UNIVERSITY OF LATVIA

Strategic Planning

Leonardo da Vinci Programme Project 'Development and Approbation of Applied Courses Based on the Transfer of Teaching Innovations in Finance and Management for Further Education of Entrepreneurs and Specialists in Latvia, Lithuania and Bulgaria'

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Introduction

Strategic planning is in our times viewed upon as a component part of the strategic management and as one of the principal management tools of an organisation management, elements of the organisation planning system. This paper will discuss the main elements of strategic planning and show the path how to get from a concept for the future of an organisation to a detailed strategic plan.

The approach to learning is based on sessions and individual studies of strategic planning by going through all the steps for strategic planning of a single organisation of one's own choice with the purpose of being able to summarise the information collected in the strategic plan of a specific organisation. Planning is considered as one of the most complex types of human activity mainly due to the necessity to operate with abstract information and events that have not yet taken place, but in order for an organisation to reach these results, however, it is necessary for these events to take place. It may be considered, therefore, that in the result of planning any concepts or seeds of the future are created, while the entire complex of strategic management will in addition to the strategic plan ensure the realisation of all these seeds of events into real life. While learning the subject of strategic management the task is particularly difficult for students if they do not possess any information and knowledge about the actual operational conditions of a particular organisation and the circumstances affecting it, therefore, the level of abstraction of any planning results is even greater making the understanding of the subject and the learning process in general significantly more difficult. The solution could be a parallel and iterative process of learning the theory and obtaining the practical knowledge and skills.

The learning material has been composed in such a way that each chapter represents a section of the strategic plan. There are questions for discussion given at the beginning of each chapter with the aim to facilitate and guide the thinking of students to the topic discussed in the respective chapter as well as to arouse their interest by demonstrating the application of the topic through an open discussion on its application. The next step in the process of instruction is the theoretical outline of the topic which the students are learning individually. During the sessions discussions with the students take place and the possible practical applications of theory in organisations at the choice of students are considered. In the closing part of the session the quintessence of any theoretical and practical conclusions drawn during the sessions or such information and knowledge that each one needs to take away with them is summarised. While one of the students is making a summary/conclusions of the session the rest of the students are testing themselves by answering the questions asked at the end of the session. The main objective for asking the closing questions for the session is the repetition of the topic which increases the understanding of the students by making theoretically practical conclusions. At the end of each chapter students must be able to tell fluently both theoretical and practical issues of the topic.

1. Role of strategic planning in management of modern organisations

The introductory questions for the topics are as follows:

1. What is your experience when observing changes in the organisational activities during the most recent years?
2. What is more important in gaining success for organisations – the environment or the strategy of an organisation, or any other conditions?
3. In your opinion, when has it been more difficult to create and successfully manage an organisation - before or now? Please, substantiate your answer.

'Most strategies are built on specific beliefs about the future. Unfortunately, the future is deeply unpredictable'. (1, page 1) This is the main contradiction faced by any organisation when creating their strategies, however, the role of strategies in modern organisations is only growing. The data published in the Harvard Business Review Magazine prove that above 50% of organisations having failed could mention an erroneous strategy as the reason instead of a bad economic situation. By inquiring the organisation managers it is possible to hear an opinion that the creation of a strategy is a labour consuming, and therefore also an expensive process for which there is simply no time and resources, as there are the daily problems that must be dealt with and that keep occurring. On the other hand, there are other organisations devoting time to the creation of formal strategies and purposefully develop the plans, without saving resources for their implementation. As we see, the approaches are highly different, and so is the success in both those organisations which have a formal strategy in place and those who doesn't. There are also situations when organisations do not have any formal strategy, but they have, however, a common clear vision concerning the future of its development. It can be reliably stated that the development of a formal strategy provides an organisation with a greater sense of security about its future. The roots of a strategy must be sought in the theory of planning which, on its turn, has originated from the military sphere. The first work which had formulated the guidelines of a strategy is considered to be Sun Tzu's 'The Art of

War' written 2,500 years ago. In this book the author being the Commander of the Chinese army formulates the rules for the carrying out of military operations. Authors like M. Porter, D.P. Norton and S. Kaplan, H. Mintzberg and others have largely contributed to the understanding of strategic organisational planning. The leading authors having written about the strategies have been classified according different strategy schools. The understanding of the different views on the issue of strategy is critical, otherwise it may occur that strategy is an abstract term, as there is not a single concept even among the scientists of what strategy really is, besides, it should be kept in mind that strategy could mean different things in different areas. Further in the text the author quotes several definitions of strategy representing the variety of opinion. The views of the different schools of strategy is important due to the reason that by using certain metaphors one can demonstrate, how different the views on one and the same idea can be. The results of the survey among businesses carried out by the author prove business representatives look upon the issue of strategy in exactly the same way, expressing in the view, form and content of a strategy their vision and understanding of the principles of enterprise operation and their role in it.

The following schools of strategy exist:

1. Design school: process of conception. Reaching the balance between internal organisational strengths, weaknesses and external opportunities and threats.
2. Planning school: formal process. …this is not merely a process of the brain, but is a formal process, which is divided in specific steps, supplemented by control tables, supported by various techniques (especially what refers to different objectives, budgets, schemes, operational plans)
3. Positioning school: analytical process. The designer of plans becomes the analyst. Includes concepts like strategic groups, value chains, theory of game playing and others, but always has some analytical specifics.
4. Entrepreneurial school: process of the vision for future. The key person is the top manager. Transformed the strategy focus from an accurate design, plan or position into an uncertain vision and a broad perspective.

5. Cognitive school: an intellectual process, which is deals mainly with the research of the strategy concept. This school also has its trends, interpretations or a constructive view on a strategy. Cognition is used to construct strategies rather as creative interpretations than simple reality charts in a more or less objective manner.
6. Learning school: a process occurring unpredictably. Strategies are created unpredictably, can be found all across the organisation, and the so called formulation and implementation link exists in it.
7. Power school: negotiating process. Further divided into two sub-groups. The micro power school sees the strategy development as such an internal policy – process which includes negotiations, putting pressure upon and confrontation between the players who have the powers. From the point of view of the macro power school an organisation is a person that exercises power over others and between its partners within the alliance, joint ventures, and other types of networking exist with the purpose of agreeing on 'collective' strategies in the interests of the organisation.
8. Culture school: a social process. The focus is on collective interests and integration – formulation of a strategy as a social process rooted in the culture of an organisation.
9. Environment school: a reactive process. Includes the so called 'probability theory' examining what reactions could be expected from an organisation in the respective environmental circumstances and the 'population ecology' imposing severe limits to strategic choices. 'Institutional theory' describing the institutional pressure that organisations are facing and is probably a hybrid of the power and cognition school.
10. Configuration school: a process of transformation. Organisations are considered as configurations – clusters of common behaviours and characteristics. If an organisation can be described by the word 'status', the

changes can be described as a rather dynamic process of transformation – a leap from one status into another. (13, pages 23-26)

This classification of strategy schools is not the only one; there is one more existing in the text books on management by authors like T. Elfring and H.W. Volberda (2001) who have classified the strategic management approaches into three strategic schools:

1. Limitation school – basically dealing with the issue where to draw the boundaries of an organisation and how to manage the process across the division line;
2. Dynamic capabilities school – strategic management is perceived as the collective learning process with the purpose of developing special organisational capabilities difficult to copy.
3. Configuration school – perceives strategy as the rising and declining process of an organisational configuration, for example, strategic techniques, archetypes and stages of development. (14, page 176)

The classification of approaches to strategic management in schools, various theories is not the creation of new theories, but it demonstrates, however the main trends in the area of strategic management.

The above discussed strategic schools show the priorities assigned by organisations in the process of strategy creation to its different parts, however, in general the majority of strategies include the following content which was formulated by Peter Drucker. When he was defining the areas for development of strategic objectives:

- Market position;
- Innovations;
- Labour efficiency;
- Material and financial resources;
- Rate of return;
- Management performance and development;
- Employee efficiency and development;
- Social responsibility.

The strategic plan may therefore be called the plan for achievement of strategic objectives or the operating plan by which an organisation is expecting to achieve its strategic objectives.

The plan defines the organisational activities and availability of resources – cash, human resources, space and equipment, required for the achievement of the objectives set. Usually an organisation develops these plans for a term from 2 to 5 years. The trend today is to reduce this period of time to 3 years, while previously the periods for the development of plans were even above 5 years. This approach has developed by taking into account the recent fast environmental changes and the inability to predict them.

Topic closing questions for discussion

1. Why so many various approaches to organisational strategy have been created and are used?
2. Which of the strategic schools seem to you to be the most appropriate for your organisation and why?
3. Can an organisation concurrently use the approaches described by different schools and how would that affect the strategy making process?

1.1. Planning

The introductory questions for the topics are as follows:

- What do you usually plan in your life?
- What are your performance results after you've done preliminary planning, and what are the results when you have simply relied on the course of events?
- What, in your opinion, should be planned and what shouldn't? Please, substantiate your opinion.

Strategic planning takes its roots from the theory of planning, and therefore, it is significant to understand the specific conditions for planning which are characteristic for all types of plans.

One of the main management functions including the ability of an organisation to look in the future and to prepare oneself for an action enabling the achievement of the objectives set forward is planning. An organisation operates successfully if its management is capable of predicting future events. This function may be defined as follows: 'planning is the organisation's process of defining its objectives, due diligence and the development of its strategic, tactical and operational activities' (1, page 187). In other words, planning is the designing of the desirable future and of effective ways for its achievement. In fact, planning is selection, therefore, planning is plausible and possible only when alternative options for action occur.

Going back to planning as a function, the four main objectives are distinguished:

- Prevention of the adverse effect of uncertainty and change;
- Focussing on the main objectives;
- Provision of the economic functioning of the system;
- Creation of possibilities for control and its streamlining.

Special place within the system of these objectives is assigned to control which is considered as further planning and as means for ensuring the performance. Control, of course, has its own functions, for example, checking of the efficiency of day-to-day operations and others, but it is, however, one of the main tools, indicators for the manager used in the management process. As it can be seen from Figure 1.1 displaying the management functions, planning and control are closely linked elements, where, on the one hand, planning crosses all the functions and ensures the possibility of control, while the control function provides the basis for improvement for a new planning cycle.

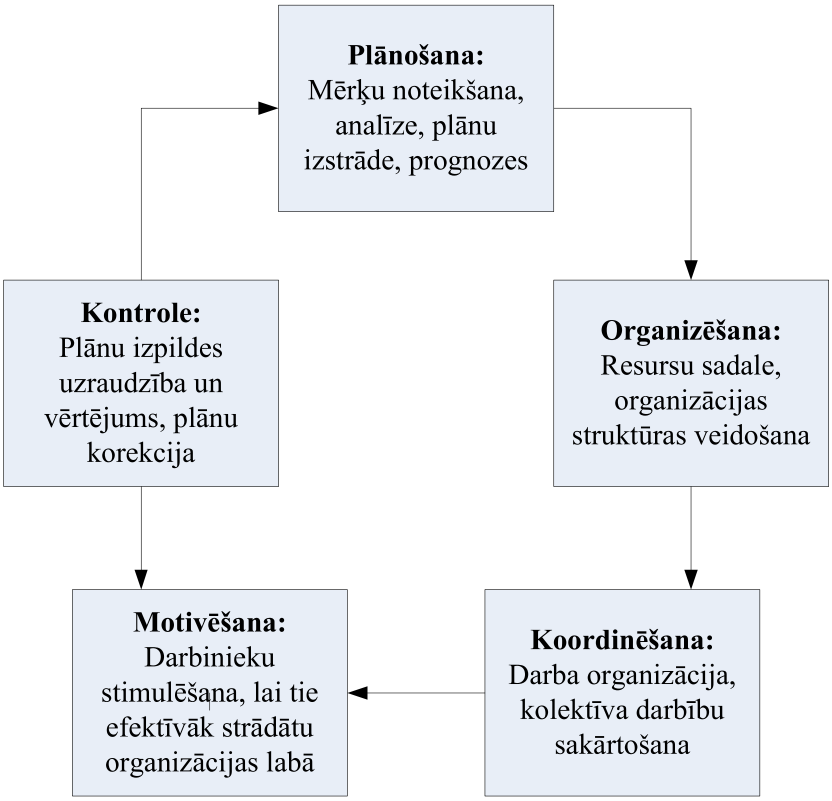


Figure 1.1 Management functions

Planning: Definition of objectives, analysis, development of plans, forecasts	
Control: Supervision and evaluation of the plan fulfilment, adjustment of plans	**Organisation:** Allocation of resources, organisational structure development
Motivation: Motivating the employees to work more efficiently for the benefit of the organisation	**Coordination:** Labour organisation, arrangement of the team work

Thus planning can be described as a systematic building of the enterprise future and it includes the process of developing and adopting the plans. The meaning of planning is generally related to the fact that it helps to increase the level of efficiency and effectiveness in an enterprise which, on its turn, discloses and reduces the potential enterprise risks, enables a focused coordination of all processes taking place in an enterprise, streamlines and strengthens these processes as well as increases the ability to be flexible and adapt to changes taking place in the external environment. In a more narrow sense it could be said that planning is the process of a systematic preparation of decisions concerning future events. The enterprise manager attempts at resolving the problems today in order to prevent from their resolution in the future. However, this can also be considered as the most arguable function as it is impossible to predict an uncertain future and to control a changing environment by planning.

Planning is one of the most complex types of human activity. 'Planning is focused on substantiation and organisation of anticipated activities. Due to planning considerate and rational decisions can be adopted, and vice versa – improvising on these issues leads to inconsiderate and unsubstantiated decisions.' (4, page 187). By effectively organising the planning process an enterprise manager would spend less time on decision-making. Although planning is a decision-making process, not every decision-making can be called planning. Planning has its own specifics, which is expressed by the following conditions:

- planning is performed prior to the commencement of the work - planning is a provisional decision-making process;
- the need for planning arises when the achievement of the desirable state of affairs depends on the adoption of a range of interrelated decisions;
- the desirable state of affairs would not set in if certain activities are not taken.

By combining the above given definitions each underlining one single characteristic of planning we have come to the result that planning is the process of a timely adoption and assessment of interrelated decisions in the situation when the desirable future state of affairs would not set in if special measures are not taken.

The types of planning may be classified in 5 groups as displayed in Figure 1.2.

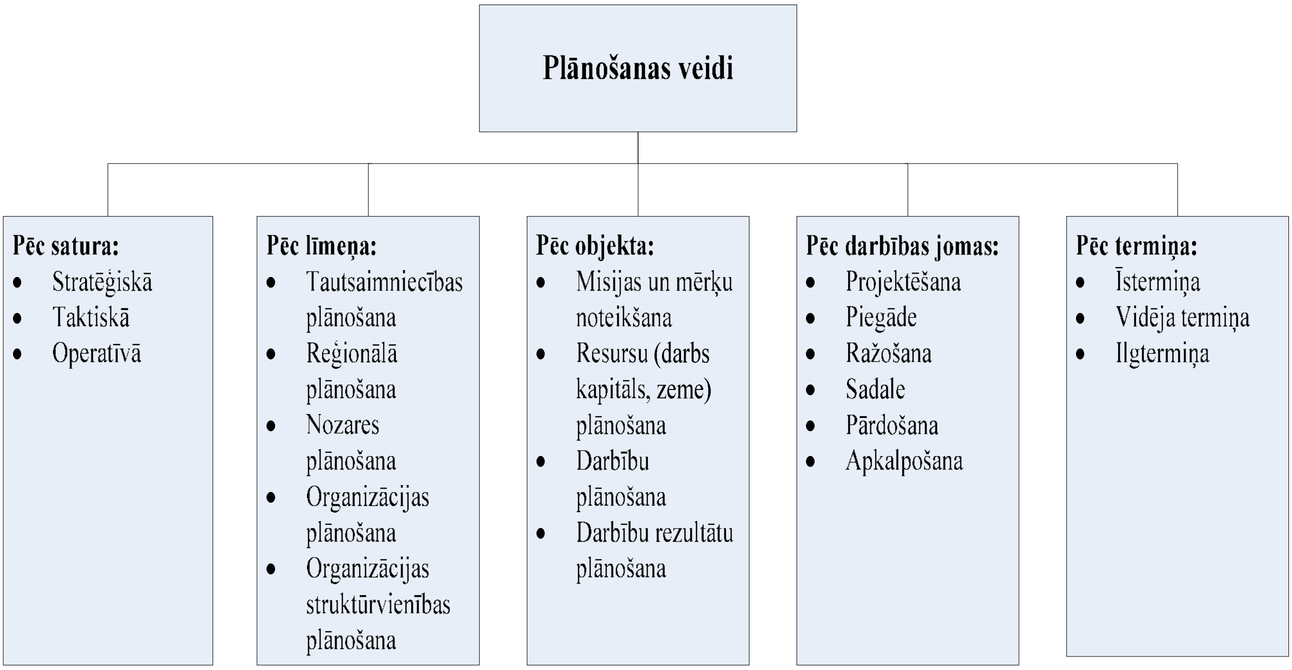


Figure 1.2 Classification of the types of planning

Types of planning				
By content: • Strategic • Tactical • Operational	**By level**: • National economy planning • Regional planning • Industry planning • Organisational planning • Organisational unit planning	**By object**: • Definition of mission and objectives • Resource planning (labour, capital, land) • Activity planning • Performance results plan	**By area of activity**: • Designing • Procurement • Production • Distribution • Sale • Service	**By term**: • Short-term • Medium-term • Long-term

1. **By content** planning is classified as follows:
   - Strategic planning is aimed at the identification of new opportunities, development of new products etc. for an organisation;
   - Tactical planning is aimed at the research and identification of the existing opportunities of an organisation (resources, products, results etc.);

- Operational planning is aimed at the realisation of the existing opportunities of an organisation.

2. **By level** planning is classified as follows:
   - National economy planning comprises the planning of the entire national economy of a particular state as a single complex of development;
   - Regional planning means the planning of a development complex of any particular region (for example, Latgale);
   - Sectoral planning is a component part of national economy planning with certain peculiarities (for example, the Latvian food industry sector needs special development planning);
   - Organisational planning depends on the planning objectives of an organisation and the arrangement of an organisation, and includes planning of activities by departments, services, units etc.
3. **By unit** planning is classified as follows:
   - Establishment of the mission and objectives of an organisation;
   - Resource planning – the planning of finance, personnel, investments, real estate etc.
   - Activity planning – includes the specifics of a particular activity at any planning level.
4. **By area of activity** planning is divided into all stages of product development:
   - Designing of products;
   - Supply of resources;
   - Manufacturing of the product;
   - Distribution of output;
   - Sale of products;
   - Customer service.
5. **By term** planning is traditionally divided as follows:

- Short-term planning in an organisation means the development of any plans for the period less than or equal to one year (monthly, quarterly, semi-annual, annual plans);
- Medium-term planning in an organisation means the development of any plan for a period from 1 to 5 years;
- Long-term planning in an organisation means the development of any plans for a period of more than 5 years (4, page 187-188).

The concept of planning classification lies in the fact that upon making any plans it is critical to take into account the boundaries for these plans within any particular type of planning. If this is not done, uncertainties may occur about the results and the planning process itself. By summarising the experience acquired in the process of making plans over several years an interesting fact should be mentioned – that the largest disagreements among the members of the planning team arise during those moments when the team members do not share a common view and they haven't agreed on what type of a plan they are talking about. From aside, a situation like this can be described as talking 'apples and oranges'. As long as the planning team members do not agree on what exactly they are talking about, efficient work will not be possible as each type of a plan has its specific conditions.

The planning principles, which are the conditions to be observed when making a plan and on which planning is actually based, have also been classified as follows:

- **Complex by nature** – being comprehensive the plan should include any situations, events which bear significance in any particular decision-making;
- Detailed approach - the plan should be not only comprehensive, but also detailed to any particulars concerning decisions, terms, persons in charge etc.;
- Accuracy – the level of accuracy depends on the types of planning;
- Clarity – the plan made must be clear and understandable for all participants involved in the plan;
- Continuity – planning should be an ongoing process, i.e., operational plans correspond to short-term plans, tactical – to medium term, while strategic - to long-term plans;

- Flexibility – a possibility should be provided to adapt for the changing situation, i.e., to plan the resources by taking into consideration various alternatives etc. (4, page 189)

It follows from the description above that the main stages of the planning process are the definition of the planning objective through application of the criteria, problem analysis, which helps to identify the opening position, the desirable state of affairs, the problems and the means, and finally the search for the alternatives.

Planning is not possible without information, therefore specific methods and techniques are used which help to analyse the planning process. Data describing the internal and external environment of an organisation serve as the input data to these processes. However, the data from the plans and control data fixed in specific plans and statements serve as the output or the outgoing data from these processes.

Topic closing questions for discussion

- What could be the effects for an organisation if its planning function is not ensured in full or if it is not professionally performed?
- Can an organisation which does not plan its future operations exist?
- What is the difference between the planning of products and of an organisation as a system? Give some examples of product development and organisational plans.

2. Strategic planning

The introductory questions for the topics are as follows:

- What are the main differences between the conditions for strategic planning and the day-to-day activities?
- How does strategic planning contribute to an organisation, and how would you substantiate to the shareholders that it is necessary to make a new strategic plan by allocating the resources required for its development?
- If you should start a new job as the manager of an organisation facing difficulties, where would you rank the task of developing a new strategic plan on your to-do list? Substantiate your order of priorities.

When turning to the research of a strategy and strategic planning it should be clarified, what strategy is. The word 'strategy' has originated from the Greek word *strategos* meaning 'the general art'. The term of strategy is historically associated with military operations. It is explained in the dictionary as 'military science and art for the general planning and conduct of large scale military operations'. (5, page 20) Military theoreticians in fact discuss and describe strategy as a means, with the help of which one of the sides can defeat its enemy with even larger and stronger troops, if it is possible to divert the location of an engagement or confrontation to a more advantageous territory for that side. It should be admitted though that in the 60-ties of the 20-th century the term of strategy acquired a new meaning in the area of organisational management, which is understood as an area of activity.

Today in theory several definitions of strategy can be met. The two general definitions are as follows:

- Strategy is the definition of long-term basic objectives and areas of activity of an organisation, allocation of the resources required for their achievement;
- Strategy is a system of logical, integrating and balanced decisions.

Strategy performance can be also viewed from the three aspects described below. The first formulation of a strategy – strategy development, second – implementation of strategy, i.e., the practical application of strategy, and finally – strategy control – either the strategy itself or the way of implementation is changed in order to ensure the desirable effect. (6, page 4) It follows from those aspects that strategic management is the formulation and development of an effective strategy with the help of certain methods and activities in order to adjust to the internal and external environment of an organisation and to realise the strategic objectives. Therefore, it can be said that strategic management is a range of successive steps within which the enterprise managers should perform the following tasks:

- Analyse opportunities and threats or limitations that could externally exist for the enterprise;
- Analyse strengths and weaknesses in the internal environment of an enterprise;
- Identify the mission and develop the objectives of an organisation;
- Formulate strategy (at the corporate level, business unit level, functional level) that would match the strengths and weaknesses of an enterprise and the opportunities and threats from the external environment;
- Implement the strategy;
- Get involved in strategic control measures in order to ensure the fulfilment of organisational objectives. (6, page 4).

Enterprise manager should also take into account the component parts of the organisational strategy and the main ones are as follows:

- **Area of activities (field) of an organisation** related to certain goods, services and markets within which they are competitive; For example, the Skonto enterprise operates in several industries – areas of restaurants, construction, transit;
- **Dislocation and distribution of resources** is also a strategic problem. How to distribute limited resources among various areas of activity in order to achieve a possibly higher return on capital? Many companies now are now try to

invest the capital gained in one industry into another area of activity by thus increasing their rates of profit.

- **Special (different) capabilities** – something that an organisation can stand out with among its competitors. For example, companies try to differ in quality, delivery terms, etc.;
- **Growth and return on capital is the result of combination of the areas of activity**, distribution of resources and special capabilities. An organisation must establish its development objectives and profit targets. From this point of view, for example, the types of distribution (direct sales or with the help of intermediaries), specialisation of production (for example, if spare parts should be manufactured in-house or a supplier should be used).

Strategic management is not possible without strategic planning which is one of the component parts of strategic management.

Strategic planning is the establishment of viable connections among long-term objectives, resources and environmental conditions of an organisation by using certain methods and activities.

Strategy types appear in the stage of strategic planning and these are: intensification (development) strategy; integration strategy; diversification strategy; reduction strategy. For a successful operation of an organisation it is critical to accept and understand that the strategy of an organisation as a system is not the same as product strategies. For example, an organisation at this point may have a very good diversified range of products/services, but at the same time it may not have any future vision for the organisation as a system. Usually such an attitude by the organisation management to strategy results in the deterioration of the performance results of an organisation over a longer period of time due to poor coordination of activities and the inevitable uncertainty transiting from the external environment of an organisation to the internal environment by causing the situations of increased stress in the activities of an organisation and reduction in its efficiency. The 4 main approaches to organisational strategy stated above, which were set forth by M. Porter are critical for the understanding of this issue and for the decision-making about the development of an organisation as a system. The same topic will be already in greater detail discussed in Section 9.1 under the topic 'Corporate level strategy'.

Strategies can be graphically presented in different ways, and therefore, in this paper we are giving several examples of strategic management and the process of planning. The fact that there is no common view on the graphical presentation of a strategy in the science of management generally only proves the diversity that exists in organisations all across the world in relation to strategy issues.

In Figure 2.1 the process of strategic management is outlined as a continuous and cyclical process of improvement where at the end of each cycle an upgrading of the overall system takes place according to the evaluation of the previous strategy.

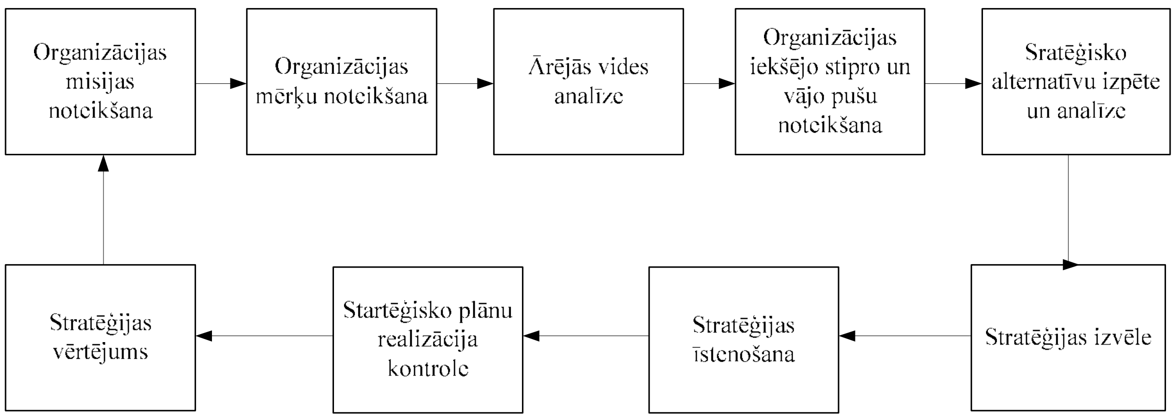


Figure 2.1 Steps of the strategic planning process

Definition of organisational mission	Definition or organisational goals	Analysis of external environment	Identification of internal organisational strengths and weaknesses	Research and analysis of strategic alternatives
Strategy evaluation	Realisation control of strategic plans		Strategy implementation	Strategy selection

Figure 2.2 outlines the process step-by-step, starting from the evaluation of the strategy for the previous period until the tools for ensuring the process of its implementation. This approach is particularly convenient for small and medium-sized organisations where it is necessary to show successively both the process and the realisation mechanism. It is not complicated to apply this approach either.

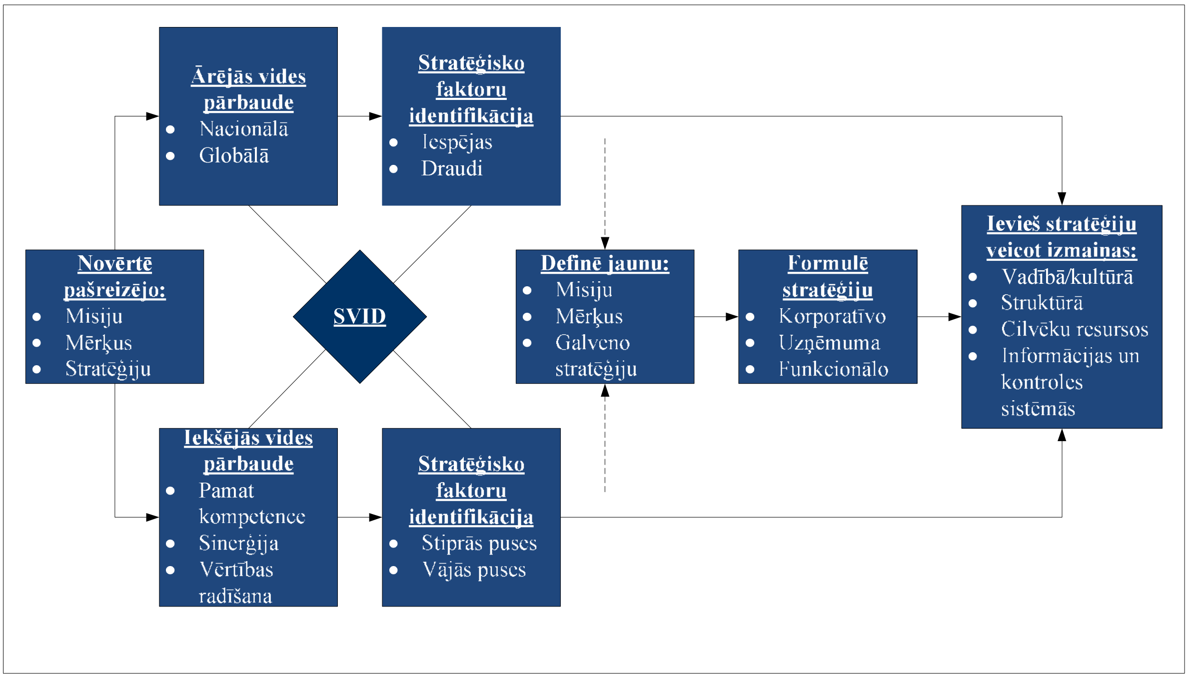


Figure 2.2 The strategic management process

	External analysis • National • Global	**Identification of strategic factors** • Opportunities • Threats			
Evaluate the present: • Mission • Objectives • Strategy	**SWOT**		**Defining a new**: • Mission • Objectives • Main strategy	**Strategy formulation**: • Corporate • Business • Functional	**Strategy implementation by adjusting**: • Management/ Culture • Structure • Human resources • Information and Control systems
	Internal analysis: • Core competency • Synergy • Value creation	**Identification of strategic factors**: • Strengths • Weaknesses			

Figure 2.3 which illustrates the management process intended for large corporations that need individual and appropriate strategy implementation strategies and dynamic management of competencies across the entire organisation. This strategic scheme focuses more on the issue of strategy coordination in the organisation as a whole.

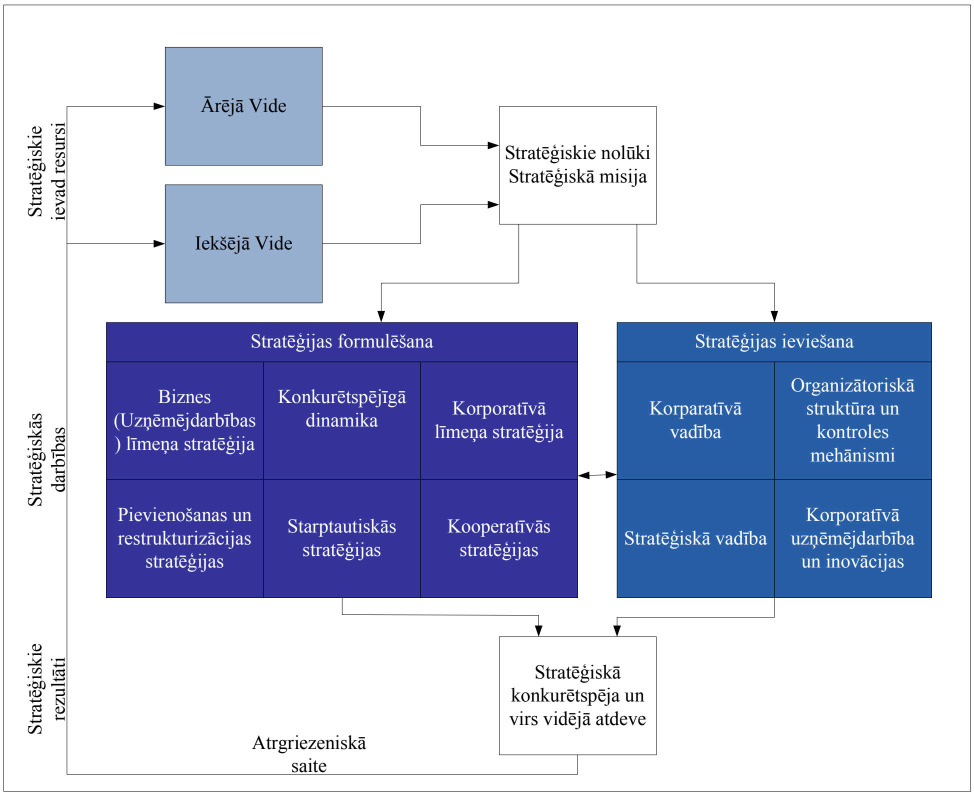


Figure 2.3 The strategic management/control process

Strategic input resources					
Strategic activities	Strategy formulation			Strategy implementation	
	Business level strategy	Competitive dynamics	Corporate level strategy	Corporate management	Organisational structure and control tools
	Acquisition and reorganisation strategy	International strategies	Cooperative strategies	Strategic management	Corporate business and innovations
Strategic results	Feedback		Strategic competitiveness and return above the average		

No matter which of the approaches for strategy development an organisation chooses, it is necessary to design it in successive steps as follows:

1. Evaluation of the previous strategy;
2. Analysis of the current situation;
3. Definition or provisional approval of the mission, the vision and the purpose of existence;
4. Strategy formulation;
5. Development of a strategy development plan;
6. Strategy approval (pursuant to the management hierarchy as provided in the articles of association of an enterprise);
7. Strategy implementation;
8. Strategy implementation control.

Questions for discussion:

1. Please, describe what is the role of strategic planning in organisational planning?
2. When and on what occasions strategic planning should be started? Who is the person initiating a new strategy?
3. Who is the person initiating a new strategy? Give specific examples.

3. Organisational environment

The introductory questions for the topics are as follows:

- Why is the organisational environment so important and interesting to the executive management team?
- What are the consequences, if an organisation insufficiently takes care of its organisational environment?
- What are the ethically acceptable techniques for cognition of an environment that you would be ready to apply?
- What are the sources of internal and external information, and which of them have you used at work?

The environment into which an enterprise operates is called business environment. The most substantial characteristics of business environment is that it is constantly changing due to technology and information exchange development; the changes are particularly rapid, for example, for insurance companies. There are two types of classification found in the theory of economy:

- Micro-environment – suppliers, consumers, competitors, stakeholders, human resources, financial accounting, procurement function, research, innovation, development, production supply, sales, production function, marketing;
- Macro-environment – economic, political, legal, social, technological, physical and institutional environment.

On the other hand, the type of classification most commonly used in the books on business management is related with the organisational boundaries, where everything that lies within the scope of an organisation is considered to be the internal environment, while everything outside – as the external environment.

The division of organisational environment into internal and external environment is displayed in Figure 3.1.

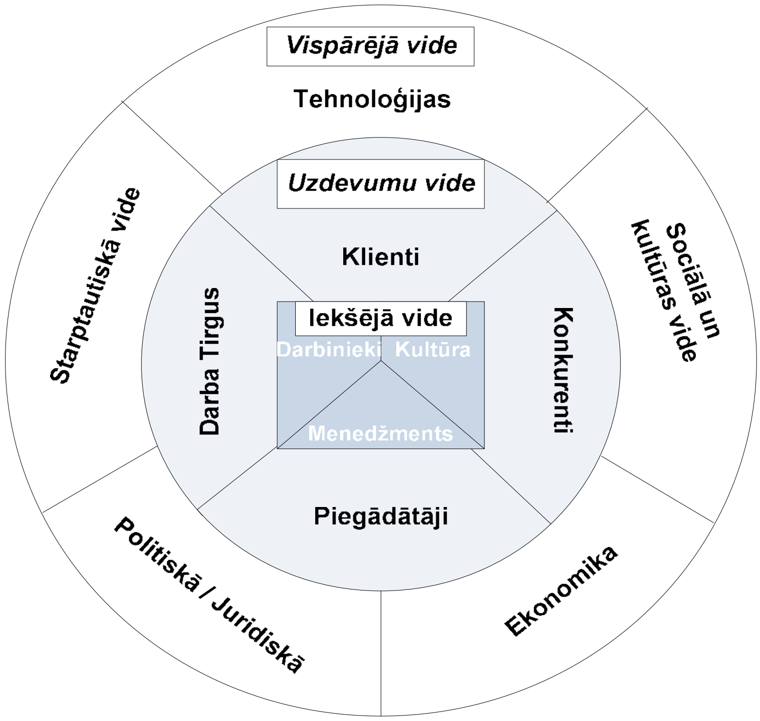


Figure 3.1 Internal and external organisational environment

			General environment			
			Technologies			
			Task environment			
International environment			Customers		Socio cultural environment	
		Internal environment				
	Labour market	Employees	Management	Culture	Competitors	
			Suppliers			
Political/Legal environment				Economic environment		

For a better understanding of the division in organisational environment it is necessary to look at the organisation from the theory of systems point of view where organisations are viewed as open systems drawing resources from the external environment and delivering services and products back into the external environment. When analysing the enterprise external environment, an enterprise answers the question – what operations should be taken up by the enterprise. While when analysing the enterprise internal environment, an enterprise answers the question – what are we able do at the enterprise. This balance between the desires and possibilities particularly is the main issue that an organisation wishes to learn from the environmental analysis which is then used in the preparation of the strategic plan.

Questions for discussion:

- Why an organisation should be an open system and what happens if an organisation closes in?
- By what the division of environment differs in the theory of economy and the theory of business management? Why in your opinion these different divisions have occurred and in what way does each of them contribute to an organisation?
- How to avoid a situation which arises often, when making strategic plans that the desires do not match the real possibilities of an organisation? How would you resolve this problem?

3.1 Internal organisational environment

The introductory questions for the topics are as follows:

- Which is more important for a successful operation of an organisation - the internal or the external environment of an organisation? Substantiate your opinion.
- Which internal environment factors would you as a manager of an organisation control most and why?
- Where organisation managers can obtain reliable information on the internal environment of their organisation and what they should do with this information?

The global economy of today is a highly dynamic environment which is characterised by a great number of changes. Economy today should be described as the economy of change within the scope of which such enterprises are operating that need to adapt to the changing situation as well as that must have at least some advantages over the rest of the market participants, i.e., successfully compete. Dominance over competitors or advantage, because of which the customers choose the production of the enterprise, ensures the survival and development of that enterprise. It can be said therefore, that a competitive advantage in today's global economy of change is the decisive tool in the fight among competitors and constitutes solid grounds for a successful operation and development of the enterprise. Competitive advantage today is the central issue of managing any enterprise, because it answers the question – what makes an enterprise is better than other enterprises? Research of competitive advantages is the main task and content of the enterprise internal environment analysis.

By assessing the enterprise internal environment within the scope of strategic management the three following principal areas are analysed:

- Competitive advantage and its model;
- Resources and capabilities at the disposal of an enterprise;
- The need for the enterprise to change, including both the enterprise value chain as a method of managing the competitive advantage and the internal forces or change drivers in the enterprise which define the need to change. (5, page 105)

In publications of research different authors offer different definitions of a competitive advantage, but they all have a common element, i.e., the profit as the competitive advantage measure. However, it is not appropriate to use profit alone as the criterion for a competitive advantage. Several problems exist making the measurement of a competitive advantage limited when using the amount of profit in absolute figures. Absolute profit is not an objective measure of competitiveness. Often businesses try in different ways, both legally and illegally, to hide or, on the contrary, to overestimate the true amount of enterprise profit. Investments are also a significant factor, which can affect the enterprise operating results not only in Latvia, but as well across the world. The fact that an enterprise possesses a competitive advantage also in a situation, when the enterprise is a profit-making entity, but the level of profit is below the average for the industry. The nature of profit is also a significant limiting factor - it shows, how the enterprise has been doing in the past, but does not show the future potential of its present profit-making capacity.

The best way to assess the competitiveness of an enterprise is to assess the return on sales (ROS), return on assets (ROA) or the gross profit margin calculated by deducting total costs from total revenues and dividing the resulting amount by total costs.

Return on sales of an enterprise is generally based on the three following pillars:

- The value a customer assigns to the product of an enterprise;
- The price determined by the enterprise on its products;
- Costs incurred in manufacturing of products. (5, page 107)

In the result, the term 'competitive advantage' is defined as follows: competitive advantage is the value adding activities and resources allowing a return above the average in the industry, is capable of maintaining it over a period of many years and is sustainable. (5, page 107)

In order to achieve a sustainable competitive advantage an enterprise must correctly balance the cost of using a product with the help of the differentiation and corresponding prices strategy in the given conditions of demand in the industry and the cost structure of the enterprise at different output volumes.

It can be stated that an enterprise possesses a sustainable competitive advantage if the enterprise realises a strategy which is not concurrently realised neither by the existing, nor potential competitors, and on the condition that the competitors are not capable of emulating the benefits arising from such strategy. Sustainability of a competitive advantage depends on the following four factors:

1. **Barriers to emulation** – making it difficult for the competitors to emulate the distinctive capabilities of an enterprise. The higher emulation barrier, the more sustainable the competitive advantage of an enterprise.

2. **Competitor capabilities** – the capabilities of competitors to emulate or to imitate, or copy a competitive advantage have two characteristics: first, the historically developed area of strategic activities of competitors determining the inability of an enterprise to change an already established business complex in order to adjust to new market trends and competition. Second – absorption capacities of an enterprise, i.e., the ability of an enterprise to identify, evaluate, accept and use new knowledge.
3. **Level of dynamics of the industry** – a fast changing industry. Sustainability of a competitive advantage depends from the level of dynamics in an industry and the life-cycle of the product.
4. **Dynamic capabilities** – these are processes capable of transforming, reorganising and improving the resources and capabilities of an enterprise in order to adjust or create new dynamic changes in the external environment.

The definition of a competitive advantage described above indicates its components describing the substance of a competitive advantage into greater detail, and arranges it in a certain order by building the competitive advantage model as illustrated in Figure 3.2.

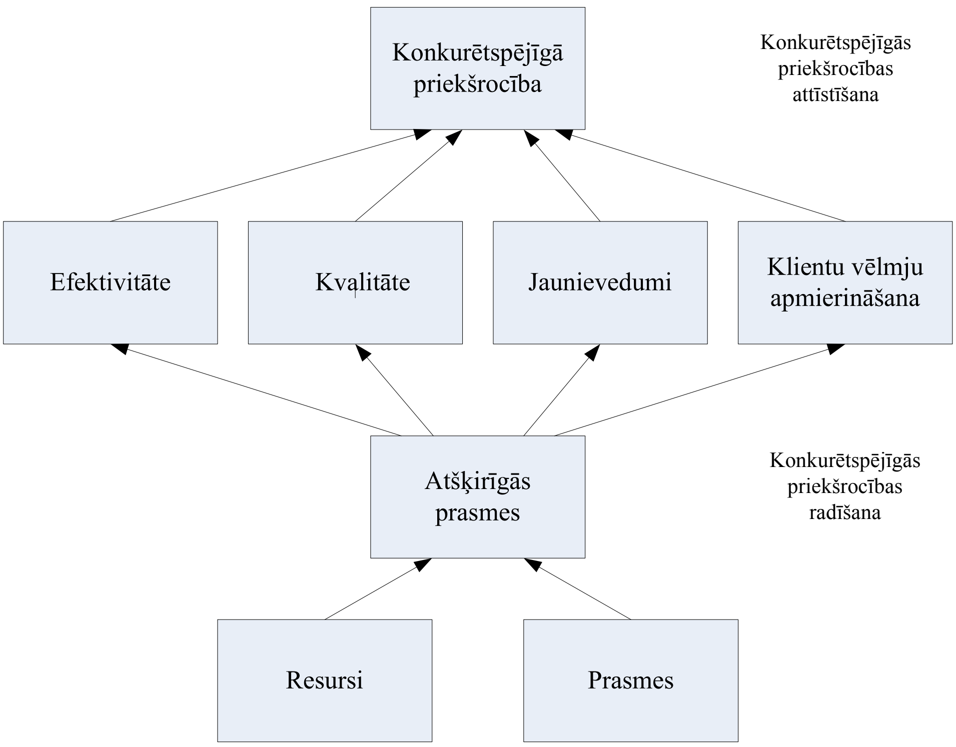


Figure 3.2 The model of competitive advantage

Competitive advantage				Development of competitive advantage
Efficiency	Quality	Innovations	Responsiveness to customer needs	
Distinctive competencies				Creation of competitive advantage
Resources		Capabilities		

The competitive advantage model has several components. The sources of competitive advantages are **the resources and capabilities** at the disposal of an enterprise. Not all resources and capabilities may serve as the basis for a competitive advantage. Only the distinctive resources and distinctive capabilities that are described by a single term as **distinctive competencies** constitute the basis for any competitive advantage. **Efficiency, quality, innovation and customer responsiveness** are the four elements that are able to develop a competitive advantage. The concept of these components lies in the fact that by reaching any of the elements at a higher level than any of the competitor, the enterprise has ensured its competitive advantage.

The process of provision for a competitive advantage consists of two parts or two successive sub-processes as follows:

1. The establishment of competitive advantages is associated with the identification and analysis of the sources of competitive advantage, establishment of the distinctive competencies as well as the definition of competitive advantage.
2. The development of competitive advantage takes place by using one of the following four methods: increased efficiency, raising of quality, better innovations and the achievement of better customer responsiveness. (5, page 112)

Let us describe in more detail each of the components of the model of provision of competitive advantage.

To be more complete, the analysis of a competitive advantage should be tied together with the analysis of the enterprise internal environment. While by analysing an enterprise one should start with the sources or competitive advantage, i.e., **the resources and competencies** of an enterprise. Resources in the meaning of strategic management are the enterprise assets, the information and the know-how controlled by the enterprise, with the help of which the enterprise can create and implement its strategy. While the competencies mean that the enterprise possesses the necessary knowledge, capabilities and attitude to operate in a specific area of activities.

Identification of resources and competencies though, would not let anyone draw conclusions about the competitive advantage of an enterprise. As it is seen form Figure 3.2 only the distinctive resources and distinctive capabilities that have been combined under a single term **'distinctive competencies'** for the purposes of simplification serve as the basis for a competitive advantage. Two terms should be discriminated – basic competencies and distinctive competencies. Basic competencies include those resources and capabilities with the help of which an enterprise can compete in the market successfully and that ensure its profit-earning capacity. Distinctive competencies are those basic competencies that allow an enterprise achieve higher efficiency or innovations, or customer responsiveness by thus creating a greater value and respectively building a competitive advantage.

Every enterprise has certain basic competencies, and it must attempt to establish also the distinctive competencies of the enterprise. In order for a basic competency to be transformed into a distinctive competency it must match several requirements. The range of these requirements is known as the VRIO concept (from the first letters of the four English words): valuable; rare; inimitable; organisation. (5, page 115)

The components of competitive advantage are also called the competitive advantage development methods that an enterprise can use when developing its competitive advantage regardless of the industry, goods or services rendered by it. These methods are used in the development of strategies at the functional level as they are dealing directly with the changes in the enterprise resources and competencies.

An enterprise is a system for the transformation of various types of investments (land, labour, capital, entrepreneurial power, technological know-how) and its assets into a product. Efficient operation of the system with possibly lower costs in order to maximise the profits is in the interests of every enterprise.

Efficiency is the relationship between the performance result of a system (products made) and the investments (production factors) used to produce the result. The main objective in ensuring efficiency is to make any effort to achieve the lowest possible cost per unit, and all functions performed by the enterprise are involved in this process. The lower the costs are, the higher the efficiency of an enterprise.

The second component capable of developing the competitive advantage is **quality**. Quality is a range of properties and peculiarities of a product or service referring to its capacity to respond to specific or notional customer needs. Note that high quality production is those products and services that are reliable and perform their intended functions.

Innovation is something new, unprecedented in the operations or production of an enterprise, and includes advancement in the types of the products made, the process of production, management system, organisational structure or the strategies implemented by the enterprise. The development of competitive advantage by focus on innovations means a wide complex of measures using both the distinctive and the basic competencies of an enterprise in order to create innovations by thus developing its competitive advantage. There are two types of innovations: substantial change, which is a radical digression from the existing technologies due to the fact that something cardinally new has been implemented, and an upgrade, which is the improvement of the existing technology.

As the last but not least, the responsiveness to customer needs should be mentioned meaning that an enterprise should provide to its customers exactly what they need and exactly when they need it. **Responsiveness to customer needs** includes the provision of a higher product value at a higher price or preference in selection if an identical price is provided. Responsiveness to customer needs may be achieved in two ways: by reducing the costs to customers and improving the customer performance results. High level of labour efficiency, quality improvement and introduction of innovations - these are all the methods that the enterprise can use to achieve customer satisfaction. (5, page 121)

Although the distinctive competencies are by themselves the source of competitive advantage at the enterprise level, they are incapable of ensuring the competitive advantage that would be based on lower costs or would be distinctive. The building of advantages is possible only in action, i.e., the process of using the distinctive competencies or, in other words, in the process of product development. The most widespread method of analysis viewing the activity of a system of resources and capabilities or a product development process is the analysis of an enterprise chain of value.

The value chain is a specific method of analysis considering an enterprise as a chain of successive activities transforming the factors of production into ready products to which customers assign certain value. The analysis of the value chain links together the following basic components of analysis: definition of the structure for the enterprise operational process and clarification of the value added for each component of that process which builds the competitive advantage for the enterprise. Thus analysis of the value chain is an instrument for assessing which of the enterprise operations create competitive advantage and whether the cost structures of the enterprise correspond to a lower cost or a distinctive advantage. The value chain helps to understand into more depth the enterprise resources and capabilities as the sources of its competitive advantage. (5, page 122)

Two value chain models can be found in research publications:

- Value chain model by McKinsey's Consulting Group (see Figure 3.3). The model is based on the assumption that any process of an enterprise creating value is based on six successive and separate steps: technology development, product design, production, marketing, distribution, post-sales service.

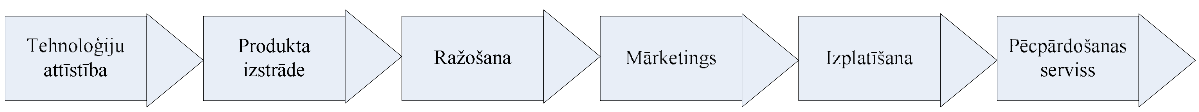


Figure 3.3 McKinsey's value chain model

Technology development	Product design	Production	Marketing	Distribution	Post-sales service

- The value chain model developed by M. Porter. Unlike McKinsey's model, all activities in an enterprise are split into two large groups – core activities and auxiliary activities. See Figure 3.4.

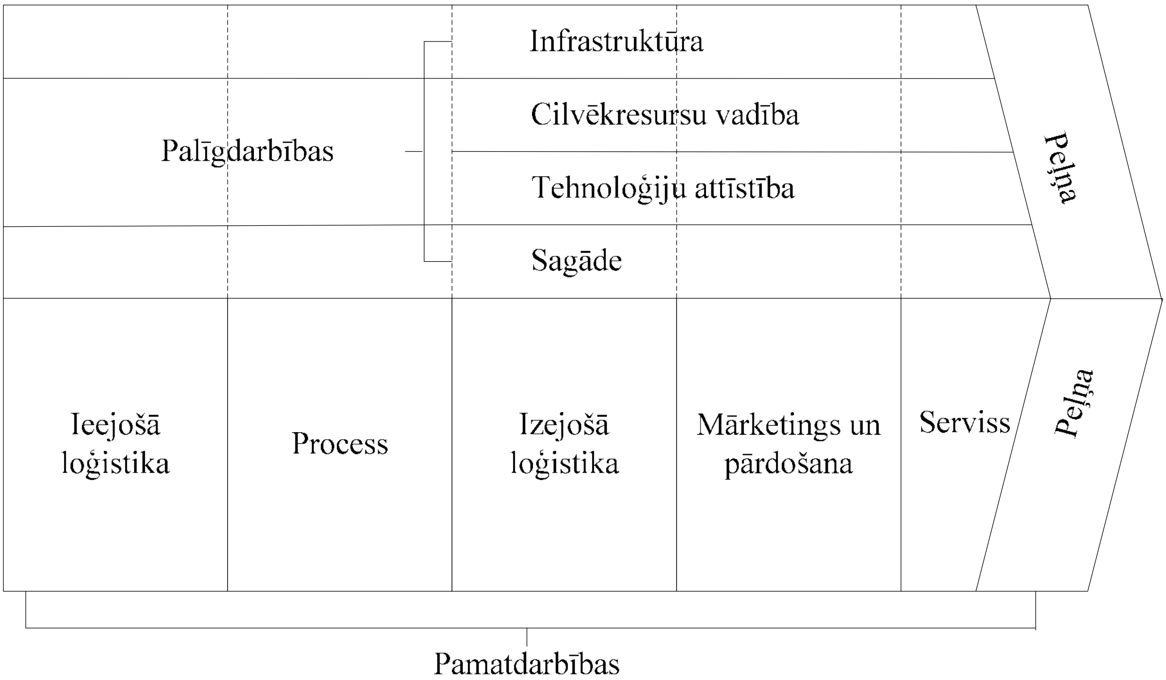


Figure 3.4 M. Porter's value chain model

Auxiliary activities		Infrastructure			Profit
		Human resources management			
		Technology development			
		Procurement			
Inbound logistics	Process	Outbound logistics	Marketing and sales	Service	Profit
Core activities					

Any activities performed by an enterprise are divided into core activities and auxiliary activities as it has been shown in Figure 3.4. Core or primary activities are related to making the physical goods: their production, marketing and delivery to customers and their guarantee servicing. Core activities are arranged in a logical sequence of creating the product. Support or auxiliary activities are functional activities allowing and helping the core activities to take place; these are, for example, procurement, research and technology development, human resources management and infrastructure. (5, page 124)

Designing the value added chain is a process in the result of which it is determined, what are the core activities and the auxiliary activities of an enterprise. The enterprise business process lies at the basis of designing the value chain, and it is important to distinguish those activities that can be measured by costs or otherwise assessed as values from the customer's point of view.

Designing of the value chain can be performed in two different ways:

- In the direction of product development. Starting from the purchase and supply of raw materials up to the delivery of a ready-made product to customer, each activity within the value chain must be defined step by step;
- Backward, starting with the ready-made product. This approach provides for analysis of the ready-made product, its qualities and a walk-through backwards all of its stages of development.

The value chain of an enterprise must be analysed by using several methods in order to analyse the process of adding value as comprehensively as possible. The value chain analysis should be carried out with the purpose of understanding how the different resources and capabilities of an enterprise, linked together in a single system make a competitive advantage. The analysis is based on several methods: global value chain analysis, analysis of the cost and value indicators and analysis of the links within the value chain.

Global value chain is the system of all value added activities of an enterprise involved in the making of a certain product, starting from the acquisition of raw materials till the delivery of the ready-made product to the customer. Analysis of the global value chain is necessary for the purpose of assessment by the enterprise, in which stage of this system from raw materials to end users the enterprise is and who are the suppliers and the buyers from the value chain perspective. Furthermore, it should be underlined that successful enterprises analyse not only their own value chain, but also the value chains of their suppliers and customers. This process is called the supply chain analysis. (5, page 127)

Upon carrying out the analysis of the enterprise resources and capabilities, the two main components of this analysis are identified to assess the situation of the enterprise:

1. What resources and capabilities are there at the enterprise?

2. What is the value adding system of an enterprise and what role does it play in the global value system?

It is not effective to look separately at each of these elements, therefore, by analysing the resources and the capabilities both above mentioned components should be combined together in a single system – the resource consumption analysis. The resource consumption analysis addresses the following two central components: cost indicators, which are the indicators of the enterprise activities incurring costs, and the value indicators or the uniqueness indicators, which are the reason for specifying certain activities as unique.

By analysing the value and cost indicators, the three following substantial issues should be addressed:

- Consumption of resources, where it is assessed, whether an enterprise is using the resources for the value adding activities? And, how much of the resources are consumed by those activities, that do not add any value or are even contradictory to it.
- The nature of costs, where the two following types of incurring costs are distinguished: costs incurred by the enterprise activities, for example, lease of plant and machinery, office rent, wages, etc., and the costs incurred by outsourcing the performance of certain activities or buying the raw materials from outside, for example, advertising materials, raw materials, janitor service etc.;
- Changes in the cost structure – as the enterprise develops and expands its operations an analysis should be made of how the cost structure would change as well as of the potential enterprise development scenarios, and it should be assessed how the enterprise cost structure would respectively be altered.

Finally, the analysis of the links within the value chain should be mentioned as one of the enterprise value chain analysis. The purpose of such analysis is by using the existing or creating new links to find possibilities to reduce costs or to try to increase the value of a product or service by thus making a competitive advantage. By analysing the links, the value chain should be carefully examined whether any of the links established between the activities constitute a distinctive competency of an enterprise. The analysis of the links is the only formal method providing with an insight into the analysis of intangible resources and capabilities, from the perspective of the enterprise process of product development. Several types of such links exist:

- Links between the primary activities;
- Links between the primary activities and the auxiliary activities;
- Links between different auxiliary activities;
- External links.

Questions for discussion:

- What are the components of the internal environment and how are they measured?
- How often should an organisation control the dynamics of the internal environment components?
- Which management structural units of an organisation are responsible for the internal environment of an enterprise and what should be undertaken by the management to improve it?
- Give an example on how in practice an organisation ensures the acquisition of a competitive advantage and its maintenance over a longer period of time?

3.2. External organisational environment

The introductory questions for the topics are as follows:

- What, in your opinion , are the main external organisational features and how are they affecting an organisation?
- Which level of management is responsible for the flow and use of external information in an organisation?

- What would you do if you learned that the external environment becomes more and more unfavourable for the organisation managed by you?

The external organisational environment contains all external forces and organisations that an enterprise meets on its way during its day-to-day and strategic work. External environmental environment includes all such components that have the potential of influencing the organisation and that are situated outside the organisation, for example, resources, competitors, technologies, economic conditions. Any such factors or events that are far from the organisation and whose effect is not directly noticed are not included. It is seen from the chart in Figure 3.1 that a further division of external environment is as follows:

- General external environment or macro-environment includes all those environmental forces and conditions that either directly or indirectly affect any enterprise in any industry, and usually these factors cannot be influenced by entrepreneurs; The overall social environment, the economic and demographic factors;
- The environment of objectives – the environment directly affecting the day-to-day activities of an organisation - competitors, suppliers, customers.

Other authors use 'competition environment' instead of the 'objectives environment' using the components of the Porter 5 forces model – force of customers, force of suppliers, threat of substitutes, threat of new market entrants and threat of competitors. In this paper the focus will be on the environment of objectives as a component of the external environment.

General environment consists of different environmental factors or forces:

- International;
- Technological;
- Social and cultural;
- Economic;
- Political and legal.

Let us look at each of the general environment factors separately.

International/ global dimension is a part of the general environment which represents any events taking place in other countries and the opportunities arising to the Latvian enterprises abroad. These are the key political events, critical global markets, new industrial countries, different cultures and institutional attitudes. International environment creates new competitors, customers and suppliers as well as influences the social, technological and cultural trends. The majority of the Latvian enterprises and industries must choose whether they should compete on the international market or they are under the threat of extinction.

Technological dimension – a part of the general environment which includes the scientific and technological innovations in the respective area of activity and the society in general. Product innovations, application of know-how, focus on the private capital and government aid for the expenditure on research and development.

Social and cultural dimension – a part of the general environment which represents the demographic conditions,

norms, customs, the system of values of the population as well as the demographic profile - grounds for research on employees and customer bases, the demographic effect on social norms and values (vegetarianism, smoking, cholesterol levels), changes in the trends of career developments, women at work and ethnical mix. This part comprises factors like geographical distribution of the population, density of population, average age, sex, level of education, level of income and distribution, issues on ecology.

Economic dimension – a part of the general environment characterising the economic health of the country overall or any part of it (district, region) comprising the purchasing power, the level of unemployment, the interest rates etc. Economic dimension tends to become more complex due to globalisation and internationalisation. It is influenced by factors like trade deficit, budget deficit or surplus, rates on private savings, rate on corporate savings, GDP, and inflation.

Political – legal dimension – a part of the general environment including the laws by state and local governments in respect of entrepreneurs and their political activities imposing restrictions on businesses, for example, health protection, environmental protection, labour laws, customs, different laws on entrepreneurship, etc. This dimension includes also any anti-trust laws, laws on taxation, philosophy of deregulation, labour laws, philosophy and politics on education. The pressure groups are groups of interest working within the existing political arrangements with the purpose of influencing the companies to work in the interests of the society (the Green movement, non-governmental organisations).

Environment of objectives is the external environment directly affecting the day-to-day activities of an organisation - competitors, suppliers, customers, and labour market. Customers are the individuals and organisations receiving services and goods from an organisation. Competitors are the organisations operating in the same industry or according to the same business type and supply goods or services to one and the same customer group. Every industry has its own specific conditions of competition. Suppliers are individuals or enterprises that supply raw materials and that an organisation uses for the creation of a product or service. Labour market is individuals available to contracting for work in an organisation. Continuous investments in human resources through recruitment of employees, training, and education are required in order to achieve the objectives of an enterprise.

External environment analysis is done by scanning for early, potential changes in the environment, its components and trends (incomplete data) as well as by monitoring with the intention of identifying any consequences and the meaning of changes in the environment through ongoing observation of the changes and trends of the environment.

Speaking about the organisation and environment relationship the following question of why an organisation cares so much about the external factors must be answered. Environment creates instability, multiple unknown variables that organisation managers are facing. There are two possibilities, i.e., to create an organisation which is suitable for the environment or to try influence the environment. Organisations must manage the uncertainty of the environment in order for the organisational work to be efficient. Uncertainty means that the organisation managers do not have sufficient information about the factors (conditions) of the environment in order to understand and anticipate all the needs and changes of the environment. There are the following strategies of adapting to the environment:

- Objectives for expanding the boundaries;
- Forecasting and planning;
- Flexible structures;
- Acquisitions and joint ventures.

Let us describe them one by one. **Objectives for expanding departments and boundaries** include the role of linking together and coordinating the organisation with the components of the external environment. In order to implement this some specific objectives must be fulfilled:

– identify and process the information on changes in the external environment;
– represent the organisational interests in externally, for example, the functions of the marketing and procurement department employees are expanded for working with the clients and suppliers directly and through market survey;
– industrial intelligence.

Forecasting and planning is one of the main activities in many organisations. Very often particularly at times of high instability in the external environment the departments for forecasting and planning are established. During the assessment it is possible to determine the probable time limits and strategic management trends.

Flexible structures – it means that the organisational structures must be capable of responding effectively to the changes in the external environment. Organisational (natural) structures typically have free movement, less conditions, teamwork and a decentralised decision-taking process. There are teams established for the solution of various unexpected problems. Mechanical structures typically have precisely defined objectives and a multitude of conditions, less teamwork and a centralised decision-taking process. They operate well in a highly stable environment.

Acquisitions and Joint Ventures, and the Ways of Reducing the Uncertainty Acquisition is the merging of two or more enterprises into one. Joint venture is a strategic alliance of two or more enterprises.

The environment cannot be controlled, while it can be influenced, therefore, those components that are causing problems should be changed. The usual means for influencing the components of the environment are the advertisements, PR (Public Relations), political activities (lobbies), trade associations (employers’ association, chamber of commerce and industry, bank association, etc.).

Advertising and Public Relations Advertising has become a very effective way for controlling the demand for the products or services of an enterprise and has become a solid means for reducing the uncertainties surrounding the customer base of an enterprise. Public relations are very similar to advertising, although its main purpose is to influence the attitude of the public towards the enterprise itself. This includes:

– advertisements;
– speeches;
– reporting by mass media.

The political activities represent the efforts by enterprise to influence the government legislation take the course similar to that of the enterprise. This includes:

- lobbies;
- party sponsorship;
- consultants.

Trade associations are organisations established by enterprises sharing the same interests with the purpose of influencing the business environment.

Questions for discussion:

- To what extent can organisations influence the external environment? Substantiate your opinion.
- Would you, if you were the manager of an organisation, organise the work to adapt to the requirements of the environment, make an effort to influence the environment or try to prepare the organisation for the possible future changes?
- Do you see opportunities or threats in the external environment of the organisation? Why some see more threats and some – more opportunities in the organisational environment?

4. Methods for strategic planning

The introductory questions for the topics are as follows:

- What methods for the analysis of organisational activities have you used and what results have you obtained from the application of these methods?
- Which are the main criteria according to which you would choose the necessary methods for the analysis of the activities of your organisation?
- Would you use individual work in the application of methods for analysis of the organisational activities or establish teams dealing with the collection of information and data processing? Substantiate your choice.

Organisation managers today have a very wide range of applicable methods available for gaining the understanding of organisational activities, strategic and operational decision-taking. A large variety of the methods available cause problems for many managers in cases when the methods for analysis are not applied in conformity with their conditions of use. We will discuss only the methods that are most often applied in strategic planning.

4.1. The SWOT method

The introductory questions for the topics are as follows:

- Why is it necessary for an organisation to know its strengths and weaknesses? What would you, as the manager of an organisation, do with this information?
- Have you used the SWOT method before and what were the results?

The assessment of the external and internal environment allows for the identification of the enterprise strengths and weaknesses, opportunities and threats existing in the external environment as well as its competitiveness. In order to measure competitiveness of an enterprise several factors have to be taken into account.

- How strong is the competitiveness of an enterprise?
- Would the enterprise competitiveness be strengthening or declining, if it continues to realise the current strategy?
- What is the position of an enterprise compared to its main competitors taking into account the main factor of industry development?
- What is defining the competitive advantage of an enterprise?
- What are the capabilities of an enterprise to defend its position in the industry, taking into account the industry competition factors?

Strengths and Weaknesses of an Enterprise

Strengths of an Enterprise	**Weaknesses of an Enterprise**
Important core competencies	Poor reputation among the customers
Large market share	Gradual loss of market share
Distinctive market strategy	Shortage of financial resources
Increase in the number of consumers and customer loyalty	Revenue growth rate lower than in the industry on average
Participant to a strong strategic group	Slow pace of product development
Operations in fast growing market segments	Participant to a weak strategic group
Clearly differentiated products	Insufficient resources for acquisition of market
Advantages in terms of costs	Costs are higher than those of competitors
Profit above the industry average level	Market share too small
Best technology in the industry	Inability to oppose the external threats
Active and enterprising managers	Low quality of products
Capability to use the opportunities arising in the external environment	Lack of experience and competencies in the industry

Threats and Opportunities of an Enterprise

External Opportunities	**External Threats**
Opportunities to conquer new markets	Emerging of substitute products in the market
New customer needs	Emerging of low-cost competing products in the market
Integration down or against the flow	Threats to lose foreign markets and currency exchange fluctuations
Access to attractive foreign markets	Slow-down in the market increase
Carelessness of competitors	Necessity for price regulation
Opportunities to expand production in line with the demand	Increasing influence from suppliers and buyers
Introduction of new technologies	Changes in the taste and needs of buyers

When comparing an enterprise with its main competitors in the respective industry, one must assess its strengths and weaknesses, and the changes within the scope of the strategy to be implemented. It is useful to perform this comparison by taking into consideration the following measures: quality of services, customer service, customer satisfaction, financial position, plant and equipment, basic skills, qualification and loyalty of personnel.

Before an enterprise begins to consider formulating its strategy it is useful to summarise all of the information and opinions about what the course of its business is like. A useful way to present it in a brief and concise manner is the SWOT matrix. This is a table where one of the matrix parameters is the competitiveness of each business unit which depends on the strengths and weaknesses in comparison with the competitors, while the second parameter is the external influence determined by its opportunities and threats.

The SWOT matrix like the other methods is a means that can be used for the arrangement of the facts under the control of the enterprise management in such a way that through correlations between the data some specific processes going on in an organisation are revealed. The SWOT categories are strengths, weaknesses, opportunities, and threats. Usually they are placed in squares as illustrated in Figure 4.1. (7, page 155).

Spēks	Vājums
Izdevība	Draudi

Figure 4.1 SWOT analysis

Strength	Weakness
Opportunity	Threat

Strengths and Weaknesses These categories refer to the situation within the business. Strength can be anything that an enterprise possesses and what it does to gain success. A computer chip, an area of specific knowledge, a particular process exceptionally well done is strength.

Threats and Opportunities Exist outside the organisation. Opportunity is any beneficial situation that an enterprise could use to gain success in its business. Opportunities are the emerging markets, an increased demand for a certain type of products or services, competitor bankruptcy, derogations from any regulations imposed etc. Threats are changes of external conditions that may have harmful effects on business. (7, page 116)

In order to realise the SWOT analysis the necessary data should be collected from the analysis of the signs of success, culture analysis, analysis of personnel skills/gifts, financial performance analysis, process analysis, risk analysis, cause-and-effect analysis, relative data analysis, absolute scale analysis and change readiness analysis.

First, the strengths and weaknesses should be tackled. The first objective is to identify what factors represent the strengths – anything performed so well that it is bound for making success, and what factors represent the weaknesses - anything that is not being done as well as it should be and causes any regress.

When analysing the opportunities and the threat, it would be necessary to collect data from customer analysis, competitor analysis, environmental analysis, analysis of the signs of success, input barrier analysis, resource availability analysis, financial performance analysis, risk analysis, portfolio analysis and life cycle analysis. Opportunities and threats refer to processes outside any specific organisation. It should be considered in which markets the opportunities can be found and what prevents an organisation from using them (7, page 117).

The SWOT matrix has multiple modifications and its application for the assessment of the current state and the future state of an organisation or the so-called short-term and long-term SWOT analysis can be mentioned as one of such modifications. In addition to that, each entry can be categorised by using the functional categories existing in an organisation, for example, the categories of finance, marketing, production and others. If a brain-storm session is organised accordingly in order to create the SWOT matrix of an organisation, each of the entries is assigned the respective category. Thus an assessment made by all organisational units summarised in a SWOT matrix is obtained which can be used further in the development of functional strategies. For example, when grouping by category, the entries under the category of finance can be easily found in each of the SWOT squares, and therefore, we see the strengths and weaknesses, and the external threats and opportunities of the organisation's financial system.

Another way to use the SWOT analysis in the organisation is the competitor and the critical supply approach. It is critical to distinguish between the two approaches to SWOT analysis, the current situation and the future analysis.

Creation of the short-term SWOT matrix includes the identification of the existing competitors, the aspects of critical supply and the main operating aspects. Identification of the existing competitors stimulates the identification of the current critical supply components and the most significant operating factors, as well as the identification of the current strategic resources, because these can be found by answering the question: 'Why are the successful competitors successful?'

At the same time the long-term SWOT matrix focuses rather on the most significant future operating factors than on the critical supply factors as it is the case with the short-term SWOT analysis. The table below gives a summary of the long-term and the short-term SWOT analysis:

Step	Short-Term SWOT Analysis	Long-Term SWOT Analysis
1	**Identification of the existing competitors** Competitors: • have equivalent offers; • respond to similar customer needs; • similar geographical location; • size of the market shares. When performing the grouping, those competitors that are generally ranged as top three in all components should be considered	**Statement of the present situation**
2	**The components constituting the critical supply are identified** Usually theses are the components ensuring success in sales (components ensuring the order).	**Determining the most significant factors for future operations** Expressed as an interruption between the current most significant operating factors and the future situation assessed through the objectives planned.
3	**The present most significant operating factors are established** Usually these are the operating	**Identification of future strategic resources** It is necessary to define those resources that would ensure the competitive advantage for

	activities and environmental components that the organisation must be strong at to make success.	the organisation in the future.
4	**Current strategic resources are identified** Usually given in comparison to the competitors and the main factors ensuring the operations of an organisation.	**Future strengths and weaknesses** Assessed in relation to potential future competitors. Potential future competitors are identified. Strategic resources are respectively divided into strengths and weaknesses.
5	**Identification of present concerns** These are usually concerns that an organisation should address immediately.	**Future opportunities and threats are defined** The main strategic issues of an organisation are classified into opportunities and threats.

Other authors offer the extended SWOT matrix where the horizontal axis represents the competitiveness of a business, while the vertical axis - the impact from the external environment, and which has nine sectors. This type of the matrix is illustrated in Figure 4.2.

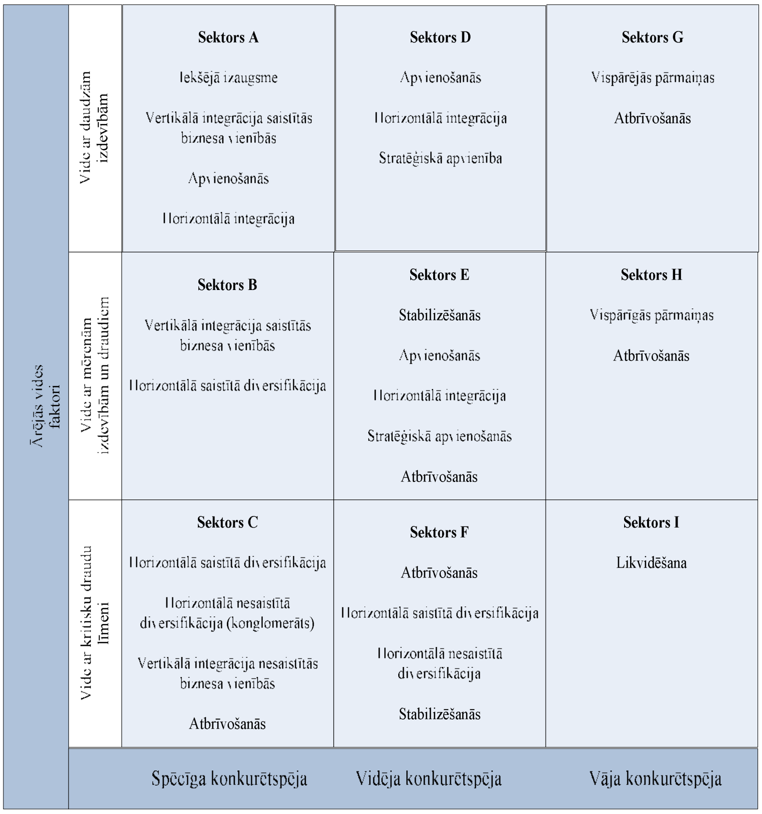


Figure 4.2 The extended SWOT matrix

External factors	Environment with many opportunities	**Sector A** Internal growth Vertical integration in related units Merger Horizontal integration	**Sector D** Merger Horizontal integration Strategic alliance	**Sector G** General changes Disposal
	Environment with moderate threats and opportunities	**Sector B** Vertical integration in related units Horizontal related diversification	**Sector E** Stabilisation Merger Horizontal integration Strategic alliance Disposal	**Sector H** General changes Disposal
	Environment with a critical threat level	**Sector C** Horizontal related diversification Horizontal unrelated diversification (conglomerate) Vertical integration in unrelated units	**Sector F** Disposal Horizontal related diversification Horizontal unrelated diversification Stabilisation	**Sector I** Dissolution

		Disposal		
		Strong competition	Average competition	Weak competition

In this matrix the competitiveness of each business unit is assessed by three degrees: strong, average and weak. The impact from the external environment is also assessed by three degrees: an environment with a vast range of opportunities, an environment of moderate opportunities and threats and an environment that considerably jeopardises the business units of an organisation.

The corporate level, business and functional level strategies are closely interrelated. Therefore, each of these strategies at the different levels, strong or weak, provides its contribution into the efficiency of the entire organisation.

Compliance of the organisational business units to any of the sectors of the matrix depends on the competitiveness of this unit and on the external factors.

The main shortage of this matrix is the over-generalised recommendations for further development of the portfolio. The extended SWOT matrix is obviously more useful as it is logically arranged and the conclusions drawn from it correspond to the main principles of common logics.

Finally, the SWOT matrix is a very common method used by almost any organisation as a tool for planning, problem analysis and solution finding. This is generally due to the fact that this method is easy to understand and simple to use as well as to the possibility of using it for the needs of both large organisations and micro-enterprises. The SWOT matrix is a handy tool also for summarising the information obtained as a result of all the various methods applied in the strategy development process.

Questions for discussion

1. What problems do you resolve by using the SWOT matrix? What is it most suitable for?
2. Would you apply in the development of the organisational strategy the 2 SWOT matrix approach, where the first one describes the present situation, while the other

outlines the future situation? How in your opinion does this approach benefit the organisation?

3. How the possible strategies should be best designed by using the SWOT matrix so as to avoid restricting any potential solutions by using simplified solutions?
4. Can the SWOT matrix be used for the solution of private concerns? Give a possible example.
5. Make the SWOT analysis for the organisation of your choice.

4.2. Competitor analysis

The introductory questions for the topics are as follows:

- How important is it to have the information about competitors to the organisation and how will you, as the manager, use this information?
- Are products or organisations competing among themselves? Substantiate your opinion.

Strategic groups are enterprise groups following same or similar strategy within the same strategic dimension. They have same market positions, they offer similar or identical products to the same customers, and make the same choices concerning production technologies and organisational activities. However, not all of the enterprises in an industry are following the same strategies. Competition is higher within a group. Porter's 5 forces model rather refers to a strategic group than the industry in general. The smaller the differences among groups are, the higher the competition among them.

Every organisation has a competitor. Monopolies operating in the public sector carefully observe the potential offers for contracting their services, multi-national companies are conflicting within each particular product/service level, and medium-sized businesses pursue similar clients, while small businesses discover that product development and pricing is related to the prospects of competitors.

The relations of competition do not manifest in all areas the same way. It is important to understand what the specific relationships with competitors are like. 'Potential interrelation of an organisation with other business entities can be described as:

- partnership in a dance;
- sitting in the waiting-room;
- navigation in a trawler together with the rest of the fleet.' (7, page 60)

Let us describe each of them. **'Competitor dance'** – sometimes there are so few competitors that the potential customers know well all of the organisations. To be distinctive, these organisations need to think about the differentiation of their products/services and if their offer to the clients is made in a public space and speaks for itself, for example, airlines, banks, one should take into consideration that they will need to control their competitors and respond quickly to their activities. These organisations are as if linked in a circle dance around. Should a competitor move a few steps into one direction, the others will move correspondingly, by often following the leader. In the search for uniqueness the differences in services or the possibilities to maintain loyalty they are inevitably spending their time and resources. (7, page 61)

Inside the **'waiting room'** the competitors are familiar with, while they are also independent and differentiated from each other. Competitors do not fight against each other, because usually they serve different market segments with same clients. They are expecting clients to arrive while sitting in the waiting room. Because each of them is offering different goods and services, then as the offer of one competitor changes, there is no large necessity to make any changes. (7, page 61)

The last, but not least – **the trawler** - is a model described as the searches made by many players in the big market of opportunities. Such a situation occurs in different industries with many competitors that customers do not know. Customer preferences are not determined by the properties of products, but other by factors, and competitors do not have to take the same steps. The more customers there are and the more often they accept a product or a service, the more there will be also competitors. If the competition barriers are low, many competitors will appear, for example, professional services firms and specialised shops.

Thus, organisations have a variety of relationships with their competitors. The more closely you are linked with your competitors, the larger efforts must be made to identify your competitors. These competitors have their development objectives which can be realised only if they acquire a certain market share.

The key to winning the survival in an overcrowded market is a very clear identification of own market position in relation to competitors. There are several questions to which the enterprise manager must find the answers. The smaller the number of competitors, the easier it is to acquire the information, as all market participants are on the open and can be easily traced in the newspapers, conferences, advertisements. The more competitors there are, the more difficult it is to trace them. Questions to ask are as follows:

- What are your competitors?
- What are their products and services? -
- What is the potential market share owned by them?
- What leverages ensure their success?
- Why do they have advantages in price?
- What is their financial status?
- What could be their next step?

Likewise the following questions should be clarified:

- What are the potential competitors?
- What is the probability that they would enter this particular market?
- What would they do to attract your clients?
- What threats this is causing?

Prepare a seven column table for laying out the answers to the first seven questions. See Figure 4.3.

Konkurenti	Produkti / pakalpojumi	Tirgus daļa	Neparastās īpašības / pievilcība	Cenas priekšrocība	Finansiālā pozīcija	Iespējamā nākotne

Figure 4.3 Competitor analysis (4, page 62)

Competitors	Products/services	Market share	Outstanding qualities/attractiveness	Price advantage	Financial position	Future potential

What are your competitors? – This question can be more easily clarified by identifying your competitors in each segment. If there are many competitors, list only the most significant. Insert this list in the first column of the seven column table.

What are their products/services? – List the services offered by the competitor, which is competing directly with your organisation in each of the segments. Highlight these organisations in yellow – they are the most similar to yours and must be specially marked. It is highly possible that there will be also competitors that you see only in one or few segments and which are offering only a few products/services. Highlight these big organisations in different colours. They may be convinced pursuers of their own path in the market.

What is the potential market share owned by them? – If there are only some big players in the market, it can be considerably easy to calculate their market share and to identify which owns what shares. If there are many players, the estimates will not be so reliable anymore. Put down your assessment of the market shares in percent in the column next. It is possible that you have been given some unique offers representing the market share in the amount of 100%. This is particularly good news (as long as they bring profit). To continue, arrange your list in a descending order by entering at the top the organisation with the largest market share.

What do they gain from their leverages? – From the point of view of the clients there are two types of attributes pertaining to fixed assets and the resources raised. Fixed assets are required for an organisation to continue its operations. The assets raised (leverages) are used for securing the operations of an enterprise. Competitors may have different leverage attributes and they are using them for attracting the clients. If a client starts liking any of the leverage attributes, the rest of competitors would copy this attribute for this particular client. Some time later the leverage attributes become available to all, everyone naturally expects to acquire them, they lose value in the eyes of the clients and become attributes to fixed assets. Thus more and more leverage attributes are included in the standards of our products. So, what leverage attributes pertain to the products of your competitors which you do not offer? List them along with the products and services in the next column.

How do they benefit from their advantages in prices? – Reduced prices increase the capacity giving the possibility for development of a leverage attribute. If your pricing structure differs from that of your competitor, list the main reasons in the next column.

What is their current financial status? – Prices of specific market shares, data from an expertise disclosed by mass media, annual reports allow finding out whether the financial status of a competitor has improved and whether the competitor is getting ready for the war on prices, or whether it is facing difficulties with new investments or the search of possibilities for joining forces with others. Enter this information in the next column. Give your assessment within a system of five marks. 1 point means that they are in the best position, 3 – that they are neither better nor worse off than the rest, 5 means that they are in difficulties. The 2 and 4 point scores are adding slight differences to the evaluation scale.

What could be their next step? – By knowing what your competitors would do you can get ahead of them or at least become their next follower. Often it is not a secret what steps your competitors are going to take next – the websites are full of information concerning their next steps, they discuss them in conferences and they are printed in booklets advertising the expected products and services, and in some details they reveal their further areas of development. Put down their product/service in the next column. Now you have acquired a real picture and are in the position of evaluating also your positions in relation to your competitors. Use the three colours used before to mark your potential threats by highlighting those competitors that pose the highest threat to you today, those who are the biggest threat for the future and those that do not pose any serious threat at all. From this moment on take a very close look at the first two competitors.

What are the potential competitors? – You can only draft the information about your potential competitors, and the generalised table that you used before would not be suitable for that purpose. There are only four columns assigned for potential competitors in Figure 4.4.

Potenciālie konkurneti	Varbūtība viņu iesējamai ienākšanai tirgū	Iespējamie paņēmieni jūsu klientu pievilināšanai	Iespējamais apdraudējums

Figure 4.4 Potential competitor analysis

Potential competitors	Probability for a possible entry into the market	Possible techniques for the attraction of your clients	Potential threat

The best option to complete this table is to ask for help from those employees of your organisation who have a better information system with the data about your industry. According to this information use the same method as before for checking; try to find information about other competitors: review their websites, have a look into their booklets, etc.; in the scale of 1 – 5 evaluate the probability for their entry the market by assigning point 1 to a higher probability. Evaluate the level of threat by A, B, C – the highest threat being given an A, medium – B, lowest – C.

Now colour those competitors the entry of which in the market is most probable and those which constitute the threat to you least. Compare your methods of attracting customers with theirs.

Finally, organisations often face the dilemma associated with the sources of information. Which part of information should be kept confident to make it impossible for the competitors to steal or use organisation's ideas, and what part of information should be made public in order for the existing and potential competitors to learn about its offer? Usually these are the marketing specialists who are distributing this information and, as they are more interested in their sales objectives than keeping secrets, it is possible, that a lot of information would be found in this public space.

It is not difficult to notice that during conferences many details and ideas are disclosed, especially, if the issue becomes a top priority and if you have a sufficiently large employee network in your area of industry. You shouldn't forget to question also those employees having recently been working for your competitors. As it has been already mentioned, it is necessary to create a place where the employees would be able to accumulate any information regarding the competitors. (7, page 66)

Competitor analysis is not a general overview of the competitors, the analysis of the competition environment focuses on every enterprise that you are directly competing with. Several methods are used for the acquisition of information, for example, competitor intelligence, data acquisition from websites, statistical overviews, etc. The question about what data acquisition methods are ethical is important. This question preferably needs to be answered by each organisation independently in accordance with the organisational culture and the system of values existing therein.

The components of competitor analysis are graphically presented in Figure 4.5 where the main focus is on the possible future activities of organisation's competitors in relation to the future strategic objectives of the organisation.

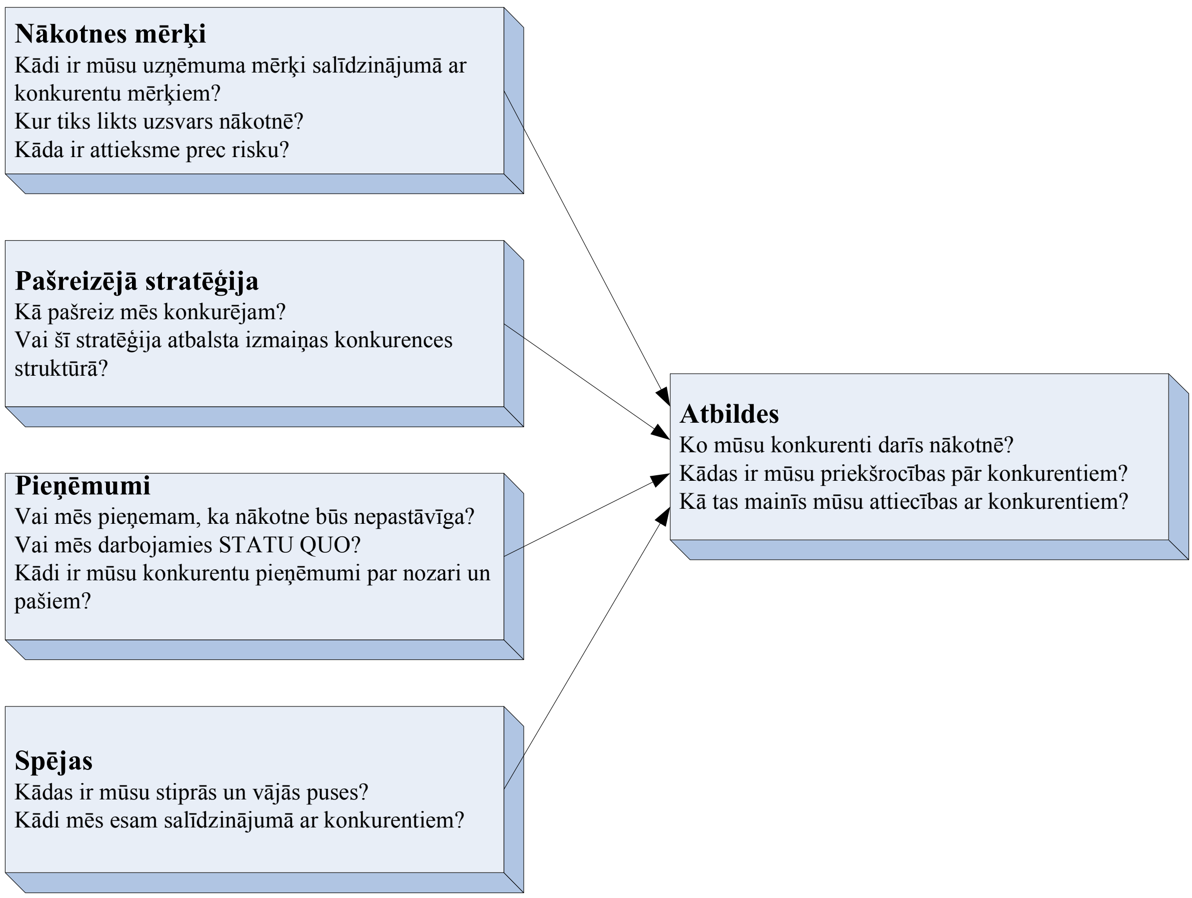


Figure 4.5 Components of competitor analysis

Objectives for the future What are the objectives of our organisation in comparison with those of the competitors? What will be the focus for the future? What is the attitude towards risk?	**Answers** What our competitors are going to do in the future? What are our advantages over the competitors? How would that change our relationships with the competitors?
Current strategy How do we currently compete? Does this strategy support any changes in the competition structure?	
Assumptions Do we accept that the future will be uncertain? Are we operating STATUS QUO? What are the assumptions of our competitors about our industry and about themselves?	
Abilities What are our strengths and weaknesses? How do we look in comparison with the competitors?	

Questions for discussion:

- Why is it necessary to acquire dynamic data on organisation's competitors? How does the organisation benefit from this?
- What methods of information acquisition you would consider appropriate and ethical in order to obtain information about the activities of your competitors?
- Is there any risk, in your opinion, by focussing on competitor analysis overwhelmingly to start copying competitors and consequently losing the battle of competition?
- Perform the competitor analysis of an organisation at your choice.

4.3. The McKinsey 7-S model

The introductory questions for the topics are as follows:

- How critical is the compliance between the area of development and the underlying organisational values to the achievement of its strategic objectives? Substantiate your opinion.
- What is more important – to keep compliant with the values and cultural terms of an organisation or to use an occurring opportunity?

The McKinsey 7-S model shows and helps to ensure the coordination and balancing of the internal operational activities necessary for a successful operation of an organisation. It was developed by Tom Peters and Robert Waterman – two consultants working at McKinsey & Company in 1980. This model tries to answer the question of importance to any organisation in its strategy development process – how much an organisation is suited and in position to achieve the objectives defined for itself. There are several approaches in answering this question. Some of the approaches analyse the internal factors, some – the external factors, while some are combining these two perspectives. In general, the answer is reduced to the factors that are examined.

The 7-S model is applicable for a variety of organisational management needs in which the coordination of many aspects of management is required, for example:

- improvement of organisation’s performance;
- assessment of possible future changes;
- coordination of departments and processes in cases of merger;
- in the strategy improvement process when any improvements are made to it;
- may be used for the coordination of the team or project work.

The 7-S matrix includes seven interrelated factors which are categorised as either ‘hard’ or ‘soft’ elements:

Hard Elements	**Soft Elements**
Strategy	Shared values
Structure	Skills
Systems	Style
	Staff

It is easier to define or identify the ‘hard’ elements, and the management can impact them directly. These are elements like strategic notification, organisational chart and authority levels, formal processes and IT systems.

‘Soft’ elements are more difficult to describe, they are less tangible and affected more by the culture. However, these elements are not less important than the ‘hard’ elements if an organisation wishes to gain success.

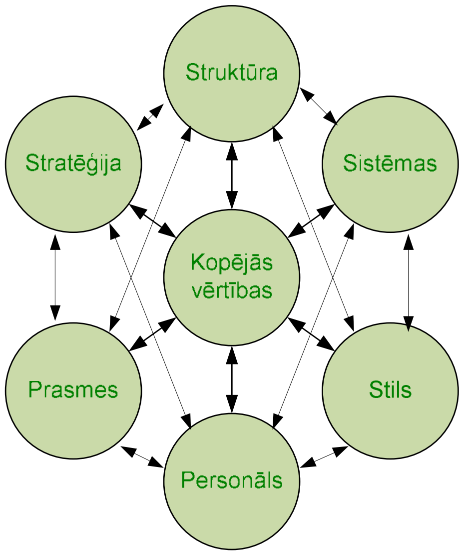


Figure 4.6 The McKinsey 7-S model

	Structure	
Strategy		Systems
	Shared values	
Skills		Style
	Human resources	

The interrelated factors of the McKinsey 7-S model are displayed in Figure 4.6. The description of each element is given in the table below.

Strategy	Plan developed for maintaining and creating competitive advantages over competitors. Activities planned by an organisation in response to or for anticipated changes in the external environment.
Structure	The way an organisation is structured, the hierarchy of authorities. It is designed as the basis for specialisation and coordination of an organisation. It is affected by the strategy, size and diversity of an organisation.
Systems	Daily activities and procedures performed by the employees in order to ensure the fulfilment of their objectives. Procedures may be formal or informal and they should support the strategy.

Style/culture	Consists of two components: **Organisational culture:** dominating values and assumptions, norms having developed over time and become relatively independent features of organisational activities **Management style:** it is more important what the managers do than what they say; how do the organisation managers spend their time? What are they focussing on?
Staff	Employees, people and their general capabilities. Personnel management – a process which is used for the advancement of managers, the process of specialisation, ways to build the management system of values, to introduce new employees to the organisation, employee career management.
Skills	Existing skills and competencies of organisation's employees or distinctive competencies – what the organisation does best, the way of expanding or transforming the overall capabilities of an organisation.
Shared values	**'Higher goals'** – the underlying values of an organisation which are rooted in its culture and the overall labour ethics. Placed in the middle of the model by thus underlining their importance and influence on all other organisational elements. Strategy, systems, style, personnel and skills follow from the concept that lies at the basis for foundation of the organisation and that it represents. The primary vision regarding the existence of an organisation represents the view of its founders on the meaning for its existence and its area of development. Along with any changes in the values the entire set of organisational elements also change.

Efficient organisations usually achieve the integrity of all these elements. Consequently this model has another name, i.e., Organisational Efficiency Diagnostic Model.

This model is advantageous for the commencement of a process of change in an organisation by giving it the necessary direction.

The next question – how to use this model? The model is based on the theory that an organisation will operate well if all of the elements are in integrated with and complementary to each other. Therefore, the model can be used in order to identify the non-integrated elements by thus increasing organisational efficiency, or to maintain the integrity (efficiency) in other situations of change.

No matter what the organisational changes are - restructuring, introduction of new processes, merger, new systems, management changes, the model can be used in order to check the integrity and interdependence of the different organisational elements by ensuring that the changes taking place in a certain place of an organisation are taken into account across the entire organisation.

The model can be used for planning by recording the current situation (point A) and the future situation upon realisation of the plans (point B) allowing for identification of the differences already planned and the inconsistencies. Therefore, the management task of the management is to integrate all of the principal organisational elements both during the plan implementation and upon the achievement of the expected results.

It is not simple to make changes to an organisation; the 7-S model helps to ask the right questions, though it does not provide the answers. The correct answers must be found individually by using the appropriate knowledge, skills and experience.

Some questions that can be used to tell the differences between the existing situation A and the results of implementation of future plans B. First, by answering the questions a statement of the current situation is made, and second, by answering the same questions a statement of the future situation for the results of implementing the plans B is made.

Strategy	What is our strategy? How do we plan to achieve our objectives? How do we cope with the pressure from competition? How do we respond to changes in customer requirements? How is the strategy adjusted to changes in the environment?

Structure	How is the organisation structured? What is the hierarchy distribution? How the different departments are coordinating their activities? How the members of teamwork organise and agree on their activities? Is decision-taking and control centralised or decentralised? Considering what we are doing, is it the way it should be? What are the communication channels? Well-defined, direct or indirect?
Systems	What are the main systems used by the organisation? (financial, personnel management, communication, record-keeping) What are the control mechanisms; how are they controlled and assessed? What are the internal regulations and processes for their use?
Style/Culture	How integrating is the management style? How efficient is the organisational management? Are the employees oriented at competing or cooperating with each other? Is there true teamwork functioning in the organisation or are there just regular work groups?
Staff	What positions or specialists are represented in the teams? What positions need to be filled? What competencies are they missing?
Skills	What are the dominating skills in the organisation? What skills are missing in the organisation? What is the organisation/teams doing well? Are present employees capable of doing the job well? How are the skills supervised and evaluated?
Shared values	What are the underlying organisational values? What is the corporate/team culture of the organisation? How strong are the values? What are the underlying values on which the organisation has been founded?

Following the analysis of the organisational values at point A and point B and the identification of the differences the process of harmonisation begins.

Shared values: Are they integrated with the structure, the strategy and the systems? If not, what changes should be made?

'Hard' Elements How well these are integrated with each other? The changes required are identified.

'Soft' Elements Do they support the desirable 'hard' elements? Do they support each other? What changes are required?

The process of harmonisation is an iterative process with the purpose of achieving a higher degree of efficiency in the course of strategy implementation of the organisation as well as the achievement of the objectives laid down in the strategy. (5)

Questions for discussion:

- In which cases you would certainly use the 7-S model?
- What measures would you undertake if you found after using the model that any inconsistencies exist? Name 5 successive measures.
- Perform the 7-S analysis of an organisation of your choice.

4.4. The Boston matrix

The introductory questions for the topics are as follows:

- How would you identify the product/service groups into which an organisation needs to invest financial resources for development?
- How important is the provision of finances for the development of products/services and how to achieve it considering the comparatively short life-cycles of products today?

One of the most popular business unit portfolio planning matrices is the so-called development component or the Boston matrix. This matrix was developed in 1967 by the Boston Consulting Group, BCG. It specialises in strategic planning in order to help the top management of organisations to define the cash flow conditions for strategic business units and to change the combination of business units within an organisation.

The matrix is derived from a simple proposition (a plan) including only two factors defining what benefits there are from offered market positions. The first is the rate of growth within a specific segment, and the second is the relative occupied market share (9, page 377). It is also illustrated in Figure 4.7 where the horizontal axis represents the relative market share of the business unit analysed, while the vertical axis – the relative rate of growth within the industry of operation of the strategic business unit. (5, page 238)

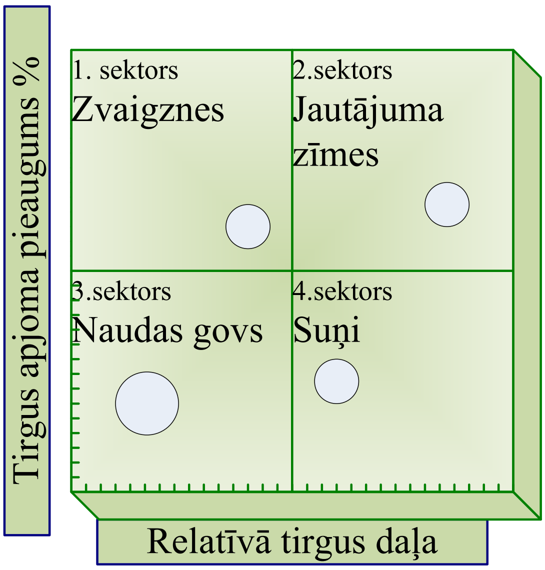


Figure 4.7 The Boston matrix

Increase in the market share, in %	**Sector 1** Stars	**Sector 2** Question marks
	Sector 3 Cash cows	**Sector 4** Dogs
	Relative market share	

The relative market share is the market share owned by a strategic business unit in relation to the market share of the enterprise with the largest market share. For example, if the market share of a strategic business unit is 10%, while the enterprise with the largest market share it is 30%, then the relative market share of the strategic business unit is 10/30 or 0.3. (5, page 108)

Only the strategic business unit which is the market leader the relative market share is above 1.0. Therefore, the border between a small and a large relative market share is estimated to be within the borders of 0.7 to 0.8. If a strategic business unit has a large market share it can significantly reduce its costs by benefiting from the economy of scale.

The relative growth rate of the industry is established dependent on whether the industry is developing faster or slower than on average within an economy, and often it is bordering on a high and a low rate of development. If a strategic business unit is operating in a fast developing industry, its competition environment is more advantageous than that if it were operating in an industry with a slow rate of development. (10, page 109)

The matrix is divided into four sectors and the business units (or products) corresponding to each sector are assigned their appropriate names in business jargon:

- Star;
- Question marks;
- Cash cows;
- Dogs. (5, page 109).

The individual business units in this matrix are usually displayed in the form of a circle, and the size of each circle is proportionate to the turnover of that business unit within the scope of the organisation as a whole. The description of business units can be visually linked to their product life cycles.

Star In the opening stage, when the product is recently developed and its production is commenced, the market share is growing, while it is still small, the future perspective of the product or the business unit is still dim. The status of a question mark can be reasonably attributed to such a business, as its development is dependent on many factors, including on whether the organisation will be capable of investing the necessary resources in production development, advertising and acquisition of the market share. The management should devote all efforts at this stage of development to market expansion. This is concurrently related with the expansion of production, while the main objective of the managers is the market acquisition in particular in order to be able to sell the total output produced and to use the production capacity in full.

Question Mark By expanding production an enterprise can concurrently increase its market share by gaining the status of the star. This is possible, however, only if the increase in production of the enterprise exceeds the average industry growth rate and if the total output produced is sold. If the production capacities of the enterprise are growing slower than on average in the industry, the business still stays in the status of the question mark. Sufficient competitiveness is not reached and it can be threatened by competitors. Therefore, it is important during this stage to invest the necessary resources in order to achieve a fast growth of the production capacity and a market share increase. By reaching the status of the star, i.e., by acquiring a significant market share in a fast-developing industry and by continuing to expand the production capacities, an enterprise can maintain this status for a certain period of time. It is possible if the total market share continues to grow and if the competition is not particularly intensive. During this period investments from outside can decrease, but all profits are usually, however, invested in the expansion of production and the market. An enterprise at this stage must strive to acquire a possibly larger market share in order to improve its competitiveness and future profitability (10, page 11).

Cash Cow Moving over to the status of the cash cow is usually related with the exhaustion of production growth. There can be several reasons to that. Most often it happens along with the stagnation in the market when the market demand for the product or service is no more increasing. Possibly the competition has become more intense and the pressure exerted by the newcomers requires larger assets for the building and maintaining of market barriers, advertising and attraction of new clients. This can be also the result of internal development peculiarities, when all existing capacities are efficiently used and investments for introduction of new technologies, construction of new facilities and acquisition of expensive equipment items are required.

In this situation an organisation does not have the confidence in a growing market demand and an efficient use of the newly created production capacities. In conditions of quickly changing demand from the customers the enterprise management may decide in favour of a more prudent strategy: maximum efficient use of the existing production capacities, development of a new, more perspective product or product group by investing resources in the establishment of a modern production facility and market provision. The largest the share acquired during the stage of the star, the larger the market share as the enterprise stabilises its production capacity and reaches the status of the cash cow. As during this stage no resources must be spent on expansion of the production and market acquisition, the largest share of profit is retained in the enterprise which it can spend on the development and launching of another product.

Dog By losing a market share to the most active competitors or by narrowing the production an enterprise reaches the sector of the dog. During this stage the amount of profit made by the organisation on an outdated business is gradually reduced and the future faith of the product becomes an issue. (10, page 112)

The manager has the following three options:

1. Use the so-called harvesting strategy when the enterprise continues to operate and gains profit even from a small market share. As during this stage production is usually being optimised, personnel trained, repairs and upgrading of equipment taking place, advertising and customer attraction does not require large expenses, the enterprise can gain profit for a long period of time still.
2. To get rid of such an enterprise by selling it to competitors at a more or less acceptable price.
3. Discontinue the production and restructure the existing production facility for other businesses.

The assets raised from those processes can be invested by the organisation in the development of new products and the increase of their market share.

The main purpose for using the Boston matrix is to establish what the best uses of the financial resources of organisations are (see Figure 4.8.b) in order to ensure development and profitability. (5, page 241) The Boston Consultancy Group suggests the following:

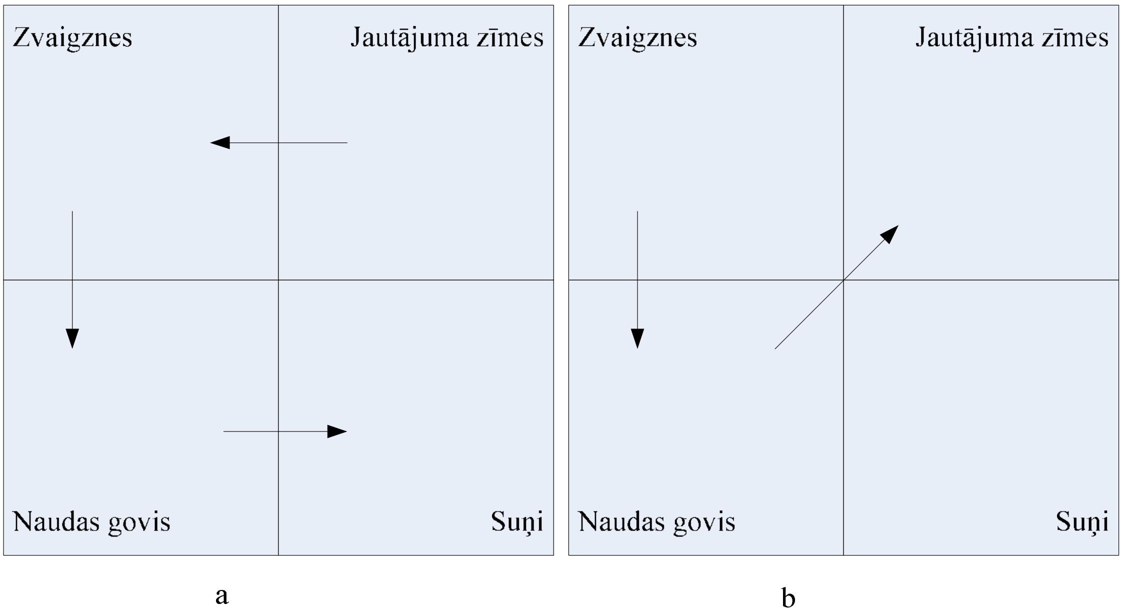
a) cash obtained from *cash cows* should be used for the transformation of selected *question marks* into *stars*. The long-term objective is the strengthening of competitiveness for *stars*;

b) non-perspective *question marks* should be get rid of in order to reduce the need for organisation's cash resources;

c) organisations should leave those industries where the strategic business units owned by them are the *dogs*.

If an organisation does not have enough *cash cows*, *stars* or *question marks* it should consider a merger or dissolution of some business units in order to create a balanced portfolio of business units. The portfolio should hold a sufficient amount of *stars* and *question marks* in order to ensure development and the profit-earning capacity, as well as of *cash cows* in order to ensure financial support to *stars* and *question marks*. (5, page 133)

The description shows that every element of the portfolio lives a life cycle of its own by passing through the different squares of the Boston matrix as shown in Figure 4.8.a. It shows how the portfolio elements start their way as *question marks* and disappear from the portfolio as *dogs*.



Figures 4.8.a, 4.8.b Movements of a business unit in the Boston matrix

Stars	Question marks	Stars	Question marks
Cash cows	Dogs	Cash cows	Dogs

One should not forget, however, that these names may also be attributed to clients. There are customers who are relatively loyal, who constantly buy a wide range of products and are advantageous for your organisation. Their predictable behaviour means that it is necessary to renew the processes taking place in your enterprise in order to serve their needs, while the recurring activities mean that competent employees need to be recruited for them. You should never pay too little attention to cash cow. There are customers – the stars who earn and may require special attention and an individual approach. Every enterprise will face also some dogs and question marks. (7, page 114).

The advantage of this matrix is the possibility to determine the strategic positions of each product or product group and to develop recommendations for the creation of the strategic balance of the cash flow. The disadvantages of the matrix, however, are that the rate of return of the business is affected by too many factors that are ignored in the model, and neither it is suitable for industries where the level of competition is not high.

Furthermore, some authors have mentioned that the Boston matrix also has the shortage of the model being too simple. Evaluation of the strategic business units by using only two factors can be mistaken, because in practice some other factors not less important must be also taken into account. Although market share undoubtedly dominates among factors determining the competitiveness of strategic business units, enterprises can also raise their competitiveness by differentiating their range of products in order to serve a specific market segment or niche. Businesses with a small market share can be highly profitable and they may have a high level of competitiveness in some market segments. (10, page 114)

Likewise with the competitive advantage – it must be controlled, so should be the enterprise portfolio. The same as with the competitive advantage, which must be developed when it is reached, so should be the enterprise portfolio be controlled regardless of whether the balance is achieved or not. This is a short-term balance.

Questions for discussion:

Determine the following for the organisation of your analysis:

- What products should be sold further and what should be taken out of production?
- Into what products further investments should be made and form which the assets previously invested should be recovered?
- What are the most valuable clients in terms of ensuring the best sales results for your organisation?
- What clients would be important for the future of your organisation?
- What clients should be gained and from which clients can be given away?
- Perform the analysis of an organisation at your choice by building the Boston matrix.

4.5. M. Porter's 5 forces model

The introductory questions for the topics are as follows:

- What in your opinion determines the success of an organisation: the industry in which it operates or its internal resources, skills and competencies?
- Are there any common characteristics for the organisations operating within the same industry? Substantiate your views.

An industry is an aggregate of several enterprises offering similar products or services. By 'similar products' we understand those products that the customers consider as the substitute products. It is important to set the boundaries. First, this would help the managers to understand the 'ring' they are competing in. Second, by setting the boundaries focus is made on competitors of an enterprise. Setting of the industry boundaries allows an enterprise to discern their competitors and producers of the substitute products. These aspects are highly important in building the enterprise competition strategy. Third, setting of the industry boundaries allows managers to identify the key success driving factors. (5, page 82)

When the boundaries for an industry have been set it is the objective of managers to analyse the competitive forces existing within the industry to identify the opportunities and threats. The best way to assess the competition environment is to use M. Porter's five forces model. This is a set of tools structured by the competition environment of an enterprise, designed so as to be able to assess these forces and their mutual interrelations. Although all enterprises should be competitive, the nature of competition differs by industry. (5, page 84)

In accordance with M. Porter's five forces model, there are five key competition forces in every industry (see Figure 4.9):

- Threat of new market entrants;
- Force of suppliers;
- Force of customers;
- Threat of the substitutes;
- Nature of competition within an industry.

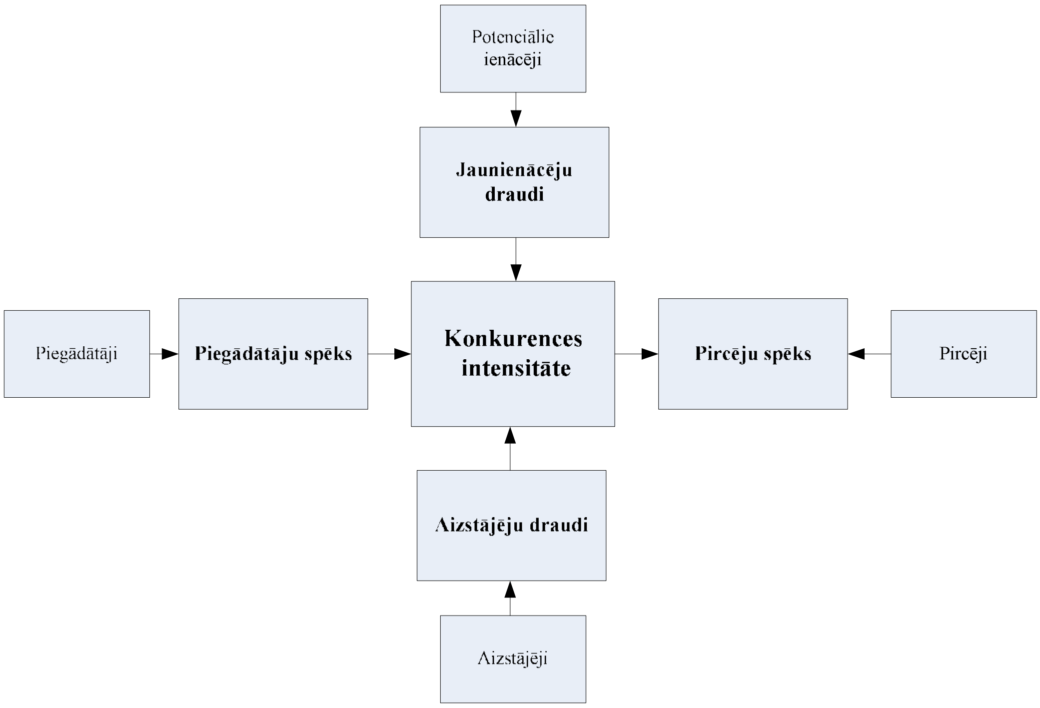


Figure 4.9 M. Porter's five forces model for industry analysis

		Potential new entrants		
		Threat of new entrants		
Suppliers	**Supplier force**	**Intensity of competition**	**Customer force**	Customers
		Threat of substitutes		
		Substitutes		

M. Porter believes that the stronger each of these forces is, the more limited the possibility for the industry enterprise to raise the prices and to gain higher profits. Within Porter's system a strong competitive force can be considered a threat as it reduces the profit-earning capacity. The strength of the above mentioned five forces may vary over time depending on changes of different conditions within the industry. It is the task of the manager to count the opportunities and threats that the changes in the five forces can cause and to take the decisions concerning the appropriate strategic action. Likewise the enterprise may, upon choosing its strategy, change the strength of one or several forces to its own advantage. (5, page 84)

Let us consider every one of M. Porter's competition forces.

Threat of New Entrants Usually difficult to assess. They bring in extra production capacities leading to a fall in prices and profits. Competition forces the existing enterprises to be more efficient in their activities. Taking decision on entering a new market is the function of the two following factors: the barriers to entry and the potential counter-activities from the existing competitors. Within the scope of this paper we will describe the function of the first factors in more detail. Therefore, the threat that some new enterprises will appear in the industry depends on what and how high the barriers to entering the market are. Barriers to entry are economic forces slowing down or impeding the entry of new organisations into the industry. The most wide-spread entry barriers are as follows:

- Economy of scale – it is the critical amount of increase in efficiency as it is expanding in scale. As the enterprise is entering an industry the level of output is usually small and are increasing only with the time along with the growth in market share. The quality of output increases with the time, while the costs per unit are decreasing;
- Product differentiation – in the course of time clients may start believing that the manufactured product or the service is unique. Differentiation of products is closely related to the loyalty on behalf of the clients and may build barriers to entry if the desire of the clients to buy the goods of a specific firm may become insurmountable by the entrants. It should be added that the new entrants usually have to allocate a lot of time and resources to overcome the loyalty of the clients to a specific product. In such occasions usually the price is reduced.
- Capital requirement – if a market entry requires a large amount of capital, it is closed for enterprises which are short of assets. The entry capital costs may differ greatly form industry to industry.
- Change-over costs – these are the expenses incurred when changing over from one supplier to another, for example, employee training, change of technology, assets invested before. The stronger the cooperation between partners the

smaller the probability that an enterprise is going to change its business partners.

- Access to distribution channels – over time enterprises build effective distribution channels. The inability to access the goods distribution channels constitute another barrier for new entrants. No matter how good is the product if it cannot be put before a buyer and if it cannot be sold. As soon as the relationships are established, an enterprise takes care of those relationships in order to avoid high change-over costs.
- Expenses incurred regardless of volume – in some cases new entrants do not have the possibilities to copy the price advantages obtained by the present market participants. These are gained by technologies, access to raw materials, location, government subsidies.
- Government policies – in planned economy competitors are practically excluded from the market. This is also true in respect of the nationalised industries. The trend towards a free market economy and privatisation means that some industries will be facing competition for the first time. It is important, how the government will regulate economy, how it would raise capital from outside, how it would protect the national market and how consistent its policy would be. With the help of concessions a government may be in the position of controlling the access to a certain industry, for example, the production of alcohol, banking, truck carriage, utility services.
- Repression – in some industries there is a considerable threat of repressions against new entrants. The existing enterprises do not want new enterprises to appear in the industry and try to make their entry into the market too expensive. If there are only some big enterprises in the industry they may, for example, to reduce the prices for their gods for some time in order to make the operations of the new entrants unprofitable and thus to force them out of the market.

As the function of the second type of factors, which refers to the decision on entering a new market, the following counter-measures from the existing competitors should be mentioned:

- When a strong response is anticipated from existing enterprises of an industry;
- What could it be like and on what occasions?
- When large investments are made into fixed assets without alternative use and when there is a slow growth in the industry.

The force of suppliers is a considerable force, as they are also capable of influencing the profitability of an industry. Force of suppliers is most often expressed in the impact made by the following factors:

- Production which is important for buyers. If a supplier provides the buyer with a product of high importance to him, the supplier will be in a more advantageous negotiating position;
- Products with a high replacement cost or if substitutes of sufficient quality are not available;
- There are some large suppliers dominating in the industry and there are higher concentrations than in the industry itself;
- The capacity of the supplier to enter the same industry, to which it supplies. Some suppliers may cause serious threat to buyers by entering the industry;
- Buyers are not capable of entering the industry, which supplies to them. This may be due to technological know-how or some other considerations;
- The products supplied are critical to the market position of the sellers;
- Effectiveness of supplier products has incurred high change-over expenses to the industry.

Buyers of industry goods or services are sometimes in a situation when they are capable of influencing the enterprises in order to ensure lower prices or a better service for themselves. There are several factors, which determine **the force of customers** in an industry:

- The amount of purchase when the buyer practically does not have any chance to request a reduction in price due to the small amount purchased; When purchasing large amounts or in the situation when the price is comparatively high, even a small discount can make considerable savings;
- Function of the product – if the product is of first necessity, buyers would pay a higher price for that product;
- Concentration of customers - when there is a higher concentration of buyers than the enterprises who supply the products they may often obtain better terms in respect of both the price and the service;
- The production is not differentiated. Buyers gain advantages from the market if they purchase standardised, undifferentiated goods form their suppliers, as there is a possibility to change over from one supplier to another and it would not incur large costs;
- Upon entry of a customer into the industry from which it currently purchases the goods the customer gains control over a certain enterprise or even commences the production of the same goods himself. Such an activity is called counter integration. (5, page 86)

Substitute threat refers to different products or services outside the industry performing the same or similar functions, for example, substitutes for sugar, plastic glasses against those made of real glass, tea – coffee. A new product can make the existing product unnecessary. They have same or similar quality and price properties, and there is a possibility to differentiate the product according to client's values – price, quality, post-sales service.

For an enterprise the impact of any potential or actual substitutes on operations is important. The availability of substitutes defines the price ceiling for a product, by thus making the market less attractive. By analysing the threat from substitutes, questions like whether a substitute causes threat to goods and services of an enterprise are essential. How easy would the re-orientation by a client be to purchasing of substitutes? Can the threat of substitution be reduced by increasing the cost of replacement? (5, page 89)

If close substitute products exist within an industry then the above mentioned force is highly significant, and vice versa.

Intensity of competition is the fifth force affecting the profitability of an industry. The enterprises within an industry are mutually related – any action taken by any of the enterprises may trigger counter-action. The competition increases if an opportunity is perceived to acquire a larger market position. Competition is most intense when there are no certain leaders within an industry, the number of competitors is big, the fixed costs are high, the possibilities for differentiation of products are few, the exiting barriers are high, as well as when the industry growth rate is decreasing or it starts declining. The sharper the competition is, the less attractive the industry. Competition is supported by price, quality and innovations, and the strategy used most often is differentiation.

Factors affecting intensity of competition:

- Number of competitors. Whether there is a large number of competitors, or they are equally strong (fast food restaurants, supermarkets). This is because enterprises are facing difficulties in predicting the future actions of their competitors;
- Slow growth of the industry. If the industry is in the stage of maturity, competition might be increasing, as the competitors desire to take the leading position and to maintain their market shares. In the case of a growing industry, enterprises tend to concentrate on obtaining new clients and do not attempt to persuade the clients to move over from the competitors. Also the buyers in a highly developed industry are much more knowledgeable and capable of assessing the true value of a product, and therefore, they influence the profitability of an industry by reducing it;
- Fixed costs; in the situation when due to high cost of capital the fixed costs in an industry are high, competitors usually reduce their prices in order to obtain orders and raise their turnover. The war on prices may burst out. This way products are losing their value fast, for example, fashion goods, expiry date of food products;

- Low differentiation or low change-over costs, i.e., the goods are chosen rather because of the price than service;
- In the result of an increasing level of profit, in industries where it is only possible to increase the profit when a certain volume of mass production is reached, for example, the pulp industry;
- Market leader. Those markets with dominating enterprises have the highest stability;
- High exiting barriers – enterprises continue to compete within an industry, although the return on investments is low or even negative. This decision is usually taken based on economic factors when the exit of an enterprise can cause social and economic tension in a particular region if, for example, the majority of population loses jobs.
- Strategic factors, when investments need to be written off, particularly in capital-consuming industries, and emotional factors, when an emotional attraction to an enterprise arises.
- High fixed exiting costs can also be mentioned as a factor, along with the situations when maintaining the assets would be cheaper than their scrapping.

Questions for discussion:

- Is it more important to follow the changes in the operating conditions of an industry by changing the underlying values of an organisation, or is it better to change the industry of operation of an organisation so that it conforms to its values? Substantiate your choice.
- Analyse the area of industry of your organisation according to the 5 forces model.

4.6. Ansoff's matrix

The introductory questions for the topics are as follows:

- What strategic decisions concerning the future development of an organisation can be taken by the organisation, and how to assess the risk associated with these decisions?
- What, in your opinion, influences the strategic risk?

One of the methods of strategic planning analysis that can be used for the risk assessment of strategic choices is the Ansoff's Matrix or sometimes also called the Product/Market Growth Matrix.

There are many situations during different periods of the life cycle of an organisation when it is necessary to take decisions concerning further development of the organisation, for example, to expand the business, to change the business industry, to change the market segment, to develop internationally, to develop its own brand, etc. As it follows from the above listed and many more other possibilities, which could be implemented by an organisation, still the most difficult is not the question what the possibilities are, but how to select those that are most suitable for the specific organisation and the conditions of the environment in which it is operating.

Ansoff's matrix provides the possibility to evaluate the options and to choose the most appropriate strategic decision for the specific situation, which would provide the highest return on any potential investments planned.

Ansoff's matrix was published for the first time in a 1957 edition of the Harvard Business Review and opened a possibility for small and medium-sized organisations to strategically plan their growth. As it was mentioned before, this matrix is sometimes called the Product/Market Growth Matrix, because it connects the existing and new market segments with existing and new products (see Figure 4.10).

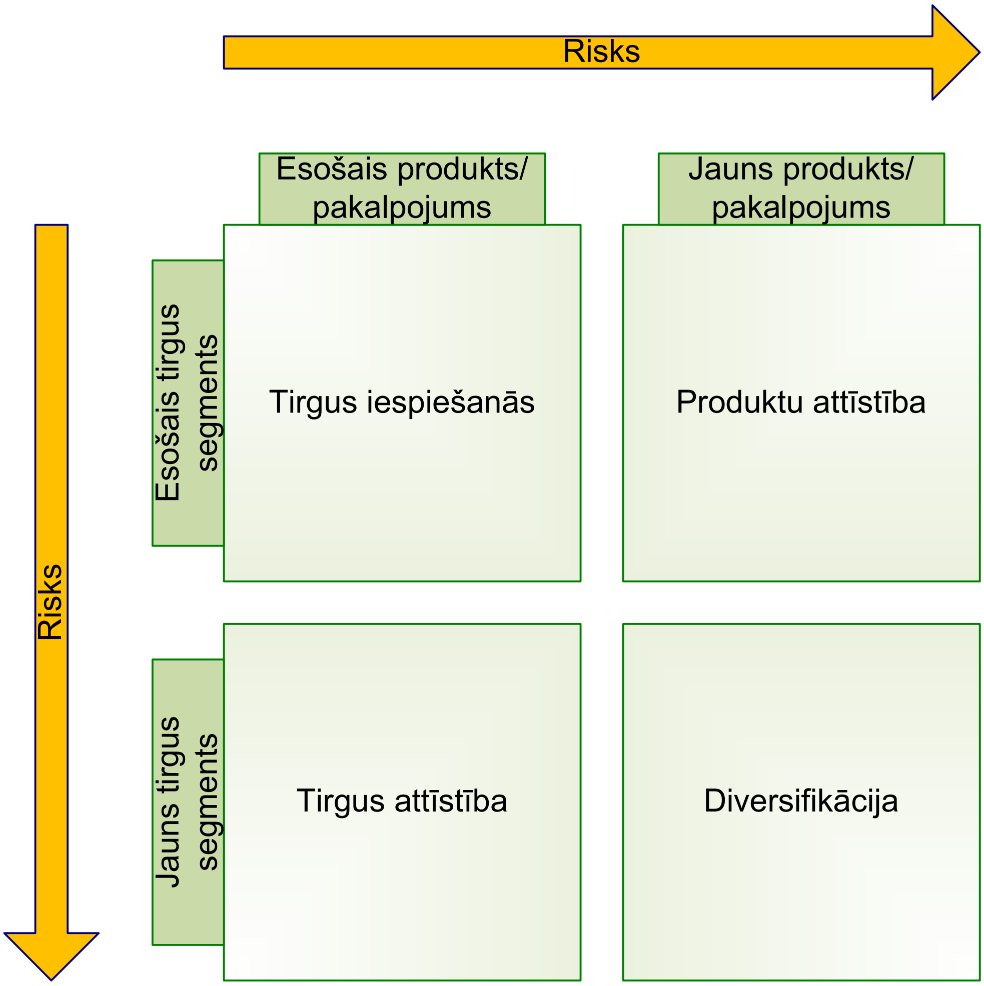


Figure 4.10 Ansoff's matrix

Risk	Risk		
		Existing product/service	New product/service
	Existing market segment	Market penetration	Product development
	New market segment	Market development	Diversification

Ansoff's matrix illustrates the risk that an organisation will face when implementing the specific strategy, and the main idea of the matrix is that by moving over to a new square (either horizontally, or vertically) the risk increases. From the organisational perspective the area of activity, the industry in which we are currently operating is highly familiar, and therefore, remaining with the existing market segments and existing products is a low-risk activity. However, by entering new market segments with the existing product or by developing new products within the existing market segments we expose the organisation to a heightened risk. The new market segment may turn out to be with different needs or market dynamics, life cycles than expected, or the new products may simply remain unsold. The risk that an organisation is undertaking is even higher if it chooses the strategy of conquering new market segments with new products.

An example for the application of Ansoff's matrix is given in the table below.

<table>
<tr>
<td>Penetration of the market

With this approach you will try to sell more of the same product/service to the same people. Therefore, the optional activities are:
Advertising - motivate more people in the existing market to choose your product or to use it more;
Introduce loyalty schemes;
Introduce the price discount or other special schemes;
Expand the sales department or increase the number of sales agents;
Buy a competitor, establish a joint venture with it.</td>
<td>Product development

With this approach you are selling more items to the same people.
Therefore, the optional activities are:
Extend the applicability of the product by manufacturing it in various modifications or by packing, grouping the product differently;
Developing related products or services (for example, a furniture manufacturing and assembling enterprise also launches production and assembly of doors correspondent by design to the specific orders, as it is highly likely that the customers introducing new design for furniture in their guest-room would find the old doors, their material, fixtures and fittings, colour inconsistent with the new furniture design);
In the service sector the time for marketing, the level of customer service or the quality should be expanded.</td>
</tr>
<tr>
<td>Market development

With this approach new markets or new market segments are sought. Effort is made to sell more of the same goods to new clients.
Therefore, the optional activities are:
Enter into new geographic regions in the local markets or abroad;</td>
<td>Diversification

This is a risky strategy. Usually the experience accumulated before does not help, there are no advantages due to volume as the effort here is to sell a totally different product/service to new and different clients.</td>
</tr>
</table>

• Use other distribution channels, for example, the internet, direct sales, in case the present sales takes place in the traditional manner; • Sell to other groups of people, other age ranges, sex or demographic profiles differing from your regular clients.	The main advantage of this strategy is that the overall organisational risk decreases along with the reducing exposure of the organisation to a particular market industry, which may have a negative or slow growth over a longer period of time leading inevitably to a higher competition.

Recommendations for reducing the risk, which arise from the application of Ansoff's matrix are that upon establishing the future strategies for organisations particular attention should be devoted to risk management. The recommendations could be as follows:

- Analyse very carefully each move from one square to another;
- Develop the capabilities and resources that are required in the new square.

Also plan for some reserves concerning the resources in case the entry in a new market or the sale of the new product/service does not go as well as planned. This usually happens, because an organisation needs time to learn to sell new products or to understand, what lies at the basis of a successful sale of a product.

In addition, there should be a plan for withdrawal in case the new product/service is not accepted or the market segment does not correspond to the specific skills and capabilities of your organisation. The plan must include an exit strategy from launching the new product or acquiring the new market segment, and it must be substantiated so that your organisation is not exposed to any financial risks to the organisation's existence. (11)

Questions for discussion:

- Why is it so risky to launch the production of a new product for a new market segment? How would you, as the manager of an organisation, reduce this risk?
- Perform an analysis of an organisation at your choice by using Ansoff's matrix.

4.7. Benchmarking

The introductory questions for the topics are as follows:

- How does an organisation benefit from its comparison with other organisations of its own or other industries?
- What, in your opinion, is the benchmark for the definition of organisational sustainability and development perspectives? Do such benchmarks exist at all?
- What parameters would you like to compare for the organisation analysed by you? Substantiate your choice.

Benchmarking/comparison is defined as 'a permanent, systematic process of comparing organisations, functions or business sectors to the world's bests in order to build new standards and/or improve the existing processes'. (6, page 185) Benchmarking may likewise serve also as a systematic analysis of the processes. Workflow is constantly being controlled and compared to the world's leading and best indicators, and the information gathered that helps to take successive steps in order to improve the workflow itself.

There are four basic types of benchmarking:

- Internal – benchmarking within an organisation, i.e., among the structural units;
- Competitiveness – benchmarking activities and achievements with direct competitors;
- Functional – benchmarking of similar processes within the scope of a wide range of industries;
- General – comparison of performance among unrelated industries.

All types of benchmarking can be very beneficial as they are capable of revealing new strengths and weaknesses of an organisation or its structural units, illustrate the potential improvements, objectives, new guidelines and fresh ideas. The basic components of benchmarking are comparing with the best by using quantitative indicators, as well as the development of the benchmarking concept for the purposes of the learning process, which not only helps to compare, but also to understand the processes serving as the basis for the various performances.

The following main phases are included in the process of benchmarking:

- **the planning phase** (including the identification of the object to be standardised, definition of the performance measures, identification of those objects to be compared against and identification of the sources of information);
- **the analysis phase** (data evaluation and interpretation, identification of performance 'gaps', analysis of potential causes facilitating the 'formation' of gaps);
- **the action phase**;
- **the phase for control and review**.

The above mentioned phases may, however, be divided into the following steps:

- identification of the area of activity;
- the choice of partners against which the standard will be set;
- definition of the methods for the collection of measures, units, indicators and data;
- gathering of data;
- inconsistency analysis – following the existing figures, state the facts;
- presentation of analysis and discussing a set of new objectives;
- preparation of an action plan;
- supervision over the process of implementing the standards made.

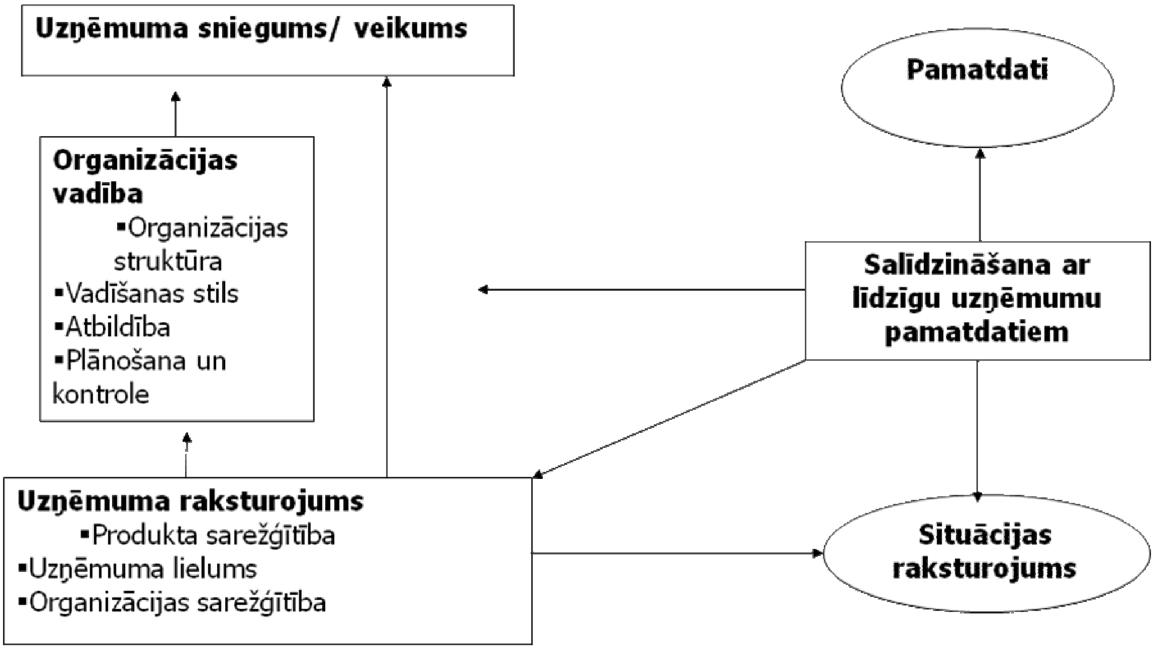


Figure 4.11 Graphical presentation of benchmarking

Enterprise performance	**Primary data**
Organisational management • Organisational structure • Management and style • Responsibility • Planning and control	**Comparison against the primary data of similar enterprises**
Description of enterprise • Complexity of the product • Size of the enterprise • Organisational complexity	**Description of the situation**

Prior to the commencement of benchmarking the following question must be asked: what do we want to achieve by carrying out the benchmarking. The concept can be defined more easily by answering the following questions:

- How well are we doing our job?
- Are we doing it as well as others?
- How can we do it better?
- Difference between concept and performance must be kept in mind.

Benchmarking may be started by competitor analysis that should be rather extensive and reach also beyond the industry. Comparison may also encourage employees to compete with their competitors or to develop their competitiveness in order to win the competitors, as they are around today and will be around tomorrow as well. (6, page 188)

Questions for discussion:

- How to apply the methodology of comparison within an organisation? How can an organisation benefit from it and what are the related risks?
- What are the main difficulties if an organisation chooses to use the method of comparison for the evaluation of its performance?
- Perform the benchmarking/comparison of an organisation of your choice within the industry of its operation.

5. Critical success factors

The introductory questions for the topics are as follows:

- Do common factors for success exist in each industry or they cannot be determined? Substantiate your opinion.
- How to find one's competitive advantage if an organisation has taken the decision to start operating in a completely new industry? How to find out what are the main conditions of operation in the new industry?
- How would you start a strategy implementation process? Give 5 steps.

The process of developing a strategy for realisation in an organisation permanently creates new perspectives and illuminates the basic elements of an organisation. What we have experienced rather strengthens our confidence in order to illuminate better what is still needed and to provide further context regarding what needs to be done. It often reveals a new understanding of the consequences. One of the reasons which is constantly supported that these activities are carried out in a team with a common understanding of the activities to be performed not only as a general outline, but also in detail and nuances. Without this common understanding and without a deep knowledge concerning the possible changes the process set will not be functioning. In order to achieve any changes, the leader must not only gain the understanding among his employees, but also win their consent. The strategy development process helps to gain the understanding about it. (12, page 164). We may state that just like it is possible to identify for each industry those activities and priorities that are critical for organisations operating within the industry, which are called the critical success factors of an industry, also every strategic plan includes its critical success factors. These are events, skills, competencies or processes without which the realisation of the overall plan is impossible or has a very large risk of not being realised. However, they cannot always be easily disclosed and noticed. Even if they are known to the management team, one of the main objectives of the management is to convince about them the managers at all levels who are involved in the strategy realisation process.

The following steps or stages for developing the critical factor can be established:

Step 1 – collect the main documentation about productivity – what has been achieved until now:

- statement of purpose;
- statement of vision;
- statement of values;
- statements of strategic intents.

As an additional document a results summary from the conclusions made can be prepared with the description of the main statements, impacts and the newest strategic intentions, as well as a statement from the problem solving session by Ansoff's matrix.

Step 2 – participants to the process should be given the explanation of the purpose for the meeting in order to identify the critical success factors which are the most widely-ranged objectives that we need to reach in order to achieve the strategic purpose.

- Explain what is known about the critical factors;
- Explain, how in the result of this session an enterprise will be in the position of setting the quarterly or semi-annual targets with each employee or operational unit, or, in other words, will be able to prepare the short-term operating plan.

3. Step 3:

- Review the statement of purpose – to encourage commentaries;
- Review the statement of vision – to encourage commentaries;
- Review the statement of values – to encourage commentaries;
- Review the statement of strategic intents – to encourage commentaries.

Step 4 Split the group into smaller sub-groups, if possible: Assign one or more parts of the strategic intents to each sub-group. The group is controlled as follows:

- A future perspective is adopted, for example, of 5 years. Imagine that the enterprise has become largely successful by reaching this strategic intent. Take a retrospective look and describe the main thing leading to this successful result:

- a practical, detailed and functional consideration thought should be given to it. (12, page 165)

Then the group is given 1 hour for consideration. Then the hearings of the results take place by noting the key points derived from the example analysed. Writing in the past tense helps to recall that the consideration should be given to what has been in the past, i.e., prior to the success. Then common views are combined, as usually the main views are the common ones, but also some new findings must be added. These are the critical factors of an enterprise that need to be reviewed, discussed and also checked whether these are sufficient in number, too many, if they can be fulfilled, are challenging enough, interesting enough and whether they would really help to achieve the strategic intent.

Step 5 Critical success factors are divided into sub-groups and the next task is to transform these factors into sequential operating plans which are defined as:

- divide the critical success factors into a range of measurable successive objectives;
- define the resulting values of the measures;
- assess the resources required.

There is one hour allowed for this work and also the volunteers can be invited to join. In the course of work an agreement must be reached on how these operating results will be connected with the process for definition of organisational or unit objectives. (12, page 166).

Questions for discussion:

- Imagine that you are the manager of an organisation and you have to convince the employees about the importance of critical success factors. Explain to your employees, why some of the factors are more important in the organisational plan than others and how you defined which factors are critical.
- Perform the critical success factor analysis for an organisation of your choice in one of its areas of activity.

6. Identification of core competencies

The introductory questions for the topics are as follows:

- Are there any competencies, without which an organisation could not exist?
- Can competencies be unique and how does an organisation benefit from unique competencies?
- How does an organisation acquire competencies?

Identification of core competencies is considered to be the final stage of the strategy development process. Having a clear purpose (or intent), having the best vision of the future environment, having coordinated strategic intents and critical success factors and having a well-developed action plan, the next task is to evaluate what skills and knowledge will be required for a successful implementation of the strategy.

When a successful and modern strategy is discussed, competencies can be defined as the 'strengths and opportunities that we will need to develop for the management of our strategic intent' (12, page 178) To be able to summarise all of the ideas, competencies can be classified into three categories:

1. *Generic competencies* – a competency without which no further continuation of any serious organisation is possible. This competency means continuous quality improvement, ongoing improvement of processes, ongoing improvement of customer satisfaction as well as the ability to change fast, to learn fast etc.
   Speaking about competencies at this level we refer to organisational competencies. This is what an organisation is capable of achieving by the existing system and the competencies of the employees operating this system. Sometimes these are called core competencies as they are at the heart of each enterprise.
2. *Industry-specific competencies* – competencies that an organisation needs to be able to operate in the selected industry. Majority of industries create professional and trade standards, i.e., being the knowledge necessary for people to be

employed in this industry. Furthermore, in many industries a commitment is sought in order to continue professional development, and therefore, for the employees of the industry to be able to also raise their qualification.

3. *Components of competitive advantage* – competencies that permanently allow an organisation to be better than its competitors. These may be general, basic organisational competencies developed to a high level of excellence. For example, sustainable quality and reliability of Japanese car engines is the core competency shared by *Toyota*, *Nissan*, *Honda* and *Mitsubishi* which they are capable of achieving regardless of where they are manufactured. The excellent service of *Singapore Airlines* is a competency ensured by its competitive advantage.

   It is important that the potential buyers believe that they can constantly rely on this competency being a characteristic feature of the abilities of the supplier – and only then a competency can be measured as competitive advantage (12, page 179).

All these competency categories are united when they are considered as strengths and opportunities that will be required to achieve the strategic intent. The main reason behind this is that the strategies are developed and that the people in charge for its implementation are involved in this process and help to formulate, define and inform about the results. Competency is the capability to do what a person understands and what must be done.

How to develop the competency structure? This task can be done within a group or, for a greater efficiency, any of the team members individually can perform the task quicker and receive an agreement from the rest of the participants during discussion. This can be done also by some special subdivision in an enterprise, for example, by personnel department. It is important that the nominated department manager recognises the competency structure and is prepared to implement it through the definition of objectives, development planning and so on. The following steps must be taken:

Step 1 Action plan should be used as a reference point. This is important, as it helps to sum up the strategic intents, critical success factors and objectives that the participant has put forward for himself. All this information helps to identify the necessary competencies.

Step 2 When considering the strategic intent and the critical success factors all broadly defined competencies that come into mind should be listed.

Step 3 For every competency list the basic knowledge that is required for demonstration of the competency.

4. Step 4 For every competency list the basic skills that are required for demonstration of the competency.

5. Step 5 Put down the person, an individual or a group of individuals next to each competency who will have to prove it.

6. Step 6 During this step it is necessary to compare the views with the rest of the team members and to make a synthesis of the results.

7. Step 7 The above mentioned steps must be described and the competency structure is ready. There is also the beginning and the end of the development plan, where those persons who must develop the particular competency are identified. (12, page 182).

The competency structure is the preliminary document of the development plan for each individual in the organisation. The development plan is created for every employee and the direct manager of that employee has agreed on the current competency level compared to what is the level required. Such a plan must include bilaterally approved objectives that have been quantified as best as possible.

Upon implementation of the strategic intent it would be inevitably related to people's behavioural changes and the way they perform their work. This, on its turn, includes a re-assessment of competencies in order to do what is required for the support of the strategic intent. Competency structure is a simple and effective instrument assisting in the definition of a correct and appropriate development plan. (12, page 185)

Questions for discussion:

- Which category of competencies is the organisation of your choice missing? Why has it happened and what would you do to change the situation?
- Perform an analysis of core competencies for the organisation of your choice.

7. Balanced Scorecard

The introductory questions for the topics are as follows:

- What measures would you use to assess the organisational performance?
- Which categories of measures are key in determining the long-term development perspectives of an organisation?
- How would you understand a balanced organisational performance? Is it possible to find a balance in organisational performance and what can destroy this balance?

Balanced scorecard is the measuring tool applicable in management which is intended for the development, assessment and adjustment of business strategy. In addition to the financial perspective it is also advancing the customer perspectives, activities, the inclusion of organisational updates and learning skills (see Figure 7.1). The balanced scorecard system helps to see the non-financial resources summary results in financial terms within a longer-period of time and answers the following questions:

- What is important for our shareholders (stakeholders)?
- How do our clients perceive us?
- What internal process can provide the value added?
- Are we innovative and ready for the future?

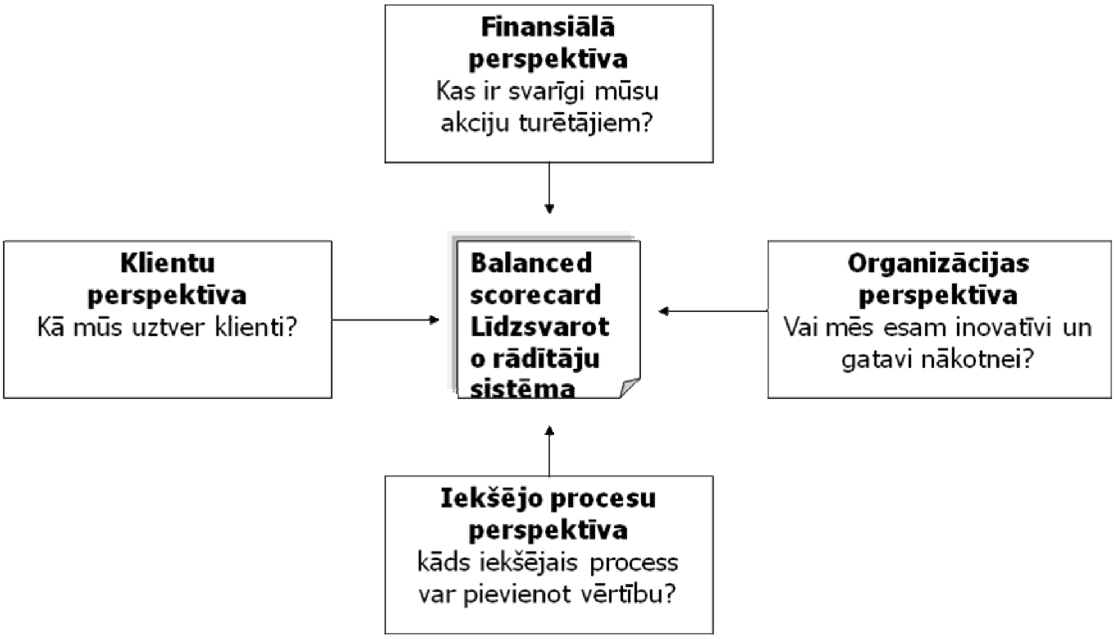


Figure 7.1 The Balanced Scorecard

	Financial perspective What is important for our shareholders?	
Client perspective How are we perceived by our clients?	**Balanced scorecard**	**Organisational perspective** Are we innovative and ready for the future?
	Internal processes perspective What internal processes can add value?	

Balanced scorecard depends on the type of enterprise.

Financial perspective:

- Operating revenue;
- ROI, ROCE, EVA (or any other type of return ratios);
- Increase in sales and revenue;
- Return from a product/customer;
- Revenue par unit/client/employee;
- Cost per unit;
- Sales costs in percent of the total costs or revenues.

Client perspective:

- Market share in target segments;
- Business development of existing clients;
- Return on clients;
- Delivery on time and without any damages;
- Returned goods policy;
- Complaints and handling;
- Information telephone lines.

Internal processes perspective;

- New sales results in percent of the total sales results;
- Product development cycle.

Learning and growth perspectives:

- Answers the question – are we successful at managing, developing and maintaining our human resources, knowledge and system?
- Employee satisfaction level;
- Rate of income or return per employee;
- Overlapping, duplication of jobs;
- Length of the cycle, time for the re-qualification of employees;
- New ideas (per each employee involved);
- Availability of information in relation to information requirement.

Questions for discussion

- How important are the quantifiable and non-quantifiable measures for an organisation in order to assess the organisation's long-term perspectives?
- Which of the criteria would you use for your organisation in each balanced scorecard category?

8. Risk analysis

The introductory questions for the topics are as follows:

- What do you consider to be a risk for your future strategy?
- What would you do if you found out that there is a risk for the implementation of your strategy during its development process?

There is a whole industry devoted to risk analysis, especially in relation to insurance and legal aspects. Risk analysis used in the process of strategic planning is much more straightforward than the analysis that an enterprise is possibly performing within the scope of its business units and provides the enterprise with the assessment of the potential threat for the future. The following issues must be considered:

- What is the main threat to you caused by your clients?
- What threatens your processes most?
- What is the main threat caused to you by the competitors?
- What threats can be posed by your employees?
- What is threatening your premises and equipment?

You must prepare a four column table for each of the risk factors as in Figure 8.1.

Riska faktors	Ietekme	Sekas (naudas izteiksmē)	Varbūtība

Figure 8.1 Risk analysis

Risk factor	Impact	Effects (in cash terms)	Probability

In column one all risk factors that may cause a threat to an enterprise are listed. The threat must be real instead of a chance that 'a comet will collide with the planet Earth' which is not only negligible, but also hard to predict. The threat must be sufficiently big to be able to considerably affect the course of the organisation and it might occur within a period of the nearest 12-24 months.

In the second column the impact that will be caused by the threat, if it comes true, should be indicated; this has to be explained in a few words. In the third column the potential effects should be assessed in terms of cash – the amount of revenue lost annually. And in the final, fourth column the assessment of the probability that the threat will realise should be given. If the probability is high, the score 1 should be given, if the threat is only hypothetical – 3, while if the threat is negligible – 5 should be entered. (7, page 89)

Speaking about the sources of information, the data could be collected by inquiring the people dealing with the business insurance cases as well as the accounting. If it is impossible to acquire such data, one must speak to those employees who work in areas with the highest threat. It is likely that they have already assessed all the factors and their probable effects.

Questions for discussion

- How critical is the risk analysis in the process of organisational strategy development?
- During which stages of the strategy development and implementation you would perform the risk analysis?
- On which factors you would focus most?
- Perform the risk analysis of an organisation at your choice and complete the table for at least 5 risk factors?

9. Strategy levels

The introductory questions for the topics are as follows:

- Is it necessary to develop strategies for several levels and why isn't it sufficient with just one common level?
- Which of the levels would you consider to be the most important and why?

The necessity of organisations to create multi-level systems follows partially from the organisational structure which, on its turn, represents the organisational objectives, traditions, culture and the vision of the organisational founders regarding its future, as well as the understanding of business in general. If an organisation exists in reality as a multi-level system, consequently also the strategies must be developed at multiple levels. The second most important condition for a multi-level strategic approach that organisations do not only embody, for example, products/services, but also the structural units, procedures, processes, employees, and consequently it can be said that organisations exist as systems independent of the products themselves. As we know, products and services change, while organisations remain and by adjusting to new market requirements continue to market more and more new products and services. Therefore, it is logical, that organisations can develop strategies for their development as an autonomous system within another larger system (corporate strategy), can establish strategies for the development of their products/services or the provision of their competitiveness (business level strategies), as well as for the provision of operation or functioning of their systems, processes (functional strategies).

The majority of our contemporary organisations have both functional and general managers. General management is in charge of the operation of the entire organisation or a major part of it. While the functional managers are responsible for some specific functions of the organisation, for example, production, sales, accounting, etc.

In a typical multi-operational enterprise the three main management levels exist: corporate level, business level and functional level. Functional managers have a certain strategic role. (5, page 34)

Every strategic management level has a different scope of issues for consideration. The higher the level of strategic management the more critical for the future of an enterprise are the decisions made. Strategic management levels are related with the enterprise organisational structure, but the differences existing between them are substantial, as it is illustrated in Table 9.1.

Strategic management level	**Level in the organisational structure**
There are three management levels and they exist in enterprises of any size – in both multi-national and individual.	The number of management levels may be endless and it depends on the size of an enterprise.
Every level indicates the substance, area of competence and subordination of the decisions that are taken at each level regardless of the size of an enterprise	The area of operational control, subordination and reporting of each employee is disclosed.
Management levels are not officially defined, they develop objectively, depending on the decisions to be taken and their area of competence	Management levels are formally defined and are changing following any management changes.
Management levels are not a parallel division in the enterprise structure.	Management levels are a parallel enterprise structure.
For every management level a corresponding strategy level exists.	There is no definite strategy within the management levels.

Figure 9.1 Description of strategic and organisational management levels

As illustrated in Figure 9.2 it is possible to distinguish among three levels of management: corporate, business and functional level. The role of a competitive advantage and the content of its creation and development are different in every level of strategic management.

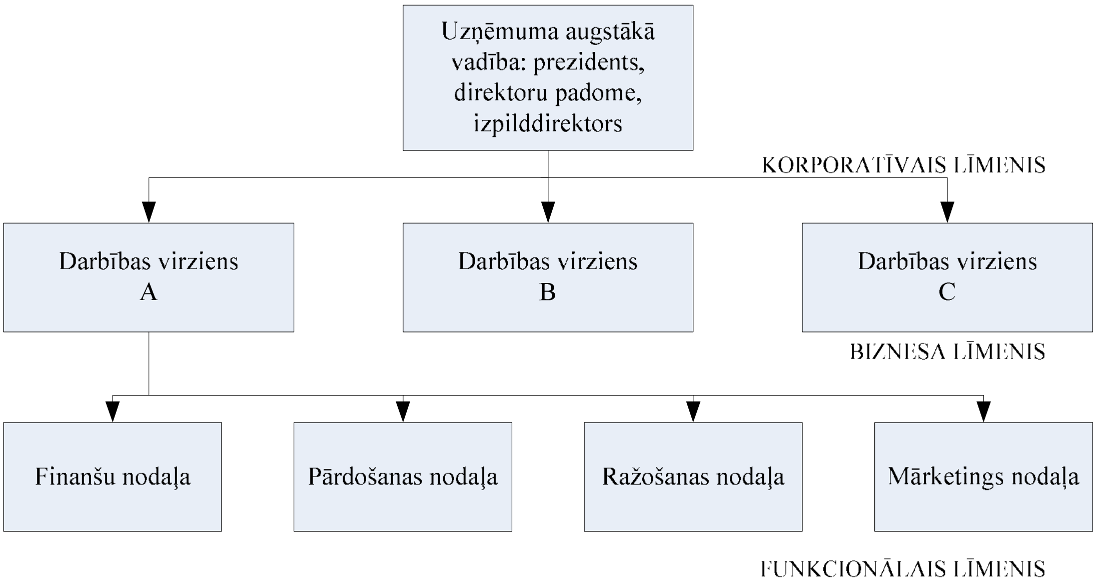


Figure 9.2 Enterprise strategic management levels

		Top management of the enterprise: the president, board of directors, CEO		
				CORPORATE LEVEL
Area of activity A		Area of activity B		Area of activity C
				BUSINESS LEVEL
Finance department	Sales department	Production department	Marketing department	
				FUNCTIONAL LEVEL

Corporate level consists of an executive director, other senior managers, board of directors and the enterprise personnel. These people are at the top level of the decision-taking process. Their responsibilities include the definition of organisational mission and objectives, strategy formulation and implementation, creation of resources in different areas of activity and the employee management.

Business level consists of the separate strategic business units or unit managers and the personnel subordinated to them. Their strategic objective is to implement the general guidelines on the specific area of activity and its objectives received from the corporate level through the use of the specific and straightforward strategies of their business units.

Managers at the functional level are responsible for the functions of the specific operations of the enterprise. The responsibilities of these managers include the creation of functional strategies for production, marketing, etc. that would assist in implementing the strategic objectives put forward by the general management at the business and corporate levels. Functional managers also provide the greatest part of the information allowing the business and corporate level managers formulate real and achievable strategies. (5, page 35)

Every strategic level will be described in more detail in further sections of this paper.

Questions for discussion:

- How would you coordinate strategies at different levels and who is in charge in the organisation for the coordination of the strategies at various levels?
- Is it possible to start planning the strategies in the opposite order, functional strategy first, then the business level strategy and then the corporate level strategy?

9.1. Corporate level strategies

The introductory questions for the topics are as follows:

What are the primary issues of organisational performance?

Would you be willing to create an organisation in which the entire chain of value added belonged to this organisation or would you rather choose to specialise in the management of one single link in the value added chain and its development?

Corporate management level is the highest management level in any organisation as at the corporate level the main decisions concerning the existence of an enterprise are made. Corporate level strategy should provide an answer to several questions:

1. In which areas of operation an organisation should compete in order to achieve maximum effect in the long-term?
2. How should an organisation develop geographically?
3. What are the areas of activity of an enterprise?
4. How to manage its distinctive area of activity and competency portfolio?

5. What strategy should an organisation use in order to enter into and exit from business circulation?

Depending on the mission and the main objectives defined in an enterprise a corporate level strategy is being developed and its definition is the final component of the strategy formulation process. Corporate level strategies are guiding the enterprise business model and determining, how strategies will be used at the business and functional level in order to strengthen a sustainable competitive advantage of an enterprise.

Corporate level strategies address the issues related to the multi-business model, because as an enterprise is involved in several areas of activity it is also managing the distinctive business model of each area of activity. Enterprise managers should take a decision on how the multi-business model should be managed.

This section will discuss the selection of different strategies realised by an organisation at the corporate level. Organisations at the corporate level can use the following:

- Vertical integration strategy;
- Horizontal integration strategy;
- Related or unrelated diversification strategy. (10, page 76)

Corporate level strategy is a map of objectives to some extent with the coordinates for the entire enterprise clearly indicated which shows the direction for further development of the enterprise. At the same time when moving along this map an enterprise either continues to search for or has already found its place in the market as it is seen in Figure 9.2 (10, page 214)

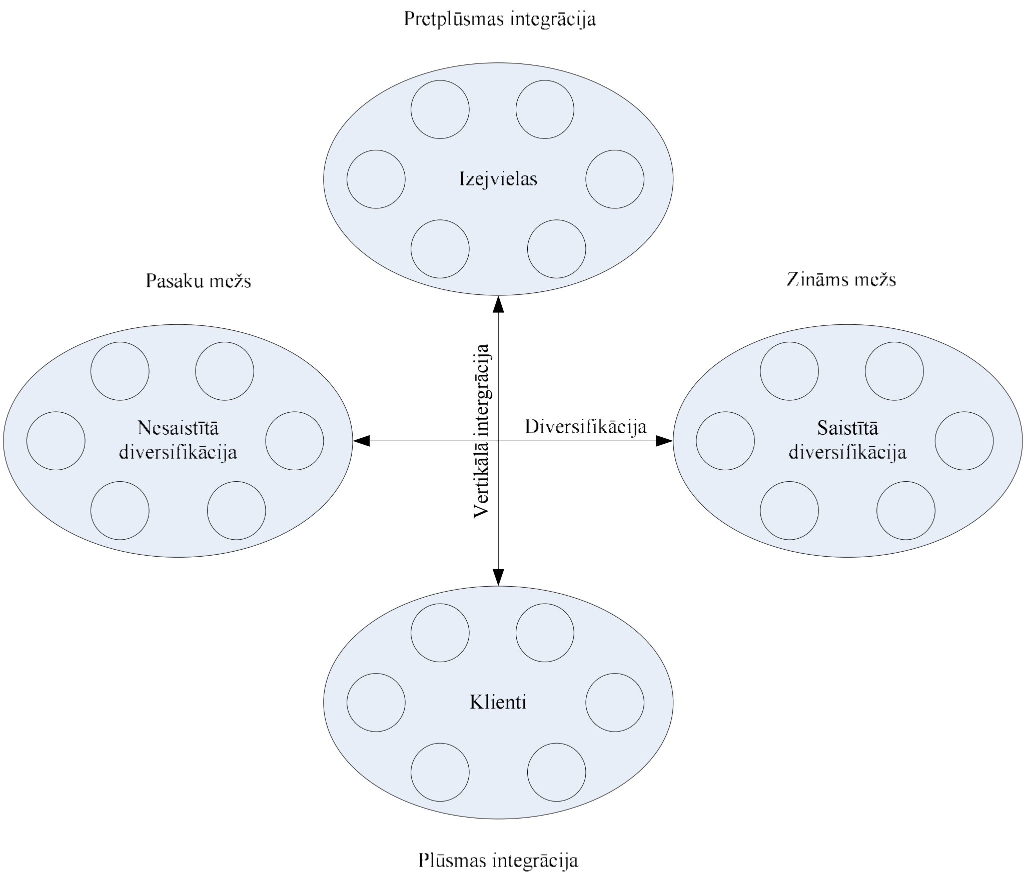


Figure 9.2 Sample mapping of corporate level objectives

<table>
<tr><td></td><td colspan="2">Counter-flow integration</td><td></td></tr>
<tr><td></td><td colspan="2">Raw materials</td><td></td></tr>
<tr><td colspan="2">Fabulous forest</td><td colspan="2">Familiar forest</td></tr>
<tr><td>Unrelated diversification</td><td>Vertical integration</td><td>Diversification</td><td>Related diversification</td></tr>
<tr><td></td><td colspan="2">Clients</td><td></td></tr>
<tr><td></td><td colspan="2">Flow integration</td><td></td></tr>
</table>

The main objective of corporate strategies is the increase of the enterprise value. Consequently, upon implementation of corporate strategies the value added should be created. Value added can be created by either reducing the costs or differentiating the products which provide for a possibility of increasing their price. Therefore, upon developing the corporate level strategies, an organisation must take this into account in respect of the business level strategies ensuring its competitive advantage. (page 76)

Let us look at each of the strategy types.

Vertical integration means that an organisation produces its raw materials (counter-flow integration or integration backward) or sells its output itself (flow integration or integration forward). (10, page 81)

The vertical integration flows are illustrated in Figure 9.3 (5, page 217)

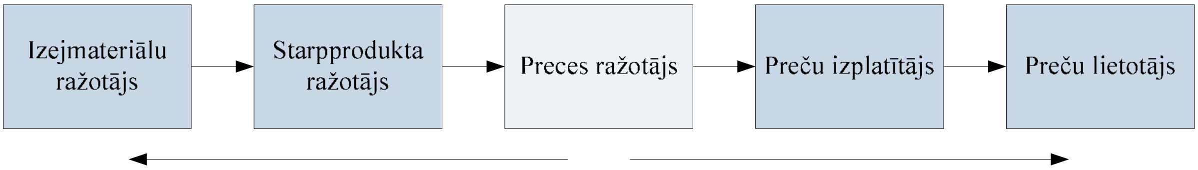


Figure 9.3 Links in the value chain from raw materials to end users

Manufacturer of raw materials	Manufacturer of intermediary product	Manufacturer of the product	Distributor of goods	End-user of goods

Vertical integration can be both partial and full. Performing all activities starting from acquisition of raw materials to sale of the product or service to its end user can be considered as full integration. Performing some of these activities is a partial integration. Likewise vertical integration can be directed forward or backward across the entire distribution channel. Vertical integration backward is when enterprises benefit from supplying firms with products, details and raw materials. Vertical integration forward is when an enterprise is entering the same industry which uses, distributes or sells the production of the enterprise. The companies having gained the benefits are closer to the end user of the product. (6, page 99)

Organisations are realising a full counter-flow vertical integration when they are manufacturing all its necessary raw materials and the full flow vertical integration if it performs the distribution of all of its output itself. However, if an organisation purchases a part of the raw materials form external suppliers or if a part of its output is being sold by external distributors, it uses the strategy of partial vertical integration. (5, page 217)

When realising the vertical integration strategy organisations are also incurring losses. The most significant of them are:

- increase in costs;
- losses incurred due to fast technological changes;
- losses incurred as a result of an unpredictable demand.

These losses are reducing the value added that an organisation gains by using vertical integration.

<u>Increasing the costs</u> Although vertical integration is often implemented with the purpose of gaining the advantage in terms of production costs it is often the case that the opposite effect is obtained, because the costs are increasing, in fact. This happens when an organisation has committed to purchasing the raw materials from their internal suppliers, while the prices of external suppliers are lower. The enterprise internal suppliers can have higher operating costs, because they know that they would be always able to sell their output to another department of the organisation. The subdivision, having not felt any competition from outside for obtaining the contracts for the sale of its products loses any initiative to find the opportunities in lowering its operating costs. The managers get under the temptation and rather increase the costs of other organisational departments than search for the ways to reduce these costs. Therefore, the lack of initiatives for cost reduction may result in an increase of the operating costs. In order to avoid this situation, some organisations choose to integrate vertically only a part of the necessary supplies. The second source for the increase in costs is higher costs of coordination in order to ensure integrated supplies across the entire chain of making the product.

<u>Technological changes</u> When technologies change very fast, vertical integration creates the risk for an organisation to remain technologically obsolete.

<u>Varying demands</u> When the demand for a product is constant, vertical integration can be realised considerably easy. Constant demand allows for better planning and coordination of activities necessary for the output of various products. When the demand is varying and unpredictable, it becomes more difficult to achieve a close coordination between the vertically integrated activities. This largely increases the bureaucratic costs.

The necessity to distribute the production capacities in various stages of the production processes. If the demand is unpredictable, it is useful to purchase the raw materials form independent suppliers instead of performing any vertical integration. The realisation of vertical integration in this situation means assuming the risk of producing the raw materials with incomplete capacities in different periods, and purchasing the missing materials from external suppliers as the demand is growing. In order to reduce the risk it is better to integrate only a part of the supplies by meeting the minimum demand (5, page 220)

The second strategic option that companies can implement at the corporate level is the **horizontal integration**.

Some enterprises, when they wish to expand, acquire other enterprises operating in the same business under their property and call this process a horizontal integration. There are several reasons, why to involve in horizontal integration. One of the main reasons is to increase the market share. Thanks to the increase in revenues, a larger market share provides a greater force in negotiations with the suppliers and the customers (6, page 93).

In the case of a reduced force of suppliers and customers as a result of horizontal integration an enterprise can increase its profit. This way an enterprise is controlling the industry which provides the possibility to reduce the prices for raw materials. Therefore, the total costs of an enterprise decrease. In the result of industry consolidation a company acquires control over the majority of the amount produced within the industry. Due to this factor buyers are more dependent on the production manufactured by the enterprise. The enterprise receives an opportunity to increase the costs and to make profit, as the buyers now have lower options available. (10, page 81)

A larger stake in the market also provides the opportunity to reduce the enterprise costs through the economy of scale as well as to promote its goods and services more effectively to a larger target market and allow a better access to the distribution channels. (6, page 94) Expansion of enterprises provides the opportunity for the fixed cost apportionment to a larger amount by thus reducing its costs per unit. Besides, the costs can be also reduced by eliminating the overlapping functions. (10, page 79)

In the case of horizontal integration the value of the products offered by an enterprise can increase as the company is in the position of offering a wider range of products by combining them in a package. This provides the opportunity to the enterprise to offer various product packages at a fixed price. As the buyer only has to pay once when buying various necessary products, he values higher the package offered. In other words, the development of product packages increases the competitive advantage which is based on differentiation. Another opportunity to increase the value of the products offered by an enterprise in the case of horizontal integration is cross-selling. (10, page 79)

Apart the factors mentioned above, the enterprise profitability is also boosted by the reduction in number of competitors in the case of horizontal integration. Intensity of competition can decrease due to two reasons:

1. Take-over of or merger with a competitor may be required in order to reduce the production capacity within an industry, which often causes wars on prices.
2. By reducing the number of players in an industry horizontal integration makes the indirect agreement on prices easier with the competitors. The larger the number of the dominating firms in the industry the more difficult it is to realise the agreement on prices among competitors. (10, page 80)

Finally, the horizontal integration may result in a higher flexibility of enterprise operations. (6, page 94)

For about ten years now the horizontal integration has become a very popular corporate strategy and enterprise take-overs and mergers have taken place in many industries.

As the last strategic choice that organisations realise at the corporate level **the related or unrelated diversification strategy** should be mentioned.

Diversification is the expansion of organisational activities by involving into new areas of business activity. Two types of diversification strategy are distinguished:

Related diversification – launching of a new type of activity of an enterprise related to the existing organisational activities or related to industries having some common the individual links of the enterprise value chain, for example, production or marketing.

Unrelated diversification – launching of an activity in a new business area unrelated to the existing organisational activities. (5, page 224)

From the point of view of the strategy related diversification is a strategy where an enterprise can transfer its competencies or apply them in other areas of business, and where an enterprise is capable of maintaining a low level of bureaucratic costs. Unrelated diversification, however, is a strategy when the functional capabilities or resources of an enterprise have minimum use for other industries and when an enterprise is capable of building enterprise-distinctive competencies. (5, page 230)

An organisation may give preference to related diversification, if the following conditions apply:

- the main capabilities and skills of an organisation can be applied in the vast majority of industries;
- the bureaucratic costs of strategy implementation do not exceed the value which is created by transferring the capabilities or by a sharing the resources.

Preference could be given to the strategy of unrelated diversification upon the following conditions:

- the main organisational functional skills are highly specialised and may be applied little outside the main area of organisation's operations;
- the top management of an organisation are qualified and capable of transforming the ineffectively managed enterprises;
- the bureaucratic costs of implementation do not exceed the value which is created in the result of realising the strategy of re-structuring. (5, page 231)

The objective of an organisation upon selecting the type of diversification is to increase its value, but a diversification that is too extensive, however, can lead to a completely opposite result and reduce the value of the organisation.

Diversification should be used as an enterprise strategy by organisations only when they have more financial resources than required for ensuring its competitive advantage in the main industry, and therefore, diversification is used only when there is a surplus of resources. by using the strategy of diversification an organisation can create additional value in three different ways: buying and transforming poorly operating enterprises, taking over the competency of another industry and gaining the economy on account of the use of shared resources. (5, page 225) Let us describe each of them.

The strategy of enterprise acquisition and restructuring is based on the assumption that an effectively managed organisation can make profit by buying an inefficient and poorly managed enterprise and by improving its performance. For the purpose of increasing its value an organisation uses several methods:

1. Changing the management for a new more vigorous and dynamic executive team.
2. Cost reduction, for example, the non-productive assets of an enterprise are sold and the number of personnel and its maintenance costs are reduced.
3. Involvement into enterprise operations, searching of options for efficiency improvement, raising of quality, generating new ideas and meeting customer needs.
4. Stimulating the motivation by putting forward the objectives for performance and introducing a system of remuneration which takes account of the achieved results. (5, page 225)

Competency takeover, when an organisation acquires an enterprise operating in an industry which is related to the organisation at least in one of its value-adding functional activity, for example, in production, marketing, etc. Thus, the level of competitiveness of the newly acquired enterprise is improved. If the takeover of competency is successfully implemented, the knowledge obtained in this way reduces the costs required for the creation of value of an organisation in the new area of business, or gives the opportunity to transform the value creating functions in its various areas of business in order to increase the total profit of the organisation. (5, page 226)

An organisation gains economy on the account of a shared use of resources, when two or several of its areas of operation are sharing the resources, as, for example, the production equipment, advertising campaigns and the costs on research. Thus every business unit invests less in the respective functional activities. By way of diversification any economy can be gained on account of a shared use of resources only if one or several functional activities of the existing organisation and the newly acquired enterprise have many properties in common.

It is useful to apply this strategy only when a shared use of resources provides a significant competitive advantage to one or several business units (5, page 227)

In the case of diversification the value of an organisation is reduced only if it implements this strategy due to the wrong reason. Such a process usually ends with the reduction in the overall profit. This happens in cases when a diversification is planned in order to reduce the overall organisational operating risk or to increase the total production volume of an organisation.

It is believed that a merger reduces the risk of bankruptcy and is in the interests of the organisation's shareholders. This factor, however, does not take account of the following two aspects:

1. Shareholders can easily reduce the risk of their shareholding in the organisation by carrying out the diversification of their securities portfolio, and this can be achieved at much lesser costs than by performing the diversification of the organisation.
2. The life cycles of different business areas are hard to predict and an overall downturn of economy can influence equally all industries. Unlike in the case of the distribution of risk, by way of diversification organisations rather obtain a larger production volume, which would increase the amount of its problems in a period of economic downturn. (5, page 229)

Expansion of an enterprise by way of adding new enterprises to it does not always create additional value. The increase of an organisation in volume must rather be a by-product of a growing profit than an objective of the diversification process.

Diversification may not necessarily provide with the expected results if there are bureaucratic costs incurred due to the implementation of this strategy. An alternative option for creating the same additional value as in the case of diversification, except without the costs of bureaucracy, is the formation of a strategic alliance with another organisation. Strategic alliances are special agreements between two or several organisations with the purpose of sharing the costs, risks and revenues related to the building of new business opportunities. The fact that any income made must be distributed among the partners should be mentioned as one of the shortages for such an alliance. As a further disadvantage the risk undertaken by an organisation by voluntarily joining the alliance and transferring any of its distinctive competencies to the partners should be mentioned. The organisation is risking with its skills and experience that could be used by any of the partners in the alliance to directly compete with the organisation in the future. (5, page 232)

Questions for discussion:

- In which cases you would adopt the decision in favour of the diversification strategy for your organisation?
- In which cases you would consider a development strategy to be too risky for implementation in your organisation?
- In what conditions you would choose the strategy of reduction?
- In what cases you would choose the integration strategy?
- Please, create a corporate strategy for the organisation of your analysis.

9.2. Business level strategies

Introductory questions for the topic:

- Which management level is the most critical for a successful realisation of a strategy?
- Is it possible to find common properties for strategies irrespective of the area of business, and what would they be?

Strategy at the business unit level is a range of activities or a business model characteristic only of the enterprise in question for developing a competitive advantage in relation to its competitors within any given market or industry. (5, page 145) In order for an enterprise to effectively compete, such a business level strategy must be realised that would allow a full use of its competitive advantage, as well as the strategy must be developed in a manner that is compatible with the corporate level strategy of the organisation which has been described in the previous section.

When developing the business level strategy an organisation must assess the following factors:

- Product meeting the needs of the clients;
- Market where this product is sold;
- Distinctive competencies that help an organisation to ensure the satisfaction of customer needs. (10, page 43)

The needs of each client can be met with the specific characteristics of the goods or services. There are organisations offering cheap, undifferentiated products basically responding to the customer needs, while other organisations differentiate its products in order to meet the more complex needs of their customers. Therefore enterprises are segmenting the market when an enterprise with the purpose of obtaining a competitive advantage decides on grouping its clients in consideration of their important differences, needs and selections. An enterprise may choose any of the three common strategies, i.e., to serve the average client without paying attention to various groups of clients and their differing needs. An organisation can split its market into various segments and design a product which satisfies the needs of every client group. And finally, an enterprise may focus on serving only a single market segment or niche.

The objective of functional strategies is to create distinctive competencies determining the competitive advantage of an organisation. During the business strategy development an organisation must decide, how to use and to combine the distinctive competencies in order to strengthen its competitive advantage. Selection of a business strategy is based on the decision on what products should be marketed, which market segments should be attended and what distinctive competencies should be created. (10, page 45)

Therefore an organisation is given an opportunity to choose one of the three following strategies for competition or their combination as its business level strategy:

- Lower cost strategy;
- Differentiation strategy;
- Focussing or niche strategy (10, page 445).

These strategies are called general strategies as they can be used by any enterprise – a manufacturer, service provider or a non-profit organisation in every industry. Upon developing a business strategy the main requirement for the improvement of the enterprise's competitive advantage must be taken into consideration in order to win the competitors and reach a profit level above the average for the respective industry.

Competitive advantage can be built by meeting any of these three conditions: lower costs, differentiation, both factors at the same time. By supplementing the preconditions for creation of a competitive advantage with a second dimension – specific market, business level strategies can be displayed in Figure 9.4.

Zemo izmaksu stratēģija	Konkurētspējīgā priekšrocība	
	Zemākās izmaksas	Diferencēšanās
Plašs mērķa tirgus	Zemo izmaksu stratēģija	Diferencēšanas stratēģija
Šaurs mērķa tirgus	Fokusēšanās: izmaksu fokusēšana	Fokusēšanas: atšķirību fokusēšana

Figure 9.4 The business level strategy

Low cost strategy	Competitive advantage	
	Lowest costs	Differentiation
Extensive target market	Lower cost strategy	Differentiation strategy
Narrow target market	Focussing: focus on costs	Focussing: focus on differences

It follows form the table shown in Figure 9.4 that the lower cost strategy and the differentiation strategy is more suitable for an extensive or large target market.

A large market share allowing for an economy of scale in industries like procurement (volume discounts), manufacturing (mass production), financing (larger companies have more access to a lower interest rate) and distribution (mass wholesale and product promotion in the market). (6, page 143)

Large enterprises competing with the help of **the lower cost strategy** offer regular products and services across the world, i.e., they address the mass market consisting of price-sensitive clients. The results of one business differ little from other businesses and the market demand for the results is flexible. By using this strategy companies are making the effort to lower the costs particularly in the functional activities. For example, any purchases are made from the suppliers offering volume discounts and the lowest price. Mass production is carried out when it is possible to reduce the production costs per unit wherever possible. Finances are very important, too, as the cost control is a high priority. The research and development activities help to improve the efficiency of operations, logistics and distribution. Such business does not focus on the development of such new, improved products or services, which can increase the costs and minimise the advertising expenses. (6, page 142)

It can be concluded that lower cost strategy is based on the organisational capacity to supply the product (goods or services) at a lower price than the competitors. Thus, a business model basically oriented at the reduction of costs is established in the respective area of business.

In order for a lower cost strategy to work successfully an organisation must offer significant price advantages over the competitors (10, page 46)

An enterprise pursuing the lower cost strategy does not make any effort to become a leader in differentiation. The enterprise waits until the buyer is clearly willing to specify the quality of a product and only offers it to its customers when it has become an industry standard – a quality that is a must. Within the scope of the lower cost strategy enterprises usually ignore the existence of the various niches in the market. The product marketed is usually intended for an 'average' customer. The reason for this is the cost, if the cost leader will try to realise the product to various market segments and adjust the product for their needs respectively, this would lead to an increase in costs and consequently he will lose his position of the lower cost leader. The cost leader will try to adjust its product to various market niches to be able to satisfy the representatives of the biggest market niches with the least possible number of products. (5, page 151)

It is possible to describe the advantages of the lower cost strategy best by using the factors characteristic to M. Porter's five forces model – competitors, suppliers, buyers, new entrants and substitutes.

Impact of suppliers Lower cost organisations have the advantage of withstanding an increase in the raw materials which is dictated by the suppliers. As the operating costs of an enterprise are lower than those of the competitors, they are less affected by an increase in the prices for raw materials and the components to be used.

Protection from competitors Lower cost leaders are protected from the attacks by the industry competitors by their cost advantage. The lower cost strategy is based on a close correlation between a large market share and a high level of profit. The large market share is ensured if an organisation is capable of producing and supplying products or services attractive to a wide range of consumers and for a price that is lower than that of the competitors.

Constant price level Organisations are prepared to convince their competitors to prevent from waging the war of prices. The lower cost organisations, therefore, are prepared to cultivate a price discipline in the industry. Concurrently they maintain rather constant prices in the market to ensures the possibility to receive their share of the profit for all organisations of the industry.

Creation of the entry barriers Lower cost organisations are often capable of preventing the potential competitors from entering the market with their ability to lower the prices, which may cause considerable hurdles for those organisations which have intended to enter this industry. (5, page 152)

The lower cost strategy leader is in a comparatively safe position, while he is capable of ensuring this position and while the price is a critical purchasing argument for the majority of buyers.

It should be mentioned that the lower cost strategy has also several disadvantages and some of them are highly critical. The most important threats are associated with the fact that competitors are capable of finding a way how to diminish their cost structure and compete according to the same principles as it is done by the lower cost leader.

Technological changes A high capital turnover rate is often characteristic of this strategy. To manufacture products with lower costs organisations often invest considerable amounts of money in equipment and production technologies of narrow specialisation that cannot be used anywhere else and that are difficult to modify for the manufacturing of other products. In this way an organisation ties itself to a process or a technology that may fast become obsolete. (10, page 52)

Imitation Another large disadvantage that lower cost organisations often face is that the methods of cost reduction can be easily imitated and taken over by other enterprises. The cost advantages, especially in standardised processes, are short-term and volatile.

Customer needs An enterprise which is too busy with the reduction of costs may not see other changes in the market situation, for example, the increase in consumer demand for different types of products, superior quality or level of service. Organisations may not notice that the lower price isn't significant any more for the customers, but other factors are prevalent. Therefore, all activities under the lower cost strategy may turn out to be ineffective.

Single player The lower cost strategy usually allows for a successful operation of a single organisation only in the respective industry. When several organisations compete among themselves in order to become a lower cost/price manufacturer, the result is a joint battle where everyone is a loser. Within a short period of time competitors create excessive production capacities affecting the profit-earning capacity of the whole industry.

Another approach to the development of a competitive business level strategy is **the use of differentiation**.

Enterprises using the differentiation strategy are offering or manufacturing a different product or service in a specific industry. It means that these enterprises address the big markets with relatively inflexible demand where clients are prepared to pay average and high prices for a different production. As the enterprises of this strategy are not price-sensitive the focus should be made on functional quality of every product or service. (6, page 144)

Thus the differentiation strategy is based on a different, unique delivery to the consumer which makes the product offered by the organisation distinctive from those offered by the competitors. (10, page 54)

When realising the strategy of differentiation, enterprises are trying to differ themselves and make their products different by following the principle - the less the product will resemble the product of a competitor, the more it is protected from imitation. An enterprise that follows a differentiation strategy divides the market into several segments and the next step is to take a decision about how to become different in the market. Therefore, two types of differentiation options are distinguished:

- *Broad differentiation*, i.e., when a product is offered to the majority of the market niches with same qualities;
- *Focused differentiation*, i.e., when an enterprise can focus on specific segments where the distinctive competitive advantage of an enterprise is offered.

The role of costs in the implementation of the differentiation strategy is a highly important issue. Differentiation can be achieved in many ways, i.e., the external design of a product can be different, more up-to-date materials and a better quality process can be used in the production, as well as a special type of sale or service can be offered. Any of the qualities mentioned creates extra costs. The differentiation strategy allows the achievement of a higher profit only if the surcharge for the product exceeds the product development costs. The differentiation strategy is based on a strategic assumption – differentiation does not mean that an organisation can neglect its cost structure. In other words, differentiation costs may not exceed the price premium that an enterprise may earn on the different product. (5, page 156)

The main option in almost any differentiation strategy for gaining a competitive advantage is the care of the quality of product or service. Organisations may improve the quality of products through its design qualities, thus making them different and attractive to consumers. Products can be made original by a particular design difficult to imitate, thus creating an impression of unique quality.

Products of advanced technologies provide natural grounds for differentiation. New qualities are identified with a higher quality enabling the distinction of the organisational brand from competitors. Specially designed devices may be used in the production process making it difficult for the competitors to imitate the product quality. (10, page 57)

It can be considered that responding to the needs of customers constitutes the grounds for the differentiation strategy. Any potential opportunity to raise the perceived value of the product from the point of view of a client opens the door to the differentiation strategy. There are several approaches how the subjective evaluation of a product by customer can be raised or how the product can be made distinctive from the point of view of the client.

Reduction of customer costs An important type of the customer cost reduction in the achievement of differentiation is the development of such products for which a shorter period of maintenance, lower consumption of other physical, emotional or financial resources is required and which are more energy-efficient.

Another way to achieve differentiation is a constant improvement of customer satisfaction. This means an improved product design and quality by surpassing the competitors.

Regardless of the existing market segmentation, meeting the customer needs provides the possibility to enterprises to increase differentiation. The objective of these products is not the reduction of customer costs, but an increased satisfaction by meeting their demands.

Differentiation advantages can be gained by increasing the subjective customer assessment of the goods or services. The achievement of this objective is more difficult, because an enterprise must change and increase the value of a product in the eyes of customers. It is difficult to realise a differentiation strategy that is based on the subjective customer perception of the value of goods, and does not always provide the desirable results. (10, page 59)

Differentiation strategy has its advantages and disadvantages. Stability of competition can be mentioned as the first advantage. The differentiation strategy allows and organisation to differ partially from the competitors within the industry. If an organisation manufactures highly demanded and distinctive products, it does not have the need to involve in destructive wars of price with the competitors.

The main advantage of differentiation though is that the consumers are less price-sensitive, which means that the consumers of the organisation allow for an increase in the price of goods.

Finally, differentiation builds perceptible barriers of trust that have to be overcome by organisations trying to enter the market. The peculiar or unique product makes it difficult for the new entrants to compete with the reputation and experience that an existing enterprise already possesses. (5, page 159)

Speaking about the disadvantages of the differentiation strategy one of the biggest is that other organisations are capable of affecting the unique distinction of the enterprise product by offering similar or better products. This is defined by some authors as imitation. Thus a differentiation strategy, no matter how successful in terms of building the customer trust and higher prices it is, still does not close the market for new entrants.

Another disadvantage of differentiation is the difficulty to maintain a higher price if the product becomes more recognisable in the market. Along with the aging of the product the customers become more refined in their wishes. The more knowledgeable the customers are, the more difficult it is to justify and to perceive a higher price. (5, page 160)

Finally, an organisation risks getting carried away with excessive differentiation, which may cost too much or overwhelm the possibilities of the organisation. Differentiation, just like the reduction of costs and prices, may become an obsession by managers.

The third general strategy type is the **focussed or niche strategy**. Unlike the lower cost and differentiation strategy trying to conquer more and more extensive market within the scope of the entire industry, focussed strategy is targeted at a single, narrow market niche. The underlying concept of this strategy is the specialisation of the organisational activities into a specific area, where other organisations with a broad range of activities – either using the lower cost or differentiation strategy, cannot operate efficiently.

Therefore, focussed strategies differ from the lower cost and differentiation strategy by a smaller target market volume. (10, page 64)

In a specific target market or market niche the focussed strategy is based on those activities that enterprises are using in the widely used lower cost and differentiation strategies to create a competitive advantage. It is important to keep in mind that the focussed strategy tries to use the lower cost or differentiation concept in respect of a much smaller market niche or product segment. Therefore, the resources and the experience used by an enterprise should be even more specialised, any reduction in costs should be made in consideration of the limited market size.

A thoroughly developed focussed strategy allows enterprises to make good profits in industries that seem unattractive for large companies and are changing fast. The enterprise operations are transformed in order to point out the sources of competitive advantages based either on differentiation or costs. Every organisation has chosen a certain type of customers that cannot be as easily served by other competitors with a wider scope of activities. Thus the organisations with a well-established focussed strategy have developed a distinctive competency allowing the protection of their niche from larger organisations for which it is more difficult to serve it.

Enterprises are searching for their market niche and having found they do not want to leave it. Concentration of resources and efforts invested in serving and protecting this niche makes the focussed organisation less dependent on the changes in competition environment. The focussed strategy, however, has its advantages and disadvantages, too.

<u>Uniqueness</u> Similarly as with other enterprises also the competitive advantage of a focussed enterprise is based on its four elements. In the result, an enterprise is protected from its competitors as much as it is capable of providing such a product that the competitors cannot. The ability to guarantee the product also provides the power over customers to a focussed enterprise as the customer cannot purchase the product anywhere else.

<u>Loyalty</u> In the niche served by an enterprise any new entrant must take account of the customer loyalty that the focussed enterprise has built within the market niche. This refers to both the new competitors in the respective niche and to any potential substitutes.

<u>Advantages of a niche</u> The biggest advantage of the focussed strategy is that an organisation is capable of winning its own market niche in the battle with a larger, but not as specific product manufacturing organisation. Some organisations have even managed to establish niches within a niche, thus protecting themselves even more from larger companies which cannot fulfil the requirements of the market niche equally well.

If speaking about the disadvantages of the focussed strategy, the biggest disadvantage of this strategy is the risk that the market niche may gradually transform in a market that conforms more to the description of a broader market. The differences and the factors that are most characteristic of the products may be extended, and blurred over time, thus reducing the potential for protection of the niche. The potential of competitors allows them develop new technologies or product qualities that can determine new purchasing advantages for the niche.

Lack of flexibility In a situation when the niche of a focussed enterprise disappears it is difficult to change orientation to a new niche. All capabilities and resources of the enterprise have been specialised for the serving of the respective niche, and readjustment requires both time and costs.

Force of suppliers The focussed enterprise is in a considerably worse position in relation to suppliers. The purchasing amounts of the enterprise are small, and therefore, the supplier is in the position of dictating the terms of supply to a great extent.

Cost structure As the production volumes of a focussed enterprise are considerably low, this enterprise is certainly not as competitive in terms of its cost structure as the lower cost leader. Enterprise profitability can be lowered by large investments in product innovations offered by general differentiators. (5, page 164)

Focussed strategy has its own disadvantages, too, and the largest of them is the risk that the market niche may be gradually transformed in a broader market. The differences and the factors that are most characteristic of the products may be extended, and blurred over time, thus reducing the potential for protection of the niche. The potential of competitors allows them develop new technologies or product qualities that can determine new purchasing advantages for the niche.

The second disadvantage is the lack of flexibility. As the niche of a focussed enterprise disappears, it is much more difficult for such an enterprise to change the orientation to a new niche. The change of profile requires both time and costs.

The third disadvantage is the force of suppliers; as the purchasing amounts of the enterprise are negligible the supplier is in the position of dictating the terms of supply to a great extent.

As the last, but not least disadvantage of the focussed strategy the cost structure should be mentioned. As the production volumes of a focussed enterprise are considerably low, this enterprise is not as competitive in terms of its cost structure as it is under the lower cost strategy. (5, page 164)

Questions for discussion:

- How many lower cost leaders can there be in a single market?
- What could be the limitations of the differentiation strategy?
- Which business level strategy would you select for the organisation of your analysis?

9.3. Functional level strategies

The introductory questions for the topics are as follows:

- Why is it necessary to create strategies for organisational functions, is it not enough with just corporate and business level strategies?
- Can the functional level strategies exist only, what risks would this create to an organisation?

The functional level strategies are the lowest strategy management level as it lies most closely to the sources of the competitive advantage of an enterprise – its resources and skills. Functional level strategies are a maximum effective use of the resources of a specific department in order to successfully realise the entire organisational strategy and reach the objectives. This strategy includes areas like human resources management, the management of production/services, procurement and stock management, research and development, the information systems management, financial management and marketing. (5, page 179)

The list above list shows what strategies within an enterprise can exist at the functional level. When developing a functional level strategy the functions to be performed by an enterprise must be analysed based on the elements that constitute the competitive advantage.

By looking at each element of competitive advantage individually – efficiency, quality, innovations and response to customer needs, the fact that in ensuring competitive advantages the superiority of the specific element over the respective element of the competitive advantage of competitors is significant.

Every function of an enterprise has its own objectives in respect of any competitive advantage elements:

- How to raise the enterprise efficiency, i.e., raising of efficiency in the enterprise as a whole with the help of all the functions to be performed in an enterprise and their strategies;
- How to raise the quality? Not only the quality of a product must be raised but also of the production supply system, process control and marketing;
- Innovations are both the development of new products and the introduction of new technologies in the enterprise operations which often constitutes the grounds for raising of efficiency and quality;
- Response to customer wishes is the central function for service oriented enterprises realising a high value added. (5, page 180)

In the real world enterprises are incapable of focussing on all elements of competitive advantage in all functions of the enterprise performance at the same time, and this is not even necessary. (10, page 20)

Further sections provide with an analysis of how to achieve the respective element at the highest level.

Superior efficiency The main objective in ensuring efficiency is to make any effort to achieve the lowest possible cost per unit, and all functions performed by the enterprise are involved in this process. (5, page 181)

Increase in efficiency can be achieved by using the effect of a large production volume or the economy of scale. The effect caused by an economy of scale determines that the operation performed at full capacity is more efficient in a large scale production. (5, page 181)

The focus in the definition is put on the technology, which is the means how the product or services is created.

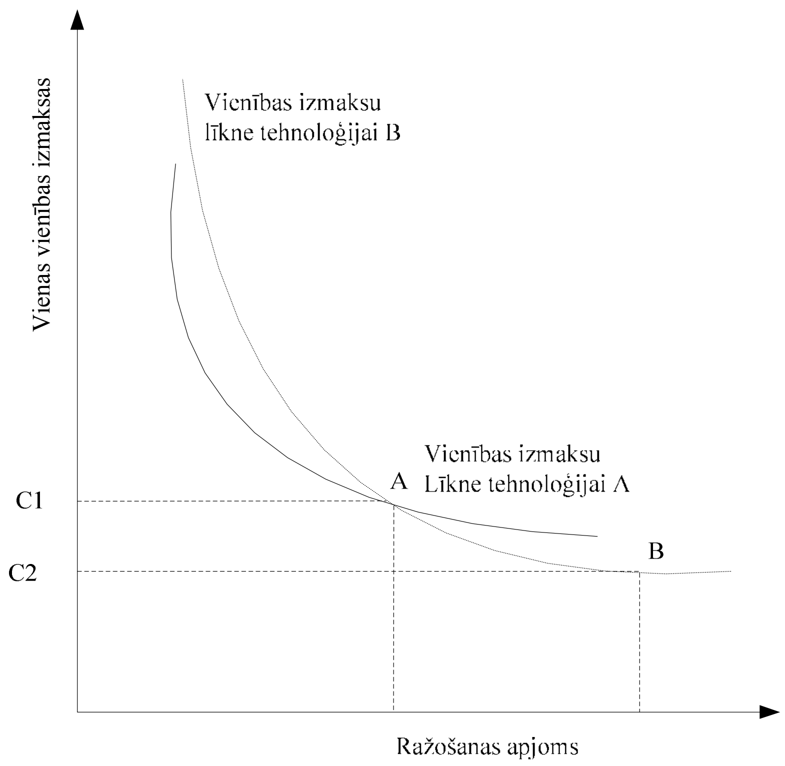


Figure 9.5 Changes in costs per unit depending on variances in scale of output

Costs per unit	Cost per unit curve for technology B	
		Cost per unit curve for technology A
	Level of output	

As illustrated in Figure 9.5, by reaching a specific volume of production (point A) and cost per unit level (C1) with the existing technology (the cost per unit curve for technology A) any further increase in volume provides a considerably low reduction in costs. Point A is being defined as the superior efficiency point. By reaching the lowest cost point (point A) the enterprise should consider a potential change of technology (the cost per unit curve for technology B) in order to obtain a radically different technological process with an entirely different graphical line displaying the dynamics of the new costs depending on production volume. This curve has another superior efficiency point (point B) for a different level of cost per unit. (10, page 22)

As an enterprise develops its competitive advantage through efficiency all efforts must be focussed on the increasing the production volumes and reducing the costs per unit in order for the cost curve to go down as fast as possible. Initially the development is often extensive: more employees are executing the process in the usual manner, similar production tools or machinery is purchased with the purpose of increasing the scale of output. Such a way of development is suitable for an enterprise for a certain period of time, while by reaching a specific volume of production the cost benefit from further increases in the output is negligible and as a result of further increases in the production volume the costs per unit may be growing. The increase in the cost per unit is related with the increase in the costs of coordination, etc. indirect costs. During the process of development enterprises should devote special attention to the technology. They must follow the curve for prime costs in order to assess the moment from when on any further provision of development requires a cardinal change in the production technology, as this is the only way to reduce costs (the cost per unit curve for technology B). Irrespective of the costs per unit being related to the production costs to a great extent, a large share of the costs are incurred also by other functions of the enterprise, for example, marketing, procurement, sales. This means that all of the enterprise functions are engaged in raising the efficiency. (10, page 23)

For many organisations the most important component of performance efficiency is the productivity of the work of personnel which is measured as output (amount of goods or services) per employee. For these enterprises the organisation of the production process is important in order to achieve the least possible time consumption for the production of one unit of output. By performing some specific recurring activities employees learn to do them quicker. This process is called the learning effect. In other words, the productivity of workers increases by time, while costs per unit decrease, because the employees learn to do the specific task most efficiently.

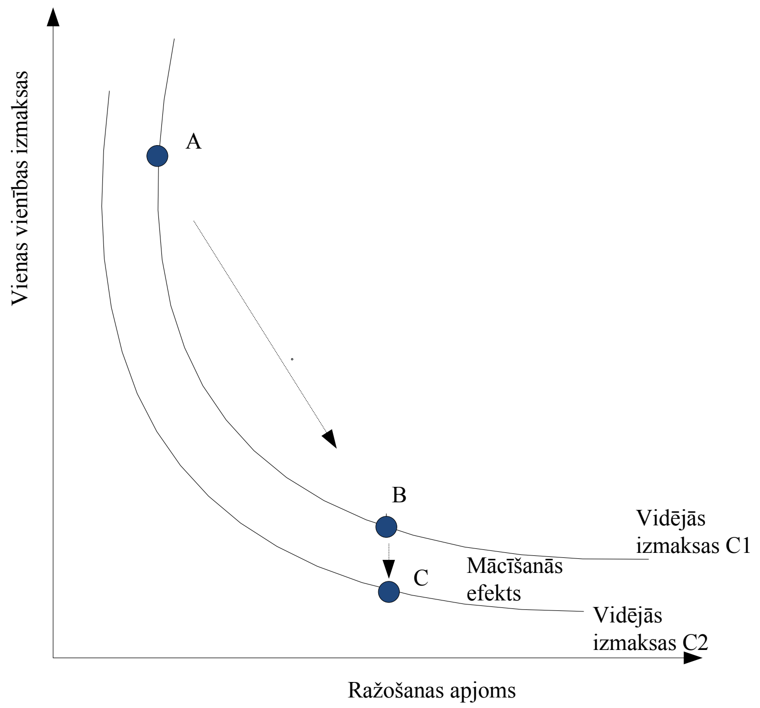


Figure 9.6 The learning effect

Cost per unit		Average cost C1
	Learning effect	
		Average cost C2
	Level of output	

As the production volume increases the cost per unit decline from point A to point B on the cost curve C1. (See Figure 9.6) As the employees reach certain competencies and perform the operations much quicker, the cost curve C2 changes also, in the result of which, upon maintaining a certain production volume, the costs per unit are lower than before (from B to C). (10, page 25)

Not only those employed in core production operations but also the managers learn by time how to manage the production process more efficiently. The learning effect becomes most important when technologically complex tasks need to be performed as in such cases there is much more to learn.

Apart from the two theoretical conclusions for efficiency improvement that were already mentioned any measures oriented at the rational use of the resources are important, for example, the arrangements for consumption of resources.

As it has been already mentioned before, all of the enterprise functions are engaged in raising the efficiency. In order to achieve a higher efficiency the following primary roles of the enterprise functions must be taken into consideration:

Enterprise function	**Primary roles**
Infrastructure	Provide companywide commitment to raising efficiency. Facilitate cooperation among various functional departments.
Production	Where appropriate, pursue economies of scale.
Marketing	Adopt aggressive marketing to rapidly go down the experience curve. Limit customer defection rates by building loyalty towards the enterprise.
Materials management	Implement the just-in-time system.
Research and development	Design products that are easy to manufacture. Seek possibilities for process innovations.
Human resources management	Develop training programs to raise quality. Implement pay for performance.

Quality Quality is a range of properties and peculiarities of a product or service referring to its capability to respond to specific or notional customer needs. Quality in strategic management theory is defined as follows: high quality production is those products and services that are reliable and perform their intended functions. In books on research several definitions of quality exist depending on what is the object of research and what is the context for quality analysis:

1) Customer based quality – better design, state-of-the-art product qualities and other, sometimes resource-consuming improvements;
2) Manufacturing based quality – compliance with the standards and the principle 'do it right from the start';
3) Product based quality – meaning an accurate and measurable value of the variable; (10, page 27)

It is accepted in practice that quality must be associated with the products offered by an enterprise, but quality should refer not only to products, but also to the processes in general. A well-managed and transparent performance of an enterprise is the basis for the creation of a high-quality product. When analysing the methods for creation of a competitive advantage, it can be concluded that quality is the quality of both the product and the process.

The impact of quality on the competitive advantage of an enterprise is two-fold. (see Figure 9.7)

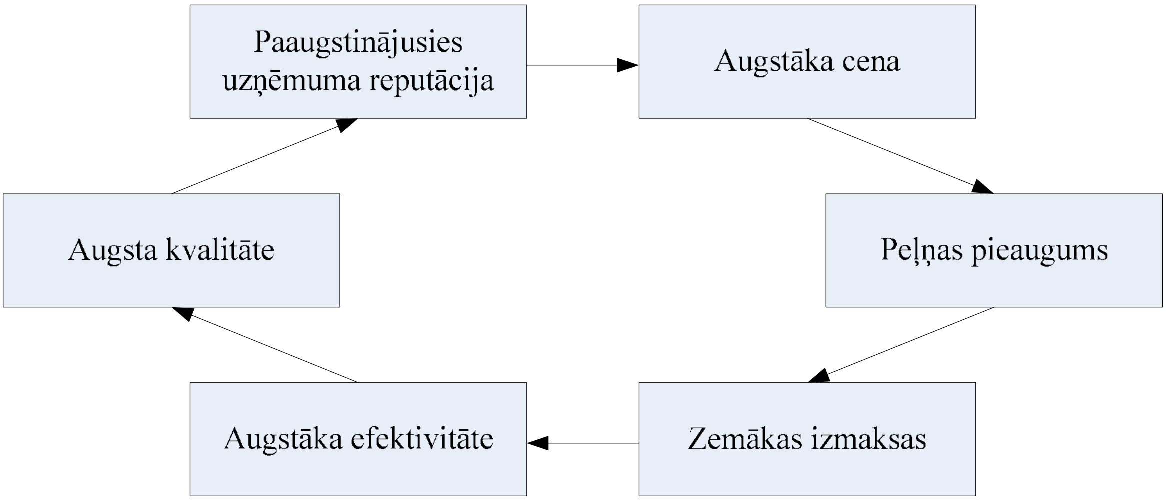


Figure 9.7 Quality impact on costs

	Increased enterprise reputation	Higher price	
High quality			Increase in profit
	Higher efficiency	Lower costs	

1. Quality affects competitive advantage in connection with the increase in production efficiency and consequently lower costs per unit. By improving the quality system of an enterprise it is possible to save up to 30% of the costs. This can be achieved by avoiding the production of faulty goods or the provision of services below the standard. As a result, the time that is spent by correcting the mistakes made, and therefore, the labour efficiency is improved and costs per unit are reduced.
2. High quality production raises the reputation of an enterprise, makes its brand and trademark recognisable among other enterprises. Impeccable reputation provides the opportunity to raise the product price and allows for conquering a larger market share by thus increasing the scale of output. (10, page 28)

The most up-to-date management method used for the achievement of high quality is *Total Quality Management* (TQM). TQM is a management philosophy based on raising the quality of goods and services which suggests that all activities of an enterprise, all of its employees should be focussing on the achievement of this objective. Total Quality Management principles were designed by consultants in the USA. One of the most prominent founders of TQM is W. Eward Deming. His theory is based on the five steps chain reaction:

1. Improved quality means that costs decrease as there are fewer delays, less errors, less corrections of faulty goods, less time and materials consumed.
2. Labour productivity improves.
3. Better quality leads to higher market share and allows increased prices.
4. Due to this profitability increases and it is possible to remain in the business.
5. Consequently enterprise expands production and creates new jobs. (5, page 194)

TQM implementation in organisations is realised in a certain order and in a very close cooperation with all the functions in order to achieve a common aim – quality improvement. Several principles underlying the performance of TQM have been developed:

- Real involvement by senior management in the attainment of quality;
- Planning and organisation of quality improvement, strategic quality planning;
- Informed participation of the entire personnel in the improvement of quality, human resources management and planning;
- Constant supervision of processes and quality, process quality management;
- Systematic education of the management and the employees;
- Focus on customers and customer satisfaction. (10, page 30)

Enterprise function	Primary roles
Infrastructure	Provide leadership and commitment to quality across the enterprise. Find ways to measure quality. Ask the input of employees to find problems.

	Encourage cooperation among the functional departments.
Production	Shorten the length of the production runs. Trace defects back to source.
Marketing	Focus on the needs of customers. Provide customers' feedback on quality.
Materials management	Rationalise suppliers. Help suppliers implement TQM. Trace defects back to suppliers.
Research and development	Design products that are easy to manufacture. Seek possibilities for process innovations.
Human resources management	Develop TQM training programs. Organise employees into quality teams.

Innovations This is the most important factor of the competitive advantage. Successful innovation of products and processes provides uniqueness to an enterprise. It may bring larger profits through price increases or cost reductions. The number of errors, however, upon deciding for an introduction of an innovation into production is still very large. The four main factors for failure are as follows:

1. Uncertainty – it is impossible to predict the exact amount of demand.
2. Poor commercialisation – the new product may be underdeveloped in order to satisfy the customer needs for quality and design.
3. The lengthy period of development – enterprises are operating too slowly in order to market their products within a year. The reason is that the wishes of customers have changed since the moment of launching the innovation.

4. Poor positioning strategy – an enterprise is introducing potentially promising products, but the sales amounts do not build up, because the product is not correctly positioned in the market. (5, page 197)

The main roles of functional units in reaching high innovation levels are as follows:

Enterprise function	**Primary roles**
Infrastructure	Management of overall innovation project. Facilitation of cross-functional cooperation.
Production	Cooperation with R&D on designing products that are easy to manufacture. Working with R&D to develop new products.
Marketing	Provision of market data to R&D. Working with R&D to develop new products.
Materials management	No primary responsibility.
Research and development	Development of new products and processes. Cooperation between the marketing and production departments during the development of new products and processes.
Information systems	Using the information systems to coordinate cross-functional and cross-company product development work.
Human resources management	Definition and hiring of talented scientists and engineers.

Responsiveness to customer needs In order to achieve an excellent responsiveness to customer needs the enterprise must provide what the customer wants. An enterprise, which is capable of responding to customer needs, undoubtedly has a competitive advantage. Besides, for the satisfaction of customer needs the development of new products may be necessary with the qualities that the existing products do not possess. In other words, the achievement of higher efficiency, quality and innovation is a part of what the customers need. There are two more conditions for the achievement of this objective: the focus on customers and their wishes and the search for new ways of responding to those wishes. (5, page 199)

Customer focus – organisations cannot respond to customer needs if they are unaware of what the customers want. The first step, therefore, is the overall enterprise motivation for the recognition of and compliance with the customer needs.

Satisfaction of customer needs – the necessity to customise the goods and services to the wishes of customers is a significant component of customer satisfaction. When customising the products to the wishes of customers, enterprises should take a significant factor into consideration – cost-effectiveness. This means, what costs and in what amount are incurred by creating the additional value to the product. Cost-effectiveness is measured by comparing the potential profit gained with the costs incurred by the new quality. (10, page 40)

Along with the quality and timely customer service there are also other factors for increasing the customer responsiveness:

- Design of the goods;
- High-class service;
- Guarantee services.

All these factors increase the level of customer satisfaction and responsiveness and make the enterprise distinguishable from less responsive competitors. Distinctiveness, on its turn, allows for reliability to the brand and the change of price for its products.

Enterprise function	**Primary roles**
Infrastructure	Through leadership by example, build a

	companywide commitment to responsiveness to customers.
Production	Achieve customisation to different needs of different customers through implementation of flexible production technologies. Achieve rapid response through flexible production technologies.
Marketing	Know the customer. Communicate customer feedback to appropriate functions.
Materials management	Develop logistics systems capable of responding quickly to unanticipated customer demands (JIT).
Research and development	Bring customers into the product development process.
Information systems	Use web-based information systems to increase responsiveness to customers.
Human resources management	Develop training programs that get employees to think like customers themselves.

It can be said, therefore, that functional strategies are critically important to the provision of organisational efficiency and the implementation of the higher-level strategies. Alone, without any higher level strategies, however, they lose their guidance and integration with the overall enterprise area of development. Consequently this leads to the overall system inefficiency. It can be concluded, therefore, that even if each individual system works highly efficiently, they are not mutually integrated and the overall system turns inefficient. This fact implies the main objective of the strategic management process – to achieve the efficiency of the overall system by using the strategic guidance and the common aim.

Questions for discussion:

- How to assess the effective volume of production?
- What are the efficiency measures of an organisation?
- Please, design the functional strategy of the organisation of your analysis.

10. Strategic decision-making process

The introductory questions for the topics are as follows:

- Which decisions taken by an organisation are strategic? What attributes would you use to classify them?
- What is the difference between the strategic and the operational decisions?

The process of strategic planning has been widely described and researched. Its origins are can be found in the techniques for organisational planning, which is a process scrupulously researched and well-described within the scope of management theory. The plan has been defined as conscious designing of the future by distinguishing among and using certain methods. Definition Along with the development of the management theory and from the analysis of experience organisations came to the conclusion that it is useful to classify the plans into several categories. Three main levels of planning were designed – the operational plan, the tactical plan and the strategic plan. The main parameters for differentiation here is the term and the functions. Strategic planning is one of the sub-categories of planning with the main characteristics being its short term and the establishment of the organisational areas of activity. 'Strategic planning is the means by which an organisation organises its resources and actions to achieve its objectives.' (7, page 252). As we see the definition of strategic planning is the planning definition which is adapted for a specific purpose. Strategic 'planning takes place within the levels of organisational hierarchy, depending on the degree of complexity of its structure. For organisations of many industries it will be carried out within the corporate, business unit and department or market segment level.' (7, page 252)

Strategic plan uses several components and it is classified into several levels. In contemporary organisations the division between the corporate management and the strategic business unit or SBU is highly popular. In order for any structural unit of an organisation to qualify as a strategic business unit it must correspond to several criteria, i.e., it 'should be capable of identifying its existing and potential clients and competitors, develop a comprehensive strategy for reaching them with the help of clearly defined resources and appropriate management structure and the potential to achieve its objectives at profit given an acceptable level of risk' (7, page 224). The following can be mentioned as organisational strategy components:

Mission

The strategic planning process can be displayed also as the planning flowchart given in Figure 10.1. While from the point of view of the administrative process strategic planning consists of several activities, although each particular enterprise may use its own practice which depends on the enterprise structure and number of the levels of hierarchy:

'Management briefing Starting point for the planning decision in which the senior management of the organisation participates and which includes the following agenda:

- Assumptions concerning the external environment;
- Alternative scenarios for the future;
- Report on the course of performance of the current plan and updates on the fulfilment of the objective;
- Topic of about the possible future planning cycle.

General management team meeting Organisational mission, goals and objectives are set. The decisions adopted are widely communicated to the operational management at the business unit level and other operational management representatives.

Strategy assessment meeting Repeated meeting of the corporate and business unit managers in order to discuss the challenges, objections and opinions as well as the policies and guidelines.

Review of the plan Consolidation of the plans submitted by the SBU managers and their review on the part of the managers.

Strategy review meeting The corporate nucleus and the SBU management comes to the agreement with the managers of the business unit and operational levels.

Strategy evaluation meeting Repeated meeting of the representatives from the corporate management and the SBU for discussion of challenges, objections and opinions as well as the policies and guidelines.

Review of the plan Consolidation of the plans submitted by the SBU managers and their review on the part of the managers.

Strategy review meeting The corporate nucleus and the SBU managers agree by way of negotiations on a commonly accepted vision for the development of the SBU(s) and the plans for the SBU(s) by choosing the strategic options, modifications to the plans, allocated resources and measurable objectives.

Re-submission of the plan The submitted SBU plans are consolidated once again with the amendments done at the corporate level, and the initiative group gives a general report on the strategic plan. *Presentation to the Board* A summary of the final version of the plan is given by using the strategic terminology, it is formally submitted to the board for discussion and is usually being accepted.' (8, page 253)

As we see, in the formal administrative structure several iterations are used prior to the submission of the final plan. The iteration approach is one of the most wide-spread in large organisations. The author has identified by way of inquiry, how many iterations on average are performed by the Latvian enterprises in strategic planning processes throughout Latvia. It is important to take into account that there is a considerable difference between the corporate strategic planning and the strategic planning in small organisations. Smaller organisations do not require repeated agreement with the various levels of management. This is an argument given by the managers of smaller organisations in order to justify their lack of any formal strategic planning processes in their organisations. The author believes that any formal organisation needs a formal strategic planning process even in situations when there is only one individual working in the organisation. The manager, the owner needs to formalise his ideas and to process them in the form of a formal plan only for the reason that any long-term planning and assessment of his performance can be made over a longer period of time. Furthermore, a strategic plan is a means of motivation for smaller organisations, as it identifies the potential benefits from the achievement of its objectives.

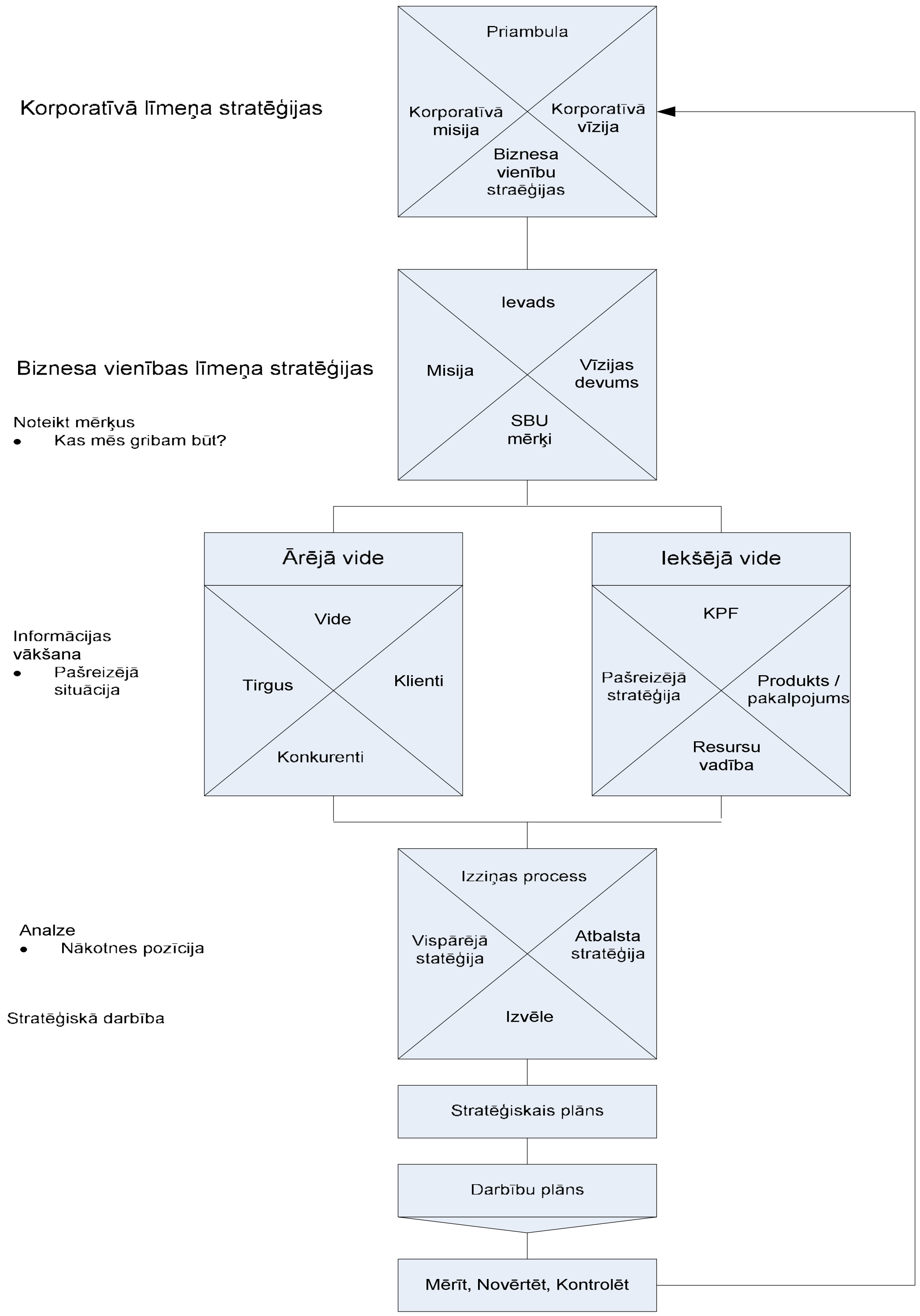


Figure 10.1 Flowchart of strategic planning

				Preamble			
Corporate level strategies			Corporate mission		Corporate vision		
				Business unit strategies			
				Introduction			
Business unit level strategies			Mission		Benefits of the vision		
Define the objectives • What we would like to be?				SBU objectives			
		External environment				Internal environment	
		Environment				KPF	
Information gathering:	Market		Clients		Current strategy		Product/ Service
• Current situation		Competitors				Resource management	
				Process of cognition			
Analysis • Future position			General strategy		Support strategies		
				Selection			
Strategic activity							
				Strategic plan			
				Action plan			
				Measure, evaluate control			

Questions for discussion:

- What is the decision-making procedure in the organisation of your analysis?
- How much time on a day-to-day basis the organisation of your analysis is devoting to strategic issues and how much to operational issues? How would you assess the effectiveness of this particular practice?

11. Strategic objectives

- What are the components of strategy? What do you consider to be the main component of strategy?
- What is the difference between goals and objectives?

11.1. Objectives

One of the most important components of strategy is the strategic objectives. In fact, strategy is the project of various level objectives and the means for their achievement supplemented by any measures demonstrating the strategy implementation progress.

In order to understand the principles for putting forward and achieving the strategic objectives it is critical to understand the theoretical grounds for the objectives themselves.

Every organisation manager should understand the issues underlying the objectives. The objectives must be effective and the criteria for effective objectives are as follows:

- Specific/concrete and measurable – they should be quantifiable, for example, 2% of the increase in profit. Inconcrete objectives are not motivating. The more flexibility is given to the employees to define their own objectives, the better management is required.
- The main tasks should be presented – the objectives cannot regulate and define every aspect of the works to be performed by each employee. Some areas of main indicators must be identified. Categories of indicators may be used, which can be divided into financial indicators, customer-specific indicators, production related indicators, future-oriented indicators (including the labour resources).
- Challenging, but realisable – if the objectives are unrealisable the moral level of the employees decreases. If an objective is too easy, any motivation is lost. The objectives must be challenging *tension objectives* that challenge the employees to attain high standards. However, some restrictions must be taken into account, which are the resources, time, machinery and financing.

- Specific term – the period of time should be specified for an objective, within which the objective must be reached. The time period is the limit against which the results are measured. For example, 600 000 units must be produced or cash units of turnover reached within three years - 150 000 in the first, 200 000 in the second and 250 000 units in the third year.
- Related to an award – the increase in the sales volume is usually related to a salary increase, a premium, therefore, to the benefits associated with the achievement of the objective. People achieving any set objectives must be rewarded. Any awards give significance and importance to the objectives and ensure the aspiration by the employees to achieve them. The failure to fulfil the objectives set is often not the direct fault of the specific employees, but rather of the market situation. Awards can be acceptable even if an employee has only partially achieved an objective in a difficult situation.

The measures listed in the table provided in Figure 11.1 are used for the measurement of the results for an objective. During the development of a strategy an organisation is usually selecting groups of measures for each strategy section and defines the attainable results for these measures - the targets which an organisation wishes to achieve by ensuring thus the implementation of the overall organisational strategy.

	Organizācijas mērķi
Globālais mērķis	**Rādītāji**
Peļņa un ienesīgums	1. Peļņas summa 2. Peļņas pieaugums 3. Peļņas pieaugums uz vienu akciju 4. Dividendes uz vienu akciju 5. Peļņa un investētais kapitāls 6. Peļņa un apgrozījums
Mārketings	1. Pārdošanas apjoms 2. Preču pārdošanas apjoma pieaugums 3. Tirgus daļa 4. Tirgus daļas pieaugums
Ražošanas efektivitāte	1. Saražotā produkcija pret strādnieku skaitu 2. Produkcijas vienības ražošanas izmaksas
Produkcija	1. Sortimenta paplašināšana 2. Preču kvalitātes paaugstināšana 3. Preču īpatnības
Ražošanas jauda	1. Produkcijas apjoms 2. Fiksētās izmaksas 3. Ražošanas platība 4. Ražošanas apjoms pret ražošanas telpu platību 5. Ražošanas apjoms pret pamatlīdzekļiem
Finansu resursi	1. Optimāla kapitāla struktūra 2. Naudas plūsmas stabilitāte 3. Apgrozījuma kapitāla pietiekamība 4. Likviditātes koeficents
Cilvēku resursi	1. Darba disciplīna 2. Kvalifikācijas paaugstināšana
Zinātniski pētnieciskais darbs	1. Jaunas produkcijas īpatsvars kopējā ražošanas apjomā 2. Jaunas produkcijas efektivitāte (patērētāja efekts)
Sociālā atbildība	1. Labdarības pasākumi 2. Darbavietu nodrošināšana 3. Sociālā nodrošināšana (pensiju fondi, apdrošināšana)

Figure 11.1 Measures of strategic objectives

	Organisational goals
Global objective	**Measures**
Profit and rate of return	1. Amount of profit 2. Increase in profit 3. Increase in profit per share 4. Amount of dividends per share 5. Profit and capital invested 6. Profit and turnover
Marketing	1. Sales amount 2. Increase in the amount of product sales 3. Market share 4. Increase in the market share
Production efficiency	1. Amount of output per number of workers 2. Production costs per unit
Production	1. Increase in the product range 2. Increase in the quality of goods 3. Unique qualities of goods

Production capacity	1. Amount of output 2. Fixed costs 3. Production floor area 4. Amount of output per the production floor area 5. Amount of output per value of fixed assets
Financial resources	1. Optimal capital structure 2. Constant cash flow 3. Working capital adequacy 4. Liquidity ratios
Human resources	1. Labour organisation 2. Raising of qualification
Research work	1. Percentage of new products from the total production amount 2. Efficiency of new production (consumer effect)
Social responsibility	1. Charity events 2. Provision of jobs 3. Social insurance (pension funds, insurance)

There may be situations, however, when organisations establish their objectives in a non-professional manner or they are not specific. Therefore, the objectives are not verifiable and their realisation is impossible in fact. See Figure 11.2. You can see the samples of verifiable and non-verifiable objectives.

Verifiable and non-verifiable objectives	
Non-verifiable objectives	Verifiable objectives
1. Gain reasonable profit	1. Realise 12% of investments by the end of current financial year
2. Improve communication with the public	Issue a monthly bulletin on 2 pages starting with the year 2000 Contribute no more than 40 hours in its preparation
3. Improve labour productivity	By December 31, 2000 expand the production by 5% without investing additional resources and by ensuring the same quality.

4. Improve the work of the managers	To plan and to invest into a 40 hour program on the subject 'Management Basics' by devoting no more than 200 working hours to the training of the management team.
5. Introduce a computer system	By December 31, 2000 introduce a computerised control system in the production department, by allocating no more than 500 labour hours for the system analysis and by spending no more than 10% of the working hours on the work in the first 3 months

Figure 11.2 Comparison of verifiable and non-verifiable objectives

Objectives can be established by using the bottom up or the top down approach. The basis for setting of objectives is provided by the top managers who supervise the enterprise performance analysis and make the logical judgements about the strengths and weaknesses, opportunities and threats of the organisation, and the subordinated managers who act on the basis of the higher aims and the mission.

The following recommendations must be taken into consideration in setting the objectives:

- Separate business objectives from other objectives;
- Concretise the objective;
- Concretise the way to measure the achievements;
- Concretise any set objective or standard;
- Concretise the term of the objective;
- Organise the objectives as to their importance;
- Establish how to coordinate the achievement of objectives;
- Appoint the person in charge;
- An objective can be changed, if necessary.

The issue about the grounds for putting forward any objectives and the creation of any strategies by the managers of an organisation is always critical. The general principles are illustrated in Figure 11.3.

The factors affecting the strategic choice of an enterprise are displayed in Figure 11.3.

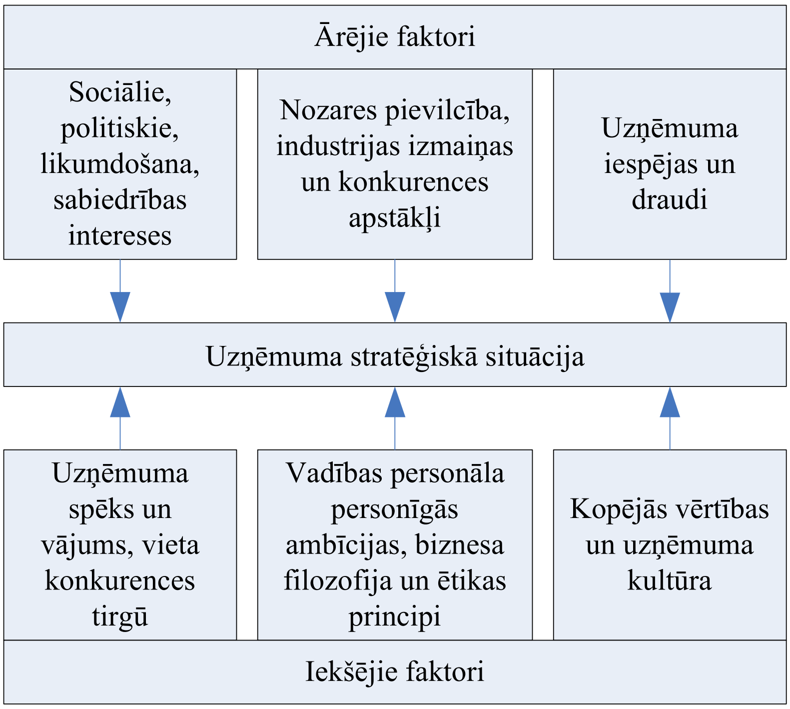


Figure 11.3 Factors affecting the strategic choice of an enterprise

External factors		
Social, political, legislation, social interests	Attractiveness of the industry, changes in the industry and conditions of competition	Enterprise opportunities and threats
Strategic situation in the enterprise		
Enterprise strengths and weaknesses, place in the competition market	Personal ambitions of the management team, business philosophy and principles of ethics	Shared values and corporate culture
Internal factors		

An enterprise manager must face the following problems when setting the objectives:

- Lack of conceptual aspects (understanding of the objectives);
- Lack of guidelines (missions, general objectives);
- Difficulties in establishing the objectives;
- Focussing on short-term goals (top management);
- Threat of inflexibility (often changing, inconsistency);
- Risk associated with the achievement of an objective,
- Stress involved in realising the objectives;
- Loss of confidence by employees.

Figure 11.4 illustrates the hierarchy and interdependence of objectives.

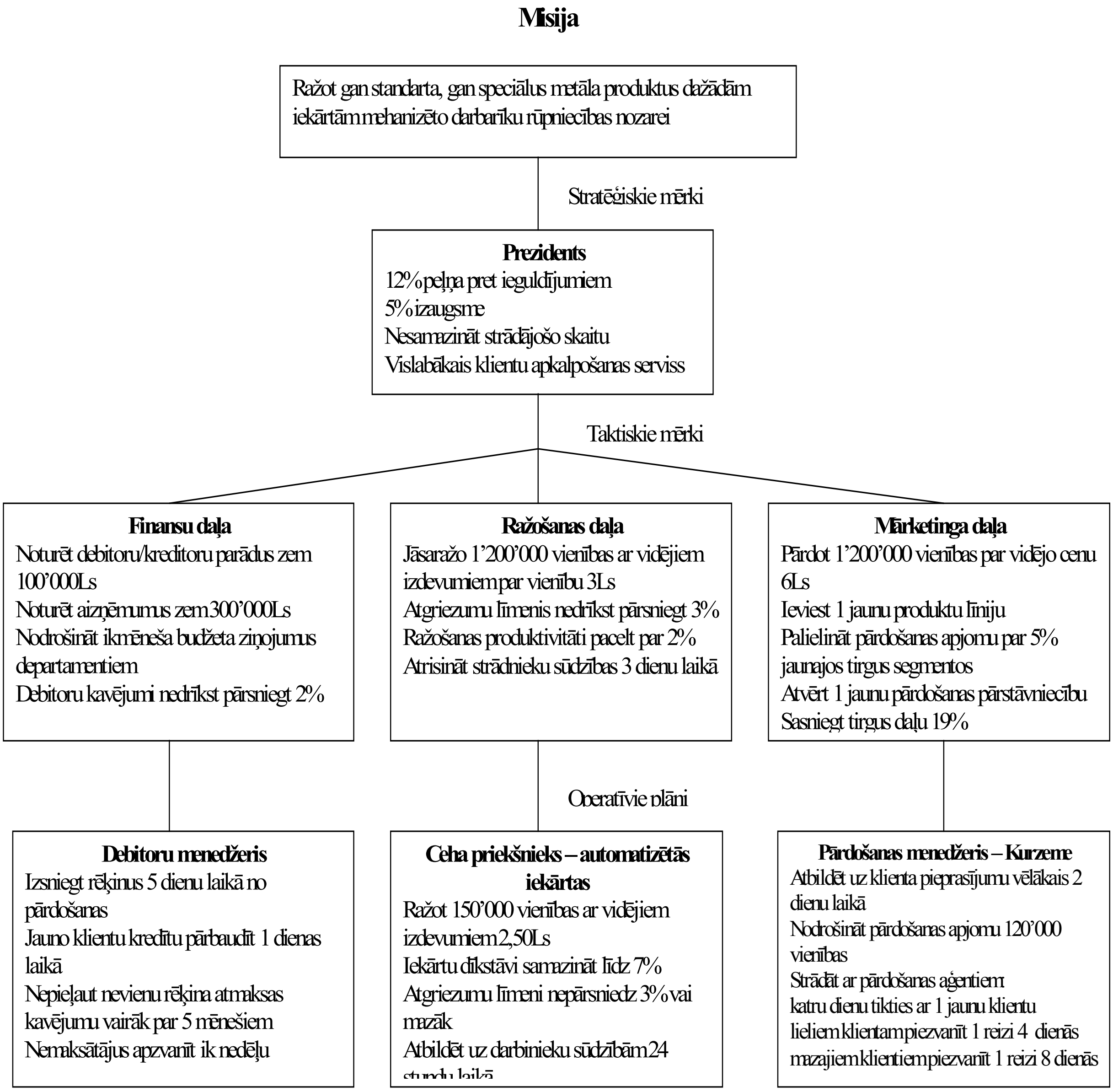


Figure 11.4 Hierarchy of objectives

	Mission	
	Manufacture standard and special metal products for different types of equipment for the mechanised tools industry	
	Strategic objectives	
	President	

	12% return on investments 5% growth No personnel cuts Best customer service	
	Tactical objectives	
Finance department Maintain debtor/creditor debts below Ls 100,000 Maintain loans below Ls 300,000 Provide monthly budget reports to departments Overdue debtors cannot exceed 2%	**Production department** 1,200,000 units must be produced at the average cost per unit of Ls 3 Waste levels cannot exceed 3% Raise production efficiency by 2% Tackle employee complaints within 3 days	**Marketing department** Sell 1,200,000 units at the average price of Ls 6 Introduce 1 new product line Increase sales amounts by 5% in new market segments Open 1 sales representative office Reach a market share of 19%
	Operational plans	
Accounts receivable manager Issue invoices within 5 days from the moment of sales Check creditworthiness of new clients in 1 day Prevent any invoices from being paid by a delay of above 5 months Call the defaulters once a week	**Production unit manager – automated machinery** Manufacture 150,000 units at the average cost of Ls 2.50 per unit Minimise the idle time of machinery to 7% Level of waste must not exceed 3% Respond to employee complaints within 24 hours	**Sales manager – Kurzeme** Respond to customer requests in 2 days latest Ensure the sales amount of 120,000 units Work with the sales agents Meet 1 new client each day Call large clients once every 4 days Call small clients once every 8 days

11.2. Hierarchy of objectives

Strategic objectives are a broad statement of where an organisation wishes to be in the future by rather including the overall organisation rather than specific structural units of an organisation. Strategic objectives are also called the official objectives. Peter Drucker offers the following areas for establishing the strategic objectives:

- Market position;
- Innovations;
- Labour efficiency;
- Material and financial resources;
- Rate of return;
- Management performance and development;
- Employee efficiency and development;
- Public relations.

Tactical objectives are the objectives to be achieved by the main organisational departments and units. These refer to middle management and describe what the main structural units should do in order to reach the main aims of the organisation. For example, to provide the courses of the English language in an enterprise as part of the general employee educational programme if there is the intent for educating the personnel included in the enterprise mission.

Tactical plans are made in order to achieve the main strategic objectives and to fulfil a specific part of the enterprise strategy. Tactical plans are usually prepared for 1 to 2 years. The word has originated from the military area – 'tactical weapons'. The strategic weapons – nuclear rockets, bomb carriers, were provided in order to reach the strategic objective of causing a considerable damage to the enemy, the tactical weapons – war planes, were provided in order to fulfil a part of the strategic mission. Tactical plans define what the main structural units will do in order to achieve the strategic objective. The middle management identifies its specific tactical tasks based on the strategic plan.

Operational objectives are the specific results expected from the departments, work groups and individuals. They can be accurately measured. For example, 'issue 150 sales orders per week', 'ensure 90% of the supplies within 2 days from the day of order receipt'.

Operational plans are the plans developed at the lower levels of organisational management in order to provide the operational objectives and ensure the fulfilment of the tactical plans. An operational plan is the tool used by the unit manager to run the daily or weekly tasks and to control their fulfilment. Operational objectives are expressed in quantifiable terms and the department plans explain how they will be achieved. The specifics of operational plans are the work performance schedule and their alignment with the budget.

Questions for discussion and an exercise:

- Substantiate the importance of objectives to your organisation.
- Formulate 5 strategic, 5 tactical and 5 operational objectives for the organisation of your analysis.

12. Strategic plan

The introductory questions for the topics are as follows:

- Name those elements that you would by all means include in the strategic plan of the organisation managed by you?
- Can only strategic guidelines exist, generally signed main areas and components of development of an organisation, or there must be a detailed strategic plan established? What would you develop if you were an organisation manager?

The strategic plan is an action plan by which an organisation plans to achieve its strategic objectives. Draft of the plan, which defines the organisational activities and availability of resources – cash, human resources, space and equipment, required for the achievement of the objectives set. Strategic plans are usually prepared for a long-term – from 2 to 5 years. The main task of a strategic plan is to ensure the realisation of organisational objectives within a certain period of time.

The strategic plan consists of the following sections:

1. **Summary** – not exceeding 2 pages.
2. **Contents**
3. **Introduction** and/or a brief background of the enterprise, including the organisational chart of the organisation. Under this section a description should be provided on how many organisations were created, what services were provided, the programs, key events, main changes. The objective – to demonstrate to anyone having no information about the enterprise what it does and what it is.
4. **Stakeholder analysis**, where:

   - listing and explaining the significance of any stakeholders, competitors, allies and customer groups in the strategic planning process, enterprise functioning and the achievement of the organisational mission;

   - a section with the explanation of the significance of the stakeholders and customer groups in the existence of the organisation.
5. **Application of the methods for external environment analysis**:
    - PEST;

- Porter's 5 forces model;
- CSF;
- Competitor analysis;
- The Boston matrix;
- etc.

6. **Analysis of the internal environment**:
   - Financial;
   - Organisational value chain;
   - Culture;
   - Resources, capabilities (materials, intangibles);
   - Motivation audit;
   - etc.
7. **Statement of mission**

   A clear, brief statement of the mission outlines the enterprise reasons of existence, philosophy and values, which are the core section of the plan. The reason for the existence of an enterprise can be described in a separate paragraph, particularly describing the responsibility of the mission, explaining the unique qualities, competencies of the enterprise or disclosing the cultural attributes, philosophy and/or values.

   It may be necessary in order to respond to the needs of the stakeholders or clientele for information about the enterprise.
8. **Trends and events (T&E)**

   Trends and events are described by showing their significance for the organisation. It should be started with the global and finished with the local trends and events affecting the organisation.
9. **Strengths, weaknesses, opportunities, threats (the SWOT matrix)**

   The SWOT model analyses the political, economic, social, technological and international aspects by projecting their changes to the organisation. If possible, the points of the SWOT analysis should be organised by category, as well as, as far as possible, the SWOT matrix should be supplemented with data, charts and tables.

10. Critical issues:

- How do they affect the organisation?
- Grouped by importance and priority

11. **Strategic alternatives** In all strategic levels: areas of activity, location, operational management, financial management.

12. Marketing/market segment:

- Investors must be convinced that the sales forecasts can be fulfilled and that the competition cannot affect it;
- Market research comprising the target markets, positions and market share assessment. Assessment of all competitors, particularly emphasising, why you will be the best. Assessment of all market sources and types of assistance that would be necessary for this market segment.
- Demonstrate the pricing strategy; the price determines the profile of goods for any market segments.
- Define the advertising plans and the planned costs in relation to the strategy offered.

13. **Financial section** comprising the following activities:

- Present the reports;
- Describe the sources for the resources required and how these resources will be used;
- Preparation of the budget;
- Profit or loss plan;
- Illustrate the stages of financing in order to provide the investors with the possibilities of assessing the project in various stages.

14. **Management**: **Objectives, roles, strategies and indicators**

- Explains the significance of any objectives, roles and indicators for the organisation in a clear and concrete manner.

The most important section of the plan:

- Gives the list of main challenges (problems, directions for development);
- Each of the challenges is described by using several objectives;
- One or two roles follow each of the objectives the fulfilment of which will result in the achievement of the objectives;
- The roles are followed by one or several strategies or ways for the fulfilment of the role;
- After each series of challenges (objective, role, strategy) a listing of indicators should follow describing the achievement of the results.

This section can be graphically presented as follows:

- **Challenge 1**
  - Objective 1
    - Role 1
      - Strategy 1
      - Strategy 2
    - Role 2
      - Strategy 1
      - Strategy 2
    - Indicators
  - Objective 2
    - Role 1
      - Strategy 1
      - Strategy 2
    - Role 2
      - Strategy 1
      - Strategy 2
    - Indicators
- **Challenge 2**

15. **Evaluation and implementation**

    Evaluation is performed with the help of indicators. A section should be included on when and how the plan will be reviewed and evaluated. If the plan is particularly complex, a separate section must be provided with the description of the implementation procedures (persons in charge, specific activities, products, resources required and fulfilment schedules).

16. **Future vision**

    Depending on the term of the strategic plan (for example, 5 years) it is determined, what would the organisation look like in 5 years time. It should look positive, inspirational and unique. The question on what we would desire to look like should be answered.

17. **Addendums**

    These play a significant role in the interpretation of the plan, but it is better not to enclose them. Bibliography is listed only if the citations are given. Any charts and tables must be incorporated in the text.

Questions for discussion and exercises:

- Is strategy about competition and survival of an enterprise?
- Are the enterprises or products competing?
- Devise the strategic plan of the organisation of your analysis according to the above given scheme.

13. Strategy efficiency evaluation

The introductory questions for the topics are as follows:

- How important it is to know the efficiency of own strategy and what happens if it is not controlled?
- Which stakeholder groups are mostly interested in the efficiency of the strategy and which may oppose its evaluation?

Prior to evaluating the efficiency of a strategy it is useful to find out what the traditional ways of evaluating and measuring the performance of an organisation are.

The income statement and the balance sheet were and still are the primary instruments of evaluation for the majority of enterprises. They provide with an objective total picture, show a snap-shot of the organisational performance at a certain moment in time as well as by looking at the income statement and the balance sheet that are a couple of years old we get an insight into the former activities of the enterprise. The only limitation of the income statement and the balance sheet data is that they only disclose the financial performance of the enterprise. The argument for this is that the financial performance is the only reasonable and justifiable measurement that should be taken seriously, as the continuity of an organisation depends directly on its financial results. The substantiation is also that the assets and liabilities of an organisation can be only understood if transformed into a financial view where it would be difficult to be mistaken.

The picture that the financial performance cannot display is what would be the potential success of the enterprise in the future. The potential success will be as good as its strategy is. A high level of operational interruptions even in obviously successful enterprises and their long-term survival is based on a very specific, certain strategy or an overall position strategy and the ability to implement it.

The purpose of strategy assessment is two-fold:

- Is it happening? Is the enterprise doing what it had devised to do? Are the critical success factors being achieved?

- Does the strategy work? Was the selection correct? Do the established strategic intents provide the necessary results? (12, page 188)

In a hyper-competitive environment where enterprises are operating today, the above given second group of questions should not be asked too often, although sometimes the answers to these questions must be provided even in the situation of having the smallest evidence. Good managers are also know when to go back and destroy the existing strategy in favour of a new strategy. (12, page 188)

Sometimes the pressure from investment providers is hard to withstand. Announcement of the profit results causes the fall in the price per share, any fall in the price per share may alarm the employees, and worried employees have the tendency to alienate the clients who place their orders somewhere else.

All the evidence proves that those organisations that will be capable of effectively managing the relationships between all stakeholders will survive and flourish. If the stakeholders receive no surprises, if they are aware of the main strategic policies of the organisation, if they are notified of any potential effects of the strategy, they would usually support that organisation even if the main enterprise performance indicators do not look very promising for some time.

Before having a look at the methods for evaluation it is useful to clarify what needs to be evaluated. Efficiency of the enterprise strategy must be evaluated and it is performed based on some concrete or general criteria which are common for the entire organisation. These criteria were developed by Robert Kaplan and David Norton who are offering a highly valuable set of overall, comprehensive criteria in their books and magazines. (12, page 189)

Kaplan and Norton have designed a concept called *the balanced scorecard*. This system includes 4 main areas or perspectives of how to evaluate whether the selected strategy is successful:

1. **Financial perspective** – still a very important measure, as it is believed to be universal, widely understood and almost without any cultural barriers. The traditional financial evaluation means profitability and return on capital invested. Organisations are more and more often rated, however, also by their economic value added. Profit

due to shareholders is usually critical for those enterprises where the proprietorship is held by a wide range of owners.

2. **Customer perspective** – includes several possible options although each of them is somehow related to customer satisfaction which is the basis for maintaining the customer and acquiring the market share through the attraction of new clients.
3. **Internal environment and process perspective** – a range of processes done by the enterprise internally, i.e., all things that have been done in order to manufacture a product, offer a service, deliver the product to the market, etc. Internal measurements are related to productivity and efficiency in the area of organisational performance. This applies to advanced quality improvements and continuous cost reduction.
4. Learning and growth perspective – applies to areas like employee development, i.e., whether it is possible to improve the organisational performance by providing the necessary information to and carrying out the training activities of the employees. (12, page 189) The above described four perspectives included in the balanced scorecard have a

great value, because:

a) they provide with a straightforward and comprehensive view from the strategic achievement evaluation perspective (financial, customer, internal environment, growth);
b) they help to integrate the following process of thinking – 'What can I do and how can I evaluate, how effectively I have improved and managed my organisation or its unit performance following these four criteria. (12, page 192)

Form the above described evaluation criteria another approach for strategy development is derived and a strategic intent is established. The steps for establishing a strategy are graphically illustrated in Figure 13.1 (12, page 192)

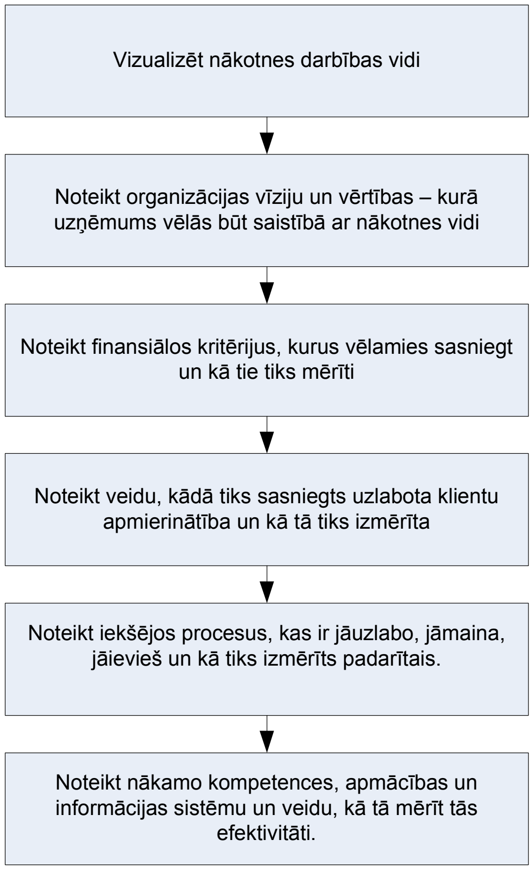


Figure 13.1 Strategy development process

Visualise the future operating environment
Define the vision and values of an organisation – where an enterprise would like to exist in relation to future environment
Identify the financial criteria that we wish to achieve and how they will be measured
Define the way in which an improved customer satisfaction will be achieved and how it will be measured
Identify the internal processes that need to be improved, changed, introduced and how the results will be measured
Define the future competency, training and information system and how to measure its efficiency

Also the reasons for the approach of the balanced scorecard being risky in the process of strategy development should be mentioned. They are as follows:

- insufficient focus is made on all important *future perspectives* which is critical when a viable strategic intent should be determined;

- it is assumed that the vision and the values are already existent in the organisation, but it is often not the case. Besides, it is very rare for all stakeholders to have a common view. Due to this reason in the two first steps the vision and the values of the organisation are reaffirmed, as it is shown in Figure 13.1;
- there is no detailed deal with the competitors provided. Very few possibilities to predict the future markets with the existing and new competitors by testing the different types of customer impact. (12, page 193)

On the other hand, though, as soon as an enterprise goes through this vision of the future, the balanced scorecard approach finalises some surprisingly pragmatic ways to advance the implementation of the strategy. It has a certain value, because serious measurements require a certain level of coordination, approximation of views and agreement.

Questions for discussion and exercises:

- Which strategic perspectives would you use as priorities for the evaluation of the strategic progress in your organisation? What does it depend on?
- Prepare the evaluation plan for a strategy created by you.

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