STRATEGY

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Strategic Management Essentials

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

Strategic planning is used synonymously with the term *strategic management*, however, the former is more often used in the business worlds, whereas the latter is often used in academia.

The purpose of strategic management is to exploit and create new and different opportunities tomorrow, **long-range planning**, in contrast, tries to optimize for tomorrow the trends of today.

A strategic plan is a company's game plan.

Stages of strategic management

The **strategic-management process** consists of 3 stages:

- **Strategy formulation** includes:
    - Developing a vision and mission
    - Identifying an organization's external opportunities and threats
    - Determining internal strengths and weaknesses
    - Establishing long-term objectives
    - Generating alternative strategies
    - Choosing particular strategies to pursue
- **Strategy implementation** requires a firm to:
    - Establish annual objectives
    - Device policies
    - Motivate employees
    - Allocate resources so that formulated strategies can be executed
    - Developing a strategy-supportive culture
    - Creating an effective organizational structure
    - Redirecting marketing efforts
    - Preparing budgets
    - Developing and using IS
    - Linking employee compensation to organizational performance
    - Interpersonal skills are especially critical for successful strategy implementation
- **Strategy evaluation:** the final stage in strategic management
    - 3 fundamental strategy-evaluation activities are:
        - Reviewing external and internal factors that are the bases for current strategies
        - Measuring performance
        - Taking corrective actions
- Formulation, implementation, and evaluation of strategy activities occur at three hierarchical levels in a large organization:
    - Corporate

- Divisional or strategic business unit
- Functional

Integrating intuition and analysis

The strategic-management process can be described as an objective, logical, systematic approach for making major decisions in an organization. It attempts to organize qualitative and quantitative information in a way that allows effective decisions to be made under conditions uncertainty.

Intuition is particularly useful for making decisions in situations of great uncertainty or little precedent.

Competitive advantage can be defined as anything that a firm does especially well compared to rival firms. When a firm can do something that rival firms cannot do or owns something that rival firms desire, that can represent a competitive advantage.

A firm must strive to achieve **sustained competitive advantage** by:

- Continually adapting to changes in external trends and events and internal capabilities, competencies, and resources
- Effectively formulating, implementing, and evaluating strategies that capitalize on those factors

Strategists are the individuals most responsible for the success or failure of an organization.

- Strategists help an organization gather, analyze, and organize information. They track industry and competitive trends, develop forecasting models and scenario analyses, evaluate corporate and divisional performance, spot emerging market opportunities, identify business threats, and develop creative action plans.
- Strategic planners usually serve in a support or staff role.

Vision and mission statement

- A **vision statement** answers the question, what do we want to become?
  - Often considered the first step in strategic planning
  - Many vision statements are a single sentence
- **Mission statements** are enduring statement of purpose that distinguish one business from other similar firms
  - A mission statement identifies the scope of a firm's operation in product and market terms
  - It addresses the basic question that faces all strategists: what is our business?
  - A clear mission statements describes the values and priorities of an organization

External opportunities and threats refer to economic, social, cultural, demographic, environmental, political, legal, governmental, technological, and competitive trends and events that could significantly benefit or harm an organization in the future.

The process of conducting research and gathering and assimilating external information is sometimes called **environmental scanning** or industry analysis. Lobbying is one activity that some organization use to influence external opportunities and threats.

Internal strengths and **internal weaknesses** are an organization's controllable activities that are performed especially well or poorly. There arise in the management, marketing, finance/accounting, production/operation, R&D, and MIS activities of a business.

Strengths and weaknesses are determined relative to competitors. *Relative deficiency or superiority is important information.*

Specificity is important because strategies will be formulated and resources allocated based on this information.

Internal factors can be determined in a number of ways, including computing ratios, measuring performance, and comparing to past periods and industry wages.

Objectives should be challenging, measurable, consistent, reasonable, and clear.

Strategies are the means by which **long-term objectives** will be achieved. Business strategies may include geographic expansion, diversification, acquisition, product development, market penetration, retrenchment, divestiture, liquidation, and joint ventures.

Annual objectives are short-term milestones that organizations must achieve to reach long-term objectives.

Policies are the means by which annual objectives will be achieved, and include guidelines, rules, and procedures established to support efforts to achieve stated objectives.

Communication is a key to successful strategic management.

Types of strategies

Long-term objectives represent the results expected from pursuing certain strategies. Strategies represent the actions to be taken to accomplish long-term objectives. The time frame for objectives and strategies should be consistent, usually from 2 to 5 years.

- Long-term objectives are needed at the corporate, divisional, and functional levels of an organization.

Financial vs. strategic objectives

Financial objectives include those associated with growth in revenues, growth in earnings, higher dividends, larger profit margins, greater return on investment, higher earnings per share, a rising stock price, improved cash flow, etc.

Strategic objectives include things such as a larger market share, quicker on-time delivery than rivals, shorter design-to-market times than rivals, lower costs than rivals, higher product quality than rivals, wider geographic coverage than rivals, achieving technological leadership, consistently getting new or improved products to market ahead of rivals, etc.

Not managing by objectives

Strategists should avoid the following:

- Managing by extrapolation
- Managing by crisis
- Managing by subjective
- Managing by hope

Types of strategies

Many, if not most, organizations simultaneously pursue a combination of two or more strategies, but a **combination strategy** can be exceptionally risky if carried too far.

TABLE 4-4 Alternative Strategies Defined and Exemplified

Strategy	Definition	Examples
Forward Integration	Gaining ownership or increased control over distributors or retailers	Forward Integration—PayPal is pushing its service off the Web and into stores via an agreement with Discover card.
Backward Integration	Seeking ownership or increased control of a firm's suppliers	Backward Integration—Fancy Motels Inc. acquiring a furniture manufacturer.
Horizontal Integration	Seeking ownership or increased control over competitors	Horizontal Integration—Britain's GlaxoSmithKline PLC acquired Human Genome Sciences Inc. for $3 billion.
Market Penetration	Seeking increased market share for present products or services in present markets through greater marketing efforts	Market Penetration—PepsiCo is heavily advertising its new Diet Pepsi special-edition silver cans featuring the blue-and-red Pepsi logo in a heart shape.
Market Development	Introducing present products or services into new geographic area	Market Development—China Petrochemical purchased three Canadian oil companies, Daylight Energy, Tanganyika Oil, and Syncrude Canada.
Product Development	Seeking increased sales by improving present products or services or developing new ones	Product Development—General Electric is building new composite material jet engines, whereas rival Pratt & Whitney is developing newly designed jet engines.
Related Diversification	Adding new but related products or services	Related Diversification—The toy retailer, Toys 'R' Us developed a new Wi-Fi tablet computer for children (the Tabeo for $149.99).
Unrelated Diversification	Adding new, unrelated products or services	Unrelated Diversification—Retailer IKEA is opening a chain of motels in Europe.
Retrenchment	Regrouping through cost and asset reduction to reverse declining sales and profit	Retrenchment—Callaway Golf cut 12 percent of its workforce; Deutsche Bank AG cut 1,000 jobs from its investment bank segment.
Divestiture	Selling a division or part of an organization	Divestiture—Dean Foods sold off its WhiteWave-Alpro organic dairy business.
Liquidation	Selling all of a company's assets, in parts, for their tangible worth	Liquidation—Big Sky Farms, one of Canada's biggest hog-producing firms, liquidated.

Levels of strategies

Top executives, middle, and lower-level managers must be involved in the strategic-planning process to the extent possible

Integration strategies

Forward integration involves gaining ownership or increased control over distributors or retailers.

- An effective means of implementing forward integration is **franchising**.
    - Businesses can expand rapidly by franchising because costs and opportunities are spread among many individuals

- 6 guidelines indicate when forward integration may be an effective strategy:
    - When an organization's present distributors are expensive, unreliable, or incapable of meeting the firm's distribution needs
    - When the availability of quality distributors is so limited as to offer a competitive advantage
    - When an organization competes in an industry that is growing and is expected to continue to grow markedly
    - When an organization has both the capital and human resources needed to manage the new business
    - When the advantages of stable production are particularly high
    - When present distributors or retailers have high profit margins

Backward integration is a strategy of seeking ownership or increased control of a firm's suppliers. This strategy can be especially appropriate when a firm's current suppliers are unreliable, too costly, or cannot meet the firm's need.

- **De-integration** makes sense in industries that have global sources of supply
- Global competition is also spurring firms to reduce their number of suppliers and to demand higher levels of service and quality from those they keep.
- 7 guidelines when backward integration may be an effective strategy:
    - When an organization's present suppliers are expensive, unreliable, or incapable of meeting the firm's needs for parts, components, assemblies, or raw materials
    - When the number of suppliers is small and the number of competitors is large
    - When an organization competes in an industry that is growing rapidly
    - When an organization has both capital and human resources to manage the new business
    - When the advantages of stable prices are particularly important
    - When present suppliers have high profit margins
    - When an organization needs to quickly acquire a needed resource

Horizontal integration refers to a strategy of seeking ownership of or increased control over a firm's competitors.

- Mergers, acquisitions, and takeovers among competitors allow for increased economies of scale and enhanced transfer of resources and competencies
- 5 guidelines indicate when horizontal strategy may be an effective strategy
    - When an organization can gain monopolistic characteristics in a particular area or region without being challenged by the federal government
    - When an organization competes in a growing industry
    - When increased economies of scale provide major competitive advantages
    - When an organization has both the capital and human talent needed to successfully manage an expanded organization
    - When competitors are faltering as a result of a lack of managerial expertise or a need for particular resources than an organization possesses

Intensive strategies

A market penetration strategy seeks to increase market share for present products or services in present markets through greater marketing efforts.

- Market penetration includes increasing the number of salespersons, increasing advertising expenditures, offering extensive sales promotion items, or increasing publicity efforts
- 5 guidelines indicate when market penetration may be an effective strategy
  - When current markets are not saturated with a particular product or service
  - When the usage rate of present customers could be increased significantly
  - When the market shares of major competitors have been declining while total industry sales have been increasing
  - When the correlation between dollar sales and dollar marketing expenditures historically has been high
  - When increased economies of scale provide major competitive advantages

Market development involves introducing present products or services into new geographic areas.

- 6 guidelines indicate when market development may be an effective strategy:
  - When new channels of distribution are available that are reliable, inexpensive, and of good quality
  - When an organization is successful at what it does
  - When new untapped or unsaturated markets exist
  - When an organization has the needed capital and human resources to manage expanded operations
  - When an organization has excess production capacity
  - When an organization's basic industry is rapidly becoming global in scope

Product development is a strategy that seeks increased sales by improving or modifying present products or services.

- Usually entails large R&D expenditures
- 5 guidelines indicate when product development may be an effective strategy:
  - When an organization has successful products that are in the maturity stage of the product life cycle
  - When an organization competes in an industry that is characterized by rapid technological developments
  - When major competitors offer better quality products at comparable prices
  - When an organization competes in a high growth industry
  - When an organization has especially strong R&D capabilities

Diversification strategies

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

- Transferring competitively valuable expertise, technological know-how, or other capabilities from one business to another
- Combining the related activities of separate businesses into a single operation to achieve lower costs
- Exploiting common use of a well-known brand name
- Cross-business collaboration to create competitively valuable resource strengths and capabilities

Related diversification

- 6 guidelines for when related diversification may be an effective strategy:
    - When an organization competed in a no-growth or slow-growth industry
    - When adding new, but related, products would significantly enhance the sales of current products
    - When new, but related, products could be offered at highly competitive prices
    - When new, but related, products have seasonal sales levels that counterbalance an organization's existing peaks and valleys
    - When an organization's products are currently in the declining stage of the product's life cycle
    - When an organization has a strong management team

An unrelated diversification strategy favors capitalizing on a portfolio of businesses that are capable of delivering excellent financial performance in their respective industries, rather than striving to capitalize on value chain strategic fits among the businesses.

- 10 guidelines for when unrelated diversification may be an effective strategy:
    - When revenues derived from an organization's current products or services would increase significantly by adding the new, unrelated products
    - When an organization competed in a highly competitive or a no-growth industry
    - When an organization's present channels of distribution can be used to market the new products to current customers
    - When the new products have countercyclical sales patters compared to an organization's present products
    - When an organization's basic industry is experiencing declining annual sales and profits
    - When an organization has the capital and managerial talent needed to compete successfully in a new industry
    - When an organization has the opportunity to purchase an unrelated business that is an attractive investment opportunity
    - When there exists financial synergy between the acquired and acquiring firm
    - When existing markets for an organization's present products are saturated

- When antitrust action could be charged against an organization that historically has concentrated on a single industry

Defensive strategies

Retrenchment occurs when an organization regroups through cost and asset reduction to reverse declining sales and profits.

- Sometimes called a *turnaround* or *reorganizational strategy*, retrenchment is designed to fortify an organization's basic distinctive competence.
- Can entail selling of land and buildings to raise needed cash, pruning product lines, closing marginal businesses, closing obsolete factories, automating processes, reducing the number of employees, and instituting expense control systems
- **Bankruptcy** can be an effective type of retrenchment strategy, it can allow a firm to avoid major debt obligation and to void union contracts. 5 major types of bankruptcy:
  - *Chapter 7 bankruptcy* is a liquidation procedure used only when a corporation sees no hope of being able to operate successfully or to obtain the necessary creditor agreement
  - *Chapter 9 bankruptcy* applies to municipalities
  - *Chapter 11bankruptcy* allows organizations to reorganize and come back after filing a petition for protection
  - *Chapter 12 bankruptcy* was created by the Family Farmer Bankruptcy Act of 1986, became effective in 1987, and provides special relief to family farmers with debt equal to or less than $1.5 million.
  - *Chapter 13 bankruptcy* is a reorganization plan similar to Chapter 11, but is available only to small businesses owned by individuals with unsecured debts of less than $100,000 and secured debts of less than $350,000
- 5 guidelines for when retrenchment may be an effective strategy:
  - When an organization has a clearly distinctive competence but has failed consistently to meet its objectives and goals over time
  - When an organization is one of the weaker competitors in a given industry
  - When an organization is plagued by inefficiency, low profitability, poor employee morale, and pressure from stockholders to improve performance
  - When an organization has failed to capitalize on external opportunities, minimize external threats, take advantage of internal strengths, and overcome internal weaknesses over time
  - When an organization has grown so large so quickly that major internal reorganization is needed

Selling a division or part of an organization is called divestiture. Divestiture often is used to raise capital for further strategic acquisitions or investments.

- 6 guidelines for when divestiture may be an effective strategy:
  - When an organization has pursued a retrenchment strategy and failed to accomplish needed improvements

- When a division needs more resources to be competitive than the company can provide
- When a division is responsible for an organization's overall poor performance
- When a division is a misfit with the rest of an organization
- When a large amount of cash is needed quickly and cannot be obtained reasonably from other sources
- When government antitrust action threatens an organization

Liquidation

Selling all of a company's assets for their tangible worth is called liquidation.

- Liquidation is a recognition of defeat and consequently can be an emotionally difficult strategy.
- 3 guidelines indicate when liquidation may be an effective strategy:
    - when an organization has pursued both a retrenchment strategy and a divestiture strategy, and neither has been successful
    - when an organization's only alternative is bankruptcy. Liquidation represents an orderly and planned means of obtaining the greatest possible cash for an organization's assets
    - when the stockholders of a firm can minimize their losses by selling the organization's assets

Michael Porter's 5 generic strategies

Strategies allow organization to gain competitive advantage from 3 different bases, called **generic strategies** by Porter:

- **Cost leadership** emphasizes producing standardized products a low per-unit cost for consumers who are price-sensitive. Two alternative types of cost leadership strategies can be defined:
    - Type 1 is a *low-cost* strategy that offers products or services to a wide range of customers at the lowest price available
    - Type 2 is a *best-value* strategy that offers products or services to a wide range of customers at the best price-value available on the market
- **Differentiation**, Porter's Type 3, is a strategy aimed at producing products and services considered unique and directed at consumers who are relatively price-insensitive
- **Focus** means producing products and services that fulfill the needs of small groups of consumers. Two alternatives types of focus strategies are:
    - Type 4, a low-cost focus strategy that offers products or services to a small range of customers at the lowest price available on the market
    - Type 5, a best-value focus strategy that offers products or services to a small range of customers at the best price-value available. Sometimes called focused differentiation
- Larger firms with greater access to resources typically compete on a cost leadership or differentiation basis, smaller firms often compete on a focus basis
- It isn't effective to pursue a cost leadership strategy in a small market because profit margins are generally too small

Cost leadership strategies (type 1 and 2)

- A primary reason for pursuing forward, backward, and horizontal integration strategies is to gain low-cost or best-value cost leadership benefits
- Cost leadership generally must be pursued in conjunction with differentiation
- A number of cost elements affect the relative attractiveness of generic strategies, including:
    - Economies or diseconomies of scale achieved
    - Learning and experience curve effects
    - The percentage of capacity utilization achieved
    - Linkages with suppliers and distributors
- Striving to be the low-cost producer in an industry can be especially effective when:
    - The market is composed of many price-sensitive buyers
    - When there are few ways to achieve product differentiation
    - When buyers do not care much about differences from brand to brand
    - When there are a large number of buyers with significant bargaining power
- To employ a cost leadership strategy successfully, a firm must ensure that its total costs across its overall value chain are lower than competitors' total costs. Ways to accomplish this:
    - Perform value chain activities more efficiently than rivals and control the factors that drive the costs of value chain activities
    - Revamp the firm's overall value chain to eliminate or bypass some cost-producing activities
- A type 1 or 2 cost leadership strategy can be especially effective under the following conditions:
    - When price competition among rival sellers is especially vigorous
    - When the products of rival sellers are essentially identical and supplies are readily available from any of several eager sellers
    - When there are few ways to achieve product differentiation that have value to buyers
    - When most buyers use the product in the same ways
    - When buyers incur low costs in switching their purchases from one seller to another
    - When buyers are large and have significant power to bargain down prices
    - When industry newcomers use introductory low prices to attract buyers and build a customer base
- Some risks of pursuing cost leadership are that:
    - Competitors may imitate the strategy
    - Technological breakthroughs in the industry may make the strategy ineffective
    - Buyer interest may swing to other differentiating features besides price

Differentiation strategies (type 3)

Differentiation doesn't guarantee competitive advantage, especially if standard products sufficiently meet customer needs or if rapid imitation by competitors is possible.

- Successful differentiation can mean greater product flexibility, great compatibility, lower costs, improved service, less maintenance, greater convenience, or more features
- A risk of pursuing a differentiation strategy is that the unique product may not be valued highly enough by customers to justify the higher price
- Another risk is that competitors may quickly develop ways to copy the differentiation features
- Common organizational requirements for a successful differentiation strategy include strong coordination among the R&D and marketing functions and substantial amenities to attract scientists and creative people
- Differentiation opportunities exist or can potentially be develop anywhere along the firm's value chain, including supply chain activities, product R&D activities, production and technological activities, manufacturing activities, HRM activities, distribution activities, or marketing activities
- To the extent that differentiating attributes are tough for rivals to copy, a differentiation strategy will be especially effective, but the sources of uniqueness must be time-consuming, cost prohibitive, and simply too burdensome for rivals to match.
- A type 3 differentiation strategy can be especially effective under the following conditions:
  - When there are many ways to differentiate the product or service and many buyers perceive these differences as having value
  - When buyer needs and uses are diverse
  - When few rival firms are following a similar differentiation approach
  - When technological change is fast paced and competition revolves around rapidly evolving product features

Focus strategies (type 4 and 5)

A successful focus strategy depends on an industry segment that is of sufficient size, has good growth potential, and is not crucial to the success of other major competitors.

- Focus strategies are most effective when consumers have distinctive preferences or requirements and when rival firms are not attempting to specialize in the same target segment
- Risks of pursuing a focus strategy include the possibility that numerous competitors will recognize the successful focus strategy and copy it or that consumer preferences will drift toward the product attributes desired by the market as a whole
- A low-cost, type 4, or best value, type 5, focus strategy can be especially attractive under the following conditions:
  - When the target market niche is large, profitable, and growing
  - When industry leaders do not consider the niche to be crucial to their own success

- When industry leaders consider it too costly or difficult to meet the specialized needs of the target market niche
- When the industry has many different niches and segments
- When few, if any, other rivals are attempting to specialize in the same target segment

Strategies for competing in turbulent, high-velocity markets
Some industries are changing so fast that researchers call them **turbulent, high-velocity markets**.

Means of achieving strategies

Cooperation among competitors
For collaboration between competitors to succeed, both firms must contribute something distinctive, such as technology, distribution, basic research, or manufacturing capacity.

- A major risk is that unintended transfers of important skills or technology may occur at organizational levels below where the deal was signed

Joint venture and partnering
- **Join venture** is a popular strategy that occurs when two or more companies form a temporary partnership or consortium for the purpose of capitalizing on some opportunity
- Other types of **cooperative arrangements** include R&D partnerships, cross-distribution agreements, cross-licensing agreements, cross-manufacturing agreements, and joint-bidding consortia
- Both allow companies to improve communications and networking, to globalize operations, and to minimize risk
- Joint ventures are proving to be a more effective way to enhance corporate growth than mergers and acquisitions
- Strategic partnering takes many forms, including outsourcing, information sharing, joint marketing, and joint R&D
- Joint ventures and partnerships are less risky for companies than mergers
- Common problems that cause joint ventures to fail:
    - Managers who must collaborate daily in operating the venture are not involved in forming or shaping the venture
    - The venture may benefit the partnering companies but may not benefit customers
    - The venture may not be supported equally by both partners
    - The venture may begin to compete more with one of the partners than the other
- Six guidelines for when a joint venture may be especially effective:
    - When a privately owned organization is forming a joint venture with a publicly owned organization
    - When a domestic organization is forming a joint venture with a foreign company
    - When the distinct competencies of two or more firms complement each other especially well

- When some project is potentially profitable but requires overwhelming resources and risks
- When two or more smaller firms have trouble competing with a large firm
- When there exists a need to quickly introduce a new tech

Merger/acquisition

- A **merger** occurs when 2 organizations of about equal size unite to form 1 enterprise
- An **acquisition** occurs when a large organization purchases a smaller firm, or vice versa
- When a merger or acquisition is not desired by both parties, it is called a **takeover** or **hostile takeover**
- If the acquisition is desired by both firms, it's termed a **friendly merger**
- **White knight** is a term that refers to a firm that agrees to acquire another firm when that other firm is facing a hostile takeover by some company
- A **leveraged buyout (LBO)** occurs when a corporation's shareholders are bought by the company's management and other private investors using borrowed funds.
    - Besides trying to avoid a hostile takeover, other reasons for initiation an LBO are senior management decisions that particular divisions don't fit into an overall corporate strategy, must be sold to raise cash, or receipt of an attractive offering price
    - An LBO takes a corporation private

Private-equity acquisitions

- PE firms increasingly are buying companies from other PE firms, called **secondary buyouts**, PE firms especially, but other firms also, in 2012 extensively borrowed money, at record low interest rates, simply to fund dividend payouts to themselves, known as **dividend recapitalizations**.

First mover advantages refer to the benefits a firm may achieve by entering a new market or developing a new product or service prior to rival firms.

- Some advantages of being a first mover include:
    - Securing access to rare resources
    - Gaining new knowledge of key factors and issues
    - Carving out market share and a position that is easy to defend and costly for rival firms to overtake
- Can be an excellent strategy when such actions:
    - Build a firm's image and reputation with buyers
    - Produce cost advantages over rivals in terms of new technologies, new components, new distribution channels, etc.
    - Create strongly loyal customers
    - Make imitation or duplication by a rival hard or unlikely
- Risks associated with being the first mover, such as unexpected and unanticipated problems and costs that occur from being the first firm doing business in the new market

- Being a slow mover can be effective when a firm can easily copy or imitate the lead firm's products or services

Outsourcing and reshoring

Business-process outsourcing (BPO) involves companies hiring other companies to take over various parts of their functional operations, such as HR, IS, payroll, accounting, customer service, and even marking.

- Companies choose to outsource their functional operations for several reasons:
    - It's less expensive
    - It allows the firm to focus on its core business
    - It enables the firm to provide better services
    - **Reshoring** is the new term that refers to US companies planning to move some of their manufacturing back to the USA

Strategic management in nonprofit and governmental organizations

Nonprofit organizations are basically just like for-profit companies expect for two major differences:

- Nonprofits don't pay taxes
- Nonprofits don't have shareholders to provide capital

Vision and mission analysis

What do we want to become?

A vision statement should answer the basic question, “What do we want to become?”

- A clear vision provides the foundation for developing a comprehensive mission statement.
- The vision statement should be established first and foremost

What is our business?

The **mission statement** is a declaration of an organization’s reason for being.

- It answers the pivotal question “What is our business?”
- A clear mission statement is essential for effectively establishing objectives and formulating strategies
- Sometimes called a **creed statement**, a statement of purpose, a statement of philosophy, a statement of beliefs, a statement of business principles, or a statement defining our business, a mission statement reveals what an organization wants to be and whom it wants to serve

Vision vs. mission

The **vision statement** answers the question “What do we want to become?”
Both profit and vision are needed to motivate a workforce effectively.

Vision statement analysis

A vision statement should at a minimum reveal the type of business the firm engages.

The process of developing vision and mission statements

A widely used approach to developing a vision and mission statement is first to select several articles about these statements and ask all managers to read these as background information. Then ask managers themselves to prepare a vision and mission statement for the organization.

Importance of vision and mission statements

Organizations carefully develop a written mission statement in order to reap the following benefits:

- To make sure all employees/managers understand the firm’s purpose or reason for being
- To provide a basis for prioritization of key internal and external factors utilized to formulate feasible strategies
- To provide a basis for the allocation of resources
- To provide a basis for organizing work, departments, activities, and segments around a common purpose

A resolution of divergent views

Another benefit of developing a comprehensive mission statement is that divergent views among managers can be revealed and resolved through the process.

Considerable disagreement among an organization's strategists over vision and mission statements can cause trouble if not resolved.

In multidivisional organizations, strategists should ensure that divisional units perform strategic-management tasks, including the development of a statement of vision and mission. Each division should involve its own managers and employees in developing a vision and mission statement that is consistent with and supportive of the corporate mission.

Characteristics of a mission statement

A declaration of attitude

- A good mission statement allows for the generation and consideration of a range of feasible alternative objectives and strategies without unduly stifling management creativity
- A mission statement needs to be broad to reconcile differences effectively among, and appeal to, and organization's diverse **stakeholders**, the individuals and groups of individuals who have a special stake or claim on the company. Thus, a mission statement should be **reconciliatory**
- A good mission statement indicates the relative attention that an organization will devote to meeting the claims of various stakeholders
- An effective mission statement should not be too lengthy; recommended length is less than 250 words. An effective mission statement should arouse positive feelings and emotions about an organization; it should be inspiring in the sense that it motivates readers to action.

A customer orientation

A good mission statement describes an organization's purpose, customers, products or services, markets, philosophy, and basic technology.

- A good mission statement reflects the anticipations of customers
- Good mission statements identify the utility of a firm's products to its customers

Mission statement components

An effective statement should include these 9 **mission statement components**:

- Customers
- Products
- Markets
- Technology
- Concern for survival, growth, and profitability
- Philosophy
- Self-concept
- Concern for public image
- Concern for employees

The internal audit

The nature of an internal audit
Objectives and strategies are established with the intention of capitalizing on internal strengths and overcoming weaknesses.

Key internal forces
Strategic planning must include a detailed assessment of how the firm is doing in all internal areas.

- A firm's strengths that cannot be easily matched or imitated by competitors are called **distinctive competencies**. Building competitive advantages involves taking advantage of distinctive competencies

The process of performing an internal audit closely parallels the process of performing an external audit.

- Representative managers and employees from throughout the firm need to be involved in determining a firm's strengths and weaknesses
- The internal audit requires gathering and assimilating information about the firm's management, marketing, finance and accounting, production and operations, R&D, and MIS operations
- Compared to the external audit, the process of performing an internal audit provides more opportunity for participants to understand how their jobs, departments, and divisions fit into the whole organization
- **Communication** may be the most important word in management. Performing an internal audit requires gathering, assimilating, and evaluating information about the firm's operations
- Strategic management is a highly interactive process that requires effective coordination among management, marketing and accounting, production and operations, R&D, and MIS managers
- **Financial ratio analysis** exemplified the complexity of relationships among the functional areas of business
    - The effectiveness of strategy formulation, implementation, and evaluation activities hinges on a clear understanding of how major business functions affect one another
    - For strategies to succeed, a coordinated effort among all the functional areas of business is needed

The resource-based view
The **resource-based view (RBV)** approach to competitive advantage contends that internal resources are more important for a firm than external factors in achieving and sustaining competitive advantage.

- Organizational performance will primarily be determined by internal resources that can be grouped into 3 all-encompassing categories:
    - Physical resources
        - Include all plant and equipment, location, technology, raw materials, and machines
    - Human resources

        - Include all employees, training, experience, intelligence, knowledge, skills, and abilities
    - Organizational resources
        - Include firm structure, planning processes, information systems, patents, trademarks, copyrights, databases, etc.
- RBV theory asserts that resources are actually what helps a firm exploit opportunities and neutralize threats
- Basic premise of the RBV is that the mix, type, amount, and nature of a firm's internal resources should be considered first and foremost in devising strategies that can lead to sustainable competitive advantage
- Managing strategically according to the RBV involves developing and exploiting a firm's unique resources and capabilities, and continually maintaining and strengthening those resources
- For a resource to be valuable it must be either:
    - Rare
    - Hard to imitate
    - Not easily substitutable
- Often called **empirical indicators**, the 3 aforementioned characteristics of resources enable a firm to implement strategies that improve its efficiency and effectiveness and lead to a sustainable competitive advantage

Integrating strategy and culture

Organizational culture can be defined as a pattern of behavior that has been developed by an organization as it learns to cope with its problem of external adaptation and internal integration, and that has worked well enough to be considered valid and to be taught to new members as the correct way to perceive, think, and feel.
Cultural products include values, beliefs, rites, rituals, ceremonies, myths, stories, legends, sagas, language, metaphors, symbols, heroes, and heroines.

- An organization's culture must support the collective commitment of its people to a common purpose. It must foster competence and enthusiasm among managers and employees
- Organizational culture significantly affects business decisions and thus must be evaluated during an internal strategic-management audit

Management

The **functions of management** consist of 5 basic activities:

- ### Planning
    - The essential bridge between the present and future that increases the likelihood of achieving desired results
    - Planning is the process by which one determines whether to attempt a task, works out the most effective way of reaching desired objectives, and prepares to overcome unexpected difficulties with adequate resources
    - The process of planning must involve managers and employees
    - The time horizon for planning decreases from 2 to 5 years for top-level to less than 6 months for lower-level managers

  - Planning allows an organization to identify and take advantage of external opportunities as well as minimize the impact of external threats
  - Also includes developing a mission forecasting future events and trends, establishing objectives, and choosing strategies to pursue
  - An organization can develop synergy through planning
    - **Synergy** exists when everyone pulls together as a team that knows what it wants to achieve and can result in powerful competitive advantages
- Organizing
  - The purpose of **organizing** is to achieve coordinated effort by defining task and authority relationships
  - Organizing means determining who does what and who reports to whom
  - The organizing function of management can be viewed as consisting of 3 sequential activities:
    - Breaking down tasks into jobs
      - Breaking down tasks into jobs requires the development of job descriptions and job specifications
    - Combining jobs to form departments
    - Delegating authority
  - The most common forms of departmentalization are functional, divisional, strategic, business unit, and matrix
- Motivating
  - **Motivating** can be defined as the process of influencing people to accomplish specific objectives
  - The motivating function of management includes at least 4 major components:
    - Leadership
      - Includes developing a vision of the firm's future and inspiring people to work hard to achieve that vision
    - Group dynamics
      - Play a major role in employee morale and satisfaction
    - Communication
      - A major component in motivation
      - Good two-way communication is vital for gaining support for departmental and divisional objectives and policies
      - Top-down communication can encourage bottom-up communication
      - A primary reason for instituting strategic management is to build and support effective communication networks throughout the firm
    - Organizational change
- Staffing
  - The management function of **staffing**, also called **personnel management** or **human resource management**, includes activities such as recruiting, interviewing, testing, selecting, orienting, training, developing, caring for, evaluating, rewarding, disciplining, promoting,

transferring, demoting, and dismissing employees, as well as managing union relations
    - It's important to identify strengths and weaknesses in the staffing area
    - The hr department coordinates staffing decisions in the firm so that an organization as a whole meets legal requirements. This department also provides needed consistency in administering company rules, wages, policies, and employee benefits as well as collective bargaining with unions
    - HRM is particularly challenging for international companies
- Controlling
    - The **controlling** function of management includes all of those activities undertaken to ensure that actual operations conform to planned operations
    - The controlling function of management is particularly important for effective strategy evaluation
    - Controlling consists of 4 basis steps:
        - Establishing performance standards
        - Measuring individual and organizational performance
        - Comparing actual performance to planned performance standards
        - Taking corrective actions
    - Measuring individual performance is often conducted ineffectively or not at all in organizations. Reasons for this shortcoming are that evaluations can create confrontations, that most managers prefer to avoid, can take more time than most managers are willing to give, and can require skills that many managers lack.

Marketing

Can be described as the process of defining, anticipating, creating, and fulfilling customers' needs and wants for products and services. There are 7 basic **functions of marketing**:

- Customer analysis
    - **Customer** analysis is the examination and evaluation of consumer needs, desires, and wants
    - Involves administering customer surveys, analyzing consumer information, evaluating market positioning strategies, developing customer profiles, and determining optimal market segmentation strategies
- Selling products and services
    - **Selling** includes many marketing activities, such as advertising, sales promotion, publicity, personal selling, sales force management, customer relations, and dealer relations
    - Especially critical when a firm pursues a market penetration strategy
    - Personal selling is most important for industrial goods companies, whereas advertising is most important for consumer goods companies
    - Determining organizational strengths and weaknesses in the selling function of marketing is an important part of performing an internal strategic-management audit
- Product and service planning

- **Product and service planning** includes activities such as:
  - Test marketing
  - Product and brand positioning
  - Devising warranties
  - Packaging
  - Determining product options, features, style, and quality
  - Deleting old products
  - Providing for customer service
- Product and service planning is particularly important when a company is pursuing product development or diversification
- **Test marketing** is one of the most effective product and service planning techniques
  - Allow an organization to test alternative marketing plans and to forecast future sales of new products

- Pricing
  - 5 major stakeholder affect pricing decisions
    - Consumers
    - Governments
    - Suppliers
    - Distributors
    - Competitors
  - An organization will pursue a forward integration strategy primarily to gain better control over prices charges to consumers
  - Strategists should view price from both a short-run and a long-run perspective because competitors can copy price changes with relative ease
- Distribution
  - **Distribution** includes warehousing, distribution channels, distributions coverage, retail site locations, sales territories, inventory levels and location, transportation carriers, wholesaling, and retailing
  - Distribution becomes especially important when a firm is striving to implement a market development or forward integration strategy
- Marketing research
  - **Marketing research** is the systematic gathering, recording, and analyzing of data about problems relating to the marketing of goods and services
    - Can uncover critical strengths and weaknesses, and marketing researchers employ numerous scales, instruments, procedures, concepts, and techniques to gather information
    - Marketing research activities support all of the major business functions of an organization
- Opportunity analysis
  - **Cost/benefit analysis**, involves assessing the costs, benefits, and risks associated with marketing decisions. 3 steps are required to perform a cost/benefit analysis:
    - Compute the total costs associated with a decision
    - Estimate the total benefits from the decision
    - Compare the total costs with the total benefits
  - One key factor to be considered is risk

- Government agencies across the world rely on a basic set of key cost/benefit indicators, including:
  - NPV – net present value
  - PVB – present value of benefits
  - PVC – present value of costs
  - PVB/PVC = BCR – benefit cost ratio
  - PVB - PVC = net benefit
  - NPV/k – k is the level of funds available

Finance and accounting

Finance and accounting functions

comprise 3 decisions:

- The **investment decision**
  - Also called **capital budgeting**
  - Is the allocation and reallocation of capital and resources to project, products, assets, and divisions of an organization
- The **financing decision**
  - Determines the best capital structure for the firm and includes examining various methods by which the firm can raise capital
  - 2 key financial ratios that indicate whether a firm's financing decisions have been effective are the debt-to-equity ratio and the debt-to-total-assets ratio
- The **dividend decision**
  - Concerns issues such as the percentage of earnings paid to stockholders, the stability of dividends paid over time, and the repurchase of issuance of stock
  - 3 financial ratios that are helpful in evaluation a firm's dividend decisions are the earning-per-share ratio, the dividends-per-share ratio, and the price-earnings ratio
    - Paying cash dividends is customary
    - Dividends represent a sales point for investment bankers
    - Shareholders often demand dividends
    - Paying dividends will result in a higher stock price

Basic types of financial ratios

Trend analysis is a useful technique that incorporates both the time and industry average dimensions of financial ratios.

Key financial ratios can be classified into the following 5 types:

- **Liquidity ratios** measure a firm's ability to meet maturing short-term obligations
  - Current ratio
  - Quick (acid-test) ratio
- **Leverage ratios** measure the extend to which a firm has been financed by debt
  - Debt-to-total-assets ratio
  - Debt-to-equity ratio
  - Long-term debt-to-equity ratio

  - Times-interest-earned (coverage) ratio
- **Activity ratios** measure how effectively a firm is using its resources
  - Inventory turnover
  - Fixed assets turnover
  - Total assets turnover
  - Accounts receivable turnover
  - Average collection period
- **Profitability ratios** measure management's overall effectiveness as shown by the returns generated on sales and investment
  - Gross profit margin
  - Operating profit margin
  - Net profit margin
  - Return on total assets
  - Return on stockholders' equity
  - Earnings per share
  - Price-earnings ratio
- **Growth ratios** measure the firm's ability to maintain its economic position in the growth of the economy and industry
  - Sales
  - Net income
  - Earnings per share
  - Dividends per share

Financial ratio analysis should be conducted on 3 separate fronts:

- How has each ratio changed over time?
- How does each ratio compare to industry norms?
- How does each ratio compare with key competitors?

Limitations of financial ratio analysis:

- Financial ratios are based on accounting data, and firms differ in their treatment of such items as depreciation, inventory valuation, R&D expenditures, pension plan costs, mergers, and taxes
- Seasonal factors can influence comparative ratios
- Departures from industry averages don't always indicate that a firm is doing especially well or badly
- Financial ratios are not very actionable in terms of revealing potential strategies needed

A firm's financial condition depends not only on the functions of finance, but also on many other factors, including:

- Management, marketing, management productions and operations, R&D, and MIS
- Actions by competitors, suppliers, distributors, creditors, customers, and shareholders
- Economic, social, cultural, demographic, environmental, political, governmental, legal, and technological trends

Breakeven analysis

As a firm lowers prices, its **breakeven (BE) point** in terms of units sold increases. The breakeven point can be defined as the quantity of units that a firm must sell for its total revenues (TR) to equal its total costs (TC).

- Increasing fixed costs also raises a firm's breakeven quantity
- Adding **fixed costs (FC)**, such as plant, equipment, stores, advertising, and land, may be detrimental whenever there is doubt that significantly more units can be sold to offset those expenditures
- **Variable costs (VC)**, such as labor and materials, when increased, have the effect of raising the breakeven point
- *BE Quantity = TFC divided by (price – VC)*

Some limitations of breakeven analysis:

- Breakeven analysis is only a supply side analysis
- It assumes that fixed costs are constant
- It assumes average variable costs are constant per unit of output
- It assumes that the quantity of goods produced is equal to the quantity of goods sold
- In multiproduct companies, it assumes that the relative proportions of each product sold and produced are constant

Production and operations

The extent to which a manufacturing plant's output reaches its potential output is called **capacity utilization**.

The **production/operations function** of a business consists of all those activities that transform inputs into goods and services.

In most industries, the major costs of producing a product or service are incurred within operations.

Research and development

The 5th major area of internal operations that should be examined for specific strengths and weaknesses is **research and development (R&D)**.

- Organizations invest in R&D because they believe that such an investment will lead to a superior product or service and will give them competitive advantages
- R&D expenditures are directed at developing new products before competitors do, at improving product quality, or at improving manufacturing processes to reduce costs
- Effective management of R&D function requires a strategic and operational partnership between R&D and the other vital business functions

Internal and external research and development

4 approaches to determining R&D budget allocations commonly are used:

- Financing as many project proposals as possible
- Using a percentage-of-sales method
- Budgeting about the same amount that competitors spend for R&D

- Deciding how many successful new products are needed and working backward to estimate the required R&D investment

R&D in organizations can take 2 basic forms: internal or contract R&D.

In cases where new product introduction is the driving force for strategy, R&D activities must be extensive.

Management information systems

Assessing a firm's internal strengths and weaknesses in information systems is a critical dimension of performing an internal audit.

A **management information systems (MIS)** receives raw material from both the external and internal evaluation of an organization. It gathers data about marketing, finance, production, and personnel matters internally, and social, cultural, demographic, environmental, economic, political, governmental, legal, technological, and competitive factors externally. Data are integrated in ways needed to support managerial decision making.

Value chain analysis

The business of a firm can best be described as a value chain, in which total revenues minus total costs of all activities undertaken to develop and market a product or service yields value.

Value chain analysis (VCA) refers to the process whereby a firm determines the costs associated with organizational activities from purchasing raw materials to manufacturing product(s) to marketing those products.

- VCA aims to identify where low-cost advantages or disadvantages exist anywhere along the value chain from raw material to customer service activities
- VCA can enable a firm to better identify its own strengths and weaknesses, especially as compared to competitor's value chain analyses and their own data examined over time
- Conducting a VCA is supportive of the RBV's examination of a firm's assets and capabilities as sources of distinctive competence
- VCA can be critically important for a firm in monitoring whether its prices and costs are competitive
- A **core competence** is a VCA that a firm performs especially well. When a core competence evolves into a major competitive advantage, then it's called a distinctive competence

Benchmarking is an analytical tool used to determine whether a firm's VCA are competitive compared to rivals and thus conductive to winning in the marketplace.

- Typical sources of benchmarking information include:
  - Published reports
  - Trade publications
  - Suppliers
  - Distributors
  - Customers
  - Partners
  - Creditors

  - Shareholders
  - Lobbyist
  - Willing rival firms

The internal factor evaluation matrix

A summary step in conducting an internal strategic-management audit is to construct an **internal factor evaluation (IFE) matrix**. This strategy-formulation tool summarizes and evaluates the major strengths and weaknesses in the functional areas of a business, and it also provides a basis for identifying and evaluation relationships among those areas.
An IFE matrix can be developed in 5 steps:

- List key internal factors as identified in the internal-audit process
- Assign a weight that ranges from 0.0 (not important) to 1.0 (all-important) to each factor
  - The sum of all weights must equal 1.0
- Assign a 1-4 rating to each factor to indicate whether that factor represents a major weakness (1), a minor weakness (2), a minor strength (3), or a major strength (4).
- Multiple each factor's weight by its rating to determine a weighted score for each variable
- Sum the weighted scores for each variable to determine the total weighted score for the organization

Regardless of how many factors are included in an IFE matrix, the total weighted score can range from a low 1.0 to a high 4.0, with the average score being 2.5.

Strategy implementation

Manager and employee involvement and participation are essential for success in marketing, finance and accounting, R&D, and MIS activities.

Current marketing issues

Marketing decisions that may require policies:

- How to make advertisements more interactive to be more effective
- How to best take advantage of social media conservations about the company and industry
- To use exclusive dealerships or multiple channels of distribution
- To use heavy, light, or no TV advertising vs. online advertising
- To limit, or not, the share of business done with a single customer
- To be a price leader or a price follower
- To offer a complete or limited warranty
- To reward salespeople based on straight salary, straight commission, or a combination salary and commission

Marketing is more about building a two-way relationship with consumers than just informing them about a product or service.

- Marketers must get their customers involved in their company website and solicit suggestions from customers in terms of product development, customer service, and ideas
- Companies and organizations should encourage their employees to create **wikis** – websites that allow users to add, delete, and edit content regarding FQA and information across the firm's whole value chain of activities
- Firms should provide incentives to customers to share their thoughts, opinions, and experiences on the company website

New principles of marketing

- A business or organization's website must provide clear and simple instructions for customers to set up a blog or contribute to a wiki
- Customers trust each others' opinions more than a company's marketing pitch, and the more they talk freely, the more the firm can learn how to improve its product, service, and marketing
- The exponential increase in social networking and business online has created huge opportunities for marketers, however, it also has produced some severe threats, mainly that any kind of negative publicity travels fast online
- In increasing numbers, people living in underdeveloped and poor nations around the world have smartphones but no computers. This is opening up even larger markets to online marketing
- People ages 18 to 27 spend more time weekly on the internet than watching TV, listening to the radio, or watching DVD's
- Social networking sites and video sites are better means of reaching their customers than spending so many marketing dollars on traditional yellow pages or TV, magazine, radio, or newspaper ads

Market segmentation

Two variables are of central importance to strategy implementation:

- **Market segmentation**
  - Widely used in implementing strategies, especially for small and specialized firms
  - Can be defined as the subdividing of a market into distinct subsets of customers according to needs and buying habits
  - An important variable in strategy implementation for at least 3 major reasons:
    - Strategies such as market development, product development, market penetration, and diversification require increased sales through new markets and products. New or improved market-segmentation approaches are required to implement these strategies successfully
    - Market segmentation allows a firm to operate with limited resources because mass production, mass distribution, and mass advertising are not required
    - Market segmentation decisions directly affect **marketing mix variables**: product, place, promotion, and price
  - Evaluating potential market segments requires strategists to determine the characteristics and needs of consumers, to analyze consumer similarities and differences, and to develop consumer group profiles
  - Segmentation is a key to matching supply and demand
- **Product positioning**

Retention-based segmentation

To aid in more effective and efficient deployment of marketing resources, companies commonly tag each of their active customers with 3 values:

- Tag 1: is this customer at high risk of canceling the company's service?
- Tag 2: is this customer worth retaining?
- Tag 3: what retention tactics should be used to retain this customer?

The basic approach to tagging customers is to use historical retention data to make predictions about active customers regarding:

- Whether they are at high risk of canceling their service
- Whether they are profitable to retain
- What retention tactics are likely to be most effective

Does the internet make market segmentation easies?

Yes. The segments of people whom marketers want to reach online are much more precisely defined than the segments of people reached through traditional forms of media.

Product positioning/Perceptual mapping

After markets have been segmented so that the firm can target particular customer groups, the next step is to find out what customers want and expect.

The following steps are required in product positioning (aka perceptual mapping):

- Select key criteria that effectively differentiate products or services in the industry
- Diagram a two-dimensional product-positioning map with specified criteria on each axis
- Plot major competitors' products or services in the resultant four-quadrant matrix
- Identify areas in the positioning map where the company's products or services could be most competitive in the given target market
- Develop a marketing plan to position the company's products or services appropriately

Because just 2 criteria can be examined on a single product-positioning map, multiple maps are often developed to assess various approaches to strategy implementation. **Multidimensional scaling** could be used to examine 3 or more criteria simultaneously.

Some rules for using product positioning as a strategy-implementation tool:

- Look for the hole or **vacant niche**
- Don't serve 2 segments with the same strategy
- Don't position yourself in the middle of the map. The middle usually means a strategy that is not clearly perceived to have any distinguishing characteristics

An effective product-positioning strategy meets 2 criteria:

- It uniquely distinguishes a company from the competition
- It leads customers to expect slightly less service than a company can deliver

Under-promise and then over-deliver is the key!

Perceptual maps may also display consumers' ideal points.

- These points reflect ideal combinations of the 2 dimensions as seen by a consumer
- Areas where there is a cluster of ideal points indicates a **market segment**
- Areas without ideal points are sometimes referred to as **demand voids**

Finance and accounting issues

Several finance and accounting concepts central to strategy implementation are:

- Acquiring needed capital
- Developing projected financial statements
- Preparing financial budgets
- Evaluating the worth of a business

Some examples of decisions that may require finance and accounting policies are:

- To raise capital with short-term debt, long-term debt, preferred stock, or common stock
- To lease or buy fixed assets
- To determine an appropriate dividend payout ratio

- To use last-in, first-out (LIFO), first-in, first-out (FIFO), or a market-value accounting approach
- To extend the time of accounts receivable
- To establish a certain percentage discount on accounts within a specified period of time
- To determine the amount of cash that should be kept on hand

Acquiring capital to implement strategies

Besides net profit from operation and the sale of assets, two basic sources of capital for an organization are debt and equity.

- Determining an appropriate mix of debt and equity in a firm's capital structure can be vital to successful strategy implementation
- An **(EPS/EBIT) earnings per share/earnings before interest and taxes analysis** is the most widely used technique for determining whether debt, stock, or a combination of both is the best alternative for raising capital to implement strategies
    - The purpose of EPS/EBIT analysis is to determine whether all debt, or all stock, or some combination of both yields the highest EPS values for the firm
    - EPS is perhaps the best measure of success of a company, so it's widely used in making the capital acquisition decision
    - Limitations of EPS-EBIT:
        - Using all debt or all stock to raise capital in the present may impose fixed obligations, restrictive covenants, or other constraints that could severely reduce a firm's ability to raise additional capital in the future
        - Control is a limitation
            - Ownership and control of the enterprises will be diluted when issuing additional stock
        - Interest rates are a limitation
            - If rates are expected to rise, then debt could be better than stock, regardless of the determined EPS values in the analysis
        - If the firm is already too highly leverages vs. industry average ratios, then stock may be best regardless of determined EPS values in the analysis
        - The analysis assumes stock price, tax rate, and interest rates to be the same over all economic conditions
        - The estimated EBIT low and high values are based on the prior year plus the impact of strategies to be implemented
    - When using EPS/EBIT analysis
        - Timing in relation to movements of stock prices, interest rates, and bond prices becomes important
        - In times of high stock prices, stock may prove to be the best alternative from both a cost and a demand standpoint
        - When cost of capital (interest rates) is low, debt is more attractive

- Another popular way for a company to raise capital is to issue corporate bonds

Projected financial statement analysis is a central strategy-implementation technique because it allows an organization to examine the expected results of various actions and approaches.

- This type of analysis can be used to forecast the impact of various implementation decisions
- Nearly all financial institutions require at least 3 years of projected financial statements whenever a business seeks capital
- A projected income statement and balance sheet allow an organization to compute projected financial ratios under various strategy-implementation scenarios
- When compared to prior years and to industry averages, financial ratios provide valuable insights into the feasibility of various strategy-implementation approaches

There are 6 steps in performing projected financial analysis:

- Prepare the projected income statement before the balance sheet
- Use the percentage-of-sales method to project cost of goods sold and the expense items in the income statement
- Calculate the projected net income
- Subtract from the net income any dividends to be paid for that year
- Project the balance sheet items, beginning with retained earnings and then forecasting stockholders' equity, long-term liabilities, current liabilities, total liabilities, total assets, fixed assets, and current assets – in that order
- List comments on the projected statements

On financial statements, different companies use different terms for various items, such as *revenues* or *sales* used for the same item by different companies. For net income, may firms use the term *earnings*, and others use the term *profits*.

Financial budgets

A **financial budget** is a document that details how funds will be obtained and spent for a specified period of time. Annual budgets are most common, although the period of time for a budget can range from 1 day to over 10 years.

- Financial budgeting should not be thought of as a tool for limiting expenditures but rather as a method for obtaining the most productive and profitable use of an organization's resources
- Financial budgets can be viewed as the planned allocation of a firm's resources based on forecasts of the future
- Some common types of budgets include:
    - Cash budgets
    - Operating budgets
    - Sales budgets
    - Profit budgets
    - Factory budgets
    - Capital budgets

  - Expense budgets
  - Divisional budgets
  - Variable budgets
  - Flexible budgets
  - Fixed budgets
- Perhaps the most common type of financial budget is the **cash budget**
- Financial budgets have some limitations:
  - Budgetary programs can become so detailed that they are cumbersome and overly expensive
  - Financial budgets can become a substitute for objectives
  - Budgets can hide inefficiencies if based solely on precedent rather than on periodic evaluation of circumstances and standards
  - Budgets are sometimes used as instruments of tyranny that result in frustration, resentment, absenteeism, and high turnover

Company valuation

All the various methods for determining a business's worth can be grouped into 3 main approaches:

- What a firm owns
- What a firm earns
- What a firm will bring in the market

Measuring the value of a firm:

- Determine a firm's net worth, or stockholder's equity
  - Net worth represents the sum of common stock, additional paid-in capital, and retained earnings
  - Goodwill arises only if a firm acquires another firm and pays more than the book value for that firm
    - It should be noted that FASB Rule 142 requires companies to admit once a year if the premiums they paid for acquisitions, called **goodwill**, were a waste of money
    - Goodwill is not a good thing to have on a balance sheet
- Measuring the value of a firm grows out of the belief that the worth of any business should be based largely on the future benefits its owners may derive through net profits
- **Price-earnings ratio method**
  - To use this method, divide the market price of the firm's common stock by the annual earnings per share and multiply this number by the firm's average net income for the past 5 years
- **Outstanding shares method**
  - To use this method, multiply the number of shares outstanding by the market price per share
    - If the purchase price is more than this amount, the additional dollars are called a **premium**
    - The outstanding shares method may be called the **market value** or **market capitalization** or **book value** of the firm

    - The premium is a per-share dollar amount that a person or firm is willing to pay beyond the book value of the firm to control the other company
    - If the purchase price is less than the stock price times number of shares outstanding, the difference is called a **discount**
    - Business evaluations are becoming routine in many situations

Research and development issues

Research and development personnel can play an integral part in strategy implementation.

- These individuals are generally charged with developing new products and improving old ones in a way that will allow effective strategy implementation
- R&D employees and managers perform tasks that include:
    - Transferring complex tech
    - Adjusting processes to local raw materials
    - Adapting processes to local markets
    - Altering products particular tastes and specs
- Strategies such as product development, market penetration, and related diversification require that new product be successfully developed and that old products be significantly improved
- R&D policies can enhance strategy implementation efforts to:
    - Emphasize product or process improvements
    - Stress basic or applied research
    - Be leaders or followers in R&D
    - Develop robotics or manual-type processes
    - Spend a high, average, or low amount of money on R&D
    - Perform R&D within the firm or to contract R&D to outside firms
    - Use university researchers or private-sector researchers
- There must be effective interactions between R&D departments and other functional departments in implementing different types of generic business strategies
    - Conflicts between marketing, finance, R&D, and IS departments can be minimized with clear policies and objectives

Deciding whether to go public

Initial public offerings (IPOs) move a company from being private to being public.

- Going public means selling of a percentage of a company to others to raise capital
- It dilutes the owners' control of the firm
- Not recommended for companies with less than $10 million in sales because the initial costs can be too high for the firm to generate sufficient cash flow to make going public worthwhile
- 1 dollar in 4 is the average cost paid to lawyers, accountants, and underwriters
- In addition to initial costs involved with a stock offering, there are costs and obligations associated with reporting and management in a publicly held firm
- Going public can provide major advantages:

- It can allow the firm to raise capital to develop new products, build plants, expand, grow, and market products and services more effectively

The following guidelines can be used to help decide whether to acquire R&D expertise from external firms or internally:

- If the rate of technical progress is slow, the rate of market growth is moderate, and there are significant barriers to possible new entrants, in-house R&D is preferred
- If tech is changing rapidly and the market is growing slowly, a major effort in R&D may be risky because it may lead to the development of an ultimately obsolete tech or one for which there is no market
- If tech is changing slowly but the market is growing quickly there generally is not enough time for in-house development
- If both tech progress and market growth are fast, R&D expertise should be obtained through acquisition of a well-established firm in the industry

There are at least 3 major R&D approached for implementing strategies:

- Be the first firm to market new tech products
- Be an innovative imitator of successful products, thus minimizing the risks and costs of start-up
- Be a low-cost producer by mass-producing products similar to but less expensive than products recently introduced

Management information systems (MIS) issues

Having an effective **MIS** may be the most important factor in differentiating successful from unsuccessful firms.

- The process of strategic management is facilitated immensely in firms that have an effective information system
- Information collection, retrieval, and storage can be used to create competitive advantages in ways such as cross-selling to customers, monitoring suppliers, keeping managers and employees informed, coordinating activities among divisions, and managing funds
- A good information system can allow a firm to reduce costs

Business analytics is a MIS technique that involves using software to mine huge volumes of data to help executives make decisions.

- Sometimes called predictive analytics, machine learning, or data mining, this software enables a researcher to assess and use the aggregate experience of an organization, a priceless strategic asset for a firm
- The history of a firm's interaction with its customers, suppliers, distributors, employees, rival firms, and more can all be tapped with **data mining** to generate predictive models
- Business analytics can provide a firm with proprietary business intelligence regarding, for example, which segments of customers choose your firm vs. those who defer, delay, or defect to a competitor and why

- Business analytics can reveal where competitors are weak so that marketing and sales activities can be directly targeted to take advantage of resultant opportunities
- Business analytics also is being used to slash expenses
- A key distinguishing feature of business analytics is that it is predictive rather than retrospective, in that it enables a firm to learn from experience and to make current and future decisions based on prior information