy. In regard to the industrial policy, the micro, small and medium enterprises development act 2006 has modified the previous act to increase the threshold investment. A new national pharmaceutical policy has also been announced during the year 2006 to strengthen drug regulatory system and patent office. The public-private partnership model has enabled greater private sector participation in the creation and maintenance of infrastructure. Concepts of special economic zone are under introduction and there have been a lot of hiccups in this area. New modifications are on the anvil to take care of the displaced landowners as also protection of the fertile lands. The information technology amendment bill 2006 will put in place technology applications, security practices and procedures relating to such applications.

(ii) Fiscal policy: While preparing a policy to take care of the robust growth of the economy it has also been necessary to introduce fiscal corrections to reduce the fiscal deficit. Government of India subjected itself to a fiscal discipline for reducing deficits in the key areas viz, revenue, fiscal and primary. The tax base is being broadened to include more and more new services in the tax net. Personal taxation is being reduced so that the disposable incomes are bigger and savings grow. Introduction of value added tax (VAT) in various states has been a significant success and is expected to usher price stability as well as improved earnings to the various states through higher volumes.

(iii) External sector policies: Foreign trade policy of 2004-2009 was modified through an annual supplement in 2007 for deepening the incentives provided for focused products and markets. For simplifying and liberalising the external payments regime and deepen the foreign exchange market the recommendations of the committee of Fuller Capital Account Convertibility have been considered by the Government of India and certain policy initiatives have been undertaken.

They relate to increase in overseas investment limits for joint ventures/wholly owned subsidiaries abroad by Indian companies, higher portfolio investment limits for Indian companies/domestic mutual funds, higher ceilings for investments by foreign institutional investors in Government securities and enhanced repayment limits for external commercial borrowings.

(iv) Monetary policies: The necessity to balance the growth of economy with containing inflationary pressures has guided the monetary policy. The Reserve Bank of India (RBI) have taken its stance on the monetary policy to continue to reinforce the emphasis on price stability and well anchored inflation expectations and there by sustain the growth momentum contextually, financial stability may assume greater importance in the near future. RBI has been managing this area with the cash reserve ratio (CRR) on one-hand and Repo rates on the other. The interest rates are being modified whenever necessary on the basis of the monitoring exercise on rates of inflation.

(v) Financial sector policies: In view of the critical role played by the financial sector in supporting the robust growth of economy, RBI have tightened provisioning norms and risk weights to ensure asset quality, strengthened the accounting and disclosure norms for greater transparency and discipline.

Final guidelines for the implementation of the new capital adequacy framework have been issued. Alongside its initiatives to strengthen the financial sector the RBI continue to take measures for protecting customers' rights and enhancing the quality of customer service.

Question 135: (a) What is a 'Model' in business decisions and strategies?

(b) Give various classifications of 'models'?

(c) Why should a manager consider using 'models' in business decisions and strategies?

Answer (a):

Model: The word 'model' is often used in conjunction with quantitative techniques for business decision making and for strategic choices. Almost all quantitative techniques can be classified as models. Generally all business decision situations, although decision-contents greatly vary, have certain common factors like –

- Alternative choices,
- Possibility of various outcomes against a particular choice,
- Occurrence of probabilities against an alternative, and
- Inequality of the probabilities for each outcome.

In such a situation, decision maker or the strategist has to determine the value or the utility with each unique action-outcome combination – before he makes the final decision or strategy – mostly in terms of pay-offs and costs.

A quantitative technique incorporates all these elements of business decision situations into a 'model' that is intended to maximise pay-offs and minimise costs.

Answer (b):

Classification of 'Models'

There are several basic kinds of models.

(i) Analog model: An 'analog' model is a physical representation of the real world. A mockup of an airplane is an analog model. An architect may place a mockup of a building to examine the characteristics of alternative designs. Such models are always reduced in size.

(ii) Iconic model: An 'iconic' model is one which does not act like the real thing but only looks like it. For example, a road map or an organisation charts. A road map abstract the facts like distance, direction, kinds of highways, bridges and tunnels, etc. needed by a driver. Similarly, in an organisation chart, the boxes represent specific offices or formal roles and the lines represent channels of communications and reporting relationships.

(iii) Verbal model: It involves a verbal description of a real situation. Language, written or spoken is employed to abstract the relevant factors or characteristics. A newspaper description of a football game is a verbal model.

(iv) Mathematical model: This model employs mathematical manipulation of symbols to abstract and represent the behaviour of a real-world system. The use of electronic computers has led to the rapid and wide adoption of mathematical models in managerial decisions. A complex series of mathematical formulae representing the growth of Indian economy can be classified as a model.

Answer (c):

The specific reasons are –

(i) A model in a decision situation provides a frame of reference to consider the decision-cum strategy problem. A number of diverse considerations can be brought together in an organised fashion.

(ii) A model can suggest gaps in the manager's information about the decision, even though the gaps are not immediately apparent. It can, consequently, suggest useful lines of inquiry.

(iii) A model brings out into the open the process of abstraction and decision-cum-strategy making. The process of abstraction is deliberate.

(iv) A model, be it iconic, verbal or mathematical, can be easily manipulated. For example, a mathematical model of an entire economy is capable of testing the effects of a variety of monetary and fiscal policies on economic outcomes without waiting for the actual economy to behave.

(v) A model is always cost-effective and considered as the safest means to test alternative designs.

(vi) Building a model allows the decision maker to simplify reality to the extent that he can grasp its salient characteristics, make his understanding of the situation rather more concrete, and focus his attention on the most important elements of the situation.

(vii) A model serves as a kind of filter, eliminating extraneous of confusing data, while highlighting meaningful pattern.

(viii) The primary value of a model lies in its simplicity relative to the real world.

Question 136: How are decisions taken with regard to brand selection and its use in the Indian context?

Answer:

Branding removes anonymity and gives identification to a company and its goods and services. Branding is actually a very general term covering brand names, designs, trademarks, symbols, a distinctive letterhead; an identifiable shop front or van etc., which may be used to distinguish one organisation's goods and services from another's. According to Kotler, a brand is a name, term, sign, symbol or design or combination of them, intended to identify the goods or services of one seller or group of sellers and to differentiate them from those of competitors. Branding and a firm's reputation are heavily linked.

As appropriate branding is one of the most important activities in the area of marketing of products, especially consumer products, several decisions need to be taken with regard to brand selection and its use. These are:

(1) Should the product be branded at all?

The decision to brand or not to brand a product can be taken only after considering the nature of the product, the type of outlets envisaged for the product, the perceived -advantage of branding and the estimated costs of developing the brand. Historically, it is found that brand development is closely correlated with the increase in the disposable income, the sophistication of the distribution system and the increasing size of the national market. The same trend is visible in India now. Several firms have started marketing branded products in such product categories as wheat, flour and refined salt. The reason for such a trend is that a class of consumers are willing to pay more for uniform and better quality product represented by the brand.

(2) Who should sponsor the brand?

The question of sponsorship of a brand refers to the decision as to whether it should be a manufacturer's brand, also known as a national brand or a private -brand, also known as a middlemen's brand. This is a major decision in most developed countries, where large chain/departmental stores dominate the retail distribution system. This is however, largely a hypothetical question in India where retail distribution system is highly fragmented. Only super markets have started marketing a few products that are specially packed and sold under their names. However, some retailers' brand names in product categories such as car accessories have already been established.

(3) What quality should be built into the brand?

A very crucial decision is with regard to the quality and other attributes to be built into the product. The matrix of such attributes will decide the product positioning. A marketer has the option to position his product at any segment of the market: top, bottom or the intermediate. Taking an example, "Ariel" is positioned as a premium quality and high priced product. At the other end of the scale, "Wheel" is positioned as low priced.

(4) Should each product be individually branded or a family brand should be adopted for all the products?

The marketer also has to decide at the outset whether he would like to adopt a family brand under which all the products of the company would be sold or he would like to brand each product separately. Kissan follows the former policy. The same brand name is used for jam, squashes, juices and sauces. 'Hindustan Lever' follows the latter policy. Some firms follow a slightly modified strategy. This involves using brands individually but also giving prominence to the company name or logo in all promotional campaigns as well as in product packaging. For example, Tata group Companies follow this strategy. In many cases a brand extension strategy is adopted for securing additionally mileage from a particularly successful product. For example, 'Lifebuoy Gold' and 'Lifebuoy Plus' are extensions of 'Lifebuoy'.

(5) Should two or more brands be developed in the same product category?

A firm may decide to have several brands of the same product, which to some extent are competing inter se. The basic reason is that, at least in the consumer products, various benefits, appeals and even marginal differences between brands can win a large following. Example: 'Hindustan Lever' markets several soaps under different brands for different segments.

(6) Should the established brand be given a new meaning (repositioning)?

Over the life cycle of a product, several market parameters might undergo a change. All and each of such changes call for a relook as to whether the original positioning of the product is still optimal or not. Stagnating or declining sales also point to a need for reassessment of the original product positioning. For example, 'Lifebuoy Soap' has been repositioned several times in the recent past.

Question 137: "To be effective, any Enterprise Risk Management (ERM) implementations should be integrated with strategy-setting". Do you agree?

Give your views bringing out the basic elements of ERM and the reasons why ERM is implemented.

Answer:

"To be effective, any Enterprise Risk Management (ERM) implementation should be integrated with strategy-setting". To my mind, this statement is true.

In today's challenging business environment, opportunities and risks are constantly changing, giving rise to the need for identifying, assessing, managing and monitoring the organisation's business opportunities and risks.

This, in turn, necessitates establishing the linkage between the opportunities and risks while.

Managing the business. This requirement is addressed by ERM, which redefines the value.

proposition of risk management by elevating its focus from the 'tactical' to 'the strategic ERM is about designing and implementing capabilities for managing the risks that matter. In the light of this, the statement is correct and therefore acceptable.

Basic Elements of ERM:

The following are the basic elements of ERM:

- A process, ongoing and flowing through an entity.
- Effected by people at every level of an organisation.
- Applied in strategy setting.
- Applied across the enterprise, at every level and unit and includes taking an entry-level view of risk.
- Designed to identify potential events affecting the entity and manage risk within its risk appetite.

- Able to provide reasonable assurance to an entity's management.
- Geared to the achievement of objectives in one or more separate but overlapping categories. It is 'a means to an end, not an end in itself.

Reasons why ERM is implemented:

ERM needs to be implemented for the following reasons:

- Reduce unacceptable performance variability.
- Align and integrate varying views of risk management.
- Build confidence, of investment community and stakeholders.
- Enhance corporate governance.
- Successfully respond to changing business environment
- Align strategy and corporate culture.

Question 138: (a) Why is Risk Reporting considered to be an important step in Risk Management? What are the broad categories of risks that can be identified for an organisation?

(b) Describe the following in the context of risk management:

(i) Solvency related measures, (ii) Performance related measures.

Answer (a):

Risk Reporting is an important step in Risk Management

A transparent and effective risk reporting system is essential for a company, as it is obligatory on its part to disclose all material risks that it faces and its risk management practices. In recent years, the concept of risk reporting has assumed significant importance, after the collapse of Enron as well as other corporate failures. Existence of an adequate Risk Reporting System in an organisation makes the managers more accountable for their actions. In the light of this, the importance of risk reporting system can be summarised as under:

- It can assist the Board to discharge its responsibilities, enabling the company to go for higher profits at lower risks.
- It helps in decision-making at all levels with objectivity.
- It can help investors to evaluate market situations with a view to building optimum portfolio of securities.
- Lenders can be supported in their lending operations and policy decisions.
- It can help a company in getting a better credit rating and access to cheaper source of finance.
- It develops transparency between managers and investors-leading to reduced agency cost, which in turn reduces the cost of capital and increases the basket of investment opportunities available to a firm.
- It can create a niche for the company and can act as a trendsetter for others.

Broad categories of risks that can be identified for an organisation

A number of factors influence the risk and depending upon the cause, the risks can be broadly classified into the following major types:

- Strategic Risks: examples are Government and economic factors, customers, competitors, new technologies etc.
- Operational Risks: examples are suppliers, process and internal risks, distribution, customers, competitors, environmental factors etc. ,
- Investment Risks- examples are interest rates, purchasing power, liquidity, default, convertibility, portfolio etc. ,

Answer (b):

(i) Solvency related measures in the context of risk management:

These measures concentrate on the adverse 'trail' of the probability distribution and are relevant for 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 specific 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 organisation 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 is typically calculated daily and used to monitor trading activity.
- Expected Policy holder Deficit(EPD) or Economic Cost of Ruin(ECOR) -is an enhancement to the probability of ruin concept(and thus shortfall risk at VAR) in which the severity of the ruin is also affected. Technically, it is the expected value of 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.

(ii) Performance related measures in the context of risk management:

These measures concentrate on the mid-region of the probability distribution, i.e., the region near the mean and are relevant for determination of the volatility around expected results:

- Return on Equity(ROE) i.e. , net income divided by net equity.
- Operating earnings- i.e. , net income from continuing operations, excluding realised investment

- Earnings before interests, dividends, taxes, depreciation and amortisation (EBIDTDA) 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) =EBIDTDA divided by tangible assets.

Question 139: (a) Explain management accountant's role in insurance risk management.

(b) State briefly your understanding about RAPM.

Answer (a):

In the wake of economic uncertainties through which the business passes, a management accountant has to stay close to risk management process in an organisation and bring about a structured thinking within the business about risks. Irrespective of his role, as a management accountant in an insurance company or an insured company, a management accountant has to appreciate the computation of the premium rates for different insurance product, as also fully define the character of the losses to be covered.

Value imputation of risks to be covered by the insurer's company has two aspects:

(i) Quantifying the total risk to be covered for calculating a premium as a definite fraction of the risk value covered by the policy.

(ii) If the quantification of risk is so high and the corresponding premium is also likely to be high enough for an insured to back out, then develop a framework where the insurer's company can reinsure itself for the policy risk with another insurance company. This will help in reducing the premium for the insured.

A management accountant in an insured company has his task cut out in two directions. At the time of covering the risk, he has to work closely with the cross functional team to identify the direct values of the risks involved and indirect consequent values of the risks involved. For example, in the first instance, the replacement cost of a plant being insured is a direct cost and has to be quantified by proper methodology. The next step is to estimate the consequential loss of profits due to stoppage of plant due to breakdown of the plant being replaced.

During the period of economic uncertainties, the management accountant can fortify the management thinking process -through providing a robust, highly reliable, fast and responsive, transparent and reliable Information Management, which will continuously highlight the risks inherent in every management activity.

Answer (b)

RAPM: stands for Risk Adjusted Performance Management.

The best practice recommendation

was enunciated in the G30 report on derivatives. The recommendations have been considered very sound and very much in use currently. They include:

(i) Involve senior management;

(ii) Establish independent risk managers for market and credit risk.

(iii) Market to Market on a daily basis with consistent valuation measures.

(iv) Measure and limit market and credit risk, using value at risk (VAR) techniques to estimate probable loss over a period of time.

(v) Strengthen operational controls, systems and training,

(vi) Make investment and funding forecasts,

(vii) Identify revenue sources and next conduct stress testing.

Question 140: (a) What is Business Risk? How do you measure Physical Risk?

(b) List the different statutes governing Employer-Employee liability in India.

Answer (a):

Business Risk refers to variations in earnings due to demand variability, price variability, and variability for input prices etc., which are essentially external and are market driven. Business risk which is inherent to a business due to its nature and susceptibility to environment e. g., changes of fashion, business cycles, conflicts like war, insurgency, cross-border terrorism, technological obsolescence etc.

Business risks can be divided into internal and external business risks. Internal business risk is mainly due to the variations in the operational efficiency of the company. The External business risks arise out of the circumstances imposed on the company by external forces like business cycle, certain statutory restrictions or sops.

Measurement of Physical Risks:

Physical risks (like natural calamities, fire, tsunami, earthquake etc.) can be measured by the application of technological tools. Earthquakes are measured in the Richter scale. Floods are measured through level monitoring and marking danger levels. Risk of fire is often monitored through measurement of Flash Point, Fire Point, Ignition temperatures and Propulsion temperatures. Spontaneous ignition temperatures are yet another measurement to identify fire risk, e. g., coal dumps, oil installations, explosive go downs, etc.

Physical Risk arising out of social, political, economic and legal environments are often identified through the performance of lead indicators. In social arena, lead indicators can be pestilence, expediencies, social upheavals etc. , Measurement of these social risks are done on the basis of the impact on the society, i.e. , increase in crimes, violence and accidents etc.

Political risk is often identified with the change in Government Policy approach like say-Capitalistic, Democratic or Totalitarian and can be measured by the impact of such Government policy on the economic activity e. g., Government's Industrial Policy or Labour Policy. Economic

Risk may arise out of commercial transactions, foreign exchange currency variation, capital market fluctuations, trade cycles etc. , The lead indicators risks are like variations in GDF, IIP, Balance of Payments, Stock Market Indices, etc.

Legal Risk arises out of the implications of various statutes affecting business like say-Anti Trust Bills, Factory Act, Industrial Disputes Act, Foreign Exchange Management Act (FEMA) etc.

Answer (b):

The following are some of the important statutes governing the Employer-Employee liability:

- Minimum wages Act
- Payment of wages Act
- Workmen's compensation Act
- Provident Fund act
- Gratuity Act
- Shops and Establishments Act
- Industrial Disputes Act
- Trade Union Act
- Factories Act

Question 141: (a) Define Risk Management and explain its important objectives.

(b) Enterprise risks involved in solvency transactions as well as ageing debts have to be taken care of on a day-to-day basis in the business. What are the instruments used for this purpose and application there of?

Answer (a):

"Risk Management can be defined as the logical development and execution of a plan to deal with potential losses". The risk will include both upsides as well as the downside ones .

Objectives of Risk Management:

Objectives of Risk Management can be classified under two heads -viz.,

Pre-loss Objectives and Post-loss objectives:

Pre-loss Objectives:

- Understanding the environment
- Fulfillment of external obligations-statutory requirements
- Reduction in anxiety through preventive measures.
- Social obligations to make people aware of the risks.

Post-loss objectives:

- Survival of the organisation

- Continuance of the organisation's operations
- Initiate and improve upon the income/earnings
- Obligations to the society.

Answer (b):

Major tools (instruments) for managing enterprise risk are as below:

Instrument	Purpose	Remarks
Guarantee	Guarantees can be financial guarantees or performance guarantees. ➢ Financial guarantees protects against the financial loss on failure to meet financial obligations. ➢ Performance guarantees are protection against non-performance of contractual obligations.	Financial Institutes provide Guarantees as a risk-cover against a collateral by the buyer for a consideration
Letter of Credit or Documentary Credit.	Guarantee against non-payment of purchase consideration by the buyer in the nature of off-balance sheet financing.	Financial Institutions issue this instrument for a consideration. It can be recoverable or irrevocable. It can also be revolving.
Under-writing	Under-writing is a protection mechanism available in the capital market to cover the risk of non-subscription to a public issue.	Financial Institutions offer this risk cover for a consideration after due evaluation of risk.
Collateralised Debt obligations	Taken against short-term and long-term loans for working capital as well as fixed assets.	Financial Institutions offer this risk cover for a consideration after due evaluation of risk and cover themselves completely either through hypothecation or pledges or equitable markets.
Asset Securitisation	Companies offering financial services of hire-purchasing, leasing, etc., try to raise finance through this method.	This is a special purpose vehicle (SPV) to manage default risk. Financial institutions as well as public subscribe to this method for a consideration in the form of interest and securitisation is available from the assets that are being traded.
Factoring	Companies resort to this instrument both as a risk cover and insure cash flow.	Specific financial institutions called factoring companies offer this service for a commission with recourse or without the recourse.

Question 142: What is risk? Discuss different types of risk.

Answer:

Uncertainty and risk are two terms which are anathema to every manager. Certainty and uncertainty are the two extremities on a continuous platform and risk is identified somewhere between the two extremes.

Uncertainty is a totally indefinable happening and is also unexpected. An uncertain situation is faced when the variables are many and heir interaction can be innumerable. For example different people behave and react differently to the same situation and uncertainty arises.

Risk expressed mathematically is the dispersion of a probability distribution: how much do individual outcomes deviate from the expected outcome. A simple measure of dispersion is a range of possible outcomes, which is simply the difference between upper most and the lowest outcomes. This is mathematically measured as standard deviation. Physically, risk can be identified as an event which has different probabilities of happening, but the time of the event is not known as also the impact of such risk can vary. While uncertainty cannot be quantified a risk can be quantified though mathematical models, probability models, correlation, etc. and also measured through quantitative models and technological tools.

Types of Risk:

Mark Dorfman has defined "risk management as the logical development and execution of a plan to deal with potential losses". The risk can include both upside and downside. Potential risk management often refers to reducing downside potential and enhances the returns on topside.

Risks are of many types as follows:

1. **Physical Risk** like natural calamities: fire, tsunami, floods, earthquake, etc.
2. **Business Risk** which is inherent to a business due to its nature and susceptibility to environment, e.g., change of fashion, business cycles, conflicts like war, insurgency, cross border terrorism, technological obsolescence, etc.
3. **Financial Risk** arising out of the nature of financial transactions and conduct of business and investment.

Question 143: What is Risk Management? Discuss the strategies involved in risk management.

Answer:

Risk management is the identification, assessment, and prioritisation of risks followed by coordinated and economical application of resources to minimise, 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 prioritisation 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 organisational 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 materialise. 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 organisation 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 nonavailability 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 an 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., and 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 optimisation:

Risk optimisation means utilising 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.

Question 144: 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 is 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 organisation and can be reduced or diversified by acting with in the organisation, which is through functional level strategy. The unsystematic risk, which is the market risk is external to an organisation 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.

Question 145: 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.

Question 146: What are the characteristics of Insurance Exposures?

Discuss the relationship between relative importance of identified Risk and Probability of occurrence of loss.

Answer:

The characteristics for an exposure to be covered by Insurance are as follows:

1. **Pure Risk:**

   These are classified into personal risk, property risk, liability risk and loss of income risk.

   - Personal Risk – Can happen due to premature death, old age, sickness or disability and unemployment.
   - Property Risk – Can be classified as loss of property, loss of use of property, additional expenses arising out of loss of property.
   - Liability Risk – Can arise as injury to people or damage to property or negligence or carelessness.
   - Loss of Income Risk – Consequential loss of income arising out of personal or property losses.

2. **Similar Exposures:**

   Predictions of losses through application of statistical computations with the help of theory of probability require a sizeable population of similar exposures. This is particularly important in that estimation of probabilities for the happening of an event needs an adequate large sample, as accuracy increases with bigger sample.

3. **Accidental Losses:**

   Insurance contracts allow payments only for accidental losses which beyond the insured's control. Losses taking place unintentionally alone are covered by Insurance. Suppression of information of a known risk will not entitle for compensation.

4. **Definite Loss:**

A definite loss has three facets. It should be recognizable and should be susceptible to verification. The loss should be measurable. This is particularly important in that premium are computed mainly on the estimated quantification of losses.

5. **Large Loss:**

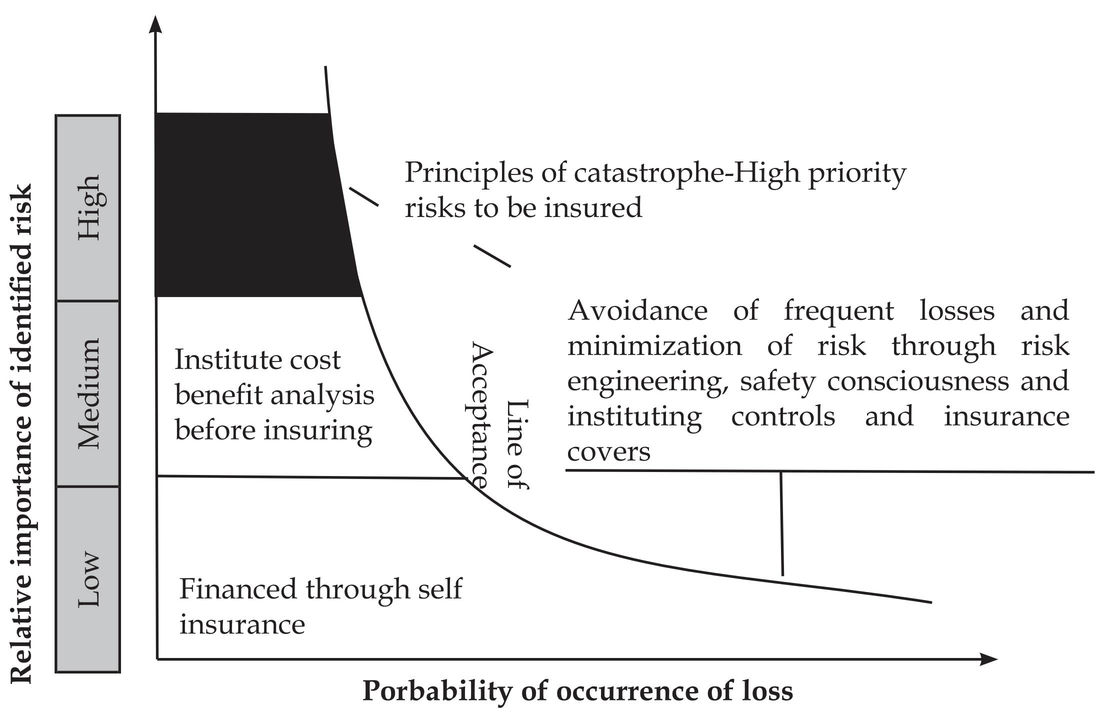
As there is always a consideration in the form of a premium for receiving a compensation for a loss, care should be taken that the premium to loss ratio is sufficiently favourable. Insurance tariffs normally form a very small percentage sometime even less than a per cent.

6. **Catastrophic Losses:**

Catastrophic losses from natural disasters have two main characteristics:

a. They are limited to geographic area where the impact has taken place.

b. Prediction of the event is very difficult. For example storms and floods or earthquakes etc. can create catastrophic losses as such an Insurer will have to take special precautions of calculating the premiums. Even then the loss may be so huge that the consumers normally resort to sharing the risks through reinsurance as also ensures dispersion of risks over a larger geographical area. To estimate the frequency and severity of the catastrophic losses probability analysis is resorted to:



Question 147: Define liability exposures.

Answer: Liability exposures can be defined as those losses, which are caused due to the failure to accomplish legally imposed obligations rather than enjoy the rights. The limit of liability of the Insurers under a policy is the sum insured.

Question 148: Describe asset liability model and its utility for managing liquidity risk and exchange rate risk.

Answer:

Asset liability management is a technique to compute matching of assets and liabilities by which a prudent management of an investment portfolio can be properly taken care of. Asset liability management is defined as "maximising the risk adjusted returns to shareholders over the long run". It is also defined as management of total balance sheet in terms of size and quality (composition of assets and liabilities).

Liquidity risk management through asset liability management

It is difficult to measure liquidity risk as it entails expecting likely inflow of deposits, loan dispersals, changes in competitive environment, etc. The most commonly used techniques for measurement of liquidity risks is the gap analysis. The assets and liabilities are arranged according to their maturity pattern in time brackets. The gap is the difference between the maturing assets to the maturing liabilities. A positive gap indicates that maturities of assets are higher than those of liabilities. A negative gap indicates that some rearrangement of funds will have to be done during that time bracket. It can be from sale of assets or issue of new liabilities or rolling over existing liabilities.

Exchange rate risk management through asset liability management

At a particular exchange rate assets and liabilities of a financial institution match exactly. As the exchange rate fluctuates this balance gets disturbed. A simple solution to correct this risk is to match assets and liabilities of the same currency. Many financial institutions do not have foreign exchange exposure as all their assets and liabilities are in rupee currency. The risk of foreign exchange borrowings of these institutions are passed on to the lenders through dollar denominator loans. The uncovered loans are hedged at the time of contracting them through forward covers for the entire amount.

Question 149: Enterprise risks involved in solvency transactions as well as ageing debts have to be taken care of on a day to day basis in the business. What are the tools (instruments) used for this purpose and application there of?

Answer: Major tools for managing enterprise risk are as below:

Instrument	Purpose	Remarks
Guarantee	Guarantees can be financial guarantees or performance guarantees. ➢ Financial guarantees protects against the financial loss on failure to meet financial obligations ➢ Performance guarantees are protectionagainstnon-performance of contractual obligations	Financial institutions provide guarantees as a risk cover against a collateral by the buyer for a consideration
Letter of credit or documentary credit	Guarantee against non payment of purchase consideration by the buyer in the nature of off-balance sheet financing	Financial institutions issue this instrument for a consideration. It can be revocable or irrevocable. Can also be revolving
Underwriting	Underwriting is a protection mechanism available in the capital market to cover the risk of non-subscription to a public issue	Financialinstitutionsofferthis risk cover for a consideration after due evaluation of risk
Collateralised debt obligations	Taken against short term and long term loans for working capital as well as fixed assets	Financialinstitutionsofferthis risk cover for a consideration after due evaluation of risk and cover themselves completely either through hypothecation or pledge or equitable markets
Asset Securitisation	Companies offering financial services of hire purchasing, leasing, etc try to raise finance through this method	This is a special purpose vehicle (SPV) to manage default risk. Financial institutions as well as public subscribe to this method for a consideration in the form of interest and securitisation is available from the assets that are being traded
Factoring	Companies resort to this instrument both as a risk cover and insure cash flow	Specific financial institutions called factoring companies offer this service for a commission with recourse or without the recourse

Question 150: What are the strategies adopted for Corporate Risk Management?

Answer:

In risk management, the following four strategies are generally adopted:

- **Risk Avoidance** is a strategy by which the organisation does not engage in the activity which involves any risk.
- **Risk Reduction** is another strategy where the organisation takes two steps. One is preventing the occurrence of risk and the second one is controlling the number of occurrences. One of the possible ways of reducing the risk is going for large number.
- **Risk Retention** is the most popular method of dealing with risk. Risk retention may be conscious or unconscious. Conscious risk retention takes place when the risk is perceived and not transferred or reduced. When a risk is not recognised, it is unconsciously retained.
- **Risk Transfer** is another method of managing risk. Risk can be transferred to a person willing to take it. Hedging or insurance are best examples for risk transfer.
- **Risk Sharing** is process by which the potential risk is shared among many, so that the loss is not borne by a single person.

Question 151: How do you shape institutions for project risk management and what are the strategies to be adopted?

Answer:

Institutions can be shaped by anchoring projects, ensuring repayment of investments, providing social utility. This risk could be avoided by stabilisation of long term future to enable investments, enhance the legitimacy of the project by developing practices like inviting the representatives of both the institutions and the public. Develop a strong framework for structuring decision making.

Question 152: How do you hedge and diversify project risk management and what are the strategies to be adopted?

Answer:

Hedging and diversification of project risk management use the following tools: portfolios, insurance and hedging. Project risk could be reduced through building a diversified portfolio to balance risks and cash flows, hedging against currency fluctuations or commodity exposures, applying financial derivatives. Risk can be transferred by insuring risks as well as diversifying investments in different countries to reduce political risk.

Question 153: How do you embrace project risk management and what are the strategies to be adopted?

Answer:

Project risk can be embraced through comprehension of residual risk. This risk could be retained by developing a proper information system regarding the residual risks, commercial aspects and developing a clear sense in bearing various risks, then understanding of particular risk domains to develop ability to bear commercial risks. This risk could be transferred through Develop information system regarding financial institutions, capital markets and special vehicle applications identification local industrialists who are ready to partner for sharing risks through a portfolio of investment, identification of international partners for sharing investments through a portfolio of investment, identification of financial institutions locally like commercial banks, identification of international financial institutions.

Question 154: 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.

Question 155: What is systematic risk and what is unsystematic risk? Discuss the further classification of systematic and unsystematic risk.

Answer:

The risk is understood as the sacrifice made by an individual by deferring the use of money to a future day by investing that money in a venture promising a higher return which has uncertainty. The forces that contribute to the variations in return can both be external or internal to a company in which an individual has invested. These forces can partly be controllable and the remaining uncontrollable. The uncontrollable portion, which is essentially external, is known as systematic risk and the controllable internal risk is known as unsystematic risk.

The external or systematic risk can be classified as three types of risk:

Market Risk: Variability in return on investments in the market is referred to as market risk. This is caused by investor reaction to the tangible as well as intangible events. Tangible events like economic, political, social events and intangible events arising out of a market psychology or the other factors like interest rates and inflation also form part of the forces behind market risk.

Interest Rate Risk: This risk refers to the uncertainty of market volumes in the future and the quantum of future income caused by the variations in the interest rates. These interest rates are normally controlled by the Reserve Bank of India in our country and the exigencies for changing the interest rates arise out of many economic factors which are monitored by the central bank i.e., R.B.I. Normally, when the interest rates increase the companies with higher quantum of borrowed money will have to pay out higher quantum of interest reducing their earnings and vice versa.

Purchasing Power Risk: Purchasing power risk is the uncertainty of the purchasing power of the monies to be received, in the future. In short purchasing power risks refers to the impact of inflation or deflation on an investment. Prudent investors normally include a premium for purchasing power risk in their estimate of expected return.

Exchange Risk: With the globalisation of market cross border transactions are on the increase. Balance of payments comprising the net effect of exports and imports are subject to fluctuation in the various currencies. As recently, the strengthening of Rupee against the Dollar imports has made imports cheaper and exports costlier. The need to recognise this exchange risk is obvious as the international trade operations may be profitable or loss-making unless this risk is taken care of.

Unsystematic Risk: Unsystematic Risk is that fraction of total risk which is unique to a company or an Industry due to inherent internal factors like managerial capabilities, consumer responsiveness, labour unrest, etc. The operating environment of the business and the financing modalities involve this unsystematic risk. The first one is known as the Business Risk and the second is the Financial Risk.

Business risks can be again divided into internal and external business risks. Internal business risk is mainly due to the variations in the operational efficiency of the company. The external business risks arise out of circumstances imposed on the company by external forces like business cycle, certain statutory restrictions or sops.

Financial risk is associated with the modalities adopted by a company to finance its activities. For instance the financial leverage like the Debt Equity Ratio or the type of borrowings and the variations thereof introduce financial risk. Lower the debt less is the financial risk

Question 156: (a) What do you mean by "Corporate Governance"? What are its salient features?

(b) Write a brief note on significance of this concept in today's context in India.

Answer (a):

Corporate Governance.

The responsibility and the accountability of top management have been focused in recent times underlying the necessity of good Corporate Governance. The issue of Corporate Governance was first taken up officially in UK in the early 90s. This resulted from a series of sensational business scandals in the late 1980s like the bankruptcy of Bank of Credit and Commercial International, Plundering of Pensions funds by Robert Maxwell etc. in UK.

Under 'Good Corporate Governance' there should be total transparency in respect of all aspects of management and its functioning. There should be financial transparency and on the related role of directors and Auditors. It is stipulated that all major investment and disinvestment proposals, changes in financial and marketing structure, important appointments and findings of the Internal Auditors etc. have to be presented to be discussed and approved by the Board of Directors of the Company. The Board should be briefed periodically on the progress of various projects under implementation. "Transparency" being the hall mark of Corporate Governance, it must be ensured that no vital information is concealed from the Board. The Directors of the Company should, make a statement in their reports and accounts on the effectiveness of the system of internal control. Further, the companies must make compliance statements as to whether or not they have complied with the financial aspects of Corporate Governance. Further, in the interest of Corporate democracy separation of power is desirable at the top level. If the chairman and the Chief Executive officer are the same, outside directors should provide a strong and independent counterweight.

Thus the basic principles of good governance are:-

- Clear responsibilities
- Precise distinction between direction and management
- Checks and balances in the governance structure
- Total transparency re : all actions of management

Answer (b):

A role on the significance of Corporate Governance in India.

In India, Corporate governance has assumed significance and urgency due to the following reasons:

- changing profile of corporate ownerships
- preferential allotment of shares to promoters
- increasing inflow of foreign capital
- and dismantling of controls that hitherto provide protective cover to poorly managed corporates.

That corporate governance in India is lacking in many respects has been highlighted on several occasions in recent years and examples of Corporate misgovernance are many like:

- FERA violation by the ITC
- Desubsidiarisation by Escorts
- Fund diversion by Shaw Wallace
- Family feud in Modi Rubber

Effectiveness of the Board of Directors is a crucial factor of good Corporate Governance. For good corporate governance, a statement of Directors Responsibility (SDR) should be attached to the Annual A/cs for better transparancy. Further the management should ensure that there is full and complete financial disclosures. Further it is also the responsibility of the top Management to ensure that the Co's, has complied with all the legal and ethical standards in accordance with the provisions of law and the Co's own statement of values.

Further the good Corporate Governance, the top Management should ensure total transparency on issues like —

- Award of high value contracts
- Dividends
- Investment in Subsidiaries
- Merger/Acquisition etc.

Application of Management Accounting in Strategic Management

Practical Illustrations

Example 1: Activity Based Costing in Service Sector

LMN Hospital is a private hospital, whose management is considering the adoption of an activity-based costing (ABC) system for the year 2011-12. The main reason for its introduction would be to provide more accurate information for pricing purposes. With the adoption of new medical technology, the amount of time that some patients stay in hospital has decreased considerably and the management feels that the current pricing strategy may no longer reflect the different costs incurred.

Prices are currently calculated by determining the direct costs for the particular type of operation and adding a mark-up of 135%. With the proposed ABC system, the management expects to use a mark-up for pricing of 15% on cost. This percentage will be based on all costs except facility sustaining costs. It has been decided that the hospital support activities should be grouped into three categories - admissions/record keeping, caring for patients and facility sustaining.

The hospital has four operating theatres that are used for nine hours a day for 300 days a year. It is expected that 7,200 operations will be performed during the coming year. The hospital has 15 consultant surgeons engaged in operating theatre work and consultancy. It is estimated that each consultant surgeon will work at the hospital for 2,000 hours in 2011-12.

The expected costs for 2011-12:

	Rs.
Nursing services and administration	9,936,000
Linen and laundry	920,000
Kitchen and food costs (three meals a day)	2,256,000
Consultant surgeons' fees	5,250,000
Insurance of buildings and general equipment	60,000
Depreciation of buildings and general equipment	520,000
Operating theatre	4,050,000
Pre-operation costs	1,260,000
Medical supplies - used in the hospital wards	1,100,000
Pathology laboratory (where blood tests etc are carried out)	920,000
Updating patient records	590,000
Patient/bed scheduling	100,000
Invoicing and collections	160,000
Housekeeping activities, including ward maintenance, window cleaning, etc.	760,000

OTHER INFORMATION FOR 2011-12

Nursing hours	480,000
Number of pathology laboratory tests	8,000
Patient days	44,000
Number of patients	9,600

Information relating to specific operations for 2011-12

	ENT (Ear, nose and throat)	Cataract
Time of stay in hospital	4 days	1 day
Operation time	2 hours	0.5 hour
Consultant surgeon's time (which includes time in the operating theatre)	3 hours	0.85 hour

Required:

(a) Before making the final decision on the costing/pricing system, management has selected two types of operation for review: an ear, nose and throat (ENT) operation and a cataract operation.

(i) Calculate the prices that would be charged under each method for the two types of operation.

(Your answer should include an explanation and calculations of the cost drivers you have used.)

(ii) Comment on the results of your calculations and the implications for the proposed pricing policy.

(b) Critically assess the method you have used to calculate the ABC prices by selecting two items/categories which you feel you should have been dealt with in a different way.

(c) Explain whether the concept of throughput accounting could be used in a hospital.

Analysis and Solution:

(a) (i) Direct costs

Consultant surgeons' fees: Rs.5,250,000 ÷ (15×2,000) = Rs.175 per hour of consultant's time
Operating theatre: Rs.4,050,000 ÷ (4×9×300) = Rs.375 per hour

Pre-operation costs: Rs.1,260,000 ÷ 7,200 = Rs.175 per operation

Indirect costs	
Caring for patients	Rs.
Nursing services/administration	9,936,000
Linen and laundry	920,000
Kitchen and food	2,256,000
Medical supplies	1,100,000
Pathology lab	920,000
	15,132,000

Admissions and record keeping

	Rs.
Updating patient records	590,000
Patient/bed scheduling	100,000
Invoicing and collections	160,000
	850,000

Facility sustaining costs	Rs.
Insurance of buildings/general equipment	60,000
Depreciation of buildings/general equipment	520,000
Housekeeping etc	760,000
	1,340,000

Cost drivers:

(1) The cost driver for caring for patients is patient days as the level of the majority of these costs depends on how long patients stay in hospital. (Medical supplies and pathology lab costs are likely to be driven by another factor but insufficient information is available to consider this further).

(2) That for admissions and record keeping is number of patients as the level of these costs varies in line with patient numbers rather than length of stay or type of illness/ treatment.

(3) There is no cost driver for facility sustaining costs as the ABC cost will not include these costs.

Cost per cost driver

Caring for patients: Rs.15,132,000÷ 44,000 = Rs.343.91

Admissions and record keeping: Rs.850,000÷ 9,600 = Rs.88.54

Prices for ENT operation

	Current system	ABC system	
	Rs.	Rs.	Rs.
Direct costs			
Consultant/surgeon fees (Rs.175×3)	525.00	525.00	
Operating theatre (Rs.375× 2)	750.00	750.00	
Pre-operation costs (Rs.175 × 1)	175.00	175.00	
	1,450.00		1,450.00
Mark-up on direct costs (× 135%)	1,957.50		
Indirect costs			
Caring for patients (Rs.343.91 × 4)		1,375.64	
Admissions and record keeping (Rs.88.54 ×1)		88.54	
			1,464.18
			2,914.18
Mark-up on cost (15%)			437.13
Price	3407,50		3,351.31

Prices for cataract operation

	Current system	ABC system	
	Rs.	Rs.	Rs.
Direct costs			
Consultant/surgeon fees (Rs.175×0.85)	148.75	148.75	
Operating theatre (Rs.375×0.5)	187.50	187.50	
Pre-operation costs (Rs.175×1)	175.00	175.00	
	511.25		511.25
Mark-up on direct costs (×135%)	690.19		
Indirect costs			
Caring for patients (Rs.343.91 × 1)		343.91	
Admissions and record keeping (Rs.88.54 ×1)		88.54	
			432.45
			943.70
Mark-up on costs (×15%)			141.56
Price	1201.44		1,085.26

(ii)

1. For both operations the ABC approach produces prices lower that those arrived at using the current system. Consideration must therefore be given to the appropriateness of the 15% mark-up if current profitability levels are to be maintained.
2. An in-depth analysis should be carried out of the facility sustaining costs in order to determine an appropriate cost driver. These costs can then be included within the total cost for pricing purposes and the most relevant price established.
3. The difference between the two prices for the ENT operation is not significant and use of the current system is unlikely to have a big effect on demand.
4. There is a marked difference between the two possible prices for the cataract operation, principally because the cost of caring for patients is relatively low (as the operation only requires patients to stay in hospital for one day). The current pricing system could therefore, be overpricing this operation, which is likely to have an effect on demand for it.

(b) To be of any significant value, an ABC system should use a greater number of cost pools/cost drivers than the three pools/two drivers proposed by the hospital. This would ensure that costs were allocated to products/services as accurately and realistically as possible. As mentioned above, the cost of medical supplies and the pathology laboratory are unlikely to be driven by the number of patient days but, given the information available in the question, they are most appropriately allocated by use of this cost driver.

Medical supplies:

The cost of medical supplies is likely to be driven by the type and complexity of the operation.

Operation time could be used as a substitute for operation complexity as it could be assumed that the more complex the operation, the longer the time in the operating theatre. A rate per operation hour could therefore be established and the cost of medical supplies allocated on this basis.

Pathology laboratory:

The allocation of such costs on the basis of patient days is inappropriate given that some operations will not require the services of the laboratory and the level of demand placed on the service will vary with the type of operation. There are three possible methods of charging the cost to operations.

1) A simple rate per test (Rs.920,000/8,000) could be charged as necessary to each type of operation.
2) A charge per type of operation could be established.
3) An average cost per type of test could be charged as necessary to each type of operation.

Nursing services and administration

Given the relative magnitude of these costs, they should be dealt with as accurately as possible. The type of nursing care will vary depending on the type of operation (from intensive care nursing to the provision of room service after a minor operation). Different cost drivers should therefore be established for different categories of nursing.

Additional analysis should be carried out to ascertain whether costs other than those for nursing are being allocated to this cost heading given the magnitude of the cost and the relatively low number of nursing hours.

(c) Throughput Accounting (TA)

The basic idea of TA is that an organisation has a given set of resources available (buildings, capital equipment, labour). Using these resources, along with any necessary purchases (in a hospital these would include medical supplies and food), products must be manufactured/ services must be provided to generate sales revenue. The most appropriate financial objective to set is therefore maximisation of throughput (which, in a hospital, would be of patients).

What relevance or value does this have for hospitals?

The requirement to generate sales revenue and the setting of financial objectives can be applied to private sector hospitals but public sector hospitals are more concerned with reducing costs and treating as many patients as possible. It is therefore the overriding objective of TA to ensure the maximisation of throughput that is of particular relevance for both private and public sector hospitals.

How can TA be applied in a hospital?

To achieve this objective TA requires the identification and elimination of any constraints, or bottleneck resources, which limit throughput. Such bottlenecks in hospitals are well publicised, and are frequently cited as the reasons for long waiting lists.

- Patient beds

- Intensive care beds
- Operating theatre time
- Surgeons' skills or time
- Other specialists' skills or time
- Doctors’ skills or time

The management of these bottlenecks is of primary concern to the manager seeking to increase throughput.

- TA requires that, if a rearrangement of existing resources or buying-in of resources (such as employing additional doctors) does not alleviate the bottleneck, investment may be necessary (in equipment, buildings and so on).
- Where a bottleneck cannot be eliminated, the number of patients admitted must be limited to the capacity of the bottleneck resource to ensure an even flow of patients in and out of the hospital.
- The elimination of one bottleneck is likely to lead to the creation of another at a previously satisfactory point, however. For example, if a bottleneck caused by too little operating theatre time is alleviated by building additional operating theatres, a bottleneck due to the lack of appropriately skilled surgeons could then arise.

The application of throughput accounting in a hospital would therefore ensure that its key and limited resources were used as effectively and efficiently as possible to ensure that the maximum numbers of patients were treated with the resources available.

The downside of TA

It is important to note that TA is often associated with increasing the speed of flow through processes in order to maximise throughput. Any measures taken in a hospital to speed up the flow of patients in and out of the hospital must be considered extremely carefully; however, as such action could put patients’ lives at risk and would not benefit the hospital in the long run. Performance measures based on maximizing throughput should not therefore be introduced or, if they are used, should be utilised in conjunction with counter-balancing measures such as re-admissions, deaths, recovery rates and so on.

Example2: Traditional Budgeting, Activity Based Budgeting and Life Cycle Costing Approach

The budget for the Production, Planning and Development Department of D Ltd., is currently prepared as part of a traditional budgetary planning and control system, The analysis of costs by expense type of the period ended 31st December where this system is in use is as follows –

Expense type	Budget %	Actual %
Salaries	60	63
Supplies	6	5
Travel Cost	12	12
Technology Cost	10	7
Occupancy Cost	12	13

The total budget and actual costs for the department for the above period are Rs,10,00,000 and Rs.10,60,000 respectively.

The Company now feels that an Activity Based Budgeting approach should be used. A number of activities have been identified for the Production, Planning and Development Department. An investigation has indicated that total budget and actual costs should be attributed to the activities on the following basis -

Activities	Budget %	Actual %
Routing/scheduling - new products	20	16
Routing/scheduling - existing products	40	34
Remedial re-routing/scheduling	5	12
Special studies - specific orders	10	8
Training	10	15
Management & Administration	15	15

Required:

1. Prepare two budget control statements for this department for the above period which compare budget with actual cost and show variances using - (a) a traditional expense based analysis and (b) an activity based analysis.
2. List some advantages claimed for the use of Activity Based Budgeting over Traditional Budgeting.
3. Comment on the use of the information provided by the activity based performance measurement statement and suggest additional information which would assist in such performance measurement.
4. Other activities have been identified and the budget quantified for the next three months as follows:

Activities	Cost Driver Unit Basis	Units of Cost Driver	Cost (in Rs.'000)
Product Design	Design Hours	8,000	(See Note 1) 20,00
Purchasing	Purchase Orders	4,000	2,00
Production	Machine Hours	12,000	(See Note 2) 15,00
Packing	Volume (cu.m.)	20,000	4,00
Distribution	Weight (kg)	1,20,000	6,00

Note 1: This includes all design costs for new products released this period.

Note 2: This includes a depreciation provision of Rs.3,00,000 of which Rs.8,000 applies to 3 months depreciation on a straight line basis for a new product (NPD). The remainder applies to other products.

New product NPD is included in the above budget. The following additional information applies to NPD:

(a) Estimated Total output over the Product Life Cycle: 5,000 units (4 years life cycle).

(b) Product Design Requirement: 400 design hours.

(c) Output for the quarter ended 31st March: 250 units.

(d) Equivalent Batch Size per purchase order: 50 units.

(e) Other product unit data: Production Time 0.75 Machine Hours: Volume 0.4 Cubic Meters; Weight 3 kg.

Prepare a unit overhead cost for Product NPD using an Activity Based Approach which includes an appropriate share of Life Cycle Costs using the information provided above.

Analysis and Solution:

1. (a) Performance Statement (Traditional Approach)

Expense type	Budget %	Budget Rs.	Actual %	Actual Rs.	Variance Rs.
Salaries	60	6,00,000	63	6,67,800	67,800 A
Supplies	6	60,000	5	53,000	7,000 F
Travel Cost	12	1,20,000	12	1,27,200	7,200 A
Technology Cost	10	1,00,000	7	74,200	25,800 F
Occupancy Cost	12	1,20,000	13	1,37,800	17,800 A
Total	100%	10,00,000	100%	10,60,000	60,000 A

1. (b) Performance Statement (Activity Based Approach)

Activities	Budget %	Budget Rs.	Actual %	Actual Rs.	Variance
Routing/scheduling - new products	20	2,00,000	16	1,69,600	30,400 F
Routing/scheduling - existing products	40	4,00,000	34	3,60,400	39,600 F
Remedial re-routing/scheduling	5	50,000	12	1,27,200	77,200 A
Special studies - specific orders	10	1,00,000	8	84,800	15,200 F
Training	10	1,00,000	15	1,59,000	59,000 A
Management & Administration	15	1,50,000	15	1,59,000	9,000 A
Total	100%	10,00,000	100%	10,60,000	60,000 A

2. Advantages of Activity Based Budgeting (ABB)

(a) ABB focuses on outcomes (activities) rather than listing of expense by "head of account" categories. Hence, ABB is more amenable for cost analysis, by focusing on behaviour of costs.

(b) ABB helps in focusing on NVA Costs and the variances thereof. Investigation of expense variances will now be more meaningful for cost control purposes.

(c) ABB leads to increased management commitment to the budget process, since it enables management to focus on the objectives of each activity and compare the outcomes with the costs that are allocated to that activity.

(d) ABB identifies resources requirements to meet the demand for activities, whereas traditional budgeting adopts and incremental approach. Hence, excess resources if any can be identified. These excessive resources can either be eliminated or re-deployed in some other manner.

(e) ABB avoids arbitrary cuts in specific budget areas in order to meet overall financial targets. Hence, ABB leads to more realistic budgeting.

3. Analysis of ABC based Performance Measurement Statement

(a) VA Activities: (i) Routing/Scheduling for new products; (ii) Routing/scheduling for existing products and (iii) Special Studies for Specific Orders can be identified as Primary Value Added Activities. All these activities have a favourable Cost Variance.

(b) NVA Activities: Remedial re-routing/scheduling is a NVA activity, but has the highest adverse variance. Hence, top priority should be assigned to investigating this variance. Steps should be taken to eliminate this activity or to reduce the cost substantially by adopting alternative work practices.

(c) Support Activities: Training, Management and Administration are Secondary Activities which support the Primary Activities. The Cost Variance for these activities are also adverse. Here, the reasons for overspending should be investigated.

Additional Information required:

(a) Cost Breakup under each activity: For each activity, breakup of costs like Salaries, Supplies, etc., should be made available, in order to pinpoint the areas of over-spending.

(b) Cost Driver Rates: The Company should also devise a system to report budgeted and actual cost driver rates. This will provide clues on the reasons for cost-incurrence, i.e. additional expenditure or savings in expenditure, extra resources consumed or reduction in resources utilized etc.

4. Computation of ABC Recovery Rates

Activities	Cost Rs.	Units of Cost Driver	Cost Driver Rate
Product Design	20,00,000	8,000 Design Hours	Rs.250 per design hour.
Purchasing	2,00,000	4,000 Purchase Orders	Rs.50 per purchase order.
Production (excluding deprn)	12,00,000	12,000 Machine Hours	Rs. 100 per machine hour.
Packing	4,00,000	20,000 cu.m.	Rs.20 per cu.m.
Distribution	6,00,000	1,20,000 kg	Rs.5 per kg.

5. Computation of OH Cost of New Product

Particulars	Computation	Rs. p.u.
Product Design	(400 Design Hours × Rs.250 per hour)÷5,000 units	20.00
Purchasing	(5 Orders × Rs.50 per order) ÷ 250 units	1.00
Production (excluding deprn.)	(0.75 machine hours × Rs.100 per hour)	75.00
Depreciation	(Rs.8,000 per quarter × 16 quarters i.e. 4 years) ÷ 5,000 units	25.60
Packing	(0.4 cu.m × Rs.20)	8.00
Distribution	(3 kg × Rs.5)	15.00
Total		144.60

Example 3: Historical Costing Vs. Activity Based Costing Technique

During the last 20 years, ABC Ltd.'s manufacturing operation has become increasingly automated with computer-controlled robots replacing operators currently manufactures over 100 products of varying levels of design complexity, a single plant wise OH absorption rate, based on Direct Labour Hours, and is used to absorb overhead costs.

In the quarter ended March, ABC's Manufacturing Overhead Costs were:

	(Rs.'000)
Equipment Operation Expenses	125
Equipment Maintenance Expenses	25
Wages paid to Technicians	85
Wages paid to Storemen	35
Wages paid to Despatch Staff	40
Total	310

During the quarter, the Company reviewed its Cost Accounting System and concluded that absorbing OH costs to individual products on a labour hour absorption basis is meaningless. Overhead Costs should be attributed to products using an Activity Based Costing system and the following was identified as the most significant activities:

(i) Receiving component consignments from suppliers

(ii) Setting up equipment for production runs

(iii) Quality Inspections

(iv) Despatching goods as per customer's orders.

It was further observed that in the short-term ABC's overheads are 40% fixed and 60% variable. Approximately, half the variable overheads vary in relating to direct labour hours worked and half vary in relation to the number of quality inspections.

Equipment Operation and Maintenance Expenses are apportioned as - Component Stores 15%, Manufacturing 70% and Goods Despatch 15%.

Technician's Wages are apportioned as - Equipment Maintenance 30%, Set-up Equipment for production runs 40% and Quality Inspections 30%.

During the quarter:

(i) A total of 1,200 Direct Labour Hours were worked (paid at Rs.12 per hour)

(ii) 980 Components Consignments were received from Suppliers.

(iii) 1,020 Production Runs were set up.

(iv) 640 Quality Inspections were carried out.

(v) 420 orders were despatched to customers.

ABC's production during the quarter included components R, S and T. The following information is available:

Component	R	S	T
Direct Labour Hours worked	25	480	50
Direct Material Costs	Rs.1,200	Rs.2,900	Rs.1.800
Component Consignments received	42	24	28
Production Runs	16	18	12
Quality Inspections	10	8	18
Orders (Goods) dispatched	22	85	46
Quantity produced	560	12,800	2,400

Required:

(1) Calculate the unit cost of R, S and T components, using ABC's existing cost accounting system.

(2) Explain how an ABC system would be developed using the information given. Calculate the unit cost of components R, S and T using ABC system.

Analysis and Solution:

1. OH Recovery Rate = Total OH ÷ Total Labour Hours = Rs.3,10,000 ÷ 2,000 = Rs. 155 p.h.

2. Computation of Product Costs using existing system

Particulars	R	S	T	Total
Direct Material	1,200	2,900	1,800	5,900
Direct Labour at Rs. 12 per hour	25×12 = 300	480 ×12 = 5,760	50 ×12 = 600	6,660
Overheads at Rs. 155 per hour	25×155 = 3,875	480×155 = 74,400	50 ×155 = 7,750	86,025
Total Costs	5,375	83,060	10,150	98,585
Production Quantity	560	12,800	2,400	
Cost per unit	Rs.9.60	Rs.6.49	Rs.4.23	

3. Creation of ABC System: The creation of ABC System would involve the following steps:

(a) Identification of significant activities of the Firm: Four significant activities identified - (i) receiving component consignments from suppliers; (ii) Setting up equipment for production runs; (iii) Quality inspections, and (iv) Despatching goods as per customer's orders.

(b) Assigning OH Costs to each activity: Attributable expenses are related to specific activities, while common expenses are apportioned to each activity as per the percentages specified in the question. Thus the OH Cost/Activity Cost Pool Statement would be as under -

Expense	Receipt from Suppliers	Set-up	Inspection	Despatch	Total
Technician's Wages (Note 1)	–	34,000	25,500	–	59,500
Eqpt. Oprn. & Maint. Exps. as 15:70:15 (Note 2)	26,325	1,22,850	–	26,325	1,75,500
Wages paid to Storemen and Despatch Staff (Direct)	35,000	–	–	40,000	75,000
Total OH	61,325	1,56,850	25,500	66,325	3,10,000

Note 1: Technician's Wages Total Rs.85,000. 30% thereof = Rs.25,500 is included in Equipment Maintenance Expenses, and the balance of Rs.59,500 is apportioned to Set Up and Inspection as 40:30 i.e. Rs.34,000 & Rs.25,500.

Note 2: Total Equipment Operation and Maintenance Expenses = 1,25,000 + 25,000 + 25,500 (from Note 1 above) = 1,75,500. This is apportioned in the ratio 15%: 70%: 15% to the relevant activities.

Note 3: The breakup of variable and fixed costs is not relevant in the above analysis.

(c) Identification of Cost Drivers for each activity: See table in point (e) below

(d) Quantification of Cost Drivers: See table in point (e) below

(e) Computation of ABC recovery rate: The relevant ABC rates are us under:

Activity	OH	Cost Driver	Quantity	ABC Rate
Receipt from Suppliers	61,325	Number of component consignments received	980	Rs.62.58 per consignment
Set-up	1,56,850	Number of Production Runs	1020	Rs. 153.77 per Production run
Inspection	25,500	Number of Quality Inspections	640	Rs.39.84 per inspecting
Despatch	66,325	Number of orders despatched	420	Rs. 157.92 per dispatch

(f) Computation of product Costs using ABC System:

Particulars	R	S	T	Total
Direct Material	1,200.00	2,900.00	1,800.00	5,900.00
Direct Labour at Rs. 12/hr.	25×12 = 300.00	480×12 = 5,760.00	50×12 = 600.00	6,660.00
Overheads:				
Receipt of Consignments	42 × 62.58 = 2,628.36	24 × 62.58 = 1,501.92	28×62.58 = 1,752.24	5,882.52
Set Up	16 × 153.77 = 2,460.32	18 × 153.77 =2,767.86	12×153.77 =1,845.24	7,073.42
Inspection	10×39.84 = 398.40	8×39.84 = 318.72	18 × 39.84 = 717.12	1,434.24
Despatch	22 ×157.92 = 3,474.24	85 × 157.92 = 13,423.20	46 × 157.92 = 7,264.32	24,161.76

Total Costs	10,461.32	26,671.70	13,978.92	51,111.94
Production Qty.	560	12,800	2,400	
Cost per unit	Rs. 18.68	Rs.2.08	Rs.5.82	

Example 4: Activity-based management— Customer profitability analysis:

In many organisations it is just as important to cost customers as it is to cost products. Different customers or groups of customers differ in their profitability. This is a relatively new ABM technique that ABC information makes possible because it creates cost pools for activities. Customers use some activities but not all, and different groups of customers have different 'activity profiles'.

Service organisations, such as a bank or a hotel, in particular need to cost customers. A bank's services for a customer will include the following types of activities:

- withdrawal of cash;
- unauthorised overdraft;
- request for a statement;
- stopping a cheque;
- returning a cheque because of insufficient funds.

Different customers or categories of customers will each use different amounts of these activities and so customer profitability profiles can be built up, and customers can be charged according to the cost to serve them. A hotel may have activities that are provided for specific types of customers, such as well laid-out gardens, a swimming pool and a bar. Older guests may appreciate and use the garden, families the swimming pool and business guests the bar. If the activities are charged to the relevant guests a correct cost per room-night can be calculated for this type of category. This will show the relative profitability and lead to strategies for encouraging the more profitable guests.

Even a manufacturing organisation can benefit from costing its customers. Not all customers cost the same to serve even if they require the same products. Some customers may be located a long way from the factory and transport may cost more. Other customers may be disruptive and place rush orders that interrupt production scheduling and require immediate, special transport. Some customers need after-sales service and help with technical matters, etc. Table 1 contains information on four different customers, A, B, C, and D in a manufacturing organisation. A single product is sold but the selling price differs because of trade discounts offered. Table 2 contains the cost per unit of each business activity and Table 3 shows the results of the customer profitability analysis.

Table 1: Information on four customers

	A	B	C	D
No. of units sold	60,000	80,000	100,000	70,000
Selling price net of discount (Re.)	0.25	0.23	0.21	0.22
No. of sales visits	2	4	6	3
No. of purchase orders	30	20	40	20

No. of deliveries	10	15	25	14
Kilometers per journey	20	30	10	50
No. of rush deliveries	—	—	1	2

Table 2: Costs of each activity

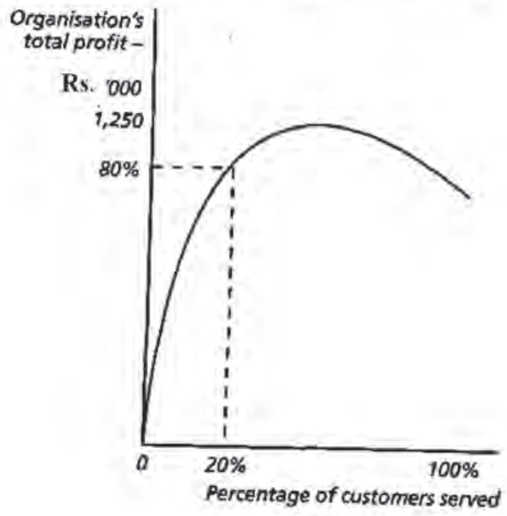
Sales visit	Rs.210 per visit
Order placing	Rs.60 per order
Product handling	Re.0.10 per item
Normal delivery cost	Rs.2 per kilometer
Rushed delivery cost	Rs.200 per delivery

Table 3: Customer profitability analysis

	A	B	C	D
	Rs.	Rs.	Rs.	Rs.
Revenue net of discount	15,000	18,400	21,000	14,400
Costs:				
Sales visits (Rs.210 ×2, etc.)	420	840	1,260	630
Order processing (Rs.60 × 30, etc.)	1,800	1,200	2,400	1,200
Product handling (Rs.0.10 × 60,000, etc.)	6,000	8,000	10,000	7,000
Delivery (Rs.2 × 20 × 10, etc.)	400	900	500	1,400
Rush deliveries (Rs.200 × 1, etc.)	-	-	200	400
	8,620	10,940	14,360	10,630
Operating profit	6,380	7,460	6,640	3,770
Percentage profitability	43%	41%	32%	26%

In this example all four customers are profitable, but C and D are not particularly so when compared with A and B. When an organization analyses the profitability of its customers it is not unusual to find that a Pareto curve exists, (see the Figure given below).That is, 20 per cent of customers provide 80 per cent of the profit and in the same Figure, it can be seen that in this case the last 80 per cent of customers do not all generate profit. The last 50 per cent actually reduce the total profit. There is no point in serving these customers as the situation stands but it may be foolish just to refuse to serve them. Instead it may be better to turn them into profitable customers if this is possible. A multifunctional team should be set up to find ways of making these customers profitable. Usually it is the small volume/order customers who are unprofitable because of high production batch costs and order processing, etc. One organisation introduced a third-party wholesaler into the supply chain and significantly reduced the cost of serving the small order customers. At the same time the organisation found that the product-range and service to the small customers improved, and so the company saved costs and the customer received an improved service.

Figure: Customer profitability curve



Activity-based management— Strategic activity management:

Strategic activity management recognises that individual activities are part of a wider process. Activities are grouped to form a total process or service. For example, serving a particular customer involves a number of discrete activities that form the total service. Strategic activity management attempts to classify each activity within the whole as a value-added or non-value-added activity. Non-value-added activities are unnecessary and should be eliminated. Non-value-added activities are often caused by inadequacies within the existing processes and cannot be eliminated unless the inadequacy is addressed. For example, dealing with customer complaints is a diversionary activity, but it cannot be eliminated unless the source of the complaints is eliminated. Another example of a non-value-added activity that is caused to a certain extent by inadequacies in the existing processes is machine set-up time.

Better product design so that fewer components are used or the use of more standard components will reduce the set-up time between component runs. So management must concentrate on eliminating non-value-added activities.

But strategic activity management is more than just eliminating non-value-added activities, important though this is.

ABC information can be used in an ABM system to assist strategic decisions, such as:

- Whether to continue with a particular activity.
- The effect on cost structure of a change in strategy, e.g. from mass production to smaller lots.
- How changes in activities and components affect the suppliers and the value chain.

Example 5: Target Costing, Value Engineering and JIT

Mr. K, president of Phoenix Electronics (PE), is concerned about the prospects of one of its major products. The president has been reviewing a marketing report with Mr. J, marketing product manager, for their 10-disk car compact disk (CD) changer. Their report indicates another price reduction is needed to meet anticipated competitors' reduction in sale price. The current selling price for their 10-disk car CD changers is Rs.3,500 per unit. It is expected that within three months PE's two major competitors will be selling their 10- disk car CD changers for Rs. 3,000 per unit. This concerns K because their current cost o producing the CD changers is Rs. 3,150 which yields a Rs. 350 profit on each unit sold.

The situation is especially disturbing because PE had implemented an activity based costing (ABC) system about two years ago. The ABC system helped them better identify costs, cost pools, cost drivers, and reduce costs. Changes made when adopting ABC reduced costs on this product by approximately 15 percent during the last two years. Now it appears cost will need to be reduced considerably more to remain competitive and to earn a profit on the 10-disk car CD changers. Total costs to produce, sell, and service the CD changer unit are as follows.

10-disk Car CD Changer

		Per Unit
Materials:	Purchased components	Rs. 1,100
	All other materials	400
Labour:	Manufacturing, direct	650
	Setups	90
	Material handling	180
	Inspection	230
Machining:	Cutting, shaping, and drilling	210
	Bending and finishing	140
Other:	Finished goods warehousing	50
	Warranty	100
	Total unit cost	3,150

Mr. K has decided to hire Mr. D, a consultant, to help decide how to proceed. After two weeks of review, discussion, and value engineering analysis, Mr. suggested that PE adopt a just-in time (JIT) cell manufacturing process to help reduce costs. He also suggested that using target costing would help in meeting the new target price.

By changing to a JIT cell manufacturing system, PE expects that manufacturing direct labour will increase by Rs.150 per finished unit. However, setup, material handling, inspection, and finished goods warehousing will all be eliminated. Machine costs will be reduced from Rs.350 to Rs.300 per unit, and warranty costs are expected to be reduced by 40 percent.

Required:

A. 1. Define "target costing"

2. Define "value engineering"

B. Determine PEs' unit target cost at the Rs. 3,000 competitive sales price while maintaining the same percentage of profit on sales as is earned on the current Rs.3,500 sales price.

C. If the just-in-time (JIT) cell manufacturing process is implemented with the changes in costs noted above; will PE meet the unit target cost you determined in Requirement B above? Prepare a schedule detailing cost reductions and the unit cost under the proposed JIT cell manufacturing process.

Analysis and Solution:

A. 1. Target costing is a method of determining the allowable cost of a product or service. The allowable cost or target cost is an estimated long-run cost of a product or service that when sold will yield a target profit. Normally, the target sales price is determined first; this is generally equal to or less than the competitive market price of the product or service. The target profit is then deducted, leaving the target cost of production to earn the desired (normal) profit.

2. Value engineering is a systematic evaluation of all aspects of the cost structure of a product or service, including research and development, design of products and processes, production, marketing, distribution and customer service, with the objective of reducing costs while satisfying customer needs. It differs from traditional approaches to cost reduction and cost control in that its focus is on the elimination of non value-added activities (e.g., waste) from the process.

Value engineering focuses on improving those qualities that the customer desires, while reducing or eliminating unnecessary moves, queues, setups, and other such activities that the customer will not pay for. The process is reengineered to eliminate non-value added work and thereby enhance the value of the process to the customer.

B. Phoenix Electronics' current profit on sales is 10 per cent [(Rs. 3,500 – Rs. 3,150) / Rs. 3,500]. Therefore, the target cost for the new product must be Rs. 3,000 less 10 percent, or Rs. 2,700 [Rs. 3,000 – (Rs. 3,000 × 10%)]

C. The proposed changes to the just-in-time (JIT) cell manufacturing process at Phoenix Electronics will bring costs down to Rs. 2,660 per unit, which is below the Rs. 2,700 target cost limit. Adjusted costs under the JIT cell manufacturing process are calculated below.

	Increase Current	(Decrease)	Revised
Materials			
Purchased components	Rs. 1,100		Rs. 1,100
All other	400		400
Labour			
Manufacturing direct	650	Rs.150	800
Setups	90	(90)	00
Material handling	180	(180)	00
Inspection	230	(230)	00
Machining			
All	350	(50)	300
Other			
Finished goods warehousing	50	(50)	00
Warranty*	100	(40)	60
Total JIT Cost	3,150	(490)	2,660

* 40% reduction

The following example explains how different 'Budgets' and 'Budgeted Income Statement' are prepared:

Example 6: Pareto Analysis

The following information of manufacture and sale is obtained from the records of XYZ Ltd. for the 12 months ending 31.12.2010

Product	Contribution (Rs.)
A	500
B	200
C	1,500
D	75
E	100
F	125
Total	2,500

You are required to prepare a Pareto product contribution chart and comment on the results.

Analysis and Solution:

Statement of Pareto Analysis

Product	Contribution Rs.	Accumulated contribution Rs.	%
C	1,500	1,500	60
A	500	2,000	80
B	200	2,200	83
F	125	2,325	93
E	100	2,425	97
D	75	2,500	100
	2,500		

Comment: Product C and A constitutes 80% contribution. Hence, the management should improve the quality of these products and frame other policies for these products instead of framing the policies for all the products uniformly.

Example 7: Application of JIT and Relevant Costing

- PQR LTD., has decided to adopt JIT policy for materials. The following effects of JIT policy are identified - Capital Expenditure Rs. 6,00,000. The new facilities will require a cash operating cost Rs. 48,000 per annum.
- Raw Material Stockholding will be reduced from Rs. 28,00,000 to Rs. 8,00,000.
- The Company can earn 15% on its long-term investments.
- The Company can avoid rental expenditure on storage facilities amounting to Rs. 30,000 per annum. Property Taxes and insurance amounting to Rs. 12,000 will be saved due to JIT Programme.
- Presently there are 7 workers in the Stores Department at a Salary of Rs. 3,000 each per month. After implementing JIT Scheme, only 2 workers will be required in this Department.

Of the balance 5 workers. 3 will be transferred to other departments, while 2 workers employment will be terminated.

- Due to receipt of smaller lots of Raw Materials, there will be some disruption of production. The Costs of Stock-out will be Rs. 3,40,000 in the first year only. These Stock-out Costs can be brought down to nil from the second year onwards.

Determine the financial impact of the JIT policy. Is it advisable for the company to implementing JIT system?

Analysis and Solution:

Statement of Cost Benefit

(A) Benefit		
Interest on working capital released		3,00,000
(28,00,000 - 8,00,000) × 15%		
Rental Expenditure		30,000
Savings in property tax		12,000
Savings in salary (2×3,000×12)		72,000
	(A)	4,14,000
(B) Expenses		
Interest on capital cost (6,00,000×15%)		90,000
Cash operating cost		48,000
Stock out cost		3,40,000
	(B)	4,78,000
Net Benefit (A-B)		(64,000)

It is better to follow just in time policy for the future year although loss exist in first year but such loss would not exist for the subsequent year because there is no stock out cost for the subsequent years.

Example 8: Value Engineering

MNO electronics makes audio player model "AB 100". It has 80 components. MNO sells 10,000 units each month at Rs. 3,000 per unit. The cost of manufacturing is Rs. 2,000 per unit or Rs. 200 lakh per month for the production of 10,000 units. Monthly manufacturing costs incurred are as follows:

	(Rs. Lakhs)
Direct material costs	100.00
Direct manufacturing labour costs	20.00
Machining costs	20.00
Testing costs	25.00
Rework costs	15.00
Ordering costs	0.20
Engineering costs	19.80
	200.00

Labour is paid on piece rate basis; therefore, MNO considers direct manufacturing labour cost as variable cost. The following additional information is available for "AB 100":

1. Testing and inspection time per unit is 2 hours.
2. 10 per cent of "AB 100' manufactured are reworked.
3. It currently takes 1 hour to manufacture each unit of "AB 100".
4. MNO places two orders per month for each component. Each component is supplied by a different supplier.

MNO has identifies activity cost pools and cost drivers for each activity. The cost per unit of the cost driver for each activity cost pool is as follows:

Manufacturing Activity	Description of activity	Cost Driver	Cost per unit of Cost driver
1. Machining Costs	Machining components	Machining Hours	Rs.200
2. Testing costs	Testing components and finished products (each hours unit of AB 100 is tested individually)	Capacity Testing	Rs.125
3. Rework costs	Correcting and fixing errors and defects	Units of 'AB 100' reworked	Rs.1,500 per unit
4. Ordering Costs	Ordering of components	No. of orders	Rs.125 per order
5. Eng. Costs	Designing & managing of products and Processes	Engineering hours	Rs.1,980 per engineering hour.

Over long-run horizon, each of the overhead costs described above vary with chosen cost drivers.

In response to competitive pressure ABC must reduce the price of its product to Rs. 2,600 and to reduce the cost by at as: Rs. 400 per unit. ABC does not anticipate increase in sales due to price reduction. However if it does not be able to minimum the current sales level.

Cost reduction on the existing model is almost impossible. Therefore MNO has decided to replace 'AB 100' by a new model 'AB 200' which is a modified version of 'AB 100'. The expected effect of design modifications is as

1. The number of component will be reduced to 50.
2. Direct material costs to be lower by Rs. 200 per unit.
3. Direct manufacturing labour cots to be lower by Rs. 20 per unit.
4. Machining time required to be lower by 20 per cent.
5. Testing time required to be lower by 20 per cent.

6. Rework to decline to 5 per cent.

7. Machining capacity and engineering hour's capacity to remain the same. MNO currently outsourcers the rework on defective units.

Required:

1. Compare the manufacturing cost per unit of 'AB 100'; and 'AB 200'.

2. Determine the immediate effect of design change and pricing decision on the operating income of MNO.

Ignore income tax. Assume that the cost per unit of each cost driver for 'AB 100' continues to apply to 'AB 200'.

Analysis and Solution:

	Present AB -100	**AB - 200**
	Rs.	Rs.
Material		
(Rs. 1,00,00,000/10,000)	1,000	800
Labour	(20,00,000/10,000) 200	180
Machining cost	(20,00,000/10,000) 200	160
Testing cost:	250	200
Rework cost	150	75
Ordering cost	2	1.25
Eng. Cost	198	198
	2,000	1,614.25

Working Notes showing present and revised costs:

Particulars	**Present**	**Revised**
Labour	1 Hr×10,000 = 10,000 hours 10,000 Hr× 200 = 2,00,000/10,000 = Rs. 200/-	0.8 Hr×10,000 = 8,000 Hours 8000 Hr×200 =16,00,000/10,000 = Rs.160/-
Testing	2 Hrs×10,000×125/10,000 = Rs.250	1.6 hrs× 10,000 × 125/10,000 = Rs.200
Rework	1,000 defective ×Rs. 1500 = Rs. 15,00,000	(10,000 × 5%) ×Rs. 1500 = Rs. 7,50,000
Ordering cost	160 orders ×125/10,000 = Rs.2	100 orders × 125/10,000 = Rs.1.25

2. The following factors may have immediate effect,

(i) Material cost,

(ii) Labour cost and

(iii) Ordering cost.

Due to reduction of component and due to a learning procedure following factors may not have immediate effect:

(i) Machine cost: (reduction of setting of time on production time)

(ii) Testing cost: (reduction of testing time application of TQM system)

(iii) Rework cost: (with application preventive, maintenance system)

Example 9: Make or Buy Concept

XYZ Ltd. has an annual production of 90,000 units for a motor component. The component cost structure is as below:

Particulars	Amount (Rs.)
Material	270 per unit
Labour (25% Fixed)	180 per unit
Expenses:	
Variable	90 per unit
Fixed	135 per unit
Total	675 per unit

(a) The purchase manager has an offer from a supplier who is willing to supply the component at Rs.540. Should the component be purchased and production stopped?

(b) Assume the resources now used for this component's manufacture are to be used to produce another new product for which the selling price is Rs. 485.

In the latter case the material price will be Rs. 200 per unit. 90,000 units of this product can be produced at the same cost basis as above for labour and expenses. Discuss whether it would be advisable to divert the resources to manufacture that new product, on the footing that the component presently being produced, be purchased from the market.

Solution

(a) Statement of Comparative Cost per unit

Manufacture	**Amount (Rs.)**	**Purchase**	**Amount (Rs.)**
Cost to be incurred due to manufacture		Purchase cost	540
Material	270		
Labour	135		
Variable overhead	90		
Relevant cost	495		540

It's better to produce a component in house because the relevant cost of manufacturing the component in house is less than the purchase cost. Further, we can say that unavoidable fixed cost = (45 + 135) × 90,000 (Deptt. Share) = 1,62,00,000.

(b) Statement of Comparative Cost

Manufacture	Amount (Rs.)	**Purchase**	Amount (Rs.)
Cost to be incurred (from Part-a)	495	Purchase cost	540
Benefit to be lost due to manufacturing (WN:1)	60		
Relevant cost	555		540

Hence, It's better to purchase the component from outside market, from costing point of view

Working Note 1

Calculation of Benefit to be lost

If the component is to be purchased from the market, then the release capacity would provide the benefit of Rs. 60 per unit as follows:

Particulars			Rs.
Selling price	-		485
Less: variable cost:			
Material	-	200	
Labour		135	
Variable-overheads	-	90	425
Benefit lost			60

Example 10: Learning Curve

A Firm has received an order to make and supply 8 units of a standard product, which involves intricate labour operations. The first unit was made in ten hours. It is understood that this type of operations is subject to 80% learning effect. The workers are paid a wage rate of Rs.12 per hour.

1. What is the total time and labour cost required to execute the above order?

2. If repeat order of 24 units is also received from the same customer, what is the labour cost necessary for the second order?

Analysis and Solution:

Since the first unit takes 10 hours and an 80% learning curve applies; average time will become 8 hours, when production is doubled and it will become 6.4 hours per unit when production is quadrupled and so on. Hence the following details can be derived.

Incremental Quantity	Cumulative Quantity	Average time per unit (hours)	Cumulative Time Taken (hours)	Incremental time taken (hours)
(1)	(2) = Total of (1)	(3)	(4) = (3)×(2)	(5) = Diff. In (4)
1	1	(given) = 10.0000	(asper Col. 3) =10.0000	-
1	2	(80% of 10) = 8.0000	(8×2) =16.0000	6.0000
2	4	(80% of 8) = 6.4000	(6.4 × 4) = 25.6000	9.6000
4	8	(80% of 6.4) = 5.1200	(5.12×8) = 40.9600	15.3600
8	16	(80% of 5.12) = 4.0960	(4.096×16) =65.5360	24.5760
16	32	(80% of 4.096) = 3.2768	(3.2768 × 32) =104.8576	39.3216

From the above table, the following calculations are made:

1. Total time required for the first eight units = 40.96 hours (from Column 4)
   Total Labour cost of first 8 units at Rs.12 per hour = 40.96 × Rs.12 = Rs.491.52
   Average Labour Cost per unit (for the first 8 units) = Rs.491.52 + 8 = Rs.61.44

2. Total time required for 32 units =104.8576 hours (from Column 4)
   Total time for the first 8 units = 40.96 hours (from Column 4)
   Hence time required for the second order of 24 units = 63.8976 hours

   Labour Cost for second order of 24 units at Rs. 12 p.h = 63.8976 × 12 = Rs.766.77

   Average Labour Cost per unit (for the next 24 units) = Rs.766.77 ÷ 24 = Rs.31.95

Example 11: Quality Improvement System - Relevant Costs analysis

A.R.C is a transporting Company that transports goods from one place to another. It measures quality of service in terms of:

(i) Time required to transport goods;

(ii) On-time delivery;

(iii) Number of lost or damaged cartons.

To improve its business prospects and performance, the Company is seriously considering to install a scheduling and tracking system, which involves an annual outlay of Rs.1,50,000, besides equipments costing Rs.2,00,000 needed for installation of the system. The Company proposes to utilise the proceeds of the fixed deposit maturing next month to purchase the equipment. The rate of interest at present on deposit is 10%. The Company furnishes the following about its present and anticipated future performance:

Particulars and On-time delivery %	Current at 85%	Expected at 95%
Variable Costs per carton lost or damaged	Rs.50	Rs.50
Fixed Costs per carton lost	Rs.30	Rs.30
Number of cartons lost or damaged	3,000	1,000

The Company expects that each percent point increase in on-time performance will result in revenue increase of Rs. 18,000 per annum. Contribution margin of 45% is required. Should

A.R.C acquires and installs the new system?

Analysis and Solution:

Particulars	Computation	Rs.
Contribution earned	Rs. 18,000 × 10×45%	81,000
Savings in Variable Costs	(3,000-1,000) × Rs.50	1,00,000
Gross Relevant Benefit		1,81,000
Less: Relevant Costs		
Annual Costs of the new system	Given	1,50,000
Interest Foregone on capital costs	Rs. 200,000 × 10%	20,000
Fixed Costs	Not Relevant	Nil
Net Relevant Benefit		11,000

Decision: The new system may be implemented.

Example 12: Activity Based Costing, Target Costing

A Ltd., manufactures two component parts for the television industry -

- T: Annual production and sales of 50,000 units at a Selling Price of Rs.40.60 per unit.
- P: Annual production and sales of 25,000 units at a Selling Price of Rs. 60 per unit.

Avery includes ail R&D and design costs in engineering costs.

There is no marketing, distribution, or customer-service costs.

The direct and indirect costs incurred by A on T and P are as follows:

Particulars	T	P	Total
Direct Materials Costs (variable)	8,50,000	6,00,000	14,50,000
Direct Manufacturing Labour Costs (variable)	3,00,000	2,00,000	5,00,000
Direct Machining Costs (see note)	1,50,000	1,00,000	2,50,000
Indirect Manufacturing Costs Machine Set-up Costs			86,250
Testing Costs			4,87,500
Engineering Costs			4,50,000
Total Costs			32,23,750

Note:

Direct Machining Costs represent the cost of machine capacity dedicated to the production of each product. These costs are fixed and are not expected to vary over the long-run horizon.

A's management identifies the following activity cost pools, cost drivers for each activity and the cost per unit of cost driver for each overhead cost pool:

Manufacturing Activity	Description of activity	Cost Driver	Cost per unit of cost driver
Setup	Preparing machine to manufacture a new batch of products.	Set up hours	Rs.25 per set up hour
Testing	Testing components and final product (Avery tests each unit of Tvez and Premia individually).	Testing hours	Rs.2 per testing hour
Engineering	Designing products and processes and ensuring their smooth functioning.	Complexity of product & processes	Costs assigned to products by special study.

Additional information is as follows –

Particulars	T	P
Production Batch Sizes	500 units	200 units
Set up time per Batch	12 hours	18 hours
Testing and Inspection Time per unit of product produced	2.5 hours	4.75 hours
Engineering Costs incurred on each product	Rs.1,70,000	Rs. 2,80,000

A is facing competitive pressure to reduce the price of T and has set a target price of Rs.34.80, well below its current price of Rs.40.60. The challenge for A is to reduce the cost of T. A's engineers have proposed new product design and process improvement for the "new T" to replace T. The new design would improve product quality, and reduce scrap and waste. The reduction in prices will not enable A to increase its current unit sales. However, if Avery does not reduce prices, it will lose sales.

The expected effects of new design relative to T are as follows -

(a) Direct Materials Costs for new T are expected to decrease by Rs.2.00 per unit.

(b) Direct Manufacturing Labour Costs for new T are expected to decrease by Re.0.50 per unit.

(c) Machining time required to make new T is expected to decrease by 20 minutes, it currently takes 1 hour to manufacture 1 unit of Tvez. The machines will be dedicated to the production of new T.

(d) New T will take 7 setup hours for each setup.

(e) Time required for testing each unit of new T is expected to be reduced by 0.5 hour,

(f) Engineering Costs will be unchanged.

Assume that the batch sizes are the same for New T as for T, if A requires additional resources to implement the new design; it can acquire these additional resources in the quantities needed. Further assume the costs per unit of cost driver for the new T are the same as those for T.

Required:

1. Calculate the full cost per unit for T and P using activity-based costing.
2. What is the markup on the full cost per unit for T?
3. What is A's target cost per unit for New T if it is to maintain the same markup percentage on the full cost per unit as it had for T?
4. Will the New T design achieve the cost reduction targets that A has set? Explain.
5. What price will A charge for New T if it uses the same markup percentage on the full cost per unit for new T as it did for T?
6. List the possible management actions that A should take regarding New Tvez.

Analysis and Solution:

1. Computation of Indirect Costs for T and P

Particulars	T	P
a. Production / Sale Quantity	50,000 units	25,000 units
b. Batch Size	500 units	200 units
c. Number of batches = a ÷ b	100 batches	125 batches
d. Set up time required at 12 and 18 hours per batch	1,200 hours	2,250 hours
e. Set up cost at Rs.25 per hour	Rs.30,000	Rs.56,250
f. Testing and Inspection time required per unit	2.5 hours	4.75 hours
g. Total Testing Hours = a × f	1,25,000 hours	1,18,750 hours
h. Testing Costs at Rs.2 per testing hour	Rs.2,50,000	Rs.2,37,500

2. Computation of Full Costs per unit for T and P

Particulars	T (50,000 units)		P (25,000 units)	
	Per Unit	Total	Per Unit	Total
Direct Materials	Rs.17.00	Rs. 8,50,000	Rs.24.00	Rs. 6,00,000
Direct Labour	Rs. 6.00	Rs. 3,00,000	Rs. 8.00	Rs. 2,00,000
Direct Machining Costs	Rs. 3.00	Rs. 1,50,000	Rs. 4.00	Rs. 1,00,000
Total Direct Costs	Rs.26.00	Rs.13,00,000	Rs.36.00	Rs. 9,00,000
Machine Set Up Costs		Rs. 30,000		Rs. 56,250
Testing Costs		Rs. 2,50,000		Rs. 2,37,500
Engineering Costs (given)		Rs. 1,70,000		Rs. 2,80,000
Total Indirect Costs	Rs. 9.00	Rs. 4,50,000	Rs.22.95	Rs. 5,73,750
Total Manufacturing Costs		Rs.17,50,000		Rs.14,73,750
Production Quantity		50,000 units		25,000 units
Full Cost per unit	Rs.35.00		Rs.58.95	

Selling Price of T	= Rs.40.60 per unit (given)
Less: Full Costs of T	= Rs.35.00 per unit (computed above)
Markup / Profit of T	= Rs. 5.60 per unit

Percentage of Mark Up on Full Cost = Rs.5.60 - Rs.35.00 = 16%

4. Target Cost in order to maintain the same markup on cost:

Revised Selling Price of New T = Rs.34.80 per unit.

In order to maintain the same markup on cost; the Selling Price should be Cost + 16% on Cost.

Since Target Cost will be Rs.34.80 - 116% = Rs.30.00

5. Statement of Costs for New T (for 50,000 units)

Particulars	Computation	Per unit	Total
Direct Materials	Given decrease = Rs.2 p.u	15.00	7,50,000
Direct Labour	Given decrease = Re.0.50 p.u	5.50	2,75,000
Direct Machining Costs	Dedicated machine - no change	3.00	1,50,000
Total Direct Costs		23.50	11,75,000
Machine Set Up Costs	100 batches × 7 hours × Rs.25	0.35	17,500
Testing Costs	50,000 units × 2 hours × Rs.2	4.00	2,00,000
Engineering Costs (given)	No change - Given	3.40	1,70,000
Total Indirect Costs		7.75	3,87,500
Total Manufacturing Costs		31.25	15,62,500

Since the Target Cost is Rs.30.00 and the estimated cost of New T is Rs.31.25, the new design will not achieve the cost reduction target set by Avery.

6. Revised Price on the estimated costs in order to maintain 16% Markup:

Revised Selling Price = Rs.31.25 + 16% thereon = Rs.36.25

7. Possible Management actions for New T:

(a) Value Engineering and Value Analysis to reduce the Direct Material Costs.

(b) Time and Motion Study in order to redefine the Direct Labour time and related costs.

(c) Exploring possibility of cost reduction in costs of Direct Machining.

(d) Identifying non-value added activities and eliminating them in order to reduce Overheads.

(e) Analysis of effect of sale of New T on sale of P.

(f) Analysis of sensitivity of sale quantity of New T to price increase from Rs.34.80 to Rs.36.25.

Example 13: Quality Improvement Programme-impact on profits

ABC Ltd. implemented a quality improvement programme and had the following results:

	2010	2011
		(Figures in Rs. '000)
Sales	6,000	6,000
Scrap	600	300
Rework	500	400
Production inspection	200	240
Product warranty	300	150
Quality training	75	150
Materials inspection	80	60

You are required to:

(i) Classify the quality costs as prevention, appraisal, internal failure and external failure and express each classes a percentage of sales.

(ii) Compute the amount of increase in profits due to quality improvement.

Analysis and Solution:

(i) Classification of Quality Costs

	2010	%of sales	2011	%of sales
Sales	6,000		6,000	
Prevention				
Quality training	75	1.25	150	2.5
Appraisal				
Product Inspection	200		240	
Materials Inspection	80		60	
	280	4.67	300	5
Internal Failure				
Scrap	600		300	
Rework	500		400	
	1100	18.33	700	11.67
External Failure				
Product warranty	300	5	150	2.5
	1755	29.25	1300	21.67

(ii) Cost reduction was effected by 7.58% (29.25 - 21.67) of sales, which is an increase in profit by Rs.4,54,800.

Example14: TQM- an application

C Ltd. makes and sells a single product, the unit specifications are as follows:

Direct Materials X : 8 sq. metre at Rs. 40per square metre

Machine Time : 0.6 Running hours

Machine cost per gross hour : Rs. 400

Selling price : Rs. 1,000

C Ltd. requires to fulfill orders for 5,000 product units per period. There are no stock of product units at the beginning or end of the period under review. The stock level of material X remains unchanged throughout the period.

C Ltd. is planning to implement a Quality Management Programme (QMP). The following additional information regarding costs and revenues are given as of now and after implementation of Quality Management Programme.

	Before the implementation of QMP		After the implementation
1.	5% of incoming material from suppliers scrapped due to poor receipt and storage organisation.	1.	Reduced to 3%.
2.	4% of material X input to the machine process is wasted due to processing problems.	2.	Reduced to 2.5%
3.	Inspection and storage of Material X costs Re.1 per square metre purchased.	3.	No change in the unit rate.
4.	Inspection during the production cycle, calibration checks on inspection equipment vendor rating and other checks cost Rs. 2,50,000 per period.	4.	Reduction of 40% of the existing cost
5.	Production Qty. is increased to allow for the down grading of 12.5% of the production units at the final inspection stage. Down graded units are sold as seconds at a discount of30% of the standard selling price.	5.	Reduction to 7.5%.
6.	Production Quantity is increased to allow for return from customers, (these are replaced free of charge) due to specification failure and account for 5% of units actually delivered to customer.	6.	Reduction to 2.5%.
7.	Product liability and other claims by customers are estimated at 3% of sales revenue from standard product sale.	7.	Reduction to 1%.
8.	Machine idle time is 20% of Gross machine hrs. used (i.e. running hour = 80% of gross/hrs.)	8.	Reduction to 12.5%.
9.	Sundry costs of Administration, Selling and Distribution total—Rs. 6,00,000 per period.	9.	Reduction by 10% of the existing.
10.	Prevention programme costs Rs. 2,00,000.	10.	Increase to Rs. 6,00,000.

The Total Quality Management Programme will have a reduction in Machine Run Time required per product unit to 0.5 hr.

Required:

(a) Prepare summaries showing the calculation of:

(i) Total production units (pre-inspection), (ii) Purchase of Materials X (square metres), (iii) Gross Machine Hours.

In each case, the figures are required for the situation both before and after the implementation of the Quality Management Programme so that orders for 5,000 product units can be fulfilled.

(b) Prepare Profit and Loss Account for Carlon Ltd. for the period showing the profit earned both before and after the implementation of the total quality program.

Analysis and Solution:

(a)		Existing		After TQM Programme
(i) Total Production units (Preinspection)				
Total sales requirements		5,000		5,000
Add : Specification losses @ 5%		250	@2.5%	125
		5,250		5,125
Downgrading at inspection	$\frac{12.5}{87.5}$ ×5,250	750	$\frac{7.5}{72.5}$ ×5,125	416
Total units before inspection		6,000		5,541
(ii) Purchase of material 'X' (Sq Mtr)				
Material required to meet (Sq Mtr) pre inspection production requirement 6,000 × 8 Sq Mtr		48,000	5,541 ×8	44,328
Processing loss	$\frac{4}{96}$ × 48,000	2,000	$\frac{2.5}{9.5}$ ×44,328	1,137
Input to the process		50,000		45,465
Scrapped material	$\frac{5}{95.5}$ ×50,000	2,632	$\frac{3}{97}$ ×45.465	1,406
Total purchases		52,632		46,871
(iii) Gross Machine Hours				
Initial requirements	6,000 × 0.6	3,600	5,541 × 0.5	2,771
Idle time	$\frac{20}{80}$ ×3,600	900	$\frac{12.0}{87.5}$ × 2,771	396
Gross time		4,500		3,167

(b) **Profit and loss statement**

		Rs.		Rs.
Sales revenue 5,000 Units × Rs. 1,000	50,00,000		50,00,000	
Sales downgraded 750 Units × Rs 700		5,25,000	416 Units × Rs. 700	2,91,200
		55,25,000		52,91,200

Costs:			
Material 52,632 Sq Mtr ×Rs 40	21,05,280	46,871 Sq Mtr × Rs. 40	18,74,840
Inspection and storage costs 52,632 Sq Mtr × Re 1	52,632	46,871 Sq Mtr × Re 1	46,871
Machine cost 4,500 Hrs ×Rs 400	18,00,000	3,167 Hrs × Rs 400	12,66,800
Inspection and other cost	2,50,000	2,50,000 × 60%	1,50,000
Product liability (3% × 50,00,000)	1,50,000	1 % × 50,00,000	50,000
Sundry cost of selling, distribution and administration.	6,00,000	6,00,000 × 90%	5,40,000
Preventive programme cost	2,00,000		6,00,000
	51,57,912		45,28,511
Net profit	3,67,088		7,62,689

Example 15: Target Costing- an application

ABC Enterprises has prepared a draft budget for the next year as follows:

Quantity	10,000 units
Sales price per unit	30
Variable costs per unit:	
Direct Materials	8
Direct Labour	6
Variable overhead (2 hrs × re. 0.50)	1
Contribution per unit	15
Budgeted Contribution	1,50,000
Budgeted Fixed costs	1,40,000
Budgeted Profit	10,000

The Board of Directors is dissatisfied with this budget, and asks a working party to come up with an alternate budget with higher target profit figures.

The working party reports back with he following suggestions that will lead to a budgeted profit of Rs. 25,000. The company should spend Rs. 28,500 on advertising, & set the target sales price up to Rs. 32 per unit. It is expected that the sales volume will also rise, inspite of the price rise, to 12,000 units.

In order to achieve the extra production capacity, however, the workforce must be able to reduce the time taken to make each unit of the product. It is proposed to offer a pay and productivity deal in which the wage rate per hour in increased to Rs. 4. The hourly rate for variable overhead will be unaffected.

Ascertain the target labour time required to achieve the target profit.

Analysis and Solution:

	Rs.	Rs.
Target profit	25,000	
Add: Fixed cost	1,40,000	
Add: Additional Advertisement	28,500	
Total contribution	1,93,500	
Sales volume	12,000	
Contribution per unit $\left(\frac{\text{Rs. } 1{,}93{,}500}{12{,}000}\right)$	16.125	
Target Selling price per unit		32.000
Less: Contribution per unit		16.125
Target variable cost p.u.		15.875
Less: Material cost p.u.		8.000
Labour + Variable overhead p.u.		7.875

(1) Labour cost per hour = x hour × Rs. 4 per hour
= Rs.4x

Variable overhead per hour = x hour × Rs. 0.5 per hour
= Re. 0.5x

(2) Time required to achieve the target profit

1.75 hours per unit

So, for 12,000 units = 12,000 × 1.75 hour
=21,000 hours

(3) Time/unit	1.75
Present	2.00
Time reduced	0.25 hr.

Example 16: Application of Target Costing

You are the manager of a paper mill (M Ltd) and have recently come across a particular type of paper, which is being sold at a substantially lower rate (by another company -ABC Ltd) than the price charged by your own mill. The value chain for one use of one tonne of such paper for ABC Ltd is as follows,

ABC Ltd. →Merchant →. Printer → Customer

ABC Ltd sells this particular paper to the merchant at the rate of Rs 1,466 per tonne. ABC Ltd pays for the freight which amounts to Rs 30 per tonne.

Average returns and allowances amount to 4% of sales and approximately equal Rs 60 per tonne.

The value chain of your company, through which the paper reaches the ultimate customer is similar to the one of ABC Ltd. However, your mill does not sell directly to the merchant, the latter receiving the paper from a huge distribution center maintained by your company at Haryana. Shipment costs from the mill to the Distribution Center amount to Rs. 11 per tonne while the operating costs in the Distribution Center have been estimated to be Rs 25 per tonne. The return on investments required by the Distribution Center for the investments made amount to an estimated Rs. 58 per tonne.

You are required to compute the "Mill manufacturing Target Cost" for this particular paper for your company. You may assume that the return on the investment expected by your company equals Rs. 120 per tonne of such paper.

Analysis and Solution:

Computation of Target Cost

	Per tonne (in Rs)	
ABC Ltd selling price to the merchant		1,466
Less: freight paid by ABC Ltd	30	
Less normal sales returns and allowances	60	
XYZ Ltds Capital charge	120	210
Target cost for XYZ Ltd		1,256
Less: Shipment cost Distribution Centre	11	
Operating cost in the Distribution Centre	25	36
Distribution centre capital charge		1,220
Less: Target manufacturing cost of the Mill		58
		1,162

Example 17: Application of Life Cycle Costing

A company is considering the purchase of a new machine for Rs, 3,50,000. It feels quite confident that it can sell the goods produced by the machine so as to yield an annual cash surplus of Rs. 1,00,000. There is however some uncertainly as to the machine s working life. A recently publish Trade Association Survey shows that members of the Association have between them owned 250 of these machines and have found the lives of the machines vary as under:

No. of year of machine life	3	4	5	6	7	Total
No. of machines having given life	20	50	100	70	10	250

Assuming a discount rate of 10% the net present value for each different machine life is as follows:

Machine life	3	4	5	6	7
NPV(Rs.)	(1,01,000)	(33,000)	29,000	86,000	1,37,000

You are required to advice whether the company should purchase a new machine or not.

Analysis and Solution:

Computation of NPV of an asset considering the probability of life of machine.

Year	Probability (a) Rs.	NPV (b) Rs.	Expected value (a × b)
3	20/250	(1,01,000)	(8,080)
4	50/250	(33,000)	(6,600)
5	100/250	29,000	11,600
6	70/250	86,000	24,080
7	10/250	1,37,000	5,480
			26,480

So, Assets should be purchased.

Example 18:Application of TQM

At the beginning of the year, Zee Company initiated a quality-improvement program. Considerable effort was expended to reduce the number of defective units produced. By the end of the year, reports from the production manager revealed that scarp and rework had both decreased. The president of the company was pleased to hear of the success but wanted some assessment of the financial impact of the improvements. To make this assessment, the following financial data were collected for the current and preceding years:

	Preceding year Rs.	**Current year Rs.**
Sales	1,00,00,000	1,00,00,000
Scrap	4,00,000	3,00,000
Rework	6,00,000	4,00,000
Product inspection	1,00,000	1,25,000
Product warranty	8,00,000	6,00,000
Quality training	40,000	80,000
Materials inspection	60,000	40,000

Required:

(i) Classify the costs as prevention, appraisal, internal failure, or external failure.

(ii) Compute quality cost as a percentage of sales for each of the two years. By how much has profit increased because of quality improvements? Assuming that quality costs can be reduced to 2.5 per cent of sales, how much additional profit is available through quality improvements (assume that sales revenues will remain the same)?

Analysis and Solution:

1. Quality cost as a % of sales

	Preceding year	**Current year**
Total quality costs	Rs. 20,00,000	Rs. 15,45,000
Percentage of sales	$\frac{20,00,000}{1,00,00,000} \times 100 = 20\%$	$\frac{15,45,000}{1,00,00,000} \times 100 = 15.45\%$

(i) Prevention costs:

Quality training

Appraisal costs:

Product inspection and materials inspection

Internal failure costs:

Scrap and rework

External failure costs:

Warranty

(ii) Preceding year - Total quality costs: Rs.20,00,000; percentage of sales; 20 per cent (Rs.20,00,000/Rs.1,00,00,000). Current year-Total quality costs: Rs. 15,45,000; percentage of sales: 15.45 per cent (Rs. 15,45,000/Rs. 1,00,00,000).

2. Profit has increased by Rs.4,55,000.
3. If quality cots drop to 2.5 per cent of sales, another Rs. 12,95,000 of profit improvement is possible (Rs. 15,45,000 - Rs.2,50,000).

Example 19: Backflush costing system in JIT environment

ABC Company uses a backflush costing system with three trigger points:

- Purchase of direct materials
- Completion of good finished units of product
- Sale of finished goods

There are no beginning inventories. Information for March, 2011 is:

	Rs.		Rs.
Direct materials purchased	4,40,000	Conversion costs allocated	2,00000
Direct materials used	4,25,000	Cost transferred to finished goods	6,25,000
Conversion costs incurred	2,11,000	Cost of goods sold	5,95,000

Required:

(a) Prepare journal entries for April (without disposing of under allocated or over allocated conversion costs). Assume there are no direct materials variances.

(a) Under an ideal JIT production system, how would the amounts in your journal entries differ from the journal entries in requirement (a)?

Solution:

(a) Journal entries for April are:

	Rs.	Rs.
Entry (i) Inventory: Materials and In-Process Control	4,40,000	
Accounts Payable Control		4,40,000
(direct materials purchased)		
Entry (ii) Conversion Costs Control	2,11,000	
Various Accounts (such as Wages Payable Control)		2,11,000
(Conversion costs incurred)		
Entry (iii) Finished Goods Control	6,25,000	
Inventory: Materials and in-Process Control		4,25,000
Conversion Costs Allocated		2,00000
(Standard cost of finished goods completed)	5,95,000	
Entry (iv) Cost of Goods Sold		
Finished Goods Control		5,95,000
(Standard costs of finished goods sold)		

s. Under an ideal JIT production system, if the manufacturing lead time per unit is very short, there could be zero inventories at the end of each day. Entry (c) would be Rs.5,95,000 finished goods production [to match finished goods sold in entry (d)], not Rs.6,25,000. If the marketing Department could only sell goods costing Rs.5,95,000, the JIT production system would call for direct materials purchases and conversion costs of lower than Rs.4,40,000 and Rs.2,11,000, respectively, in entries (a) and (b).