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Business Policy and Strategic Management

Francis Cherunilam

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Preface To The Fourth Edition

This is a thoroughly revised, significantly modified and enlarged edition. Every chapter has undergone some or other modification – revision, restructuring, elaboration etc. A number of new diagrams, boxes and examples have been added with a view to making the book more insightful and interesting.

The current edition has 20 chapters, compared to 17 of the previous edition. The new chapters are: *Social, Environmental and Economic Responsibilities of Business; Environmental Forecasting and Analysis and Knowledge Management.*

Chapters 1 and 2 have been modified with addition of new diagrams, boxes and explanations. Chapters 3 and 4 have been substantially restructured and enlarged, making them very contemporary. The chapter on *Business Environment* is characterised by substantial modification of the content and remodeling of the presentation and treatment of the subject matter. The chapter on *SWOT Analysis and Strategy Formulation* has been modified and enlarged.

The addition of the topic 'role of leadership in strategic management' is the salient modification to the chapter on '*Strategy Implementation.*'

Chapters which have been subjected to very substantial restructuring, revision and elaboration include *Mergers and Acquisitions, Turnaround Management and Corporate Restructuring* and *Globalisation.*

A lot of thinking has gone into deciding about the cases to be included in this book. Three of the 5 cases are new.

I profusely thank the academic community for the useful feedbacks and the unstinted encouragement. Words fail in thanking the Himalaya Publishing House Pvt. Ltd. for the constant encouragement.

Cochin,

18th October 2014

Dr. Francis Cherunilam

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CHAPTER

1

Strategic Management: An Introduction

PRELUDE

The Setting

As renowned Management Guru Peter Drucker has beautifully put it, management has "no choice but to anticipate the future, to attempt to mold it, and to balance short-range and long-range goals. The future will not just happen if one wishes hard enough. It requires decision – now. It imposes risk – now. It requires action – now. It demands allocation of resources – now. It requires work – now".[1] All these are rolled into what is known as Business Policy/Strategic Management/Corporate Strategy.

The profound importance of Strategic Management is highlighted by Drucker in his observation that the ultimate objective of strategic planning "is to identify the new and different businesses, technologies, and markets which the company should try to create long range. But the work starts with the question what is our present business? Indeed, it starts with the questions which of our present businesses should we abandon? Which should we play down? Which should we push and supply new resources to?"[2]

The sweeping changes in the business environment, driven mostly by the mutually reinforcing triple forces – liberalisation, privatisation and globalisation – have made the above questions immensely relevant, making strategic management all the more important. The above-mentioned forces combined with the technological and managerial revolutions, rising customer expectations, and the competitive race have made the business horizon a fast changing and, in many cases, a very discontinuous one.

In many industries across the world, the business environment is characterised by turbulent changes. The causes and consequences: ground rules of competition change, industry boundaries are redrawn, new industries and products are created and established industries are reinvented. Managing for the future has become competing for the future.

The enormous changes in the business opportunities and threats as a result of the economic liberalisation in India, ushered in 1991, and the consequential dramatic changes in the business environment have drastically altered the fortunes of companies.

As the environment changes, companies may change their vision and objectives, structure, portfolio of business, markets and competitive strategies. In the liberalised business environment,

many companies have exited some of their businesses, a number of companies have entered new businesses while many have both dropped some businesses and added new ones. The number of companies which have restructured their business, organisation and functional strategies is on the increase. The economic liberalisation and the concomitant wide opening up of business opportunities and increase in competition have, in fact, made strategic management a buzz-word among the Indian corporates. Prior to 1991, the scope of or need for strategic management in India was limited due to the controlled regime and absence of limited competition. The liberalisation has, however, vastly changed the scenario.

Gary Hamel and C.K. Prahalad, the renowned propounders of core competence, in the preface to their best seller *Competing for the Future* observe: "Substantial challenges face any organisation intent on getting to the future first. The first challenge, how to navigate from here to there, arrives as both public and private institutions struggle to plot a course through an increasingly inconstant environment, where experience is rapidly devalued and familiar landmarks no longer serve as guideposts. Never before has the institutional terrain been changing so quickly or have industry boundaries been so malleable. Never before have competitors, partners, suppliers, and buyers been so indistinguishable. How, then, does one get to the future first even when there's no map?"[3]

Indeed, the struggle for existence and growth is very hard for firms in a competitive environment. Fortunes of companies change – some times very fast and drastically. The positions of companies in the rank list of dominance flip and slip, some disappearing from the list while new ones enter. Many multinationals, with annual turnovers larger than those of GDPs of most nations, pass through periods of huge losses. Even mighty MNCs who are industry leaders are humbled by young firms. Size and resources alone do not ensure success. There are many examples of less resourceful companies with strategic intent and stretch having become magnificent success.

Conceptual Issues

The terms *Business Policy*, *Strategic Management* and *Corporate Strategy/Planning* are often used interchangeably. Their combined use, however, causes confusion. William Glueck, a well-known author on this subject, in his book *Business Policy and Strategic Management* points out that "business policy is a term traditionally associated with the course in business schools devoted to integrating the educational program of these schools and understanding what today is called strategic management."[4] This connotes that strategic management is the modern term for what was earlier called business policy.

Business Policy as a course began to be included in the curriculum of the Business Schools in the US in the 1950s following the Gordon-Howell research sponsored by the Ford Foundation and Carnegie Corporation. The objective of this course was to provide an integrated approach by binding together appropriately the various courses like Marketing, Finance, Organisational Behaviour, and Operations Management which the students learn in the earlier semesters. Business Policy, thus, sought to apply a holistic approach to business problem analysis and decision making.

The Gordon-Howell Report gained widespread acceptance that by early 1970s, most Business Schools in the US included Business Policy courses within their curriculum requirements. "As time passed, however, the focus of the course became wider and it began to consider the total organisation and its environment. For example, it addressed issues such as social responsibilities and ethics, as well as the potential impacts of political, legislative, and economic events on the successful operation of an organisation."[5]

Since 1980s, researchers and perspective thinking of a number of scholars like Michael Porter, C.K. Prahalad and Gary Hamel, contributed substantially to the development of this subject, by enlarging the analytical kit and shaking the mind-set for strategic thinking. This newer, broader emphasis prompted leaders in the field to change the name of the course from business policy to strategic management. Thus, strategic management is a broader term than business policy.

However, as mentioned earlier, the terms business policy and strategic management are often used as synonymous; but some people give different interpretations to these terms. By the term business policy, some refer to the strategy; strategic management encompasses both strategy formulation and implementation.

However, even most authors who have titled their books on this subject as *Business Policy* define it as strategic management and in the text they more often use the term strategic management and the use of the term business policy is rare. In his book *Business Policy*, which has been subtitled *Strategy Formation and Management Action*, Glueck describes "Business Policy as the strategic planning process in business and other institutions in a developed society."[6] William Boulton in his book *Business Policy*, sub-titled *The Art of Strategic Management*, states that "business policy is the study of how organisations determine and achieve their purposes. The study is concerned with the ability of organisations to achieve their objectives in a specific environment and with the top level managers of organisations who must both lead and motivate people to achieve those objectives. It is the actions of setting organisational policies that we refer to as strategic management."[7]

In the Harvard Business School, where business policy is a required course, the first half of the course considers the formulation of effective strategies. This involves the identification and analysis of problem situations. Problems are approached from the point of view of the chief executive or general manager, who is responsible for the enterprise as a whole. The second half of the course considers the implementation of the selected strategy. It examines two major processes for which the general manager must take principal responsibility: achieving stated objective and assuring that the organisation is able to renew itself by establishing new objectives.

Although terms such as *Strategic Management, Corporate Strategy* and *Corporate Planning* are often used interchangeably, a distinction may be drawn between some of them. For instance, a differentiation may be made between corporate planning and corporate strategy. Even in the absence of competition, a company may have a corporate plan – a long-term development plan. For example, even monopoly environment companies like the Indian Telephone Industries and Cochin Refineries (CRL) had corporate plans but they were not corporate strategy or strategic management. However, when the corporate plan is formulated in a competitive environment, it would amount to corporate strategy/strategic management. The planning premise and the nature of the plan would, obviously, be different in such an environment. It may be noted that after the liberalisation the CRL modified its mission, incorporating marketing of petroleum products in the scope its business, and formulated strategies to cope up with the emerging competitive environment. When HMT had a near monopoly in the domestic watch industry, its main task, particularly in the context of short supply, was supply management. But, in a competitive environment, the major challenge is demand management – it is a market share game.

It is interesting to note that the first thrust area outlined by the second Corporate Plan (1990-95) of the CRL was "to strengthen business development efforts and to maintain constant liaison with the Government so as to play an important role in the policy formulations." Rapport with the government

being a crucial determinant of the future development of a public sector enterprise, such an emphasis on liaison with the Government was not surprising. (CRL, which was renamed as Kochi Refineries Ltd. (KRL), was merged with BPCL as KRL was a standalone refinery with no retail marketing infrastructure.)

But, when the corporate plan is formulated in a competitive environment and when the public sector enterprise has more autonomy, the emphasis and nature of the plan would be different.

It may be noted that the decision of the Government to give the select well performing public sector undertakings (the navarathnas) more autonomy encouraged several of them to rethink their portfolio strategies.

STRATEGIC MANAGEMENT: MEANING AND SCOPE

Strategic management is a broader term than corporate strategy. Strategic Management consists of *Corporate Strategy* (*Portfolio Strategy*) and *Business Strategy* (*Competitive Strategy*). Corporate Strategy is a master plan for the entire organisation, as explained in Box 1.1. It decides the scope of the business or the business/businesses the company wants to be in. Business strategy is about how to succeed in the chosen business(es).

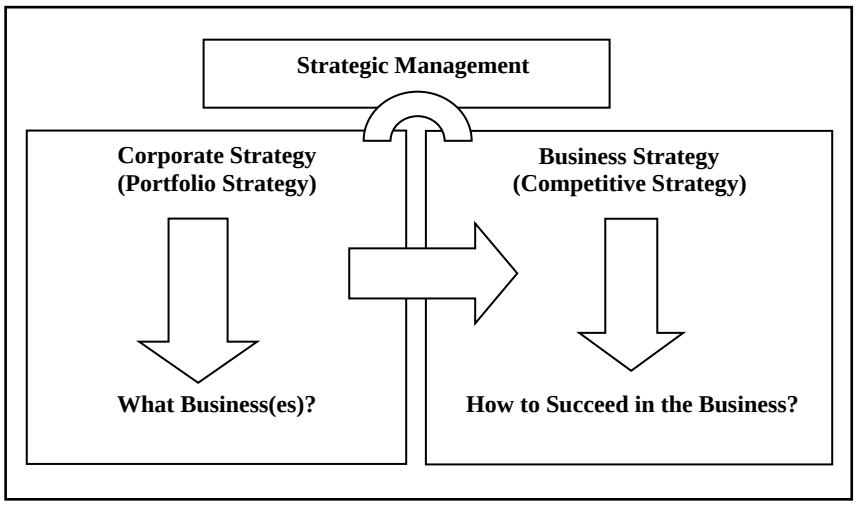

Fig. 1.1: Corporate Strategy and Business Strategy

Glueck defines strategy as a "unified, comprehensive and integrated plan relating the strategic advantages of the firm to the challenges of the environment. It is designed to ensure that the basic objectives of the enterprise are achieved."[8] Strategic management is defined as "that set of decisions and actions which leads to the development of an effective strategy or strategies to help achieve corporate objectives."[9] The above definition indicates that a strategy is not just any plan, however. "A strategy is a plan that is unified. It ties all the parts of the enterprise together. A strategy is comprehensive; it covers all major aspects of the enterprise. A strategy is integrated and all the parts of the plan are compatible with each other and fit together well."[10]

Chandler describes strategic management as the "determination of the basic long-term goals and objectives of an enterprise and adoption of course of action and allocation of resources necessary to

carry out these goals"[11] According to Paine and Naumes, "strategic management involves the decision-making and the activities in an organisation which: (1) have wider ramifications, (2) have a long time perspective, and (3) use critical resources towards perceived opportunities or threats in a changing environment "[12]

Box 1.1

Corporate Strategy – A Master Plan

The author would define corporate strategic management as the formulation and execution of a master plan for accomplishing the corporate vision:

- by consolidating/strengthening its competitive position,
- based on its : (1) vision/mission, philosophy and ethics, (2) strengths and weaknesses, and, (3) environmental opportunities and threats.

The above definition connotes the following:

1. Strategic management is a means to the end. The end, i.e. the purpose, is to realise the corporate vision/mission.
2. Corporate strategy is a master plan – a plan that encompasses the entire organisation for its overall development. It is a long-term plan that lays down the roadmap for the overall development of the organisation. All sub-plans, like divisional or sectional plans (SBU plans) shall be aligned with the scope and vision/objectives of the master plan, i.e., corporate strategy.
3. It aims at gaining/enhancing competitive advantage *vis-à- vis* other firms in the industry.
4. It is based on a SWOT analysis, i.e., corporate strategy defines the business portfolio (scope of the business). That is, on the basis of the SWOT analysis, existing business(es) may be dropped or further strengthened or new ones may be added.
5. Corporate plan, being a master plan, is likely to be complex in nature. The complexity tends to increase with the increase in the size and diversity of the business.
6. A corporate plan normally is characterised by the need for large resource commitments – investing today for tomorrow. Further, strategies pertaining to the different businesses may call for resource reallocation. Thus, strategic management is often characterised by resource mobilisation and reallocation.
7. The vision/mission, philosophy and values of the organisation have important bearing on the strategy. They may influence how the business shall be conducted or fostered or the scope of the business (i.e., the type of business the organisation can be or shall not be in.)

In short, Strategic Management/Business Policy/Corporate Strategy refers to those set of perspective management measures taken with a view to ensuring the survival and long-term success of an enterprise in a dynamic environment. Going by the origin of the word *strategy*, corporate strategy is a well-thoughtout systematic plan of action for survival and success, formulated by due consideration of the possible positions and defensive and offensive moves, and the relative strengths and weaknesses of the rivals *vis-à-vis* those of the company. Besides these, strategy in business management has an additional dimension: future perspective.

According to a survey conducted among corporate planners (USA), strategy "includes the determination and evaluation of alternative paths to an already established mission or objectives and, eventually, choice of the alternatives to be adopted".[13]

Waterman defines strategy as "a coherent set of actions aimed at gaining a sustainable advantage over competition, improving position *vis-à-vis* customers or allocating resources."[14]

Competitive orientation is an essential feature of strategic management. Kenichi Ohmae, a world renowned management expert and author, observes in his well known *The Mind of the Strategies* "What business strategy is all about – what distinguishes it from all other kinds of business planning – is, in a word, competitive advantage. Without competitors, there would be no need for strategy, for the sole purpose of strategic planning is to enable the company to gain, as efficiently as possible, a sustainable edge over its competitors. Corporate strategy, thus, implies an attempt to alter a company's strength relative to that of its competitors in the most efficient way."[15]

That competition is at the heart of strategy formulation will be clear if one considers the origin of the word strategy. The word strategy is derived from the ancient Greek word strategia, which connoted the art and science of directing military forces. Strategy is, thus, a well-thoughtout systematic plan of action to defend oneself or to defeat rivals. Strategy is formulated in anticipation of the possible positions, moves, actions and reactions of the rivals.

It is very relevant to point out in this context that in business the term rivalry is commonly used to refer to competition.

According to Thompson Jr. and Strickland, "a company's strategy is the game plan management is using to stake out a market position, conduct its operations, attract and please customers, compete successfully, and achieve organisational objectives. In crafting a strategy, management is saying, in effect, 'among all the paths and actions we could have chosen, we have decided to move in this direction, focus on these markets and customer needs, compete in this fashion, allocate our resources and energies in these ways, and rely on these particular approaches to doing business'. A strategy thus entails managerial choices among alternatives and signals organisational commitment to specific markets, competitive approaches, and ways of operating."[16]

The definitions of strategy/strategic management by their reference to mission, sustainable competitive advantage etc. implicitly indicate the futuristic nature of strategic management. Strategic management is indeed managing for the future or competing for the future.

Aa Thompson Jr. And Strickland point out, "closely related to the concept of strategy is the concept of a company's business model, a term now widely applied to management's plan for making money in a particular business. More formally, a company's business model deals with the revenue-cost-profit economics of its strategy – the actual and projected revenue streams generated by the company's product offerings and competitive approaches, the associated cost structure and profit margins, and the resulting earnings stream and return on investment. The fundamental issue surrounding a company's business model is whether a given strategy makes sense from a money-making perspective. A company's business model is, consequently, more narrowly focused than the company's business strategy. Strategy *relates to a company's competitive initiatives and business approaches (irrespective of the financial and competitive outcomes it produces), while the term business model deals with whether the revenues and costs flowing from the strategy demonstrate business viability*."[17]

The Essence of Strategy

Writers like Porter and Hamel and Prahalad emphasise that the essence of strategy is being distinctively different from the competitors. Porter, who points out that the crux of strategy is choosing to perform activities differently than rivals do, observes that the Japanese companies which triggered a global revolution in operational effectiveness in the 1970s and 1980s, pioneering practices such as

total quality management (TQM) and continuous improvement which enabled them to enjoy substantial cost and quality advantages for many years, are increasingly caught in a trap of their own making as the gap in operational effectiveness narrows. Japanese companies rarely developed distinct strategic positions (exceptions include Sony, Canon and Sega). Because of the rapid diffusion of best practices, competition based on operational effectiveness alone is mutually destructive, leading to wars of attrition that can be arrested only by limiting competition. Porter counsels that if they are to escape the mutually destructive battles now ravaging their performance, Japanese companies will have to learn strategy.[18]

Although Porter feels that the Japanese have to overcome strong cultural barriers to take themselves to strategy, there are indications that the Japanese managers are much more well prepared than others to shape and lead the future. For instance, in a survey conducted towards the end of 1980s, 80 per cent of the US managers polled believed that quality would be a fundamental source of competitive advantage in the year 2000. Yet half of the Japanese managers predicted quality to be a source of advantage in the year 2000, though 82 per cent believed it was then an important advantage. Rated first as a source of competitive advantage in the future by Japanese managers was a capacity to create fundamentally new products and businesses. What this indicates is that the Japanese managers realise that in future competitive advantages must necessarily be different from toady's; quality will simply be the price of market entry and not a competitive differentiator.[19] It is only apt to note here the observations of Hamel and Prahalad in their path-breaking *Competing for the Future*: "A capacity to invent new industries and reinvent old ones is a prerequisite for getting to the future first and a precondition for staying out in front."[20] As they succinctly put it, "strategy is as much about competing for tomorrow's industry structure as it is about competing within today's industry structure.... Competition for tomorrow's industry structure raises deeper questions such as: Whose product concepts will ultimately win out? Which standards will be adopted? How will coalitions form and What will determine each other's share of the power? And, most critically, how do we increase our ability to influence the emerging shape of a nascent industry."[21]

Hamel and Prahalad observe that most companies do not prepare themselves for competitive advantage in the future because they are "run by managers, not leaders, by maintenance engineers, not by architects."[22] The danger is that it is not the future but restructuring and re-engineering that engage the minds of many managers. These two would provide competitive advantage or help catch up with the competitors in the present but the advantages need not be sustained over a long period. In short, the quest for competitiveness shall not be confined to restructuring and re-engineering but shall necessarily include reinventing industries and regenerating strategies. While restructuring the portfolio and downsizing, headcount make the organisation smaller and re-engineering process and continuous improvement make it better, reinventing industries and regenerating strategies make the organisation different (i.e., it imparts a distinctive competitive advantage).

According to Hamel and Prahalad, "a company can control its own destiny only if it understands how to control the destiny of its industry. Organisational transformation is a secondary challenge. The primary challenge is to become the author of industry transformation."[23] They suggest that to create the future, a company must: (1) change in some fundamental way the rules of engagement in a long-standing industry, (2) redraw the boundaries between industries, and/or (3) create entirely new industries. A capacity to invent new industries and reinvent old ones is a prerequisite for getting to the future first and a precondition for staying out in front.[24]

Strategic Clash

There is a clash of views of two of the prominent strategic gurus, Porter and Hamel, regarding what strategy is.

According to Hamel, the major strategic concern is competing for future which requires reinventing today's industries and creating entirely new industries. Strategy is characterised, by and large, by discontinuous changes. "What required is not a little tweak....but a new philosophical foundation. Strategy is revolution, everything else is tactics."[25]

Porter, however, is of the view that "exhorted to think in terms of revolution, managers chase every new technology for its own sake."[26] In contrast to the revolutionary, exploratory, open-ended approach postulated by Hamel, Porter advocates a cerebral, all consistent and systematically integrated, evolutionary, rather than revolutionary, approach.

Secondly, while Hamel's concern is about pioneering reinventing industries, creating new industries and managing the migration path, Porter's concentration is on gaining sustainable competitive advantage in a given industry.

Thirdly, "Hamel's instrument is the solo violin of core competence, Porter's an orchestra playing the tune of strategic fit between different activities. To Hamel, strategy is all about finding new ways to effect enormous improvements in results – to the order of 500 per cent. Abhorring attempts at incremental improvements, he recommends using core competence to exploit discontinuities in technology, lifestyles, and work habits in order to create revolutionary new strategies".[27] Porter who holds that each and every activity must mesh into its strategic chain shuns the notion of focusing on one single activity.

According to Porter, who argues that fit drives both competitive advantage and sustainability, ... the "importance of fit among functional policies is one of the oldest ideas in strategy. Gradually, however, it has been supplanted on the management agenda. Rather than seeing the company as a whole, managers have turned to "core" competence, "critical" resources, and "key" success factors. In fact, fit is a far more central component of competitive advantage than most realise".[28]

Fourthly, according to Porter, positioning is the cornerstone of strategy (for details, see the section strategic positioning in the chapter *Competitive Analysis and Strategies*). Hamel and Prahalad, the proponents of core competence, however, remark that "companies that see strategy as primarily a positioning exercise are industry rule-takers rather than rule-breakers and rule-makers; they are unlikely to be the defining entity in their industry, now or ever."[29] They maintain that "although a view of strategy as a positioning problem is certainly legitimate, it is insufficient if the goal is to occupy the high ground in tomorrow's industries. If strategy is seen only as a positioning game, it will be difficult for a company to avoid becoming trapped in an endless game of catch-up with far-sighted competitors."[30]

Despite these differences, there are, however, several similarities in their views. Both of them "advocate a complete break from the past – Porter from the company's and Hamel from the industry's. Second, both accept that new entrants have the advantage, whether in restrained pursuit of Porter's unique, differentiated position, or in hot chase of Hamel's dramatic departure from industry norms. Third, both are strident in denouncing imitators and followers. Inept rule-makers in Hamel's book, they will become the victims, warns Porter, of the fallout of aping one another's improvements."[31]

Strategic Intent and Stretch

Hamel and Prahalad point out that strategic planning has its own limitations in envisioning future and conceiving strategies to attain the distant future goals. Strategic planning is obsessed with feasibilities, preciseness, and being realistic. This does not help to attain global leadership. "As valuable as strategic planning is, global leadership is an objective that lies outside the range of planning… companies that are afraid to commit to goals that lie outside the range of planning are unlikely to become global leaders."[32]

Global leaders have been characterised by strategic intent – an obsession with winning, unfettered by their resource constraints – in their envisioning of the future. Hamel and Prahalad point out that companies that have risen to global leadership over the recent decades invariably began with ambitions that were out of all proportion to their resources and capabilities. "But they created an obsession with winning at all levels of organisation and then sustained that obsession over the 10-20 year quest for global leadership. This obsession is termed as strategic intent. In the words of Hamel and Prahalad, on the one hand, strategic intent envisions a desired leadership position and establishes the criterion the organisation will use to chart its progress. Komatsu set out to "Encircle Caterpillar". Canon sought to "Beat Xerox". Honda strove to become a second Ford – an automotive pioneer. All are expressions of strategic intent.

At the same time, strategic intent is more than simply unfettered ambition. (Many companies possess an ambitious strategic intent yet fall short of their goals.) The concept also encompasses an active management process that includes: focusing the organisation's attention on the essence of winning; motivating people by communicating the value of the target; leaving room for individual and team contribution; sustaining enthusiasm by providing new operational definitions as circumstances change; and using intent consistently to guide resources allocations."[33]

Hamel and Prahalad[34] point out that it is the stretch – the fact that ambition forever outpaces resources – that fuels the engine of advantage creation. A firm that has a surfeit of ambition and a dearth of resources quickly discovers that it cannot merely imitate the advantages of more affluent competitors and, therefore, will be compelled to create entirely new forms of competitive advantage (such as lean manufacturing and time compression management, as in the case of Japanese companies, for example) and figure out ways of matching the existing advantages of competitors in more resources-efficient ways.

"Stretch gives birth to the motive for resource leverage. However, much care and feeding is required to transform that newborn desire into a full-grown capability for resource leverage. Exploiting every possible opportunity for resource leverage takes creativity and persistence. A firm with an extraordinary ambition but an underdeveloped capacity for resource leverage will be dismissed as a "dreamer". On the other hand, if a firm has developed a nascent capacity for resource leverage (e.g., a track record of successfully exploiting alliances, an ability to move skills across business unit boundaries, a creative approach to competitive tactics), but possesses no galvanizing ambition, it will be a "sleeper". A firm with neither aspiration nor a capacity for resource multiplication will be a "loser", and the "winners" will be those firms that have both".[35]

It is important to note that "while strategic intent is clear about ends, it is flexible as to means — it leaves room for improvisation… Achieving strategic intent requires enormous creativity with respect to means. Strategic intent implies a sizable stretch for an organisation. Current capabilities and

resources will not suffice. This forces the organisation to be more inventive, to make the most of limited resources. Whereas the traditional view of strategy focuses on the degree of fit between existing resources and current opportunities, strategic intent creates an extreme misfit between resources and ambitions."[36] Top management then challenges the organisation to close the gap by systematically building new advantages. It is pointed out that a number of Japanese companies which had far limited resources than the Eastern companies have become global leaders because of their strategic intent that stretched their organisation.

The duo argue that the fallacy of many Western companies, which followed the traditional competitor analysis, which focuses on existing resources of existing competitors, was the failure to realise that a firm's initial resource endowment (whether bountiful or meager) is an unreliable predictor of future global success. Thus, a view of strategy as stretch helps demythologize the success of those Japanese companies that have become world leaders despite initial resource handicaps. If the goal is to explain the success of Sony or Toyota or Yamaha, it is more honest to talk about the attributes of resource leverage rather than the attributes of Japanese management. The lesson for Western managers is not so much to become students of Japanese culture, but to ensure that there is sufficient stretch in their own firms to engender a relentless search for opportunities to better leverage resources.[37]

Strategic Planning and Tactical Planning

Strategic planning is defined as "an orderly process by which top management determines organisational objectives, strategies needed to reach these objectives, and short-range, top-level actions necessary to implement the strategy properly".[38] Strategic planning, which is also sometimes called corporate planning, is essentially top-level long-range planning.

"Tactical planning refers to short-range planning that is oriented towards operations and is concerned with specific and short-range details".[39]

Formal Planning and Informal Planning

Formal planning is planning which is organisationally formalised and is often systematic. In large organisations, there may be planning departments/cells manned by people with knowledge and experience in different aspects and dimensions of planning. Clearly spelt out, organisational objectives form the basis for planning. A formal planning system will have a set of procedures and it is explicit, i.e., people know what is being done. Formal plans will be documented.

Informal planning, which is common with small enterprises, and sometimes with one man dominated not so small enterprises, is often done in a casual way. A small entrepreneur may have clear objectives and perceptions and plans but he may not put them down on paper.

Informal planning many a time is intuitive, anticipatory planning which is the work of primarily one person. It may be based on past experience, the gut feeling, the judgement, the reflective thinking and perspective vision of the person.

Enterprise Strategy

"Enterprise strategy is the organisation's plan for establishing the desired relationship with other social institutions and stockholder group and maintaining the overall character of the organisation".[40] Enterprise strategy seeks to answer the question 'what do we stand for?' The mission statement may reflect the enterprise strategy.

Policy

"A policy is a broad, general guide to action which constrains or directs goal attainment. Policies do not normally dictate what action should be taken, but they do provide the boundaries within which the objectives must be pursued. Thus, policies serve to channel and guide the implementation of strategies."[41] Policy is described in Chapter 5.

Strategic Business Unit

"A strategic business unit (SBU) is an operating divisions of a firm which serves a distinct product/market segment or a well-defined set of customers or a geographic area. The SBU is given authority to make its own strategic decisions within corporate guidelines as long as it meets the corporate objectives."[42]

There are different factors which decide SBUs. Each product line or a group of related product lines may form an SBU. Nature of SBUs may be influenced by factors such the volume of business, future plans, market characteristics etc.

The SBUs of Hindustan Unilever include soaps and detergents; personal products; fats and culinary items; animal feeds; beverages; frozen foods; specialty chemicals; agribusiness; and exports. The major strategic business areas of the Murugappa Group are food processing; abrasives and refractories; plantations; farm inputs; building materials; financial services; engineering; electronics; property development and granite exports; and marketing services.

CORE COMPETENCE

The concept of core competence, propounded by the renowned management gurus Prahalad and Hamel, through an HBR article in 1990, has been widely recognised as the root of sustainable competitive advantage of an organisation. According to them, "core competencies are the collective learning in an organisation, especially how to coordinate diverse production schemes and integrate multiple streams of technologies. For example, the theoretical knowledge to put a radio on a chip does not in itself assure a company the skill to produce a miniature radio no bigger than a business card. To bring off this feat, Casio must harmonise know-how in miniaturization, microprocessor design, material science, ultra thin precision casing – the same skills it applies in its miniature card calculators, pocket TVs, and digital watches."[43] Further, "if core competence is about harmonising streams of technology, it is also about the organisation of work and the delivery of value. Among Sony's competencies is miniaturization. To bring miniaturization to its products, Sony must ensure that technologists, engineers, and marketers have shared understanding of customer needs and of technological possibilities The force of core competence is felt as decisively in services as in manufacturing. Thus, core competence is also communication, involvement, and a deep commitment to working across organisational boundaries. It involves many levels of people and all functions."[44] In short, core competence is a bundle of skills and technologies rather than a single discrete skill or technology. According to Kumar Mangalam Birla, the core competencies of the Aditya Birla Group comprise an array of skills related to process industries, project management, operations, raw material sourcing, distribution logistics, setting up dealer networks, commodity branding and raising finance at a competitive cost. The common thread running through group's diverse businesses is that they are built largely around the foundation of these competencies.[45]

Assets (factories), infrastructure (distribution systems), privileged access (low-cost energy sources), and protected markets (Government sanctioned monopolies) are not core competencies even though they may lead to higher than average profits under some circumstances.

Core competencies, which represent accumulated knowledge and skills in an organisation, can be converted into competitive advantage only if the several constituent skills and technologies are creatively harmonised and quickly reconfigured to respond to new opportunities. Prahalad and Hamel hint that although Western companies have traditionally had an advantage in the stocks of skills they possess, they have not so successfully responded to new opportunities, whereas Japanese companies like Canon, NEC and Honda who have had a lesser stock of the people and technologies that compose core competencies could move them much quicker from one business unit to another.[46]

Prahalad and Hamel point out that there are three different planes on which battle for global leadership are waged, namely core competence, core products, and end products. Core products are the components or sub-assemblies that actually contribute to the value of the end products. For example, a refrigerator is an end product and the vital component, compressor, is a core product.

According to Prahalad and Hamel, at least three tests can be applied to identify core competencies in a company.[47]

1. A core competence provides potential access to a wide variety of markets.
2. A core competence should make significant contribution to the perceived customer benefit of the end products (for example, Honda's engine expertise).
3. A core competence should be difficult for competitors to imitate.

The duo also hit at what they call the tyranny of SBUs – the view of a diversified corporation as a portfolio of products and a portfolio of businesses. They emphasise that a company should be viewed as a portfolio of competencies as well. When the corporation is conceived as a multiplicity of SBUs, no single business may feel responsible for maintaining a viable position in core products nor be able to justify the investment required to build leadership in some core competence. In the absence of a more comprehensive view imposed by corporate management, SBU management will tend to underinvest. As an SBU evolves, it often develops unique competencies. There is often a tendency to view these competencies as the sole property of the SBU. When competencies become imprisoned, the people who carry the competencies do not get assigned to the most exciting opportunities and their skills begin to atrophy. Fully leveraging the competencies across the corporation is necessary to attain leadership. The benefits of competencies, like the benefits of money supply, depend on the velocity of their circulation as well as the size of the stock the company holds.[48]

CLASSES OF DECISIONS

As Ansoff, a well-known writer on corporate strategy, observes, "from a decision point of view the overall problem of the business of the firm is to configure and direct the resource conversion process in such a way as to optimise the attainment of the obectives".[49] This calls for great many distinct and different decisions which may be broadly classified into three categories, viz., strategic, administrative and operating, each related to a different aspect of the resource conversion process.

Operating Decisions

The objectives of operating decisions, which usually absorb the bulk of the firm's energy and attention, is "to maximise the efficiency of the firm's resource conversion process, or in more conventional language, to maximise the profitability of current operations. The major decision areas are resource allocation (budgeting) among functional areas and product lines, scheduling of operations, supervision of performance, and applying control actions."[50] Thus, operational decisions pertain to implementation of the strategy at the functional level so as to achieve specific goals and targets. Operational decisions include those pertaining to production scheduling, inventory levels, pricing, marketing strategy etc.

Operating decisions are often repetitive in nature, decentralised and are at the functional levels.

Principal Decision Classes in the Firm

	Strategic	Administrative	Operating
Problem	To select product market mix which optimises firm's ROI potential	To structure firm's resources for optimum performance	To optimise realisation of ROI potential
Nature of problem	Allocation of total resources among product market opportunities	Organisation, acquisition and development of resources	Budgeting of resources among principal functional areas Scheduling resource application and conversion Supervision and control
Key decisions	Objectives and goals Diversification strategy Expansion strategy Administrative strategy Finance strategy Growth method Timing of growth	Organisation: structure of information authority, and responsibility flows Structures of resource conversion, work flows, distribution systems, facilities location Resource acquisition and development: financing, facilities and equipment, personnel, raw materials.	Operating objectives and goals Pricing and output levels Operating levels: production schedules, inventory levels, warehousing, etc. Marketing policies and strategies R&D policies and strategy control
Key characteristics	Decisions centralised Partial ignorance Decisions non-repetitive Decisions not self-regenerative	Conflict between strategy and operations Conflict between individual and institutional objectives Strong coupling between economic and social variables Decisions triggered by strategic and/or operating problems.	Decentralised decisions Risk and uncertainty Repetitive decisions Large volume decisions Sub optimisation forced by complexity Decisions self-regenerative

Fig. 1.2: Principal Decision Classes

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Administrative Decisions

The principal task of administrative decisions is to organise and mobilise for the implementation of the corporate strategy. "One part of the administrative problem is concerned with organisation: structuring of authority and responsibility relationships, work flows, information flows, distribution channels, and location of facilities. The other part is concerned with acquisition and development of resources, development of raw material sources, personnel training and development, financing and acquisition of facilities and equipments."[51] Administrative decisions are often triggered by strategic and operating problems.

Strategic Decisions

Strategic decisions pertain to the fundamental questions in what business the firm should be in and how it should be in, considering the strengths and weaknesses of the firm and the environmental threats and opportunities. "To use an engineering term, the strategic problem is concerned with establishing an impedance match between the firm and its enviornment."[52]

Strategic decisions have a long-term horizon and are non-repetitive, centralised, taken by top level management and are concerned with the allocation of the total resources among product market opportunities.

Characteristics of Strategic Decisions

1. **Future Orientation.** Long-term future direction of the organisation is an important aspect of strategic decisions. Strategic decisions often emerge from the perspective views about the economy and society, including regulatory environment, prospects of different business, industry structure, competitive environment etc.
2. **Value Orientation.** As it is implicit in the point mentioned above, strategic decisions are affected by the value system, including business ethics and philosophy.
3. **Scope of the Organisation.** This is a corollary of the two points mentioned above. The long-term direction and value orientation influence the definition of the scope of the activities of the organisation. The business/businesses, the organisation should be in, is a key decision in strategic management.
4. **Means to End.** Strategy is the means to achieve the end, i.e., the mission and goals.
5. **Resource Commitment.** Strategic decisions being long term in nature and having to do with the scope of the business of the organisation, may imply major resource commitments, including reallocation of existing resources.
6. **Strategic Fit.** Strategic decisions seek to establish a sustainable organisation-environment fit. The quint essence of strategic management is the effective deployment of organisational resources or strengths to exploit the environmental opportunities and to combat the environmental threats.
7. **Intent and Stretch:** As described earlier, strategy is also viewed as a stretch emanating from strategic intent.
8. **Competitive Orientation.** Strategic decisions aim at gaining a sustainable competitive edge for the firm.

9. **Ramifications.** Strategic decisions may affect operational and administrative decisions. For example, structure may follow strategy.
10. **Complexity.** As strategic decisions encompass mission, long-term direction, scope of the organisation, and establishment of organisation-environment fit, they are often complex in nature.
11. **Uncertainty.** Because of the long term future perspective of the strategic decisions, they can involve considerable uncertainty as future can hardly be predicted exactly.
12. **Comprehensive and Integrated.** A strategy is normally comprehensive and highly integrated.

Operational and administrative decisions may be required to improve operational efficiency. Wrong decisions can have the opposite results. Right decisions may help improve productivity, reduce costs or improve overall performance of current activities and may enable a firm to improve its competitiveness to a certain extent. Major changes in the level or scope of business come from strategic decisions. Operational and administrative decisions are often required to implement strategic decisions. Such decisions include organisational restructuring, resource reallocation, changes in functional strategies like marketing strategy. Acquisition of a firm or a greenfield project is a strategic decision but several administrative and operational decisions are required to effect it and to realise the benefits of the strategy.

Box 1.2

Strategic Shifts

Big bang changes in the scope or growth of business often result from breakthrough strategic thinking. For example, the 'go global' decision by several Tata Group companies – like Tata Steel, Tata Motors and Tata Tea (rechristened as Tata Global Beverages) – took these primarily domestic players to the big league of the respective global players. These great leaps were made possible primarily by acquiring giant foreign firms. Tata Tea's acquisition of Tetley, which was several times the size of Tata Tea, made this Indian firm the second largest tea company in the world. Tata Steel's Acquisition of Natsteel of Singapore (2004), Millennium Steel of Thailand (2005) and the massive size Anglo-Dutch steelmaker Corus (2007) enabled it to become one of the largest steel producers in the world. The value of acquisition of Corus (about $ 13 billion – the largest foreign acquisition by an Indian company – was more than the turnover of Tata Steel in 2006-07). Similarly, Tata Motors became a global player with the acquisition of Daewoo Heavy Commercial Vehicles of South Korea, the British premium automaker Jaguar Land Rover etc. Now, well over half of the total revenue of these companies are contributed by foreign sales. ITC, which was a tobacco firm, having realised the bleak future for tobacco business, diversified into hotels, paperboards and specialty papers, agri-business, information technology, packaged foods and confectionery, branded apparel, personal care and stationery. The company's robust strategy of pursuing multiple drivers of growth has resulted in significantly enlarging its capacity to create additional avenues for value creation – the non-cigarette segment net revenue growing 12-fold from about ₹ 1,360 crores in 1996 to ₹ 16,150 crore in 2012. Today, about 60 per cent of ITC's revenue comes from businesses other than cigarettes.

The Trivandrum based HLL Lifecare, a central public sector undertaking, in 2003 made a Vision 2010 which resulted in a jump in its turnover from ₹ 163 crores in 2003 to over ₹ 1000 crores by 2010 by further developing its core business and diversification. Its Vision 2020/Corporate Plan envisages a ten-fold increase in turnover to ₹ 10,000 crores by 2020. See the Case *Vision Driven HLL Lifecare* for details.

LEVELS OF STRATEGY

In a multi-business enterprise, having several SBUs, there would be four levels of strategy, viz., corporate strategy, SBU strategy, functional strategy and operational strategy. In enterprises which do not have SBUs, there will be only three levels of strategy, i.e., corporate strategy, functional strategy and operational strategy.

Corporate Strategy

Corporate strategy is the long-term strategy encompassing the entire organisation. Corporate strategy addresses fundamental questions such as what is the purpose of the enterprise, what business/businesses it wants to be in (portfolio strategy) and how to expand/get into such business/businesses (for example, by establishing greenfield enterprises or by M&As). In other words, "corporate-level strategic management is the management of activities which define the overall character and mission of the organisation, the product/service segments it will enter and leave, and the allocation of resources and management of synergy among its SBUs."[53]

Corporate strategy is formulated by the top level corporate management (board of directors, CEO, and chiefs of functional areas).

SBU Strategy

SBU-level strategy, sometimes called Business Strategy or Competitive Strategy, is concerned with decisions pertaining to the product mix, market segments and maneuvering competitive advantages for the SBU.

While corporate strategy decides the business portfolio (i.e., the types of business), the competitive strategy decides the strategy/strategies to succeed in the chosen business/businesses.

SBU strategy has to conform, obviously, to the corporate philosophy and strategy.

In short, "the SBU-level strategic management is the management of an SBU's effort to compete effectively in a particular line of business and to contribute to overall organisational purposes."[54]

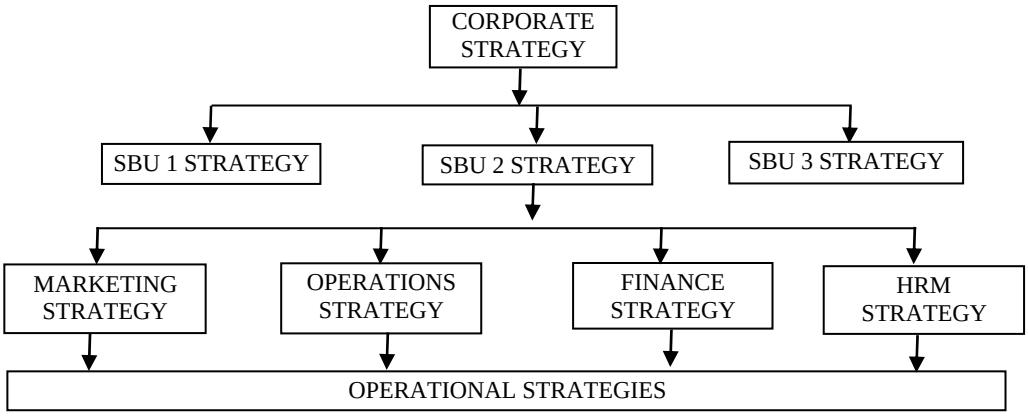

Fig. 1.3: Levels of Strategy

The responsibility for SBU strategy is with the top executives of the SBU who are normally second-tier executives in the corporate hierarchy. In single-SBU organisations, senior executives have both corporate and SBU-level responsibilities.

Characteristics of Corporate, Business and Functional Strategies

Characteristics	Corporate Strategy	Business Strategy	Functional Strategy
Scope	Entire organisation	SBU or single business company	Functional area
Source and motivation/direction	Board of directors/CEO	Corporate strategy	SBU strategy or single business company strategy
Responsibility	Top level corporate managers	Top level SBU managers or top level single business company managers	Functional level managers
Time horizon	Long term	Medium to long-term	Short to long term
Specificity	General statements of overall direction and intent	Concrete and operationally oriented	Action and implementation oriented

Fig. 1.4: Characteristics of Different Levels of Strategy

Functional Strategies

Functional-level strategies are strategies for different functional areas like production, finance, personnel, marketing etc. In other words, "functional-level strategic management is the management of relatively narrow areas of activity, which are of vital, pervasive, or continuing importance to the total organisation."[55]

Functional-level strategy is the responsibility of functional area heads.

Operational Strategies

The implementation of the functional strategies require detailed operational strategies.

ROLES OF DIFFERENT STRATEGISTS

In this section, the term strategist refers to those who are involved in strategy formulation. In other words, this section answers the question who formulate strategies?

In large organisations, board of directors, general managers, corporate planning staff (if there is such a division/cell) and, in some cases, external consultants may play a role in strategic planning.

Board of Directors

The board of directors play an important role in corporate strategy making. "The ultimate legal authority in business is that of the board of directors... Boards are held responsible to the stockholders for the following duties: ensuring the continuity of management (replacing or retiring managers), protecting the use of stockholders' resources, ensuring that managers take prudent actions regarding

corporate objectives, approving major financial and operational decisions of the managers, representing the company with other organisations and bodies in society; maintaining, revising and enforcing the corporate charter and bye-laws." [56]

The Board does not directly formulate the strategy, but it can and should play an important role in strategic management by causing the formulation of the corporate plan, evaluating it, reviewing it, evaluating its implementation and by its power to appoint or remove the chief executive officer (CEO). Kenneth Andrews observes: "A responsible and effective board should require of its management a unique and durable corporate strategy, review it periodically for its validity, use it as a reference point for all other board decisions, and share with management the risks associated with its adoption."[57]

When the board of directors is an inside board (i.e., majority of the members consists of persons holding management positions in the company), inside members may directly involve in strategy formulation by the virtue of the management positions they hold. When the board is an outside one (i.e., majority of the members do not hold management positions in the company) and the outsiders are capable persons, the evaluations, reviews and directions could be more independent, objective and meaningful. However, outside board could sometimes cause conflicts also.

According to Dr. A.S. Ganguly, Chairman, ICI India Ltd., "the Board, as a whole, has the responsibility to initiate discussion, agree and underwrite the corporation's strategic plans. The Board has the collective responsibility to ensure its implementation through agreed operational plans. Individual Executive Directors are responsible and accountable to meet the targets for specific businesses under their control".[58]

However, it was generally acknowledged that the Boards of many Indian companies were not effective. This is true of even some of the well-known companies. For example, refer to the case entitled Corporate Rejuvenation given in this book.

Information about the composition of Board of Directors is given in the chapter on *Corporate Governance.*

General Manager

The role of general managers (GMs) in strategic management is clear from the fact that strategic management is a general management function.

The general managers are the top executives of the enterprise and SBUs who are responsible for the survival and success of the enterprise.

As Jauch and Guleck succinctly and lucidly put it, "the traditional impression is that the GM is a reflective thinker who maps out strategy, designs an organisation to implement the plan and guides troops through the necessary maneuvers to accomplish objectives using vast experience and insight. The GM is the entrepreneur (sets goals), strategist (plans), organisation builder (organises), leader (directs), and chief implementer (controls). The task is to lead the firm or SBU through uncharted territory in less than certain circumstances."[59]

The most important GM, obviously, is the CEO. As George Steiner rightly points out, "there can and will be no effective formal strategic planning in an organisation in which the chief executive does not give it firm support and make sure that others in the organisation understand his depth of commitment."[60]

According to Mintzberg, "great strategies are either creative or generous. We have too few of either type. We call the creative ones visionaries – they see a world that others have been blind to. The generous ones, in contrast, bring strategy out in other people. They build organisations that foster thoughtful inquiry and creative action. The creative strategists reach out from the centre of that circular organisation to touch the edges, while the generous ones strengthen the whole circle by turning strategic thinking into a collective learning process."[61]

Corporate Planners

Large organisations may establish a corporate planning division or cell. It is a staff function and these staff personnel are known as corporate planners.

Functions and responsibilities of the corporate planning staff include:

1. Keeping track of the latest developments in the field of strategic management and disseminating such information to the strategists.
2. Supplying data inputs and analytical support needed for strategic management.
3. Environmental analysis.
4. Identifying new business opportunities.
5. Helping to establish a planning system.
6. Formulating guidelines for preparing plans.
7. Coordinating divisional plans.
8. Assisting to evaluate and control strategies.

Strategic Management Consultants

Some organisations, particularly those which do not have a corporate planning staff, make use of the services of strategic management consultant. Several Indian companies have sought the services of such consultants like McKinsey, Tata Consultancy, Ernest & Young, Goldman Sachs etc.

APPROACHES TO STRATEGY MAKING

The breadth and complexity of the subject has given rise to differing views on the scope, process and nature of strategic management.

On the basis of the strategic management process and nature of relationship between the core components of the strategic management, there are broadly two approaches, viz., *Prescriptive Approach and Emergent Approach*.

Mintzberg has identified, with reference to the style, nature and process of strategy formulation in different organisations, three modes or approaches for making strategy, viz., entrepreneurial mode, adaptive mode and planning mode.

Prescriptive and Emergent Approaches

Strategic management has long been viewed as a sequential process forming a prescriptive model based on predictive environment. The approach, however, has come to be challenged and the view that corporate strategy is an emerging process has been advanced.

Both the approaches recognise the three core components of strategic management process, viz., strategic analysis (consisting of SWOT analysis and determination of mission and objectives), strategic development (evaluation of strategic alternatives and choice of strategy) and implementation. The difference, however, is in the perception of the relationship between these basic components and their phasing.

In the prescriptive strategy, strategic analysis leads to the determination (i.e., prescription) of the long-term strategy which is then implemented. In other words, the different components are different phases of strategic management and they are neatly linked together sequentially. The model of strategic management process depicted in Fig. 1.4 and the description of it represents the prescriptive approach.

According to the emergent approach, the long-term corporate strategy cannot be predetermined. Corporate strategy, which is incremental and continuous, evolves over time, adapting to human needs and by trial and error. In the emergent strategy, the final is unclear and the components are developed as the strategy proceeds.

The emergent approach views the three core components as essentially interrelated. Strategic management is an experimental process in which the strategy development and experimentation phases are intertwined.

The emergent approach holds that the long term being uncertain, it is unrealistic to prescribe in advance a strategy with long-term perspective. The strategy should evolve responding to emerging developments and, therefore, to some extent, strategy development and implementation occur concurrently.

The mood of the emergent strategy is “let us try this strategy and continue it or change it depending on our experience”. The prescriptive strategy prescribes: “this is our strategy for the next five years, administer it”.

Figures 1.5 A and B depict the difference in the processes of the prescriptive and emergent strategies.

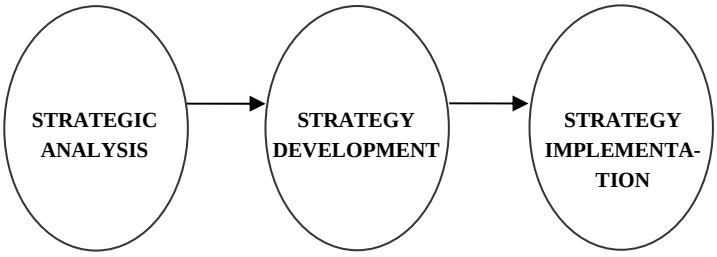

Fig. 1.5A: Prescriptive Approach

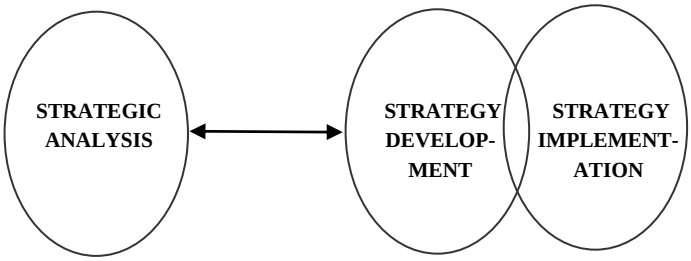

Fig. 1.5B: Emergent Approach

In the emergent approach, there is no final, agreed strategy but rather a series of experimental approaches that are considered by those involved and then developed further. Strategies emerge during a process of crafting and testing.

Both the approaches have their own merits and limitations.

The prescriptive approach provides a clear master plan for the development of the entire organisation. It makes the future direction and goals very clear and thereby forms the basis for action and evaluation. It gives advance indication of the major demands on the resources — technological, physical, human and financial – at different points of time. Refer to the illustration of the *transformation of the Reliance* given in the chapter *Business Environment*.

The prescriptive approach, at the same time, has some limitations. Future, being uncertain, cannot be predicted accurately. Many industries, in fact, are characterised by turbulence. Economic and political environments sometimes change very drastically. A perspective plan would remain valid only as long as the planning premises hold true.

There is also a criticism that the prescriptive plans tend to overlook short-term benefits in the anticipation of long-term benefits.

The major merit of the emergent approach is the constant monitoring of the environment and its flexibility to adapt to the changing environment. Another important merit claimed for the emergent strategy is the advantages of experimentation and the resultant evolution of a sound strategy.

The emergent strategy, however, lack several of the advantages of the prescriptive strategy. An organisation shall necessarily have a clear vision regarding the goals and scope of activities and direction of its development. These call for a systematically formulated long-term strategy.

An important risk of the emergent approach is that the experimentation process could turn out to be ruinous. Precious time could be lost in the trial and error process, the adoption of even which could take time because the very process involved and by the time a strategy is finally put in place the environment could change.

Under the emergent mode, in many instances, strategies emerge from a confused background and the strategies that emerge in the absence of a perspective view and clear future goals could be perspectively irrelevant or ad hoc.

Concurrence of strategy development and implementation are difficult to achieve. Effective implementation requires planning and organising in advance.

A synthesis of both the views is that they are not mutually exclusive; they could complement each other.

In fact, the prescriptive strategy now captures the essence of the emergent approach.

The prescriptive strategy is not a totally inflexible one. Constant monitoring of the environment and strategy modification, if needed, is not only compatible with the prescriptive approach but also prescribed by strategists. Further, the strategic control, described in chapter lends itself to the absorption of certain aspects of the emergent mode into the prescriptive strategy.

Mintzberg's Proposition

According to Henry Mintzberg, there are three distinct modes or approaches to making strategy, viz., entrepreneurial mode, adaptive mode and planning mode.[62]

Entrepreneurial Mode: In the entrepreneurial mode, which is the least formal of the three, although there is active search for new opportunities, strategy making is dominated by the perceptions, thinking and gut feeling of a single person who may be the entrepreneur or the chief executive in whose hands power is centralised. This mode may lend itself to organisations which are small and/or young. Growth is the dominant goal and strategy making is characterised by dramatic leaps forward in the face of uncertainty.

Adaptive Mode: The adaptive mode is characterised by a reactive approach rather than a proactive approach. In other words, strategy is formulated to solve existing problems rather than to seize new opportunities. Under this mode, obviously, clear long-term goals do not exist. Strategy making is characterised by incremental, serial and often disjoined decisions made by members of a complex group. This may be found in large organisations with many controlling groups holding each other in check.

Planning Mode: This is the most formal of all the three approaches. It is common with large and forward looking organisations, particularly in competitive environment. The approach to strategy making is very systematic and there is proper integration of decisions and strategies. The approach is proactive.

STRATEGIC MANAGEMENT PROCESS

The strategic management process encompasses three phases which together involve a number of systematic steps. These three phases are strategy formulation, implementation and evaluation and control. These broad phases encompass a number of important steps. These steps are also known as Tasks of Strategic Management and Components of Strategic Management. This section outlines the different steps/tasks. A detailed account of some of them are given in subsequent chapters.

Fig. 1.6 gives a schematic outline of the strategic management process.

Strategy Formulation

Strategy formulation involves four important steps, viz., determination of mission and objectives, analysis of strengths and weaknesses of the firm and the environmental opportunities and threats (SWOT), generation of alternative strategies and choosing the most appropriate strategy.

Determination of Vision/Mission and Objectives

"Strategic management can be defined as the art and science of formulating, implementing and evaluating cross-functional decisions that enable an organisation to achieve its objectives."[63] In short, strategy is a means to achieve the objectives. It is, therefore, quite obvious that determining the mission (which influences objectives) and objectives is the first step in strategy formulation.

The mission defines the broad social purpose and scope of the organisation whereas objectives more specifically define the direction to achieve the mission. Objectives help translate the organisational mission into results. While objectives may be generic in their expression, goals set specific targets to be achieved within a time frame. For example, a fertilizer company may state its mission as to fight world hunger and its objectives as to increase agricultural productivity through development, efficient production of improved fertilizers, generate profits to finance R&D and to

ensure satisfactory returns on investment. The goals will specify the quantity of production or growth rate or market penetration to be achieved within specified periods.

Vision/mission, objectives, goals and targets are explained in the next chapter.

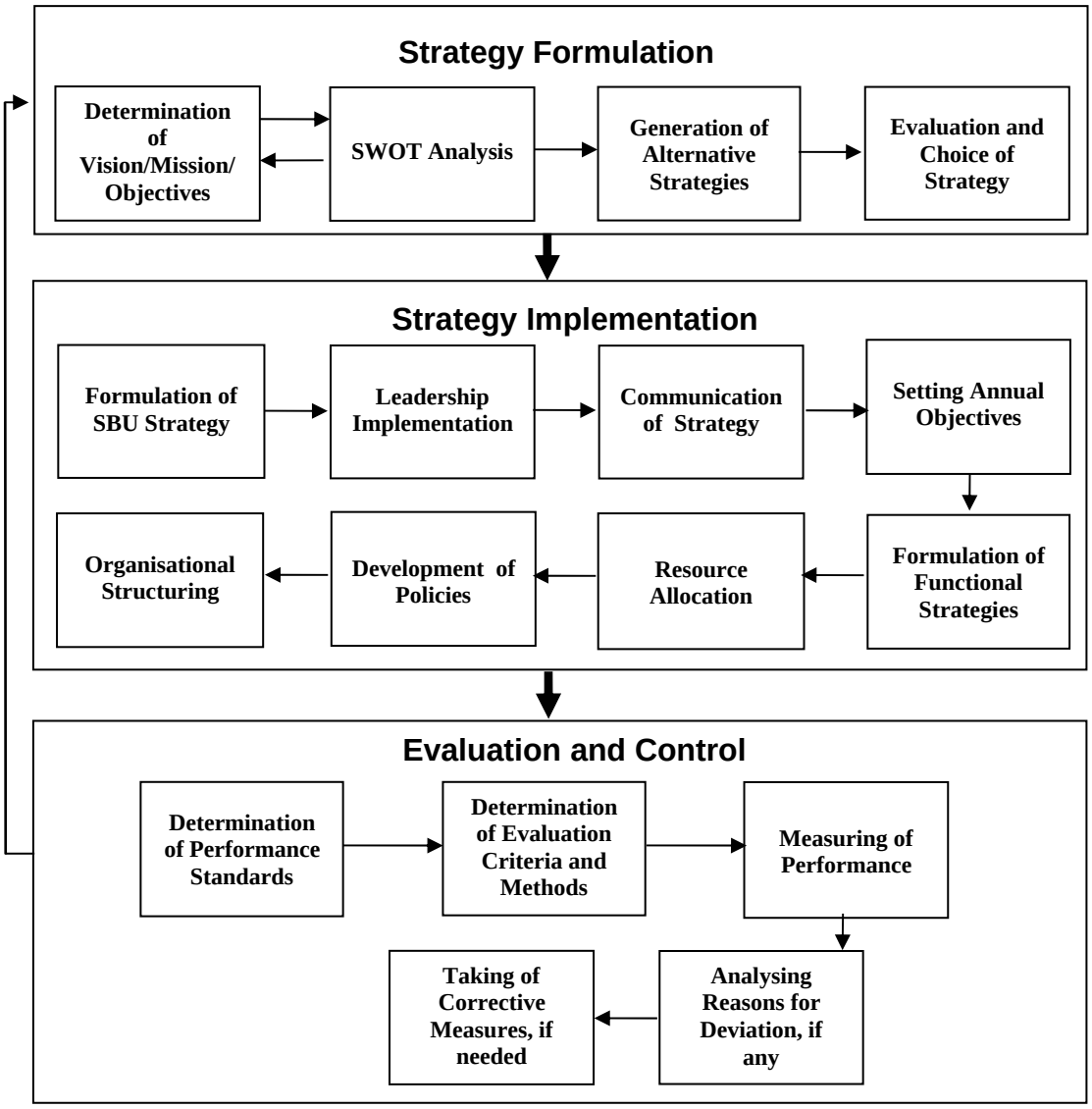

Fig. 1.6: Strategic Management Process

SWOT Analysis

In strategic management, the term strategic is used to refer to the firm-environment fit. This indicates the role of SWOT in strategic management.

The strengths and weaknesses of the firm and opportunities and threats in the environment will indicate the portfolio strategy and other strategies it should pursue.

An organisation should address questions such as what are the changes, including possible future changes, in the environment which have implications for us and how should we respond to them? What are the opportunities in the environment which can be exploited utilising our strength? What are the threats and do we have the strength to combat the threats? How can we mass up our strength? What are our weaknesses? Can we overcome or minimise the weaknesses?

The economic liberalisation in India has opened up enormous new opportunities. The liberalisation, at the same time, has posed severe threats to many existing firms because of the increase in competition. Taking advantage of these opportunities, many Indian companies have entered new businesses and expanded the existing ones. A number of companies have made an exit from some of their businesses as they realised that they do not have enough strength to be successful or that the resources can be put to better use elsewhere. Several companies have both added new businesses and dropped some of the existing ones.

SWOT analysis is dealt with in detail in a separate chapter.

Strategic Alternatives

Given the mission and objectives and having analysed the strengths and weaknesses of the firm and the environmental opportunities and threats, the strategists should proceed to generate possible alternative strategies. There may be different strategic options for accomplishing a particular objective. For example, growth in business may be achieved by increasing the share in the existing markets or by entering new markets, by horizontal integration or by a combination of these. Increase in supply may be achieved by putting up new plants or by M&A. An entry into new business may be effected by establishing a greenfield wholly owned enterprise, a joint venture or acquisition. There are, thus, a number of strategic options. It is necessary to consider all possible alternatives to make the base for choice wide.

The generic competitive strategic alternatives are dealt with in a following chapter.

Evaluation and Choice

The purpose of considering different strategic options is to adopt the most appropriate strategy. This necessitates the evaluation of the strategic alternatives with reference to certain criteria.

Criteria such as suitability, feasibility and acceptability are commonly employed to evaluate the strategic options.

❖ **Suitability**

For assessing the suitability of the strategy, questions such as the following may be posed:

1. Is the strategy in conformity with the corporate philosophy?
2. Does the strategy help accomplish the mission and objectives?
3. Does the strategy appropriately exploit the organisational strengths and environmental opportunities?
4. Is the strategy capable of combating the environmental threats and overcoming the internal weaknesses?
5. Is the strategy consistent (i.e., there must not be mutually inconsistent goals and policies)?

❖ **Feasibility**

The criteria of feasibility examines whether the strategy is realistic and workable. A strategy may outwardly appear to be good but if it is beyond the capability of the company, it is unrealistic and unworkable, i.e., it is not feasible. Questions to be answered include:

1. Can the required resources (finance, human, technology etc.) be obtained?
2. Is the technology appropriate?
3. Can the necessary inputs (power, raw materials etc.) be arranged?
4. Can the estimated sales be generated and market position attained?

❖ **Acceptability**

Besides the criteria of suitability and feasibility, there are several factors to be considered to evaluate the acceptability of the strategy. They include:

1. What will be the impact of the strategy on the cash flow and profitability?
2. Does the strategy satisfy the cut-off ROI criterion?
3. How does the strategy affect the capital structure and shareholding pattern?
4. How does it affect the relationships with stockholders?
5. How does it affect the present employees?
6. How does it affect the corporate image?
7. How does it affect the internal environment?

Implementation

Operationalising the strategy requires transcending the various components of the strategy to different levels; mobilisation and allocation of resources; structuring authority, responsibility, tasks and information flows; and establishing policies.

In a multi-SBU enterprise, strategies for the SBUs, based on the corporate strategy, will also have to be formulated.

Implementation of strategy involves a number of administrative and operational decisions.

Implementation is dealt with in detail in a separate chapter.

Evaluation and Control

Evaluation and control is the last phase of the strategic management process. The objective is to examine whether the strategy as implemented is meeting its objectives and if not to take corrective measures.

Continuous monitoring of the environment and implementation of the strategy is essential. In Fig. 1.6, the loop connecting the evaluation and control to the starting point of the strategic management process indicates that strategic management is a continuous process, the evaluation providing the feedback for modifications.

The evaluation and control is detailed in another chapter.

PRINCIPLES OF GOOD STRATEGY

According to Porter, there are three underlying principles that define a good strategy.[64]

1. A good strategy is concerned with the structural evolution of the industry as well as with the firm's own unique position within that industry.
2. A good strategy makes the company different, giving the company a unique position, involving the delivery of a particular mix of value to some array of customers which represents a subset of the industry.
3. It is not good enough to be different; a company has got to be different in ways that involve trade-offs with other ways of being different. This means that if a company wants to serve a particular target customer group with a particular definition of value, this must be inconsistent with delivering other types of value to other customers. If not, the position is easy to imitate or replicate.

TQM AND STRATEGIC MANAGEMENT

As pointed out in the beginning of his chapter, the purpose of strategic management is to gain, as efficiently as possible, a sustainable edge over the competitors. Total Quality Management (TQM) would help a company to enhance its competitiveness. The competitive edge gained by TQM may not be sustained because of the race by companies to adopt the best practices. It may be recalled that it is the emphasis on quality and cost and the early adoption TQM and the like that provided a competitive edge to a number of Japanese companies in the 1970s and 1980s. This edge is lost as other companies catch up. *Although TQM may not be able to provide a sustainable competitive advantage, in many cases, TQM is necessary to sustain competitiveness.*

Before the 1980s, companies sought to prevent defective products reaching customers by Quality Control. The flaws of this approach began to surface as the American companies began to lag behind the Japanese counterparts which adopted TQM, inspired by the American quality gurus W. Edwards Deming, Joseph M. Juran and Philip B. Crosby.

TQM is an organisational philosophy that aims at maximising customer satisfaction by constantly striving to enhance operational efficiency throughout the organisation.

It is a start to finish process that systematically integrates the strategy and all the functions activities of the organisation. It is "a coherent management system that focuses intensely on serving the needs of the customer quickly, efficiently and effectively. To do this, the TQM method measures customers' needs, measures and evaluates customer satisfaction delivered by the product or service, and engages the organisation in continuous improvement to stay tuned into changes in customers' needs."[65]

The essential characteristics of TQM are:[66]

- A customer-driven definition of quality;
- Strong quality leadership;
- Emphasis on continuous improvement;
- Reliance on facts, data, and analysis;

- Encouragement of employee participation;
- ISO 9000 certification etc. encourage organisations to embody these characteristics.

According to Certo and Peter, the TQM philosophy demands total dedication to the customer and when an organisation successfully implements TQM, it develops the following four characteristics.[67]

- Customers are intensely loyal. They are more than satisfied because the organisation meets their needs and exceeds their expectations.
- The organisation can respond to problems, needs and opportunities with minimal delays. It also minimises costs by eliminating or minimising tasks that do not add value.
- The organisation's climate supports and encourages teamwork and makes work more satisfying, motivating and meaningful for employees.
- The organisation develops and nurtures a general ethic of continuous improvement.

In addition, a method that employees understand leads them toward a state of continuous improvement.

Under TQM, quality is everybody's business and this requires a new organisational culture. The following 14 points which summarises Deming's views on the relationship between quality and management make this clear.

1. Create constancy of purpose for improvement of product and service.
2. Adopt a new philosophy in which defects are unacceptable.
3. Cease dependence on mass inspection and focus on improving the process to eliminate defects.
4. End the practice of awarding business on price tag alone. Besides the quality aspects, an organisation's purchasing function and suppliers must understand specifications and must also know what the part does for production and final customers.
5. Constantly and forever improve the system of production and service.
6. Institute modern methods of training on-the-job, clearly defining criteria for acceptable work.
7. Institute modern methods of supervising.
8. Drive out fear so that workers will feel free to ask questions, report problems, or express ideas.
9. Break down barriers between departments so that there will be a coherent and mutually understanding work culture.
10. Eliminate numerical goals for the workforce and create an environment in which the organisation as a whole must share a single goal: never-ending improvement.
11. Eliminate work standards and numerical quotas.
12. Remove barriers that hinder the hourly workers.
13. Institute a vigorous programme of education and training.
14. Create a structure in top management that will push everyday on the above 13 points.

The ultimate responsibility for implementing these principles lies with the top management of the organisation. Top management should create a system that moves the organisation to engage in continuous, daily improvement.

TQM and Strategic Management Process

It is imperative for a company which has adopted the TQM to integrate it with every phase of the strategic management.

Environmental Analysis and TQM: The environmental analysis of a company with TQM connects the needs of the external customer (the entity that buys the good or service of the company) with the various activities of the company. As Certo and Peter observe,[68] TQM usually visualises the external customer as a collection of several dimensions of customer satisfaction (such as the availability of the product, its features, safety, reliability, user-friendliness, environmental-friendliness etc.). The environmental analysis should determine these dimensions and identify the internal activities related to these dimensions so that appropriate measures that can contribute to the maximisation of customer satisfaction can be determined. Further, in a TQM company, the importance given to the internal customers help improve the organisational performance. Every division/department/employee who supplies any input, including information, to another one in the organisation treats it as an internal customer whom the internal supplier should fully satisfy.

Organisational Direction and TQM: TQM influences the organisational direction by embodying the quality philosophy in the organisational mission. Indeed, the missions of a number of organisations emphasis that quality and continuous improvement must drive every action of the organisation.

Strategy Formulation and TQM: "TQM injects the customer's perspective, the competitor's perspective and the supplier's perspective into the process of formulating strategy."[69] Focus on customer needs and preferences is the cardinal principle of TQM.

Benchmarking of the best practices of the competitors, which is common in TQM, provides a competitor's perspective. The relationship of TQM companies with their suppliers is generally characterised by *relationship marketing/partnering.* (Details of Relationship Marketing/Partnering is available in the author's *Industrrial Marketing*, Himalaya Publishing House).

Strategy Implementation and TQM: TQM helps make strategy implementation very efficient because of the clarity of organisational goals and direction, and the work and relationships culture fostered by TQM.

Strategic Control and TQM Systems established under TQM and the favourable change in the organisational culture make strategic control more effective. Benchmarking also helps efficient control.

In short, as Certo and Peter succinctly put it, "a total quality management initiative affects every step in the strategic management process. It focuses the firm's environmental analysis on the needs of external and internal customers. TQM fills the organisation's vision and mission with images of continuous improvement in customer satisfaction, keeping objectives tied securely to customer's needs. TQM requires strategy formulation to develop a plan that considers customer's, competitor's and supplier's perspectives.

TQM adds power to strategy implementation by tapping the potent force of employees' experience and insight into the organisation's operations and to strategic control through benchmarking competitive products."[70]

INTERNATIONAL STRATEGIC MANAGEMENT

The business environment is becoming increasingly global and more and more firms are becoming international or global. And many of the firms which are already in the international business are enhancing their global orientations. It is, therefore, necessary to look at strategic management in the global perspective.

In this section, we consider strategic management in two contexts: (i) a company planning to enter foreign markets including entering new markets by a company which is already international and (ii) strategic management in respect of existing foreign subsidiaries of an MNC. A foreign subsidiary may be an SBU or it may have several SBUs under it.

Figure 1.7 gives a schematic outline of international strategic management in respect of new market.

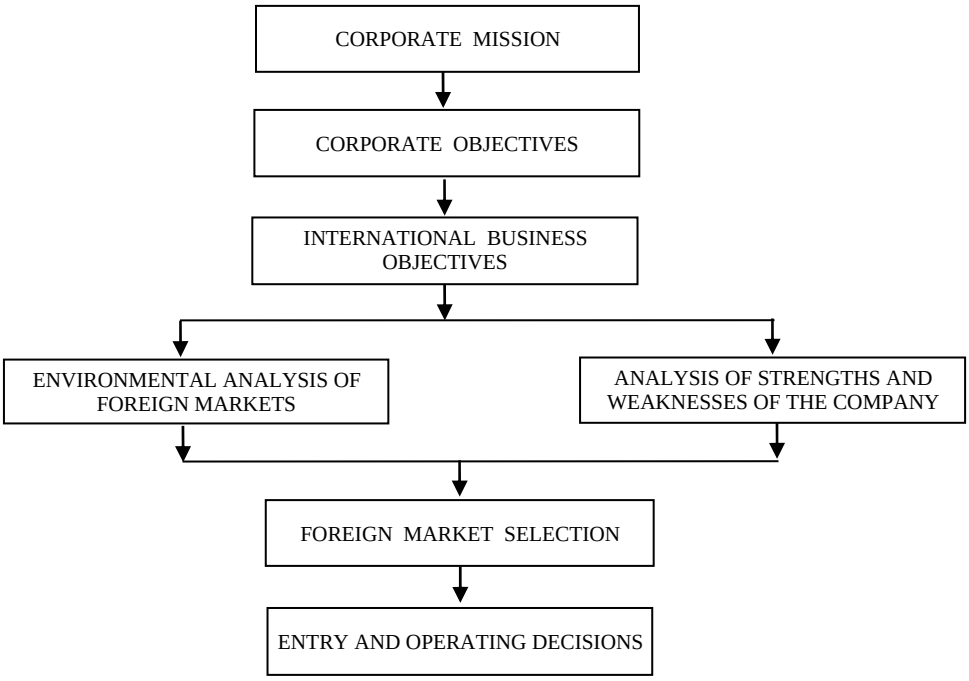

Fig. 1.7: International Strategic Management Process

Selection of the foreign market is done on the basis of SWOT analysis, i.e., strengths and weaknesses of the company and the opportunities and threats of the foreign markets. The market selection process is guided by the corporate mission and international business objectives derived from the corporate objectives.

The next major decision pertain to the foreign market entry and operating strategies. The business environment of the foreign market is a major determinant of the entry strategy. Sometimes, a company may employ different entry and operating strategies in respect of different countries depending on such factors as the business environment and objectives. The Indian pharmaceutical major Ranbaxy, for example, has wholly owned subsidiaries in several countries (some of which are manufacturing and marketing subsidiaries while others are marketing subsidiaries), joint ventures in some countries, affiliates in certain countries and licensing arrangements in some others whereas it does not have any of these types of establishments in a number of markets it serves – in all, it has business in nearly 50 countries. [A detailed account of the foreign market entry strategies is available in the author's books *International Business* (PHI Learning) and *International Marketing* (Himalaya Publishing House)]. The marketing mix strategies for the different markets is another major factor in international strategic management. Broadly, there are two alternative strategies, viz., globalisation [standardisation] and localisation [Details are available in the books mentioned above]. In many cases, marketing mix strategies vary. For example, some Indian pharmaceutical firms emphasise on formulations in the Indian market while concentrating on the bulk drugs in the foreign markets. The strategies of the Indian firms vary.

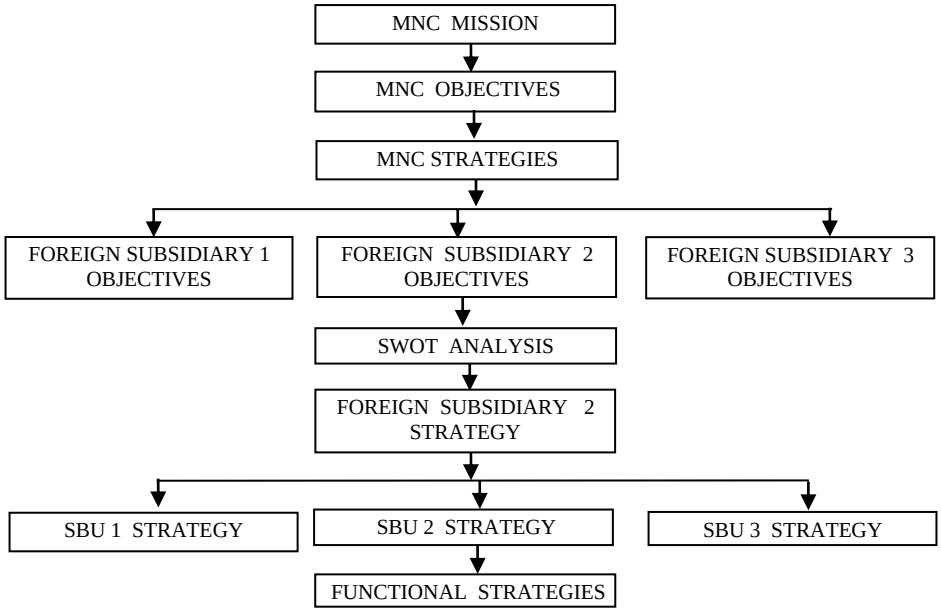

Fig. 1.8: Strategic Management Process in MNCs

Another major decision area in international strategic management is the organisational structure for the international operations.

Figure 1.8 depicts a summary outline of strategic management process in respect of existing foreign business units. The description of the strategic management process given in an earlier section of this chapter would help to explain Figures 1.6 and 1.7.

A number of multinationals keep entering new markets, that is, they are simultaneously in both the contexts referred to above. Restructuring the international operations, including shifting of production bases and modifications of other functional strategies, are common.

Companies which go international in a big way generally go in for a highly integrated networking of this global operation.

BENEFITS AND RELEVANCE OF STRATEGIC MANAGEMENT

The important benefits of strategic management mentioned below highlight its relevance.

- Strategic management helps to envision an organisation's future, formulate mission and make objectives clear. This is clear from the fact that determination of mission and objectives is the first step in the strategic management process. It may be noted that the new growth and competitive environment created by the liberalisation prompted many Indian companies to evaluate and modify their mission and objectives or to ponder over a mission for the company where one did not exist.
- The articulation of the mission and objectives and the formulation of a strategy for their accomplishment help people in the organisation understand what the organisation stands for, what is the development path charted out, what are the planned results over a period of time etc.
- It makes people realise what are they working for, what is expected of each SBU, division, functional department and, to some extent, individuals.
- Strategic management facilitates better delegation, coordination, monitoring, performance evaluation and control.
- The identification of the strengths and weaknesses may help an organisation to take measures to overcome/minimise the weaknesses and reinforce the strengths.
- The SWOT analysis, which is a part of the strategic management, helps a company to adopt suitable strategies for exploiting opportunities and combating threats. It will also help the company to drop those businesses where it would not be successful or which do not meet the objectives.
- A company with strategic management will be constantly monitoring the environment and making modifications of the strategy as and when required so that the plans are made more realistic and effective.
- Strategic management would enable a company to meet competition more effectively.
- Strategic management makes the management dynamic, appropriate to the environment and result and future oriented.
- Studies show that companies with strategic management are more effective than others, generally.

LIMITATIONS AND MISGIVINGS

Strategic management is not without limitations. While strategic management has a number of benefits as pointed out above, it is also a fact that many firms fail despite adopting strategic management and many firms which do not have strategic management are successful. In short, strategic management by itself does not ensure unconditional success.

The important limitations of strategic management are the following.

1. Strategic management is based on certain premises and if the premises do not hold valid, the strategy or plans based on them would not be realistic or effective. These points to the need for exercising due diligence in premising and to the importance of strategic control, particularly premise control, described in the chapter on *Evaluation and Control*.
2. SWOT analysis has a very important role in strategic management. Obviously, if the SWOT analysis is not right, the strategy based on it may go awry. SWOT analysis is an exercise which requires lot of expertise and information. When these two are lacking, the utility of the SWOT analysis is questionable and it could even lead to formulation of wrong or ineffective strategies.
3. Strategic management is a means to achieve the mission and objectives of the organisation. Hence, any lack of realism or other limitation of the mission/objectives would naturally get reflected in the strategy.
4. One of the criticisms against strategic management is that it sometimes makes the organisation over-ambitious and the resultant failure to reach the goals cause frustration. Unrealistic strategies may land companies in severe problems.
5. Another criticism advanced against strategic management is that it makes the future vision tunneled that several opportunities may be overlooked. Against this criticism, it may be argued that the strategy is formulated after scanning all the opportunities. Further, a good strategic management also envisages modification of the strategy when changes in the environment call for it.
6. Yet another criticism which is very akin to the above is that it makes the whole approach very rigid. Against this, it may be pointed out that a good strategic management system provides for required flexibility and modifications. Strategic control and contingency planning impart the plans some amount of adaptability to the unforeseen developments.
7. An important limitation of the strategic management is that if the implementation of the strategy is not effective, even an excellent strategy would not produce expected results. Effective implementation demands many things – resource allocation, leadership implementation, right structure, and effective evaluation and control. The reason for the failure of many strategies is the implementation failure.

   A study by Daniel Gray revealed that many of what managers called implementation difficulties were, on closer scrutiny, attributed to the following six pre-implementation factors.[71]

   (i) Poor preparation of line managers.
   (ii) Faulty definition of business units.
   (iii) Vaguely formulated goals.
   (iv) Inadequate information bases for action planning.
   (v) Badly handled reviews of business unit plans.
   (vi) Inadequate linkage of strategic planning with other control systems.

8. Another important reason for the failure of strategies, which is related to the reason mentioned above, is the lack of commitment. The top management and everyone directly involved in the implementation of the strategy should be fully committed to it. A change in the top management may affect commitment. Frequent changes at the top management and uncertainty may seriously effect the commitment, as is the case with some public sector undertakings in India.
9. A somewhat similar problem is internal resistance (some of these resistances are described in the chapter on *Management of Change*). Chances of internal resistance or indifference are more when there is lack of involvement of the internal people in the strategy formulation and when they are not taken into confidence.
10. Another problem is that strategic planning is a complex and difficult task which requires people with vision, expertise and commitment and an appropriate system.
11. It is also argued that strategic management is a costly exercise. It is unjust to consider cost alone and to ignore the benefits.
12. Many people also question the utility or need for strategic management pointing out the failure of many firms which adopted strategic management and the success of many firms which did not have it.
13. Some of the risks/limitations/problems/criticisms of strategic planning arise from the misunderstanding as to what is strategic planning. In this context, it is very relevant to recall here the warning of Drucker as to what strategic planning is not?[72]
    - It is not a box of tricks, a bundle of techniques. It is analytical thinking and commitment of resources to action.
    - Strategic planning is not forecasting. It is not masterminding the future.
    - Strategic planning does not deal with future decisions. It deals with the futurity of present decisions.
    - Strategic planning is not an attempt to eliminate risk. It is not even an attempt to minimise risk.

Porter points out, there is no strategy that can be stretched beyond the boundaries of a particular business. One of the great mistakes that has been made over and over by companies is the attempt to apply a universal strategy. This thinking leads companies into a trap (like, for example, the feeling that to win a company should have the largest market share, or the idea that all companies should reduce the cycle times, and speed up the time to the market).[73]

GROWING RELEVANCE OF STRATEGIC MANAGEMENT IN INDIA

Because of the limited competition and limited strategic maneuverability under the controlled regime, strategic management did not have much relevance in India prior to the economic liberalisation ushered in India in 1991. Things, however, have changed dramatically since then, making strategic management of great relevance.

Many companies have embraced strategic management. A number of companies have reformulated their mission and objectives. Portfolio strategies have undergone changes. Organisational restructuring have become common. Expanding opportunities and growing competition have been making companies wedded to corporate and competitive strategies. To some extent, there has even been an overpopularity of the concepts that it has also become a fashion to speak of vision, mission, corporate strategy and the like.

Let us take a look at the environmental changes that have increased the relevance of strategic management.

1. The abolition of public sector monopoly or dominance in a number of industries has enormously increased business opportunities. Many of them are high-tech and heavy investment sectors which make strategic management all the more relevant.
2. The delicensing has removed not only an important entry and growth barrier but also a consumption (and, therefore, demand) barrier. In the past, because of non-production/ limited production and import restrictions, many goods were non-available or had limited availability (in quantity and/or variety).
3. The scrapping of most of the MRTPA restrictions on entry, growth and M&As, along with the dereservation and delicensing of industries referred to above, have opened up floodgates of business opportunities for large enterprises.
4. The liberalisation of policy towards foreign capital and technology, imports and accessing foreign capital markets provides companies opportunities for enhancing their strengths to exploit the opportunities.
5. The liberalisation in other countries, the expanding foreign markets, the growing competition in India, the new policy environment etc. increases the importance of foreign markets and strategic management.
6. The grant of more autonomy to the public sector enterprises, as in the case of the navarathnas, increases the scope of strategic management.

The liberalisation, at the same time, has generated serious threats to many firms. The industrial policy liberalisations, import liberalisations and MRTPA liberalisations have opened floodgates of competition posing surging threats to many existing businesses. Companies which enjoyed the comforts of protection of the restrictive regime have now to face growing competition and a buyers' market. Many industries are characterised by increasing competition in all its dimensions: inter-firm rivalry, threat of potential competition, substitutes and growing power of buyers and suppliers.

In short, in the new environment, the old equations are not valid. Companies have to adopt strategies for establishing effective organisation-environment fit in the changing environment. Fundamental questions a company should address itself include:

- What are the opportunities and threats posed by the emerging environment?
- What are our strengths and weaknesses?
- How can we increase our strengths and overcome/minimise the weaknesses? (For eample, will acquisition of foreign technology, joint venturing, strategic alliance etc. help?)

- What is our business? Given the SWOT, what should we our business? Should we be in all the current businesses or should we exit any of them? Should we enter new business?
- How should we diversify/grow? (For example, by establishing wholly owned new undertakings, M&As, or joint ventures?)

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CHAPTER

2

Vision, Mission and Objectives

INTER-RELATIONSHIP

Vision and mission are the pivot around which corporate strategy revolves.

The terms vision/mission, objectives, goals and targets are used many a time interchangeably. However, in corporate literature, they are often used distinctively. Interestingly, the perceptions differ as to what each of these terms means. For example, while some authors opine that mission refers to the current situation, many others consider them in a future (often long term) perspective. Some companies state the mission after the vision statement as a logical evolution from the vision whereas for some companies there is only a mission statement that would reflect the vision. One who goes through the statements of vision, mission, purpose, motto, objectives, values etc. of different organisations would be amazed by the wide differences in the perception about the meaning of each of these terms.

The following statement by Fred David, a well-known author on *Strategic Management*, indicates how intertwined vision and mission are: A mission statement reveals the long-term vision of an organisation in terms of what it wants to be and whom it wants to serve. It describes an organisation's purpose, customers, products or services, markets, philosophy, and basic technology. In combination, these components of a mission statement answer a key question about an enterprise: "What is our Business?" A good answer to this question makes strategy formulation, strategy implementation and strategy evaluation activities much easier".[1]

Burt Nanus, a well-known expert on strategic vision, states that "a vision is not a mission. To state that an organisation has a mission is to state its purpose, not its direction."[2] Obviously, Nanus considers vision as the future direction of the organisation.

The view taken in this book is that there is a logical linkage and evolution between the different concepts as depicted below: Vision leads to mission (which fosters the vision) and mission leads to objectives (which are designed to achieve the mission), objectives lead to goals (which are designed to achieve the objectives) and goals lead to targets (which are set to achieve the goals).

Vision/mission and objectives are very important to strategic management. Strategic Management shot into prominence in India following the economic liberalisation that set in the early 1990s. Formulation/reformulation of vision/mission too became a widespread practice since then. It has gained such a popularity that some observers even feel that articulation of mission has become a

fad in the corporate world. That in 1996 at least two Indian journals (*Business Today* and *Analyst*) carried cover story about vision/mission reflects the great importance these concepts have gained. Of the 309 companies covered by the *Business Today* (BT) – *Gallup MBA* Survey 3, more than 50 per cent had vision statements. Almost all (98.4 per cent) of the CEOs covered by the Survey agreed that vision is necessary.

While there may be companies which articulate vision/mission for the sake of it, there is abundant evidence that clear vision is enabling many Indian companies to enormously grow/improve their performance.

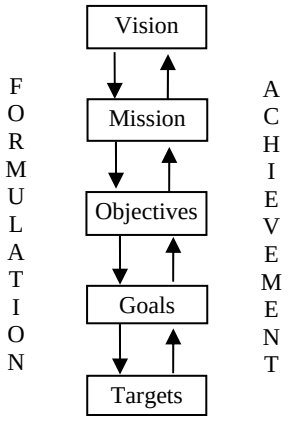

Fig. 2.1: Vision, Mission, Objectives, Goals and Targets - Sequence of Formulation and Achievement

VISION

As indicated above, lot of differing views surround 'vision'. It would be appropriate to present here the observation of Jim Collins and Jerry I. Porras, authors of the well-known books like *Better to Great* and *Built to Last: Successful Habits of Visionary Companies*: If we look at the literature on organisations and strategy, we find numerous terms for "vision" that sometimes are used synonymously, sometimes have partially overlapping meanings, and sometimes are intended to be totally distinct from each other." They quote a statement made to them by one CEO: "I've come to believe that we need a vision to guide us, but I can't seem to get my hands on what 'vision' is…no one has given me a satisfactory way of looking at vision that will help me to sort out this morass of words and set a coherent vision for my company. It's really frustrating!"[4]

As Thompson Jr. and Strickland III observe, "management's views and conclusions about what the organisation's long-term direction should be, the technology-product-customer focus it intends to pursue, and its future business scope constitute a strategic vision for the company. A strategic vision thus reflects management's aspirations for the organisation and its business, providing a panoramic view of "where we are going" and giving specifics about its future business plans. It spells out long-term business purpose and molds organisational identity. A strategic vision points an organisation in a particular direction and charts a strategic path for it to follow."[5]

According to Oren Harari, "Vision should describe a set of ideals and priorities, a picture of the future, a sense of what makes the company special and unique, a core set of principles that the

company stands for, and a broad set of compelling criteria that will help define organisational success."[6]

Collins and Porras give a very objective and meaningful expression of vision by presenting a framework for examining vision: A well-conceived vision consists of two major components—*core ideology* and an *envisioned future*… A good vision builds on the interplay between these two complementary yin-and-yang forces: it defines "what we stand for and why we exist" that does not change (the core ideology) and sets forth "what we aspire to become, to achieve, to create" that will require significant change and progress to attain (the envisioned future). Core ideology provides the glue that holds an organisation together as it grows, decentralises, diversifies, expands globally, and develops workplace diversity. Any effective vision must embody the core ideology of the organisation, which in turn consists of two distinct parts: core values, a system of guiding principles and tenets; and core purpose, the organisation's most fundamental reason for existence.[7]

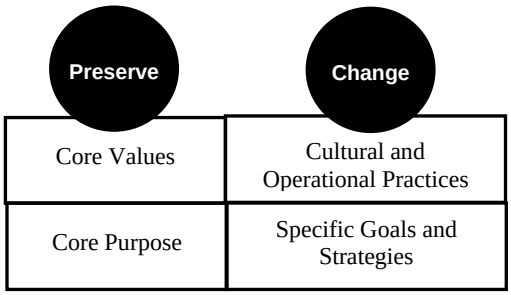

Fig. 2.2: Continuity and Change in Visionary Companies

Collins and Jerry caution that purpose (which should last at least 100 years) should not be confused with specific goals or business strategies (which should change many times in 100 years). Whereas an organisation might achieve a goal or complete a strategy, it cannot fulfill a purpose; it is like a guiding star on the horizon – forever pursued but never reached. Yet although purpose itself does not change, it does inspire change. The very fact that purpose can never be fully realised means that an organisation can never stop stimulating change and progress.[8] This is depicted in Figure 2.2. Collins and Porras view purpose and mission as components of vision.

The second primary component of the vision framework suggested by Collins and Porras is *envisioned future*. It consists of two parts: a 10-to-30-year audacious goal plus vivid descriptions of what it will be like to achieve the goal.

Research by Collins and Porras has revealed that visionary companies often use bold missions – or what they prefer to call BHAGs (pronounced BEE-hags and short-hand for Big, Hairy, Audacious Goals) – between merely having a goal and becoming committed to a huge, daunting challenge – such as climbing Mount Everest. A true BHAG is clear and compelling, serves as a unifying focal point of effort, and acts as a catalyst for team spirit. It has a clear finish line, so the organisation can know when it has achieved the goal; people like to shoot for finish lines. A BHAG engages people – it reaches out and grabs them. It is tangible, energizing, highly focused.[9]

Setting the BHAG that far into the future requires thinking beyond the current capabilities of the organisation and the current environment. Indeed, inventing such a goal forces an executive team to be visionary, rather than just strategic or tactical.

Vivid description, the second component of envisioned future described by Collins and Porras, is a vibrant, engaging, and specific description of what it will be like to achieve the BHAG. For example, Henry Ford brought to life the BHAG "to democratise the automobile" with the vivid description that he would build a motor car for the great multitude .... so low in price that no man making a good salary would be unable to own one.[10]

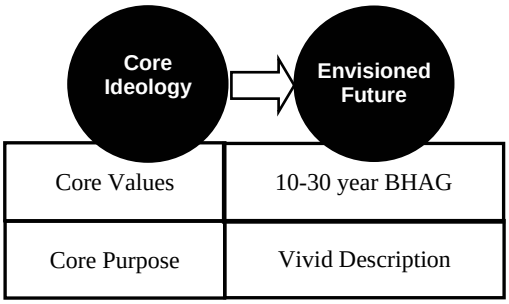

Fig. 2.3: Articulating a Vision

The descriptions of vision by some authors cited above exemplify what a vision statement ought to be, to be of enduring value and substantial contribution to the development of an organisation. There are a number of examples of companies, international and domestic, which have undergone great transformation driven by bold and challenging vision. There are many companies without a vision statement but with mission statements encompassing vision too. In case of a number of companies, the vision statement in conjuncture with complementary expressions like mission, objectives, moto, purpose, goal etc. articulate the organisational characteristics and perspective similar to the ideal model description of vision presented above. At the same time, vision/mission statements of many companies fail, unfortunately to paint *a tangible image* or a clearly envisioned future.

The definitions/statements given below make the role vision in the long-term development and positioning of an organisation further clear.

Box 2.1

Characteristic Categories of Vision

Based on an examination of vision-level BHAG, Collins and Porras suggest thinking about the following four categories: target, common enemy, role model, or internal transformation.

Target BHAGs can be quantitative or qualitative. Examples:

- Become the company that most changes the worldwide image of Japanese products as being of poor quality (*Sony, early 1950s*).
- HLL Lifecare's Vision 2020 – Corporate Plan: make the company a ₹ 10,000 crore healthcare company by the year 2020 (from about ₹ 1000 crores in 2010).

Common-enemy BHAGs involve focusing on beating a common enemy—a David versus Goliath BHAG. Examples:

- Knock off RJR as the number one tobacco company in the world (*Philip Morris, 1950s*).
- Crush Adidas (*Nike, 1960s*).

Indian companies hardly make such direct head on attack vision statements. It is, however, not difficult to find generic statements like want to become "numer one" or "industry leader."

Role-model BHAGs are particularly effective for upcoming organisations with bright prospects. Examples:

- Become the Harvard of the West (*Stanford University, 1940s*).
- Our vision is to be the global steel industry benchmark for value creation and corporate citizenship (*Tata Steel*).

Internal Transformation BHAGs tend to be effective in old or large organisations in need of internal transformation. Examples:

- Transform this company from a defense contractor into the best diversified high-technology company in the world (*Rockwell, 1995*).

We are going to be India's No. 1 non-cigarette FMCG company. We are by far No. 1, if you consider cigarettes (*ITC*).

MISSION

The review of views on vision/mission presented in the preceding subsection has already given some ideas of mission. This subsection seeks to further elaborate the concept.

"A mission statement is an enduring statement of purpose that distinguishes one business from other similar firms. A mission statement identifies the scope of a firm's operations in product and market terms."[11]

According to McGinnis,[12] a mission statement:

1. should define what the organisation is and what the organisation aspires to be;
2. should be limited enough to exclude some ventures and broad enough to allow for creative growth;
3. should distinguish a given organisation from all others;
4. should serve as a framework for evaluating both current and prospective activities; and
5. should be stated in terms sufficiently clear to be widely understood throughout the organisation.

A statement of business mission is often expressed at high levels of abstraction. This is because "mission statements are not designed to express concrete ends, but rather to provide motivation, general direction, an image, a tone, and a philosophy to guide the enterprise..... Precision might stifle creativity in the formulation of an acceptable mission or purpose. Once an aim is cast in concrete, it creates rigidity in an organisation and resists change. Vagueness leaves room for other managers to fill in the detail, perhaps even to modify general patterns. Vagueness permits more flexibility in adapting to changing environments and internal operations. It facilitates flexibility in implementation."[13]

A mission statement has certain desirable components. An ideal mission statement of business should define its customers, products or services, markets, technology, philosophy and self-concept. However, an examination of the mission statement of different organisations shows that the mission statements of several of them are not so comprehensive. A review of 622 mission statements by Graham and Havlik has revealed that no two mission statements had the exact same formula, or pattern; they varied in length as well as tone.[14]

Elements of Mission Statement

On the basis of a review of the literature, Romuald Stone suggests[15] that effective mission statements must be:

Clearly Articulated. The mission statement should be succinct and easy to understand so that the values and purpose, and goals of the organisation are clear to everybody in the organisation and will be a guide to them. For example, the mission of O.P. Jindal Group, *to become a globally competitive player with a burning desire to become the No. 1 in the steel industry*, is very simple and clear albeit very challenging. Hewlett-Packard India provides another example: *To be the leading manufacturer and supplier of measurement and computing solutions whilst achieving the highest levels of customer satisfaction, quality, and business ethics and contributing to India's technological, economic and social needs.*

Relevant. A mission statement should be appropriate to the organisation in terms of its history, culture and shared values. The Indian Oil Corporation strives *to achieve international standards of excellence in petroleum refining, marketing, and transportation with concern for customer satisfaction. To create a modern technology base for self-reliance, growth and development of the business. To contribute to the national economy by providing adequate return on investment by setting high standards of leadership in productivity and total quality. To foster culture of participation and innovation for employee growth and contribution. To help enrich quality of life of the community and preserve ecological balance and national heritage.*

Current. A mission state may become obsolete after some time. As Drucker points out, "very few definitions of the purpose and mission of a business have anything like a life expectancy of thirty, let alone fifty, years. To be good enough for ten years is probably all one can normally expect."[16] Environmental factors and organisational factors may necessitate modifications of the mission. For instance, the mission statement of Indal, first designed in April, 1987, has been revised several times. Only little more than 10 per cent of executives who participated in the BT-Gallup MBA Survey opined that the mission statement shall never be changed. About 49 of the respondents reported that their companies had changed the mission statement. According to the Survey, factors which call for change in the mission are diversification, external changes, fast growth and acquisition.

Written in a Positive (Inspiring) Tone. A mission statement should be capable of inspiring and encouraging commitment toward fulfilling the mission. It is pointed out that when Wipro Corp's R&D department faced the problem of redundancy and the threat of closure, it reached into the reserves of its employees' experience and resilience and drew up a vision of becoming a global R&D lab for hire. Energised by that dream, the employees have raised their work to a level where the lab has been repositioned as planned, and is satisfying global clients. A junior manager at Godrej Soaps testified that "since the vision exercise began, everybody in the organisation is talking about the customer. It is no longer the responsibility of the marketing department."[17] (The vision of Godrej Soaps is that *it shall operate in existing and new businesses which profitably capitalise on the Godrej Brand and our corporate image of reliability and integrity. Our objective is to delight our customers both in Indian abroad. We shall achieve these objectives through continuous improvement in quality, cost and customer services.*)

Unique. An organisation's mission statement should establish the individuality, if not uniqueness, of the company. The mission of Rallis India, for example, is *to provide the farmer with a package of*

inputs and services for optimum utilisation of balanced primary plant nutrients; micro nutrients; plant protection chemicals; water; seeds; post-harvest services; and to develop a genuine partnership with the farmer.

Enduring. Mission statements should continually guide and inspire and be challenged in the pursuit of its mission, never achieving its ultimate goal. K.B. Dadiseth, former Chairman, Hindustan Lever (now Hindustan Unilever), confirms: "the excitement of attaining the unachievable is a huge motivator for growth."[18] Several of the mission statements cited here could inspire people in the respective organisations.

Adapted to the Target Audience. The target audience (i.e., for whom the mission statement – for example, employees, stock holders, consumers or general public) has a bearing on the length, tone and visibility of the statement.

That some examples have been given above to substantiate various points does not mean that only that point under which the mission statement is mentioned is relevant to that mission. These mission statements embrace several elements. Ideally, the mission statement should define, as pointed out earlier, its customers, products or services, markets, technology, philosophy and self-concept. Many mission statements, however, are not so comprehensive.

There are, however, differences of opinion regarding what shall a mission reflect. There are two schools of thought.[19] One, the **Strategy School**, which describes mission in terms of business strategy (like what business the company should be in). The other, the **Ethics School**, argues that mission is the cultural bind that holds an outlet together. It talks about generating cooperation among employees through shared values and standards of behaviour. Again there are differences of opinion regarding for whose benefit the company exits. For shareholders? Customers? Employees? Society at large? Or a combination of some or all of them? Further, the mission may reflect the value system of the promoters or top echelons of the company.

It is suggested that answering following questions would help a company to arrive at its mission.[20]

1. What is the basic purpose of your organisation?
2. What is unique about your organisation?
3. What is likely to be different about your business five years down the road?
4. What is in your company that will make it stand out in a crowd?
5. Who are, and who should be, your principal customers?
6. What are, and what should be, your principal economic concerns?
7. What are the basic beliefs, values and philosophical priorities of your firm?

Formulation and Communication of Mission

In many cases, the founders establish the mission which may remain unchanged down the years or may be modified as the conditions change. In a number of cases, the mission is drawn up by the CEO and board of directors or a committee constituted for this purpose. Engaging consultants for drawing up mission is not uncommon. In some cases, consultants play a participative role. Many companies hold brainstorming sessions of senior executives to develop mission. Soliciting employees' views is also common.

According to a study conducted by the *Analyst*, which involved 26 companies, "the scene in India appears to be to go through the consultative-participative route. That is the only way to build credibility. For instance, at Apple Industries, the vision statement was evolved through various meetings amongst the senior management team and after calling for suggestions from employees. At Mahindra & Mahindra, workshops were carried out at two levels within the organisation with the members of the corporate planning group acting as facilitators. The Hyderabad-Bakelite Hylam had discussions at all levels culminating in the formation of a Core Vision Group which then was aided by external consultants. Banking major State Bank of India went one step ahead inviting the unions to partake in the exercise. And Satyam Computers went one up by holding discussions with their joint-venture companies as also their overseas clients.

In quite a few cases, the vision-mission statements get handed down. Thus, for instance, Thomas Cook says 'Ours is a worldwide mission statement applicable to all our units the world over compiled after getting feedback from employees world over'. At Taparia Magnetics, 'the value systems and the determination to be the No. 1 player in the field of activity is ingrained for many years'. At Indal, the vision statement emerged after deliberations amongst 70 of Indal's leaders. It was then translated, carried and explained to the entire company."[21] The BT-Gallup MBA Survey has found that well over one-fifth of the companies have engaged consultants and employees views were solicited in case of more than 90 per cent of the companies. This Survey also reveals that the mission is communicated to the employees through purposive meetings, noticeboards, company newsletters, conversations, other meetings, letters and badges.

Peter Drucker who observes that "that business purpose and business mission are so rarely given adequate thought is perhaps the most important single cause of business frustration and business failure," concludes that "defining the purpose and mission of the business is difficult, painful, and risky. But it alone enables a business to set objectives, to develop strategies, to concentrate its resources and to go to work. It alone enables a business to be managed by performance."[22]

As it is clear from the description above, vision/mission sets the direction for the strategic development of the organisation. As Drucker remarks in his *Managing for the Future*, the mission "focuses the organisation on action. It defines the specific strategies needed to attain the crucial goals. It creates a disciplined organisation. It alone can prevent the most common degenerative disease of organisations, especially large ones, splintering their always limited resources on things that are 'interesting' or look 'profitable' rather than concentrating them on a very small number of productive efforts".[23] There are several examples of organisations which substantially developed their business or improved their performance by refocusing their business. "Corporate mission statements are the operational, ethical and financial guiding lights of companies. They are not simply mottoes or slogans; they articulate the goals, dreams, behaviour, culture, and strategies of companies."[24]

As Sullivan and Harper observe, vision can provide both an organisational sense of being and a sense of enduring purpose. While incorporating a measure of today's success, vision transcends day-to-day issues. And, by providing meaning in both the present and the future, vision can empower and encourage leaders and followers to implement change.

Thus, a clear, inspiring and challenging vision/mission can provides an organisation with the road to development and drive for growth. "When the organisation has a clear sense of purpose, direction and desired future state and when this image is widely shared, individuals are able to find their own roles both in the organisation and in the larger society. This empowers individuals and confers status

upon them because they see themselves as part of a worthwhile enterprise. They gain a sense of importance, as they are transformed from robots blindly following instructions to human beings engaged in a creative and purposeful venture."

One great advantage of formulation of the mission is that it also results in a clear definition of the business of a company. Mission statement and definition of the business are indeed two sides of the same coin.

Examples of substantial impact of vision are aplenty.

In the BT-Gallup MBA Survey, 77 per cent of the CEOs have stated that vision has improved their day-to-day actions, nearly 75 per cent have stated that it improved corporate strategy and 42 per cent and 34 per cent have revealed that the vision has improved financial performance and employee satisfaction. 36 per cent of the CEOs have informed that the vision has impacted product quality, 18 per cent have felt that it has helped organisational growth, about 15 per cent each have stated that it has contributed to market performance and a sense of belonging and about 7 per cent have reported that the vision has impacted shareholder value.[25]

"When the organisation has a clear sense of purpose, direction and desired future state and when this image is widely shared, individuals are able to find their own roles both in the organisation and in the larger society. This empowers individuals and confers status upon them because they see themselves as part of a worthwhile enterprise. They gain a sense of importance, as they are transformed from robots blindly following instructions to human beings engaged in a creative and purposeful venture."[26]

One great advantage of formulation of the mission is that it also results in a clear definition of the business of a company. Mission statement and definition of the business are indeed two sides of the same coin.

Derek Abell has suggested[27] defining business along three dimensions, viz., customer groups (i.e., who is being satisfied) customer functions (i.e., what need of the customer is being satisfied) and alternative technologies (i.e., how the need is being satisfied). Such a three-dimensional definition of the business would clearly delineate the boundaries and nature of the business. However, not many mission statements are so clear and comprehensive.

As Drucker[28] suggests three fundamental questions would help to clearly define/redefine the business and formulate/reformulate the mission. These questions are:

- What is our business?
- What will our business be?
- What should our business be?

The question 'what is our business' may lead to wonderful revelations and spectacular results. Drucker points out[29] that most managers ask this question when the company is in trouble — then it must of course, be asked; but the most important time to ask this seriously is when a company has been successful and not to have done so is the reason for the crisis of many organisations.

The brilliant answer which Alfred P. Sloan gave to the question what is General Motors' (GM) business led to the enormous success of the company. The company was on the verge of collapse when Sloan took over as its CEO in the depression of 1921. Ford with one model had a 60 per cent share of the American automobile market while GM with eight models (only two of them being

profitable) was a weak second with about 12 per cent of the market. Sloan thinking through what the ideal automobile company in America would look like, thoroughly investigated the consumer preferences and tastes and redefined market segments. He came out with a strategy in which five models (including two of the existing ones) covered the market. Within five years, GM became the most dominant and profitable American automobile firm. The answer which Sloan got held good for an amazingly long period until the early 1960s but the failure to rethink the question "What is General Motors' business?" resulted in the vulnerability of the company.

Similarly, the IBM had long defined its business a data processing. Prior to 1950, this meant punch cards and equipments to sort them. But with the advent of the new technology, the business of data processing meant computers. Although IBM had not the slightest expertise in this technology, it was quick to seize this opportunity and became one of the classic examples of an excellent company. But its failure to rethink the question and its inherent organisational problems blunted its future. IBM had reinvented the industry. But later Apple and others stole the show away from it by reinventing the industry again.

It is, thus, evident that as the business environment is very dynamic, sooner or later even the most successful answer to the question 'What is our business?' becomes obsolete. Therefore, it is not sufficient that a company determines 'What is its business?' but at the same time it should also ponder over 'What will it be?' "What changes in the environment are already discernible that are likely to have high impact on the characteristics, mission, and purpose of our business? and How do we now build these anticipations into our theory of business, into its objectives, strategies and work assignments?"[30]

It is not adequate that a company identifies what will its business be? Because this aims at adaptation to anticipated changes – modifying, extending, developing the existing ongoing business. It does not explore the right firm-environment fit for the future. The future may have new or better opportunities outside the current business of the company. Or it may not be wise to continue in all or some of the current businesses. There is, therefore, a need to ask 'What should our business be?' This question is the central point of corporate strategy.

As Drucker aptly remarks, the ultimate objective of strategic planning is "to identify the new and different businesses, technologies, and markets which the company should try to create long range...Indeed, it starts with the question – Which of our present businesses should we abandon? Which should we play down? Which should we push and supply new resources to?"[31] The Chapter on Portfolio Strategy cites a number of examples, both foreign and Indian, of portfolio changes basically resulting from this fundamental, implicit, question.

The mission of Arvind Mills provides an interesting example of the vision of what should the company's business be: *To achieve global dominance in select businesses built around its core competencies through continuous product and technical innovations and customer orientation with a focus on cost-effectiveness*. Contrary to the prescriptions regarding the essentials of an ideal mission statement, it does not specify products or businesses at all. Instead it concentrates on core competencies. Thus, its staple product, denim – where it is among the world's largest producers today – is not even mentioned, indicating that the company could change its business if the market so demands. What Arvind Mills has achieved with its vision, however, is to shift the objective of its operations from manufacturing specific products to developing a competitive edge in its processes. And the competencies that it has assiduously built, keeping its vision in sight, include knowledge of

all aspects of the textile business, the ability to think global, strategic flexibility, speed, and financial engineering skills. The additional competency that it is now trying to hone: globalising the entire value chain of the textile business quickly. As a result, even if its current product falls out of fashion, the company can leverage its competencies to switch to other products without having to relinquish any of its global markets. In 1994, the company decided to exit the profitable sari business which was taken because it would not allow the company to fulfill its vision of achieving global dominance in select businesses.[32]

A mission by itself, however, does not ensure results. For its success, it requires that it is realistic, everybody in the organisation imbibes the spirit of it and is inspired by it, the management is committed to it and it is effectively strategised. These conditions do not exist in many organisations. As for some organisations, it is nothing more than a showpiece.

In many organisations, the mission is not fully ingrained in the minds of people. According to the BT-Gallup MBA Survey, only about 79 per cent of the senior managers, 66 per cent of the middle managers, 53 per cent of the junior managers, 34 per cent of the clerical cadre employees and 21 per cent of the staff cadre are able to recall the vision statement.

Mission is meaningless unless it is adequately supported by other essential inputs. It is very apt to record here Ambani's statement about what made the Reliance one of Asia's most competitive enterprises: "It has been a combination of vision, entrepreneurship and professionalism." See Figure 5.3 in Chapter 5 to get an indication of the future orientation of the Reliance.

In sum, as Drucker remarks, "Without an effective mission statement, there will be no performance...The mission statement has to express the contribution the enterprise plans to make to society, to economy, to the customer. It has to express the fact that the business enterprise is an institution of society, and serves to produce social benefits."[33]

Box 2.2

Mission, Vision, Values and Strategy

A number views about the meaning of vision and mission have been presented in the preceding pages. For brevity and simplicity, we may confide with the suggestion of Logan presented below, as to what mission, vision and values constitute.

Mission statements

- Describe the overall purpose of an organisation: what we do, who we do it for, and how and why we do it.
- Set the boundaries of the organisation's current activities.
- Are the starting point in developing a strategic vision.

As Logan observes, mission review gets an organisation back to basics. The essential activity of determining whom you serve can be a wake-up call for organisations that have started to skew their activities to meet the needs other stakeholders (such as their funders or lobby targets) and not their actual clients.

Vision statements

- Describe an ideal future.
- Reflect the essence of an organisation's mission and values.

- Answer the question, what impact do we want to have on society?
- Unite an organisation in a common, coherent strategic direction.
- Convey a larger sense of organisational purpose, so that employees see themselves as "building a cathedral" rather than "laying stones".

Values statements

- Reflect the core ideology of an organisation, the deeply held values that do not change over time.
- Answer the question, how do we carry out our mission?
- Are the values your organisation lives, breathes and reflects in all its activities, not the ones you think you should have.

Based on the above description, we may say that mission, vision and values set the mould for fabrication of the strategy.

Courtesy: Jane Logan, "Mission, Vision, Values", *The Canadian Association*, March 2004.

The right vision/mission-strategy fit and the meticulous implementation of the strategy will help build a great organisation. A prerequisite is that the mission is realistically and highly thoughtfully formulated, its implications and strategic needs are well understood and appreciated by everybody in the organisation and the top management, particularly, imbibe it in letter and spirit.

The vision of Tata Steel – "to be the benchmark through the excellence of its people, its innovative approach and overall conduct" – shall be forced to drive the global ambitions of Tata Steels which has excellently transformed itself from a technologically obsolete low productivity firm to the lowest cost steels producer in the world and globally top ranking on several parameters by which a steel company is evaluated. "Underpinning this vision is a performance culture committed to aspiration targets, safety and social responsibility, continuous improvement, openness and transparency." Today, Tata Steel group with a presence in over 50 developed European and fast growing Asian countries and with manufacturing operations in 26 countries and various ongoing projects in different parts of the world, is the world's second most geographically diversified steel producer and is the first integrated steel plant in Asia.

Box 2.3

Vision/Mission – Strategy Execution Par Excellence

There can hardly be a better example, globally, of a philanthropic mission being marvelously accomplished than that of the Aravind Eye Hospital, which is an excitement across the world. The mission emanated from the compassionate vision of the soul and heart of the legendary Founder Chairman, Dr. G. Venkataswamy, is: *to eliminate needless blindness by providing compassionate and high quality eye care*.

Aravind Eye Hospital, started in 1976 in a rented house in Madurai (Tamil Nadu) with 11 beds, has grown into a chain of seven hospitals in Tamil Nadu with 4000 beds by 2012 and in the year ending March 2012, over 2.8 million outpatients were treated and more than 350,000 surgeries were performed (60 per cent of them delivered at low or no cost) making Aravind the single largest enterprise providing eye care in the world. Despite the fact that an Aravind doctor performs an astonishingly large number of surgeries compared to the world average, the surgical complication rate in the Aravind Eye Care System (AECS) is lower than that in many western hospitals. Aravind's complication rate is less than half of UK hospitals.

The immensely efficient system for the execution of the strategy have attracted very high appreciation, and even surprise, from across the world.

There are several key attributes that define AECS' unique strategy. A sense of compassion and commitment of employees, all activities aligned with organisational mission and values, focus on core professional competencies with no frills attached, factory like efficiency and process optimisation, practice of lean management, achieving economies of scale, complete forward and backward integration of all processes and resources are the hallmark of Aravind's service, operations and its scintillating performance.[34] The McDonalds model has guided Aravind in perfecting the process.

To address fixed costs, Aravind decided that it had to maximise the use of the infrastructure and the productivity of the staff, especially the surgeons. By re-engineering the process and thereby enhancing the operating room utilisation and surgeon productivity, the number of surgeries performed by a surgeon in an hour has gone up from one to 6-8. As a result, a surgeon in Aravind conducts about 2000 surgeries annually whereas the national average is only about one-fifth of it (400) and much lower in developing countries like Bangladesh, Thailand and Indonesia.

Aravind also aggressively pursued opportunities to lower variable costs. "In the early 1990s, for example, we realised that intraocular lens manufacturers were not pricing for the Indian market, even though they had reduced the lenses' cost from $ 100 to $ 70. At that time, the average patient in India could afford to pay only about $ 10 total for the lenses and the cataract surgery. We recognised that there was no other way to solve this problem than to get into manufacturing ourselves, and so in 1992 we set up Aurolab, a non-profit charitable trust that makes intraocular lenses and other ophthalmic consumables. Our lens pricing is now about $ 2."

Though its primary focus is on ophthalmic products, Aurolab is also diversifying into related health care areas where its existing capabilities can be leveraged. Today, Aurolab has grown into an organisation with six product divisions (intraocular lenses, pharmaceuticals, sutures, instruments, spectacles, and hearing aids). Aurolab products are exported to 120 countries around the world and accounts for about 8 per cent of global share of intraocular lenses.

Translating Mission into Reality

Challenge	***Strategic Objectives***	***Operating Objectives***	***Operating Strategy***	***Outcome***
Poor patients, can't afford high cost	Drastically reduce cost, render free treatment to poor	1. Reduce fixed cost 2. Reduce variable cost	1. Reengineer operating room process 2. Own production of critical item	1. Operating room productivity increased 6-8 times 2. Lens @ 2, against $ 70 for outsourced
Most patients negligent/not aware of eye care needs. Eye care service not easily accessible	Patient education. Accessibility of eye care service	Establish system for patient education and providing accessibility	Active community involvement, screening camps, IT enabled vision centres in villages	Substantial increase in number of patients serviced
Keep enhancing capacity to treat larger population	Expand hospital chain	Generate surplus to fund new hospitals	Dual pricing and cross-subsidisation	Increase in number of hospitals. Majority of patients treated free

Aravind's efficiency allows its paying patients to subsidise the free ones, while still paying far less than they would at other Indian hospitals. Each year, Aravind does 60 per cent as many eye surgeries as the United Kingdom's National Health System, at one thousandth of the cost.

It runs hospitals in other parts of India with partners. So far about 300 hospitals in India and in other countries are using the Aravind model. All are eye hospitals. Some share Aravind's social mission. Others simply want to operate more efficiently.

OBJECTIVES, GOALS AND TARGETS

Objectives form the basis for the functioning of an organisation. Indeed, "objectives help define the organisation in its environment. Most organisations need to justify their existence, to legitimise themselves in the eyes of the government, customers, and society at large. And by stating objectives, they also attract people who identify with the objectives to work for the organisation. Thus, objectives define the enterprise".[35]

Objectives may be defined as "those ends which the organisation seeks to achieve by its existence and operations."[36]

Used broadly, the word objectives covers "long-range company aims, more specific department goals, and even individual assignments. Thus, objectives may pertain to a wide or narrow part of an enterprise, and they may be either long or short range."[37] However, as stated earlier, used strictly, these terms have distinctive meanings.

A goal is defined as "an intermediate result to be achieved by a certain time as part of the grand plan. A plan can, therefore, have many goals."[38] Specific goals are sometimes referred to as targets. (For example, the sales target for a particular year or territory.)

In other words, objectives may be "defined as the long-term results that an organisation seeks to achieve in pursuing its basic mission."[39] "Goals are short-term (one year or less) milestones or benchmarks that organisations must achieve in order for longer term objectives to be reached. Goals should be measurable, quantitative, challenging, realistic, consistent and prioritised. They should be established at the corporate, divisional, and functional levels in a large organisation. Goals should be stated in terms of management, marketing, finance, production and research and development accomplishments. A set of goals is needed for each objective that is established in an organisation. Goals are specifically important in strategy implementation, whereas objectives are particularly important in strategy formulation. Goals represent the basis for allocating resources".[40] (It may also be noted that some authors use the term objectives to refer to short-term results and goals to refer to long-term results.)

As Newman and Summer point out, often objectives of a particular nature are given a special name. For instance, we may speak of sales quotas, expense ratios, budgets, absentee rates, or market positions. The use of such descriptive terms does not remove them from the broad category of objectives."[41]

Objectives may be tangible or intangible. Tangible objectives include achievement of materially quantifiable targets or goals. Intangible objectives include factors like brand or company image, employee morale etc.

Objectives should not be static, they should be dynamic. That is, changes in the environment and/or changes in the organisational strengths and weaknesses may call for modifications to objectives. As Kotler remarks, "objectives can grow obsolete because of the continuous changes occurring in the company's marketing environment."[42] A company should, therefore, appraise how well its objectives tap the firm's opportunities and resources. Dynamic companies often conduct audit of their objectives and reformulate or reorient the objectives, if desirable, to ensure that the company's objectives are the most appropriate, given the environment and the company resources. It is such appraisal and the resultant reorientation of the business which have enabled many companies to achieve remarkable success which is often reflected in the prudent portfolio strategies and fast growth of business.

To formulate clear objectives, it is essential to get definite answers to certain questions, viz., "what business the company is in?," "what should the company's business be?", "what will the company business be?"

As stated earlier, objectives help define the organisation in its environment. Environmental analysis will help find answer to the question what should the company's business be? If 'what should be the business' is different from 'what is the business', there is certainly a need for redefining the business, matching the company resources to the environment. The question 'what will the company's business be?' exposes another dimension of business objective, namely, the long-term perspective. As Drucker succinctly puts it, 'what will the business be' is related to "what changes in the environment are already discernible that are likely to have high impact on the characteristics, mission, and purpose of our business? and how do we now build these anticipations into our theory of business, into its objectives, strategies and work assignments."[43]

While the important long-term overall objectives may remain without significant change, modifications to or change of some of the objectives and the definition of the business (what business the company should be in?) may be necessitated by environmental factors, as pointed out earlier under the section *Mission.*

IMPORTANCE OF OBJECTIVES

Objectives form the basis for the functioning of an organisation. The following points elucidate the importance or usefulness of objectives.

1. **Justify the organisation:** The objectives indicate the purpose and aims and thereby the social justification for the existence of an organisation.
2. **Provide direction:** Objectives provide direction for the functioning of an organisation. When objectives are clear, the aims of the activities of different people in the organisation converge for the achievement of the common purpose.
3. **Basis for management by objectives:** Clearly formulated objectives form the basis for management by objectives which is a way of management for results.
4. **Help strategic planning/management:** Strategic planning/management is indeed a means to achieve the objectives. Objectives, thus, help effective functioning of the organisation in a given environment.
5. **Help coordination:** As Glueck points out, objectives help coordinate decisions and decision-makers by directing "the attention of employees to desirable standards of behaviour.

It may reduce conflicts in decision-making if all employees know what the objectives are. Objectives become constraints on decisions."[44]

6. **Provide standards for assessment and control:** Objectives, by making clear what the results should be, provide the basis for control and assessment of organisational performance. "Without objectives, the organisation has no objective basis for evaluating its success."[45]
7. **Help decentralisation:** Objectives help decentralisation effective by making clear the organisational objectives to various elements in the organisation. Decentralisation, by assigning decision-making to lower level personnel, gives a subordinate executive or operator considerable leeway in deciding how to perform his work. "Turning people loose in this way will result in chaos unless the common objectives are well understood."[46]

GUIDELINES FOR IDEAL OBJECTIVES

Objectives, to be successful, should possess certain qualities and there are, therefore, some important factors to be considered while formulating the objectives. Given below are important guidelines or principles for the formulation of objectives:

1. **Participation:** To the extent possible, formulation of objectives should involve the participation of important people responsible for the achievement of the objectives. The sense of participation will provide motivation and a moral responsibility for the achievement objectives.
2. **Clarity:** Objectives should not be vague and ambiguous. They should be spelt out clearly. Further, they should be made clearly known to the people who work for their accomplishment.
3. **Realism:** Objectives should be realistic *vis-à-vis* the internal and external environments. They should be reasonable in the sense that they should be achievable with the best efforts, given the environment. At the same time, they should be high enough to elicit the full utilisation of the company's resources and skills.
4. **Flexibility:** Objectives should not be very rigid, they should be flexible. That is, changes in the environment and/or changes in the organisational strengths and weaknesses may call for modifications to the objectives. For example, objectives can grow obsolete because of the continuous changes occurring in the company's environment. A company should, therefore, well provide for flexibility to suitably modify the objectives when changes in environment call for their modification.
5. **Consistency:** Objectives should be mutually consistent throughout the organisation. That is, all objectives within the organisation should support the overall enterprise objectives.
6. **Ranking:** An organisation with multiple objectives should assign relative priorities and indicate the time horizon within which to attain each of the objectives.
7. **Verifiability:** Objective should be capable of being verified or measured. For example, an objective like reasonable profit may be subject to subjective interpretations and hence the actual performance cannot be verified specifically. On the other hand, an objective like a 15 per cent return on investment is verifiable.

8. **Balance:** There should be an appropriate balance between the different objectives of an organisation. For example, there should be a proper balance between profitability, employee welfare, customer welfare, community welfare etc. Undue emphasis on one may adversely affect others.

FACTORS AFFECTING OBJECTIVES

Objectives are not formulated in a vacuum. According to Glueck,[47] who asserts that objectives are formulated by the top managers in a firm, the choice of objectives are affected by three factors, namely,

1. Forces in the environment.
2. Internal forces.
3. The value systems of the top executives.

There are a number of environmental factors which influence business decisions. For example, an external factor like the government policy may affect the objectives of a company.

Formulation objectives is affected also by the internal factors or the realities of the enterprise's resources and internal power relationships. Enterprise's resources are undoubtedly a factor which decides the objectives. Similarly, formulation of objectives are also influenced by the internal power relationships which include factors like the extent of shareholders' confidence and support the top management enjoys and employer-employee relations.

Thirdly, the value systems of the top executives affect the formulation of objectives. For example, the *Articles of Association* of the Tata Iron and Steel Company (TISCO) was amended at the initiative of the powers that be to incorporate the provision regarding the company's social and moral responsibilities to the customers, employees, shareholders, society and the local community. Profit objective, business practices, corporate citizenship etc. are, obviously, affected by the value systems of the top executives.

HIERARCHY OF OBJECTIVES

Organisations with a hierarchical structure (i.e., with different levels of management like top level, middle level and lower level) normally have a hierarchy of objectives to be pursued at different levels.

At the zenith of the hierarchy is the organisational mission which is shaped by the vision and values of the promoters, expectations of the shareholders and environmental forces.

Below the mission is the overall objectives of the organisation, or the corporate objectives, which are long-range or strategic objectives. The corporate objectives are to be formulated and pursued by the Board of Directors and topmost managers.

The overall objectives lead to the next level of the hierarchy which consists of more specific objectives such as those in the key result areas. Such a certain per cent return or investment or a certain percentage increase in the market share over a certain period of time.

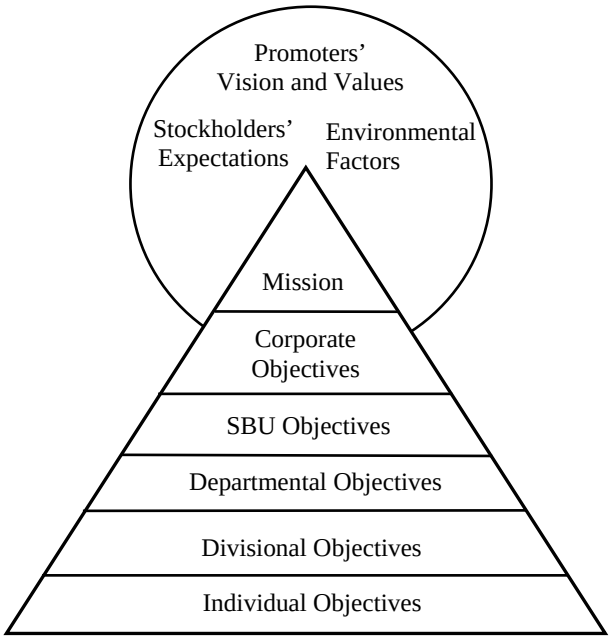

Fig. 2.4: Hierarchy of Objectives

In a multi-SBU organisation, the next level in the hierarchy is the SBU objectives. The divisional objectives are then formed on the basis of the SBU objectives.

Below the divisional objectives are the departmental objectives, i.e., the objectives for the different departments like production, marketing, finance, personnel, research and development, etc. which help achieve the corporate objectives. A department may have several sections or units under it. For example, the marketing department may have several geographical divisions like northern zone, southern zone, eastern zone and western zone or product/product group divisions like product A, product B, product C etc. Each such section will have its own objectives which will contribute to the achievement of the department objectives. Each section may have several personnel responsible for the achievement of the sectional objectives. For example, a marketing subdivision may have under it several salesmen each of whom will have to achieve a specific objective (like a sales target).

A hierarchical organisation, thus, has a hierarchy of objectives and the objectives of the different levels are designed to help achieve the overall organisational objectives.

CLASSIFICATION OF OBJECTIVES

Economic Objectives

Some of the social and economic objectives are so intertwined that it is difficult to separate them and it may be more appropriate to describe them as socio-economic objectives. However, the following may be regarded as the important economic objectives of business.

1. **Survival:** "The primary business of the every business is to stay in business" is an often-quoted statement. The growing magnitude of industrial sickness is a clear indication of the need for primary thrust on this objective. Constant monitoring of the business environment

and strategic planning are needed for survival in a competitive environment. A business cannot, obviously, achieve its objectives unless it survives and hence survival is a basic objective necessary to achieve other objectives.

2. **Return on Investment:** A return on investment is, undoubtedly, an important economic objective not only for private enterprises but also for many public sector enterprises. Private business is often profit motivated. However, the level of profit a private enterprise aims at is likely to be influenced by its social outlook and a number of environmental factors like government policy, attitude of society, competitive and other conditions of the industry etc.
3. **Growth:** Growth over time is also an economic objective of most of the business enterprises. A business may grow either vertically, horizontally or by diversification into unrelated areas. Growth may benefit not only the promoters and shareholders but also the consumers, suppliers and the national economy. Growth is not merely an objective but also a natural urge of a dynamic enterprise.
4. **Innovation:** According to Peter Drucker, there is only one valid definition of business purpose: "to create a customer and because its purpose is to create a customer, the business enterprise has two – and only two – basic functions"[48] marketing and innovation. Marketing and innovation produce results: all the rest are "costs".
5. **Betterment:** Drucker, who interprets innovation as the provision of different economic satisfactions, argues that "it is not enough for the business to provide just any economic goods and services; it must provide better and more economic ones. It is not necessary for the business to grow bigger; but it is necessary that it constantly grows better."[49]
6. **Market Share:** An increase in or maintenance of its market share is an important objective of many companies. Several companies also strive for market leadership. Sometimes, non-economic factors like the prestige and industry recognition associated with market leadership may be a more prominent factor than the economic factor which drives a company towards market leadership. Some companies also strive to attain market leadership even at the cost of profit maximisation.

Social Objectives

There has been a growing recognition of the social objectives and responsibilities of business. R.F. Barker aptly describes the situation as follows:

"Business traditionally has been responsible for quantities – for the supply of goods and jobs, for costs, prices, wages, hours of work, and for standards of living. Today, however, business is being asked to take on responsibility for the quality of life in our society. The expectation is that business - an addition to its traditional accountability for economic performance and results – will concern itself with the health of the society, that it will come up with the cures for the ills that currently beset us, and indeed, will find ways of anticipating and preventing future problems in these areas."[50]

Stern succinctly points out: "The more educated the society becomes, the more interdependent it becomes, and the more discretionary the use of its resources, the more marketing will become enmeshed in social issues. Marketing personnel are at interface between company and society. In this position, they have the responsibility not merely for designing a competitive marketing strategy, but for sensitising business to the social, as well as the product, demand of society."[51]

Comparison between Economic and Social Objectives

Economic Objectives	Social Objectives
1. Economic objectives are primarily concerned with the economic health of the enterprise.	1. Social objectives are concerned with the needs and welfare of the society.
2. Economic objectives serve the economic motive of the stockholders.	2. Social objectives serve the interests of the society.
3. Economic objectives are mostly enterprise oriented or enterprise centered.	3. Social objectives are social oriented.
4. Economic objectives are important both in short and long term.	4. The perspective of social objectives is mostly long-term.
5. Achievement of economic objectives is necessary for the survival and growth of the enterprise.	5. Social objectives justify the survival and growth of the enterprise.
6. Achievement of economic objectives is necessary for effective discharge of social objectives.	6. Social objectives justify economic objectives.
7. There is general agreement as to what constitute economic objectives.	7. There are differences of opinion as to what constitute social objectives.
8. Economic objectives are tangible.	8. Several of the social objectives are not tangible.
9. Economic objectives by themselves may benefit society.	9. Some of the social objectives reinforce the achievement of economic objectives.
10. Economic objectives are cardinal.	10. Social objectives are ordinal.
11. Economic objectives are basic objectives.	11. Economic objectives provide the base for pursuing social objectives.
12. Economic objectives are clear and definite.	12. Social objectives may have ambiguity.

Social objectives of business may be grouped into three broad categories, namely,

1. Objectives which protect consumer interests;
2. Objectives which protect the interests of workers; and
3. Objectives which protect the interests of the society.

Reconciliation of Social and Economic Objectives

We have seen above that the social and economic objectives encompass promoting the interests of different categories of people like the shareholders, workers, consumers, local population and the general public. The economic and social objectives may conflict with each other. Again, some of the social objectives may conflict with each other.

Furthering economic objectives may constrain some of the social objectives. For example, some of the efforts to increase the profit may adversely affect consumers if that results in price increase. Similarly, profit motive may harm workers' interests in some cases. Fulfillment of some of the social objectives may adversely affect the economic objectives. For example, enhanced expenditure on labour welfare, pollution control, social service etc. may eat into the profit. These could also affect consumer interest if they cause an increase in prices. It is, therefore, necessary to reconcile the conflicting objectives or to achieve a proper trade-off between the different objectives. In other words, a proper balance between the conflicting interests of the different groups should be struck.

While we consider the reconciliation of the objectives, the following factors are worth noting.

1. Profit objective need not necessarily be against the social objective. The profit goes against the social objectives only when it is aimed to make profits at the expense of the social objectives. A reasonable level of profit is not only compatible with socially responsible business but also necessary for the discharge of social obligations and responsibility. As George Goyder, the champion of the idea of *social responsibility of business*, observes, "in a responsible company, profits will continue to be the criterion of financial health. As blood is the life of man, so are profits the life of industry, and just as man must maintain life before he can be free to pursue the life objects he has set before him…so profits are necessary to business and are in the proper sense of the work primary. In short, a reasonable level of profit is necessary to enable a company to pursue the social objectives."[52]
2. In several cases, it is possible to increase profits without hindering the social objectives. For example, an increase in productivity could increase profits without causing any increase in price. Not only that, substantial productivity gains could benefit the shareholders (by increased dividends), consumers (by reduced prices) and workers (by increased remuneration) if such productivity gains are shared between capital, labour and consumers.
3. Satisfactory level of wages and expenditure on labour welfare could contribute to the economic health of the enterprise if they help to increase labour productivity and improve industrial relations. It is appropriate to note the observation of the Social Audit Committee which conducted the social audit of TISCO that, "not only should the company carry out its various obligations to the employees as well as the larger community as a matter of principle but this has also led to a higher degree of efficiency in TISCO Works and an unparalleled performance in industrial peace and considerable team spirit and discipline which have all resulted in high productivity and utilisation of capacity. The cooperation and response of the larger community have also contributed to this. It is possible to argue that, but for such a climate of cooperation from all segments, and the maintenance of certain norms and standards by the company, it would not have been possible to maintain the reasonable rates of return on investment in the face of various constraints faced by the company. It is necessary that shareholders realise this and extend their full cooperation to the company's programmes of welfare and development and that they do so ungrudgingly."

The points mentioned above indicate that although several of the objectives may outwardly appear to be conflicting, they could be mutually supporting in several cases if properly envisioned and managed.

Primary and Secondary Objectives

Some companies establish two seats of objectives, viz., primary and secondary objectives. In many such cases, the secondary objectives resemble what are generally described as the social responsibilities of business.

George Goyder in his well-known book *The Future of Private Enterprise: A Study in Responsibility*[53] set out the ultimate objects in the following four principal objects of a responsible company.

1. The extension, development and improvement of the company's business and the building up of its financial independence.
2. The payment of fair and regular dividends to the shareholders.
3. The payment of fair wages under the best possible conditions to the workers.
4. The reduction of prices to consumers.

Referring to the Articles of the Carl Zeiss Foundations, Goyder points out four secondary objectives of the company:

1. to provide a bonus for the workers;
2. to assist in promoting the amenities of the locality (without thereby attempting to dominate it);
3. to assist in developing the industry of which the firm is a member;
4. to promote education, research and development in the techniques of the industry or any other purpose approved by the directors and members in general meeting.

Short-run and Long-run Objectives

A company may have short-run and long-run objectives.

The short-run objectives may be a means to achieve long-run objectives. For example, the short-run objective of market penetration may be a strategy to help achieve the long-run objective of market dominance or profit. For instance, a key characteristic of the Japanese companies' strategy of entering the foreign markets is to build up market share rather than early profits. The Japanese are patient capitalists who are willing to wait even a decade before realising their profits.

We have seen above the primary and secondary objectives of one organisation. A company will normally pursue the secondary objectives listed therein as long-term objectives. This shall not be interpreted to mean that long-run objectives are secondary objectives. Some of the long-run objectives, like profit, are essentially primary objectives of several companies.

However, some of the long-run objectives of several companies, like development of the local community, assisting the development of the industry of which it is a part, serving the society etc. are secondary objectives.

TOP-DOWN AND BOTTOM-UP APPROACHES

For the determination of the objectives of the different levels in the hierarchy, there are two approaches. In the top-down approach, the upper level managers determine the objective for their subordinates while in the bottom-up approach, the subordinates initiate the setting up of objectives for their positions and present them to the superior for consideration.

As Koontz and Weihrich remark,[54] either approach alone is insufficient. Both are essential but the emphasis should depend on the situation including such factors as the size of the organisation, the organisational culture, the preferred leadership style of the executive and the urgency of the plan.

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CHAPTER 3

Social, Environmental and Economic Responsibilities of Business

Corporate vision/mission and strategies need to embrace social obligations and the regulatory environment.

Corporate Social Responsibility (Corporate Citizenship), a concept popular in the last several decades, has been attracting growing discussion. In the meantime, the idea of *Triple Bottom Line*, has been growing in popularity. Further, recently, there have been some very important government initiatives to foster the social commitment of the business.

In July 2011, the Ministry of Corporate Affairs, Government of India, brought out a set of *National Voluntary Guidelines on Social, Environmental and Economic Responsibilities of Business* to be adopted by all categories of enterprises, including SMEs. The Guidelines prefer the use of responsible business to corporate social responsibility.The Principles and Core elements laid down in the Guidelines are required to be integrated in the business policies, strategies and business processes emanating from the core business purpose of an enterprise.

These Government guidelines and TBL, in essence, connote more or less the same as the broad perspective of CSR.

Another recent development is that the Companies Act, 2012, which replaces the Companies Act, 1956, has certain provisions which require every company with certain level of turnover/profit to draw up a CSR Policy and earmark a certain portion of the profit for CSR activities.

A short description of the National Voluntary Guidelines and the provisions of the Companies Act, 2012, pertaining to CSR is given elsewhere in this chapter.

CSR AND TBL

The Rationale

The rational of the CSR/TBL (and the National Voluntary Guidelines) is business *vis-à-vis* the business ecosystem. The operations of business enterprises affect a wide spectrum. The resources they make use of are not limited to those of the proprietors and the impact of their operations is felt also by many a people who are in no way connected with the enterprises. The shareholders, the suppliers of resources, the consumers, the local community and society at large are affected by the way an enterprise functions. Hence, a business enterprise has to be socially very responsive so that a social

balance may be struck between the opposing interests of these groups. Further, business and other economic activities have been causing serious damage to the natural ecosystem which needs to be prevented and remedied.

In his famous book, *The Future of Private Enterprise: A Study in Responsibility*, published in 1951, George Goyder argued: "Industry…can no longer be regarded as a private arrangement for enriching shareholders. It has become a joint enterprise in which workers, management, consumers, the locality, Government and trade union officials all play a part. If the system which we know by the name private enterprise is to continue, some way must be found to embrace many interests which go to make up industry in a common purpose."[1] Later, in 1978, while delivering the C.C. Desai Memorial Lecture, he reiterated his plea that if the corporation has to function effectively, it has to be accountable to the public at large; and he sought to equate the suggestion of a responsible company with the trusteeship concept advocated by Gandhiji, the aim of which was to ensure that private property was used for the common good. The declaration issued by the international seminar on the social responsibility of business held in India in 1965 also correlated the Gandhian concept of trusteeship with the social responsibility of business as "responsibility to customers, workers, shareholders and the community."

There has been a growing acceptance of the plea that business should be socially responsible in the sense that the business enterprise, which makes use of the resources of society and depends on society for its functioning, should discharge its duties and responsibilities in enhancing the welfare of the society of which it is an integral part. The High-Powered Expert Committee on Companies and MRTPA Acts (*Sachar Committee*), in its Report submitted to Government in August 1978, observed that, "in the development of corporate ethics, we have reached a stage where the question of the social responsibility of business to the community can no longer be scoffed at or taken lightly".[2] The Committee further points out that, "in the environment of modern economic development, the corporate sector no longer functions in isolation. If the plea of the companies that they are performing a social purpose in the development of the country is to be accepted, it can only be judged by the test of social responsiveness shown to the needs of the community by the companies. The company must behave and function as a responsible member of society, like any other individual. It cannot shun moral values, nor can it ignore actual compulsions. The real need is for some focus of accountability on the part of the management which is not limited to shareholders alone. In modern times, the objective of business has to be the proper utilisation of resources for the benefit of others. A profit is still a necessary part of the total picture, but it is not the primary purpose. This implies that the claims of various interests will have to be balanced, not on the narrow ground of what is best for the shareholders alone but from the point of view of what is best for the community at large. The company must accept its obligation to be socially responsible and to work for the larger benefit of the community."[3]

The Concept/Philosophy of TBL

The term Triple Bottom Line (TBL) has become very popular recently. In essence, it is not significantly different from CSR and social audit.

The concept of TBL, consisting of the *triple Ps* – people, planet, profit – holds that a company's responsibility lies with the stakeholders, i.e., to those who are influenced, either directly or indirectly, by the actions of the firm, not merely with the shareholders. In other words, it is a reflection of the

stakeholder theory according to which the business entity should be used as a vehicle for coordinating stakeholder interests, instead of maximising shareholder (owner) profit.

TBL accounting is a term used to refer to business reporting on the financial, environmental and social returns or impacts of their operations. Such reports provide a picture of the long-term stability of an enterprise in terms of its economic vitality, social relationships with stakeholders, and environmental compliance and integrity. TBL accounting can assist businesses and their stakeholders to evaluate the impact on different dimensions of sustainable development.

SustainAbility, the consultancy company which Elkington (whose name is closely associated with the TBL concept) founded in 1987 and which works with businesses through markets in the pursuit of economic, social and environmental sustainability, gives a big picture description of TBL, as well as an accounting concept. The triple bottom line (TBL) focuses corporations not just on the economic value they add, but also on the environmental and social value they add—and destroy. At its narrowest, the term 'triple bottom line' is used as a framework for measuring and reporting corporate performance against economic, social and environmental parameters. At its broadest, the term is used to capture the whole set of values, issues and processes that companies must address in order to minimise any harm resulting from their activities and to create economic, social and environmental value. This involves being clear about the company's purpose and taking into consideration the needs of all the company's stakeholders—shareholders, customers, employees, business partners, governments, local communities and the public.[4]

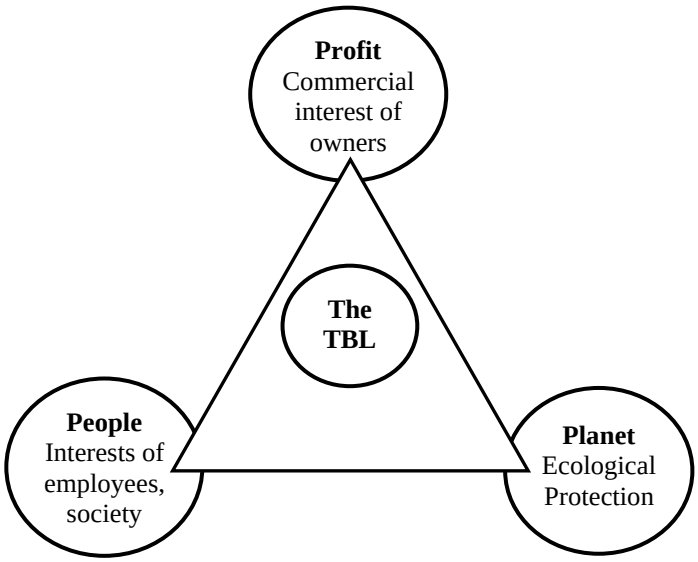

Fig. 3.1: The Components of TBL

The above descriptions clearly indicate that the accounting framework of TBL incorporates the social and environmental dimensions of the performance of an organisation, besides the traditional financial performance. The connotation of the TBL, thus, is that companies should be preparing three different (and quite separate) bottom lines:

- The traditional bottom line of the *profit and loss account*.
- The bottom line of a company's *people account* — a measure in some shape or form of how socially responsible an organisation has been in its operations.
- The bottom line of the company's *planet account* — a measure of how environmentally responsible it has been.

Box 3.1

What are the 3Ps?

People pertains to fair and beneficial business practices toward labour and the community and region in which a corporation conducts its business. A TBL company conceives a reciprocal social structure in which the well-being of corporate, labour and other stakeholder interests are interdependent.

A triple bottom line enterprise seeks to benefit many constituencies, not exploit or endanger any group of them. The "upstreaming" of a portion of profit from the marketing of finished goods back to the original producer of raw materials, i.e., a farmer in 'fair trade' agricultural practice, is a common feature. In concrete terms, a TBL business would not use child labour and monitor all contracted companies for child labour exploitation, would pay fair salaries to its workers, would maintain a safe work environment and tolerable working hours, and would not otherwise exploit a community or its labour force. A TBL business also typically seeks to "give back" by contributing to the strength and growth of its community with such things as healthcare and education. Quantifying this bottom line is relatively new, problematic and often subjective. The Global Reporting Initiative (GRI) has developed guidelines to enable corporations and NGOs alike to comparably report on the social impact of a business.

Planet (natural capital) refers to sustainable environmental practices. A TBL company endeavours to benefit the natural order as much as possible or at the least do no harm and curtail environmental impact. A TBL endeavour reduces its ecological footprint by, among other things, carefully managing its consumption of energy and non-renewables and reducing manufacturing waste as well as rendering waste less toxic before disposing of it in a safe and legal manner. 'Cradle to grave' is uppermost in the thoughts of TBL manufacturing businesses which typically conduct a life cycle assessment of products to determine what the true environmental cost is from the growth and harvesting of raw materials to manufacture to distribution to eventual disposal by the end-user. A triple bottom line company does not produce harmful or destructive products such as weapons, toxic chemicals or batteries containing dangerous heavy metals for example.

Currently, the cost of disposing of non-degradable or toxic products is borne financially by governments and environmentally by the residents near the disposal site and elsewhere. In TBL thinking, an enterprise which produces and markets a product which will create a waste problem should not be given a free ride by society. It would be more equitable for the business which manufactures and sells a problematic product to bear part of the cost of its ultimate disposal.

Ecologically destructive practices, such as overfishing or other endangering depletions of resources are avoided by TBL companies. Often environmental sustainability is the more profitable course for a business in the long run. Arguments that it costs more to be environmentally sound are often specious when the course of the business is analysed over a period of time. Generally, sustainability reporting metrics are better quantified and standardised for environmental issues than for social ones. A number of respected reporting institutes and registries exist including the Global Reporting Initiative, CERES, Institute for Sustainability and others.

The eco bottom line is akin to the concept of Eco-capitalism.

Source: Adapted from *Wikipedia — The Free Encyclopedia*

Is TBL a New/Better Idea?

The view that there shall be a holistic approach to evaluating the outcomes of the operations of business enterprises and other organisations is a long standing one. Although the usage triple bottom line or its rhythmic expression profit, people and planet – the triple P – is of recent origin, the basic idea behind it has been there in the intellectual domain for a long time.

Coining of the phrase *Triple Bottom Line*, consisting of the triple Ps – people, planet, profit – is widely (and wrongly) attributed to John Elkington in 1995 while at *SustainAbility*. The phrase got significant currency with the publication in 1997 of his book *Cannibals* with *Forks: The Triple Bottom Line of 21st Century Business* and the adoption of *Triple Bottom Line* as the title of the Anglo-Dutch oil company Shell's first sustainability report in 1997. Literature on this topic, however, cites the usage of this phrase much earlier. For example, the *Triple Bottom Line Investing* (a group advocating and publicising these principle) was founded in 1998 by Robert J. Rubinstein. It is also pointed out that in 1981 Freer Spreckley first articulated the triple bottom line in a publication called *Social Audit – A Management Tool for Cooperative Working* as he described what social enterprises should include in their performance measurement.

As pointed out in the opening paragraph of this chapter, George Goyder has given an exposition of the basic idea behind it more than six decades ago.

In the currently popular nomenclature Triple P, *People* is often linked to corporate social responsibility (CSR), and another P is in place to represent the environment. Social responsibility in a broader perspective encompasses planet too and as such the People and Planet are akin to the social responsibility of business.

Keith Davis and Robert L. Blomstorm in their book *Business, Society and Environment*, published in 1971, avers that the modern view of society is an ecological one. "Ecology is concerned with the mutual relations of human populations or systems with their environment. It is necessary to take this broad view because the influence and involvement of business are extensive. Business cannot isolate itself from the rest of society. Today, the whole society is a business's environment."[5]

The *Genuine Progress Indicator* (GPI), developed in the mid-1950s, is often considered as a replacement to the gross domestic product (GDP) economic indicator. The GPI indicator takes everything the GDP uses into account, and also adds other figures that represent the cost of the negative effects related to economic activity (such as the cost of crime, cost of ozone depletion and cost of resource depletion, among others). The GPI nets the positive and negative results of economic growth to examine whether or not it has benefited people overall. The GPI is used in green economics, sustainability and more inclusive types of economics commonly known as the *True Cost* economics.

The marketing approach/philosophy known as the *Societal Marketing Concept*, which emerged more than four decades ago, is perhaps a better proposition than the TBL because it more explicitly emphasises the long-term impact of the consumption of a product on the consumer. As Philip Kotler points out, "the addition of long-run customer welfare asks the businessman to include social and ecological considerations in his product and marketing planning. He is asked to do it not only to meet his social responsibilities but also because failure to do this may hurt his long-run interests."[6]

Frank Vanclay of University of Tasmania argues that "TBL is inherently limited in what it has to offer, and is promulgated by proponents who are largely ignorant of other approaches. Although TBL

is meant to add social and environment to the equation, it is often championed by people who have little understanding of what the social entails….the concept of TBL is not fundamentally different to the well established field of impact assessment, but that impact assessment and, in particular, the field of social impact assessment (SIA), have much more to offer in terms of accumulated experience and understanding, and a professional and theoretical base.….the originators of TBL and its current advocates seem to be ignorant of the field of impact assessment. It is argued that impact assessment, and specifically social impact assessment, offers far more to those concerned about social justice and human welfare than does TBL."

There are companies which conceived the *Triple P* concept in one form or other long before its ceremonial baptism. For example, some seven decades ago, Johnson & Johnson published its *Credo* announcing that its primary stakeholders were its customers, employees and the communities it operated in – in that order, and explicitly ahead of its stockholders. The Credo ends by affirming that "Our final responsibility is to our stockholders….When we operate according to these principles (i.e., those outlining obligations to other stakeholders) the stockholders should realise a fair return".

Back home, Tata Iron and Steel Company (TISCO), now known as Tata Steel, provides a shining example of social responsibility. The Committee appointed to conduct the Social Audit of TISCO observed in its Report observed: "At a time when Max Weber, the great German Sociologist, was advocating his theory of transforming a traditional society into a modern one through industrialisation and modern management, little did he know that in the Jungles of Bihar an Indian visionary had already planned the establishment of the first Steel City (not a mere factory) in Asia. Before he passed away, Jamsedji Tata had in a letter to his son Dorab instructed him: "Be sure to lay out wide streets planted with shady trees, every other one of a quick growing variety. Be sure there is plenty of space for lawns and gardens, reserve large areas for football, hockey and parks. Earmark areas for Hindu temples, Mohammedan mosques and Christian churches." No wonder Jamshedpur emerged as a beautiful and well developed city. 1970 witnessed a landmark development when the Articles of Association of TISCO was amended to incorporate the social and moral responsibilities of the company to consumers, employees, shareholders, society and the local people. A decade later the Board of Directors of TISCO appointed a Social Audit Committee to go in to the question of whether and to what extend the company had fulfilled its social obligations laid down in the Articles. This resulted in the first social audit ever undertaken by any company, public or private, in India, at a time it was not popular anywhere in the world. The Report of the Committee was a glowing tribute to TISCO's endeavours in the discharge of its social obligations to the various segments of the society.

In short, *Triple Bottom Line*, or *Triple P* is not a new idea; it is old wine in new bottle.

It is observed that "the apparent novelty of 3BL lies in its supporters' contention that the overall fulfillment of obligations to communities, employees, customers, and suppliers (to name but four stakeholders) should be measured, calculated, audited and reported – just as the financial performance of public companies has been for more than a century. This is an exciting promise. One of the more enduring clichés of modern management is that "if you can't measure it, you can't manage it". If we believe that ethical business practices and social responsibility are important functions of corporate governance and management, then we should welcome attempts to develop tools that make more transparent to managers, shareholders and other stakeholders just how well a firm is doing in this regard."[7]

It is argued that even the argument that it is the emphasis on measurement and reporting that characterise the 3BL movement is not true either. Those who use the language of 3BL are part of a much larger movement sometimes identified by the acronym SEAAR: social and ethical accounting, auditing and reporting. This movement (to use that term loosely) has grown in leaps and bounds over the past decade, and has produced a variety of competing standards and standard-setting bodies, including the *Global Reporting Initiative* (GRI), the SA 8000 from *Social Accountability International*, the AA 1000 from *AccountAbility*, as well as parts of various ISO standards. The most important function of these standards is to identify indicators of social performance as well as methodologies for measuring and auditing performance along these indicators.[8]

Box 3.2

What Measures Go into the Index?*

There is no universal standard method for calculating the TBL. Neither is there a universally accepted standard for the measures that comprise each of the three TBL categories. This can be viewed as a strength because it allows a user to adapt the general framework to the needs of different entities (businesses or non-profits), different projects or policies (infrastructure investment or educational programs), or different geographic boundaries (a city, region or country).

Economic Measures

Economic variables ought to be variables that deal with the bottom line and the flow of money. It could look at income or expenditures, taxes, business climate factors, employment, and business diversity factors. Specific examples include:

- Personal income
- Cost of underemployment
- Establishment churn
- Establishment sizes
- Job growth
- Employment distribution by sector
- Percentage of firms in each sector
- Revenue by sector contributing to gross state product

Environmental Measures

Environmental variables should represent measurements of natural resources and reflect potential influences to its viability. It could incorporate air and water quality, energy consumption, natural resources, solid and toxic waste, and land use/land cover. Ideally, having long-range trends available for each of the environmental variables would help organisations to identify the impacts a project or policy would have on the area. Specific examples include:

- Sulfur dioxide concentration
- Concentration of nitrogen oxides
- Selected priority pollutants
- Excessive nutrients
- Electricity consumption
- Fossil fuel consumption

- Solid waste management
- Hazardous waste management
- Change in land use/land cover

Social Measures

Social variables refer to social dimensions of a community or region and could include measurements of education, equity and access to social resources, health and well-being, quality of life, and social capital. The examples listed below are a small snippet of potential variables:

- Unemployment rate
- Female labour force participation rate
- Median household income
- Relative poverty
- Percentage of population with a post-secondary degree or certificate
- Average commute time
- Violent crimes per capita
- Health-adjusted life expectancy

Source: * Adapted from Timothy F. Slaper (*Director of Economic Analysis*, Indiana Business Research Center, Indiana University Kelley School of Business) and Tanya J. Hall (*Economic Research Analyst*, Indiana Business Research Center, Indiana University Kellog School of Business), "The Triple Bottom Line: What Is It and How Does It Work?", http://www.ibrc.indiana.edu/ibr/2011/spring/article2.html

Is Profit Incompatible with People and Planet?

There is a wrong conception that profit is not compatible with the other two Ps. This presumption is inherently dangerous because the premises of this line of thinking is that profit may be made sacrificing people and planet. A corollary of this view is that zeroing in people and planet will result in a lower level of profit.

The cardinal principle of the TBL is not a trade-off between the three but an inevitable harmonious and enduring integration of them – it shall be a way of life.

Profit objective need not necessarily be against the social objective. The profit goes against the social objectives only when it is aimed to make profits at the expense of the social objectives. A reasonable level of profit is not only compatible with socially responsible business but also necessary for the discharge of social obligations and responsibility. As George Goyder, the champion of the idea of *social responsibility of business*, observes, "in a responsible company profits will continue to be the criterion of financial health. As blood is the life of man, so are profits the life of industry, and just as man must maintain life before he can be free to pursue the life objects he has set before him…so profits are necessary to business and are in the proper sense of the word primary.[9] In short, a reasonable level of profit is necessary to enable a company to pursue the social objectives.

It is possible that adoption of the *triple P* principle will help companies in enhancing the profit in some cases. For example, the triple R – reduce, reuse, recycle – can lead to cost reduction. Similarly, use of new materials, technologies etc. as part of the green movement can also have similar effects.

Further, consumer preference for green products is increasing. Many consumers are willing to pay a premium for such products.

It is pointed out[10] that the following business-based arguments support the concept of TBL:

- **Reaching untapped market potential:** TBL companies can find financially profitable niches which were missed when money alone was the driving factor. Examples include:
  1. Adding ecotourism and geotourism to an already rich tourism market. Developing profitable methods to assist existing NGOs with their missions such as fundraising, reaching clients, or creating networking opportunities with multiple NGOs
  2. Providing products or services which benefit underserved populations and/or the environment which are also financially profitable.
- **Adapting to new business sectors:** Since many business opportunities are developing in the realm of social entrepreneurialism, businesses hoping to reach this expanding market must design themselves to be financially profitable, socially beneficial and ecologically sustainable or fail to compete with those companies who do design themselves as such. For example, Fair Trade and Ethical Trade companies require ethical and sustainable practices from all of their suppliers and service providers. A business which is planning to work with Fair Trade or Ethical Trade companies must design their business model to be TBL.

People and Planet may be antagonistic to the unscrupulous businessmen. However, they will have to fall in line when the expected moral and social commitment will become a legal obligation.

Limitations

A major difficulty in implementing TBL is accurately measuring the people and planet impacts. There is also no unanimity about the factors to be assessed. Monetisation of people and planet impact is too difficult a task. How do we assign monetary values to the species that are extinct or endangered or weather and climatic changes. Although several indices have been developed for the measurement, they all suffer from several limitations. The application of the TBL by businesses, non-profits and governments are motivated by the principles of economic, environmental and social sustainability, but differ with regard to the way they measure the three categories of outcomes. Proponents who have developed and applied sustainability assessment frameworks like the TBL encountered many challenges, chief among them, how to make an index that is both comprehensive and meaningful and how to identify suitable data for the variables that compose the index. The Genuine Progress Indicator (GPI), for example, consists of 25 variables that encompass economic, social and environmental factors. Those variables are converted into monetary units and summed into a single, dollar-denominated measure.[11]

Further, for many, TBL is mere a fad than a sincere and committed philosophy. The adoption of 3BL rhetoric by a number of very prominent multinationals without traditions of support for green and CSR principles is a more curious phenomenon. Perhaps, it should not be wholly surprising that prominent on this list are some firms trying to shake off recent reputations for decidedly irresponsible business practices or aloof management structures – firms like Shell and BP, British Telecom, AT&T and Dow Chemical. Of course, mind-set changes are possible. But, sometimes they may be eye washes or defensive tactics. There are also large organisations, such as Wal-Mart and McDonald's, which show green initiative but at the same time is unethical to 'people'.

The Emerging Scenario

A large number of business enterprises – multinationals to small ones – now use 3BL terminology in their press releases, annual reports and other documents. Most of the big accounting firms are now using the concept approvingly and offering services to help firms that want to measure, report or audit their two additional "bottom lines". Similarly, there is now a sizable portion of the investment industry devoted to screening companies on the basis of their social and environmental performance, and many of these explicitly use the language of 3BL. Governments, government departments and political parties (especially Green parties) are also well represented in the growing documentation of those advocating or accepting 3BL "principles". For many NGOs and activist organisations, 3BL seems to be pretty much an article of faith.[12]

The popularity the TBL concept made the businessmen and society more concerned about the adverse impacts of economic activities in general and of large business enterprises in particular. Now, there is even clamor for social reporting, in several cases just for the sake of it. There have been several endeavours to develop criteria and framework for social reporting. The Global Reporting Initiative is an important institution in this area. It originated as a project of the Coalition for Environmentally Responsible Economies (CERES) and the United Nations Environment Program (UNEP) in late 1997 and become an independent institution at the end of 2002. This initiative was recognised at the UN World Summit on Sustainable Development. The aim of the guidelines issued by this organisation is to enable companies and other organisations to prepare comparable TBL reports on their economic, environmental and social performances. The GRI is also working with several industries to apply a multistakeholder model to develop industry specific supplements to the core Guidelines.

It is observed that there are a number of corporations that have long prided themselves on their traditions of social responsibility and good corporate citizenship. Having succeeded despite putting principles ahead of short-term profits, societal concern is part of the lore in the cultures of companies like Johnson & Johnson, Levis Strauss, Cadbury's, and IKEA. And in the cultures of many smaller or more recent firms, from The Body Shop to your local organic grocer, CSR and green principles have often served as the organisation's very *raison d'être*. For many of these firms, social and environmental reporting provides an opportunity to display their clean laundry in public, so to speak. They have long sought to improve their social and environmental performance, so they can be confident that reporting these achievements publicly will cause little embarrassment. Indeed, insofar as many of these firms make social responsibility part of their corporate image (hoping to woo the increasingly large pool of consumers and investors who claim to be willing to pay more to support ethical firms), the adoption of 3BL principles and the production of social reports is *consistent with* other strategies of brand management. (This observation is not meant in any way to reduce these efforts to a simple marketing strategy, but just to show why they are a logical step in a direction in which the firm was already traveling.)[13]

National Voluntary Guidelines on Social, Environmental and Economic Responsibilities of Business announced by the Government and the Companies Act, 2012, now make CSR/TBL compelling in India.

It may be mentioned here that several Indian companies have been publishing social audit report, CSR report, sustainability report etc. Some companies have been very quick to respond to the *National Voluntary Guidelines.* For example, the Annual Report of ITC for 2011-12 includes reporting as per the format prescribed by the *Guidelines.*

Although the Companies Act, 2012, mandates companies to spend 2 per cent of their net profit on CSR, there are companies which spend a much higher proportion on CSR. Tata Steel, for example, has been spending 5 to 7 per cent of the profit after tax for this purpose.

GOVERNMENT GUIDELINES

The Ministry of Corporate Affairs had released Voluntary Guidelines on CSR in 2009 as the first step towards mainstreaming the concept of Business Responsibilities. Keeping in view the feedback from stakeholders, it was decided to revise the same with a more comprehensive set of guidelines that encompasses social, environmental and economical responsibilities of business. Accordingly, on 8th July, 2011, Government of India announced the *National Voluntary Guidelines on Social, Environmental and Economic Responsibilities of Business.*

Nature and Significance of the Guidelines

These Guidelines are not prescriptive in nature, but are based on practices and precepts that take into account the realities of Indian business and society as well as global trends and best practices adapted to the Indian context. It urges businesses to embrace the "triple bottom line" approach whereby its financial performance can be harmonised with the expectations of society, the environment and the many stakeholders it interfaces with in a sustainable manner.

The Guidelines have been articulated in the form of nine Principles with the Core Elements to actualise each of the principles. The Guidelines are designed to be used by all businesses irrespective of size (including MSMEs), sector or location and therefore touch on the fundamental aspects – the 'spirit' – of an enterprise.

It is expected that all businesses in India, including multinational companies that operate in the country, would consciously work towards following the Guidelines. The Guidelines also provide a framework for responsible business action for Indian MNCs planning to invest or already operating in other parts of the world. Businesses are encouraged to move beyond the recommended minimum provisions articulated in the document.

Government expects that the adoption of these National Voluntary Guidelines will improve the ability of businesses to enhance their competitive strengths, improve their reputations, increase their ability to attract and retain talent and manage their relations with investors and society at large.

Principles

The Guidelines have been articulated in the form of nine Principles with the Core Elements to actualise each of the principles. A reading of each Principle, with its attendant Core Elements, should provide a very clear basis for putting that Principle into practice.

Principle 1: Businesses should conduct and govern themselves with Ethics, Transparency and Accountability.

Principle 2: Businesses should provide goods and services that are safe and contribute to sustainability throughout their life cycle.

Principle 3: Businesses should promote the well-being of all employees.

Principle 4: Businesses should respect the interests of, and be responsive towards all stakeholders, especially those who are disadvantaged, vulnerable and marginalised.

Principle 5: Businesses should respect and promote human rights.

Principle 6: Business should respect, protect, and make efforts to restore the environment.

Principle 7: Businesses, when engaged in influencing public and regulatory policy, should do so in a responsible manner.

Principle 8: Businesses should support inclusive growth and equitable development.

Principle 9: Businesses should engage with and provide value to their customers and consumers in a responsible manner.

Actions Required

The Principles and Core elements laid down in the Guidelines are required to be integrated in the business policies, strategies and business processes emanating from the core business purpose of an enterprise. According to the Guidelines, this requires, specifically that the following actions are taken:

Leadership. The Chairman/CEO/Owner-Manager should play a proactive role in convincing the board/Top Management and staff within the business that adopting these principles is crucial for success. The board and senior management need to ensure that the principles are fully understood across the organisation and comprehensively executed.

Integration. These principles and core elements must be embedded in the business policies and strategies emanating from the core business purpose of the organization. For this to happen, these must align with each business's internal values and/or must provide clear business benefits.

Engagement. Building strong relationships and engaging with stakeholders on a consistent, continuous basis is crucial.

Reporting. Implementation process includes disclosure by companies of their impact on society and an environment to their stakeholders.

Reporting Framework

For each of these principles, companies need to provide their declaration/report on their compliance and level of compliance by providing numbers, data and any specific cases relevant to each of the principles. The format of a Business Responsibility Report is given in the Table below.

Table 3.1: The Format of a Business Responsibility Report

Part A Basic Company Information	• Business Details • Economic and Financial Details • Management Properties and Commitment • Risks, Goal and Targets that the management deems fit to disclose
Part B Compliance towards the 9 Principles	• Details of compliance across the nine different principles • Explanation to be given if the company is not compliant to any of the principles and when it plans to comply to them
Part C Business Responsibility Information	• Report on any material/significant negative consequences of the operations of the business entity • Brief on Goals and Target in the area of social, environmental and economic responsibilities for the next reporting period

COMPANIES ACT 2013 AND CSR

The much-awaited Companies Bill 2012, which consolidates and amends the Indian law relating to companies, was passed by the Lok Sabha on December 18, 2012. The Bill sought to replace the 56-year-old Companies Act, 1956, with the a new Act, viz., Companies Act, 2013.

With the new legislation, India becomes the first country to make spending towards corporate social responsibility mandatory.

According to Clause 135 of the Act, every company having net worth of ₹ 500 crore or more, or turnover of ₹ 1,000 crore or more or a net profit of ₹ 5 crore or more during any financial year shall constitute a Corporate Social Responsibility Committee (CSRC) consisting of three or more directors, out of which at least one director shall be an independent director.

The CSRC shall formulate and recommend to the Board, a Corporate Social Responsibility Policy (CSRP) which shall indicate the activities to be undertaken by the company as specified in Schedule VII of the Act. The Committee shall recommend the amount of expenditure to be incurred on these activities. The Committee shall also monitor the CSR Policy of the company from time to time.

It shall be ensured that the company spends, in every financial year, at least two per cent of the average net profits of the company during the three immediately preceding financial years, in pursuance of its CSR Policy. The company shall give preference to the local area and areas around it where it operates, for spending the amount earmarked for Corporate Social Responsibility activities.

The Board shall disclose in its report the contents of the CSR Policy as approved by the Board considering the recommendations made by the CSR Committee, and shall also place it on the company's website, if any.

According to Schedule VII, the activities which may be undertaken under the CSR Policy relate to:

(i) eradicating extreme hunger and poverty;

(ii) promotion of education;

(iii) promoting gender equality and empowering women;

(iv) reducing child mortality and improving maternal health;

(v) combating human immuno deficiency virus, acquired immune deficiency syndrome, malaria and other diseases;

(vi) ensuring environmental sustainability;

(vii) employment enhancing vocational skills;

(viii) social business projects;

(ix) contribution to the Prime Minister's National Relief Fund or any other fund set up by the Central Government or the State Governments for socio-economic development and relief and funds for the welfare of the Scheduled Castes, the Scheduled Tribes, other backward classes, minorities and women; and

(x) such other matters as may be prescribed.

It shall be ensured that the company spends, in every financial year, at least two per cent of the average net profits of the company during the three immediately preceding financial years, in pursuance of its CSR Policy. The company shall give preference to the local area and areas around it where it operates, for spending the amount earmarked for Corporate Social Responsibility activities.

In the statements laid before a company in general meeting, there shall be attached a report by its Board of Directors the details about the policy developed and implemented by the company on CSR initiatives taken during the year. If the company fails to spend the specified amount, the Board shall specify the reasons for it.

SOCIAL AUDIT

Meaning

One important issue related to social responsibility of business is how to evaluate the social performance. In other words, *social audit is a tool for evaluating how satisfactorily a company has discharged its social responsibilities. Social audit enables the public as well as the company to evaluate the social performance of the company*.

Bauer and Fenn Jr. define social audit as "a commitment to systematic assessment of and activities on some meaningful, definable domain of the company's activities that have social impact." According to Ahmed Belkaoui, "social audit much like the financial audit – is an identification and examination of the activities of the firm in order to assess, evaluate, measure and report their impact on the immediate social environment." In other words, social audit involves:

1. Identification of the firm's activities having potential social impact;
2. Assessment and evaluation of the social costs and social benefits of such activities;
3. Measurement of the social costs and benefits; and
4. Reporting, that is presenting in a proper format and manner, the social performance of the firm.

Dr. Clark C. Abt, in his book *Audit for Management*, suggests that a social Audit should, as far as possible, be approximated to an ordinary commercial audit; that this should be based on a social balance sheet with a "credit" side and "debt" side. He calls them "inputs" and "outputs" or "costs" and "benefits" so far as the social balance sheet is concerned. After suggesting that every "input" and "output" must be measured in monetary terms, he points out that the basic purpose of a business corporation is to maximise the financial return, earned on its financial investment plus the amount of social return on its social investment. To make rational investment decisions in social areas, it is necessary to know the social costs and if we are to assess them by the same measures as of financial investment, this must be expressed in dollar terms. He further asserts that, sooner or later, the social balance sheet must become a mandatory part of the normal commercial balance sheet of the company.

Objectives and Benefits of Social Audit

1. The basic objective of social audit is to evaluate the social dimensions of the performance of the company.
2. Another principal objective which follows the objective mentioned above is to take measures to improve the social performance of the company on the basis of the feedback provided by the social audit.
3. Social audit increases the *public visibility* of the organisation.
4. If the social audit reveals a socially commendable performance of the company, it will help boost the public image of the company.

Methods of Social Audit

There is no single universally agreed upon method of social auditing. Some of the important methods of social audit developed by different people or organisations are given below.

(i) Social Process Audit: The aim of the social process audit, also known as *Programme Management Audit*, is to develop an internal management information system that will allow management to create and administer the social programmes in a better way. This involves the determination of the objectives of the social programmes and a social cost-benefit analysis of the programmes with a view to determining whether these objectives have been met.

(ii) Financial Statement Format Audit: Under the financial statement format audit, the social information is presented in the conventional financial statement format, i.e., balance sheet and/or income statement.

(iii) Macro-Micro Social Indicator Audit: The macro-micro social indicator audit attempts to evaluate the micro indicators (i.e., the company's performance) against a set of macro indicators such as national policies.

(iv) Constituency Group Audit: Under this audit, the preference and attitudes of various constituencies (like employees, creditors, suppliers and customers) are identified and measured and the firm's performance is evaluated against the criteria developed for each group.

(v) Partial Social Audit: Partial social audit evaluates any particular aspects of social performance like energy conservation or ecological preservation.

(vi) Comprehensive Audit: Comprehensive audit attempts to evaluate the total performance of the organisation including social performance.

(vii) Corporate Rating Approach: In contra distinction to the audits mentioned above, this is an external evaluation of the company's performance by public groups like consumer organisations, social welfare organisations or media.

Given below is the format of social reporting used by the Cement Corporation of India.

Obstacles in Social Audit

Social audit encounters a number of problems. The important obstacles are:

1. Being a relatively new concept, social audit is yet to gain wide appreciation and acceptance.
2. Being a relatively new concept, a clear and generally well accepted methodology for conducting the social audits is not available.
3. There is no agreement as to the items to be included for social audit.
4. It is very difficult, and in several cases even impossible, to quantity the social costs and benefits of different activities or items.
5. There may be resistance within the company to social audit because of the time, effort, and difficulty involved in the task.
6. There may also be resistance because of the fear of a dismal or unsatisfactory picture that may be presented by the social audit.

As Committee set up by the Tata Iron and Steel Company Limited (TISCO) to conduct the Social Audit of the TISCO points out, though social audits have been undertaken in a number of countries, principally in the USA (to which the practice owes its origin), Japan, the UK and one or two other Western countries, the subject has not yet attained the status of a science. There is no agreement, much less unanimity, among its most ardent proponents, particularly as to its basic principles or its true objectives. It is only a child of the last decade, during which there has been a growing concern about the environment and the problems of pollution, consumer protection, workers' safety and equal employment opportunities. Melvin Anshen, Professor of Public Policy and Business Responsibility at the Graduate School of Business, Columbia University, and an eminent authority on the subject, remarks that "the social audit has been described as an idea whose time has come but which isn't ready to be taken off the drawing board and put to work".

Social Audit in India

Although the idea of social audit originated in the United States about half a century ago, it is only recently that it received serious attention of corporations even in the advance countries.

The first comprehensive social audit in India was conducted by the TISCO in 1980. It was conducted by the Social Audit Committee appointed by the Board of Directors of the company "to examine and report whether, and the extent to which, the company has fulfilled the objectives contained in Clause 3A of its Articles of Association regarding its social and moral responsibilities to the consumers, employees, shareholders, society and the local community." The report of the Committee was a glowing tribute to the endeavours of the company in the discharge of its social and moral obligations to the various segments of the society.

The High Powered Expert Committee on Companies and MRTP Acts (Sachar Committee) observes that the acceptance of the concept of social responsibility must be reflected in the information and disclosures that the company makes available for the benefit of its various

constituents – shareholders, creditors, workers and the community – and has suggested that a provision may be made in the Companies Act that every company shall give a social report which will indicate and quantify, in as precise and clear terms as possible, the various activities relating to social responsibility which have been carried out by the company in the previous year. The Committee has further suggested that it is possible that a company may be required to alter its Memorandum with respect to the objects of the company so as to carry out its activities as an obligation to the concept of social responsibility. It should be pointed out here that the TISCO had, in 1970, voluntarily incorporated in its Articles of Association its social and moral responsibilities to the consumers, employees, shareholders, society and the local people.

WORLD BUSINESS COUNCIL FOR SUSTAINABLE DEVELOPMENT

A major offender of the planet is the business sector. Awakening of captains of industry on this issue, therefore, is of critical importance. The World Business Council for Sustainable Development (WBCSD) is a commendable CEO-led global initiative to galvanise the global business community to create a sustainable future for business, society and the environment. Over the last one decade, the Council has created respected thought leadership on business and sustainability.

The World Business Council for Sustainable Development (WBCSD), founded on the eve of the 1992 Rio Earth Summit, was the brainchild of the Swiss industrialist, Stephan Schmidheiny, who had long the foresight to realise that business had an inescapable role to play in the search for sustainable development. He believed that business could act as a catalyst for change towards the achievement of sustainable development; at the same time, business needs sustainable development in order to fulfill its potential.

The WBCSD which is a CEO-led, global association of some 200 companies dealing exclusively with business and sustainable development, provides a platform for companies to explore sustainable development, share knowledge, experiences and best practices, and to advocate business positions on these issues in a variety of forums, working with governments, non-governmental and intergovernmental organisations.

Members of WBCSD are drawn from more than 30 countries and 20 major industrial sectors. The Council also benefits from a global network of some 60 national and regional business councils and regional partners. From India, Infosys technologies and Reliance Industries are members.

By thinking ahead, advocating for progress and delivering results, the WBCSD both increases the impact of our members' individual actions and catalyses collective action that can change the future of our society for the better.

The mission of WBCSD is *to provide business leadership as a catalyst for change towards sustainable development, and to support the business license to operate, innovate and grow in a world increasingly shaped by sustainable development issues.*

The Council's objectives are to:

- Be a *leading business advocate* on sustainable development;

- *Participate in policy development* to create the right framework conditions for business to make an effective contribution to sustainable human progress;
- Develop and promote the *business case for sustainable development*;
- *Demonstrate the business contribution* to sustainable development solutions and share leading edge practices among members;
- Contribute to a *sustainable future* for developing nations and nations in transition.

In order to achieve this, the Council focuses on four key areas: *Energy and Climate, Development, The Business Role* and *Ecosystems*. In order to fulfill this new mandate, the WBCSD work program includes projects and initiatives mixing both on-the-ground action and advocacy, business experiences in implementation and activities challenging sustainability thinking within companies, and the strengthening of its regional network.

During its first decade, the WBCSD was guided by the need to engage with business to highlight the importance of sustainable development and the relationship between business and sustainable development.

Working through its membership, stakeholders, partners and regional networks, the WBCSD has reached out to an extensive network and assisted these diverse groups in articulating a common vision of the business contribution to sustainable development.

The number of members, its outreach and the number of businesses – WBCSD members and others – who have moved to engage with the issue of sustainability attest to the WBCSD's success. It is also evidenced by the growing number of companies integrating corporate social responsibility and sustainability measures into their business decisions and the number of initiatives responding to sustainability concerns.

Vision 2050 Report

In 2010, The World Business Council for Sustainable Development brought out a report entitled *Vision 2050: The New Agenda for Business*, a study that lays out a pathway leading to a global population of some 9 billion people living well, within the resource limits of the planet by 2050. This Report is the result of an 18-month combined effort with CEOs and experts, and dialogues with over 200 companies and external stakeholders in some 20 countries.

Vision 2050 addressed thought-provoking questions like:

- What would a vision of a sustainable future look like?
- What are the pathways and solutions for achieving sustainability?
- What does this say for the changes needed?
- What are the risks to achieving this "sustainable" future?
- What are the dilemmas we must address to move forward?
- What are the robust actions, policies and investments needed to move rapidly onto a sustainable pathway?
- …and what is the role of business?

The report presents new opportunities for business in a broad range of business segments with the foresight to lead their societies on a sustainable business development agenda. It lays out the

challenges, pathways and options that business can use to create an opportunity-rich strategy, both regionally and globally, that will lead to a sustainable world.

The publication outlines a future in which 9 billion people live well, enjoying health, food, shelter, energy, mobility, education and other basics of life. Syngenta CEO, Michael Mack added that "humanity has largely had an exploitative relationship with our planet; we can, and should, aim to make this a symbiotic one." In the *Vision 2050* scenario, global society attains this standard of living at a sustainable rate, without further harm to biodiversity, climate and ecosystem services.

The report states that the world already has the resources to achieve *Vision 2050*, but there is a catch. The radical changes highlighted in *Vision 2050* demand a different perspective from business leaders, requiring them to rethink how they operate to stay on track for a sustainable future. This includes a radical transformation of global markets, governance and infrastructure, and a rethinking of our ideas of growth and progress.

Vision 2050 spells out the "must haves" – the things that must happen over the coming decade to make a sustainable planetary society possible. These include incorporating the costs of externalities, starting with carbon, ecosystem services and water, into the structure of the marketplace; doubling agricultural output without increasing the amount of land or water used; halting deforestation and increasing yields from planted forests: halving carbon emissions worldwide (based on 2005 levels) by 2050 through a shift to low-carbon energy systems and improved demand-side energy efficiency, and providing universal access to low-carbon mobility.

As part of this transformation, *Vision 2050* calls for a new agenda for business: to work with government and society worldwide to transform markets and competition. Sustainability shall become a key driver for all our investment decisions. New rules for markets will reframe environmental challenges as economic challenges, driving innovation and competition in the direction of sustainability and away from resource- and energy-intensive production. Rationalising prices to include such externalities as climate and biodiversity impacts will make corporate environmental efficiency a true competitive advantage across all industries and regions.

Business will lead market change by doing what business does best: forming partnerships, creating efficiencies and competitive advantage, seizing opportunities and meeting customer needs. At the same time, a shift toward sustainability will trigger trillions of dollars in new investments in infrastructure, technology and human services, creating new opportunities for business to thrive and grow. A recent study commissioned for this project with PriceWaterhouseCoopers indicates that this investment could reach US $ 3-10 trillion per annum in 2050.

Vision 2050, with its best-case scenario for sustainability and pathways for reaching it, is a tool for thought leadership, a platform for beginning the dialogue that must take place to navigate the challenging years to come. "It is hoped that the *Vision 2050* work will be used for many years to come. It is designed to be a platform for companies when deliberating strategies and for dialogue with governments and society about how to realise the sustainable future," concluded Per Sandberg, Project Director for *Vision 2050*.

(The information provided here is drawn from the website of WBCSD.)

Box 3.3

Legal Principles for Environmental Protection and Sustainable Development

The Legal Principles for Environmental Protection and Sustainable Development Adopted by the UN's *World Commission on Environment and Development* **Experts Group on Environmental Law include the following** General Principles, Rights, and Responsibilities, which are clearly indicative of the role of the Government.

Fundamental Human Right. All human beings have the fundamental right to an environment adequate for their health and well-being.

Inter-generational Equity. States shall conserve and use the environment and natural resources for the benefit of present and future generations.

Conservation and Sustainable Use. States shall maintain ecosystems and ecological processes essential for the functioning of the biosphere, shall preserve biological diversity, and shall observe the principle of optimum sustainable yield in the use of living natural resources and ecosystems.

Environmental Standards and Monitoring. States shall establish adequate environmental protection standards and monitor changes in and publish relevant data on environmental quality and resource use.

Prior Environmental Assessments. States shall make or require prior environmental assessments of proposed activities which may significantly affect the environment or use of a natural resource.

Prior Notification, Access, and Due Process. States shall inform in a timely manner all persons likely to be significantly affected by a planned activity and to grant them equal access and due process in administrative and judicial proceedings.

Sustainable Development and Assistance. States shall ensure that conservation is treated as an integral part of the planning and implementation of development activities and provide assistance to other States, especially to developing countries, in support of environmental protection and sustainable development.

General Obligation to Cooperate. States shall cooperate in good faith with other States in implementing the preceding rights and obligations.

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CHAPTER

4

Corporate Governance

Corporate governance has a significant role in strategic management. Good governance fortifies the corporate mission and philosophy, ensures compliance with government regulations and societal norms and fosters efficiency, fairness and transparency in management. Stirred by turbulence in the corporate sector, characterised by corporate failures, frauds and rampant unfairness in the conduct of business and governance in general, corporate governance has become a subject of serious and frequent discussion across the world since the early 1990s.

The great significance of corporate governance is highlighted by James D. Wolfensohn, President of World Bank, as follows: "The governance of the corporation is now as important to the world economy as the government of countries"[1]

Absence of a generally well accepted corporate governance framework consisting of a regulatory system and a system of principles and guidelines was, *inter alia*, a deterrent to the development of standard corporate governance practices. It is, therefore, not surprising that the last few decade or so has witnessed a number of committees/task forces at the national and international levels, appointed by governments, industry organisations, regulatory bodies, international organisations etc. to recommend regulatory measures and principles for corporate governance.

Box 4.1

The Truth about Corporate Governance

It would be appropriate to start the discussion of corporate governance by citing the observations of the Task Force on Corporate Governance,* constituted by the Confederation of Indian Industry (CII) under the Chairmanship Rahul Bajaj: Although "corporate governance" still remains an ambiguous and misunderstood phrase, three aspects are becoming evident:

- First, there is no unique structure of "corporate governance" in the developed world; nor is one particular type unambiguously better than others. Thus, one cannot design a code of corporate governance for Indian companies by mechanically importing one form or another.
- Second, Indian companies, banks and financial institutions (FIs) can no longer afford to ignore better corporate practices. As India gets integrated in the world market, Indian as well as international investors will demand greater disclosure, more transparent explanation for major decisions and better shareholder value.
- Third, corporate governance goes far beyond company law. The quantity, quality and frequency of financial and managerial disclosure, the extent to which the board of directors exercise their

fiduciary responsibilities towards shareholders, the quality of information that management share with their boards, and the commitment to run transparent companies that maximise long-term shareholder value cannot be legislated at any level of detail. Instead, these evolve due to the catalytic role played by the more progressive elements within the corporate sector and, thus, enhance corporate transparency and responsibility.

Source: * *Desirable Corporate Governance: A Code* – Report of CII Taskforce on Corporate Governance (1998).

WHAT IS CORPORATE GOVERNANCE?

Although corporate governance has been discussed a lot across the globe, there is considerable variations in the conceptual definition. As indicated in Box 4.1, there is no single model of corporate governance best applicable to all countries because of the differences in the business environmental factors, such the legal system, characteristics of the corporate sector, political system and government, social norms and cultural factors etc.

The above observation is based on the studies on corporate governance practices across several countries by the Asian Development Bank (2000), International Monetary Fund (1999), Organisation for Economic Cooperation and Development (OECD) (1999) and the World Bank (1999). According to the OECD Code document, different legal systems, institutional frameworks and traditions across countries have led to the development of a range of different approaches to corporate governance. In addition, observes the Narayana Murthy Committee, best-managed corporations also recognise that business ethics and corporate awareness of the environmental and societal interest of the communities within which they operate, can have an impact on the reputation and long-term performance of corporations.

The report of the first CII Task Force on Corporate Governance under the Chairmanship of Rahul Bajaj (1998) has pointed out that there is a diversity of opinion regarding beneficiaries of corporate governance. The Anglo-American system tends to focus on shareholders and various classes of creditors. Continental Europe, Japan and South Korea believe that companies should also discharge their obligations towards employees, local communities, suppliers, ancillary units, and so on.

Most of the definitions articulated in the codes of the reports on corporate governance relate corporate governance to control of the company, of corporate management, or of company conduct or managerial conduct. A simple definition, but very broad in its implications, which is often quoted, is provided by the Cadbury Report (UK): "Corporate governance is the system by which businesses are directed and controlled."

In its narrowest sense, the term may describe the formal system of accountability of senior management to the shareholders. At its most expansive, the term is stretched to include the entire network of formal and informal relations involving the corporate sector and their consequences for the society in general. Corporate governance, however, as generally understood, includes the structure, process, cultures and systems that engender the successful operation of the organisations.[2]

The Cadbury Report has elaborated that "…corporate governance is concerned with holding the balance between economic and social goals and between individual and communal goals. The governance framework is there to encourage the efficient use of resources and equally to require

accountability for the stewardship of those resources. The aim is to align as nearly as possible the interests of individuals, of corporations and of society."

"The concept of corporate governance primarily hinges on complete transparency, integrity and accountability of the management… There is also an increasingly greater focus on investor protection and public interest."[3]

The second CII Task Force on Corporate Governance, under the chairmanship of Naresh Chandra (2009) observes: Good corporate governance involves a commitment of a company to run its businesses in a legal, ethical and transparent manner – a dedication that must come from the very top and permeate throughout the organisation. That being so, much of what constitutes good corporate governance has to be voluntary. Law and regulations can, at best, define the basic framework – boundary conditions that cannot be crossed.

According to the OECD Principles of Corporate Governance, corporate governance involves a set of relationships between a company's management, its board, its shareholders and other stakeholders. Corporate governance also provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined. Good corporate governance should provide proper incentives for the board and management to pursue objectives that are in the interests of the company and its shareholders and should facilitate effective monitoring. In addition, factors such as business ethics and corporate awareness of the environmental and societal interests of the communities in which a company operates can also have an impact on its reputation and its long-term success.

The N.R. Narayana Murthy Committee on Corporate Governance, appointed by SEBI, seems to confer with the OECD view when it observes that corporate governance is the acceptance by management of the inalienable rights of shareholders as the true owners of the corporation and of their own role as trustees on behalf of the shareholders. It is about commitment to values, about ethical business conduct and about making a distinction between personal and corporate funds in the management of a company.

According to the *minimal definition* purported by the first CII Task Force (1998), corporate governance deals with laws, procedures, practices and implicit rules that determine a company's ability to take managerial decisions *vis-à-vis* its claimants — in particular, its shareholders, creditors, customers, the State and employees.

The CII Task Force observes that there is a global consensus about the objective of 'good' corporate governance: *maximising long-term shareholder value*. Since shareholders are residual claimants, this objective follows from a premise that, in well performing capital and financial markets, whatever maximises shareholder value must necessarily maximise corporate prosperity, and best satisfy the claims of creditors, employees, shareholders, and the State.

In short, "Corporate Governance may be defined as a set of systems, processes and principles which ensure that a company is governed in the best interest of all stakeholders. It is the system by which companies are directed and controlled. It is about promoting corporate fairness, transparency and accountability. In other words, 'good corporate governance' is simply 'good business'. It ensures:

- Adequate disclosures and effective decision-making to achieve corporate objectives;
- Transparency in business transactions;

- Statutory and legal compliances;
- Protection of shareholder interests;
- Commitment to values and ethical conduct of business."[4]

Now, there is a growing recognition of the difference between corporate governance and corporate management and the need to align corporate management with corporate governance.

Corporate governance is concerned with compliances, values, vision and visibility. It is about governance structure, the value orientation of the organisation, ethical norms for its performance, the direction of development and social accomplishment of the organisation and the visibility of its performance and practices. Corporate management is concerned with the efficiency of the resource use, value addition and wealth creation within the broad parameters of the corporate philosophy established by corporate governance. "In short, the concept of good corporate governance connotes that ethics is as important as economics, fair play as crucial as financial success, morals as vital as market share."

According to the Narayana Murthy Committee on Corporate Governance, the most common school of thought would have us believe that if management is about running businesses, governance is about ensuring that it is run properly. All companies need governing as well as managing. The aim of "Good Corporate Governance" is to enhance the long-term value of the company for its shareholders and all other partners.

Box 4.2

The Evolution of Corporate Governance

Corporate governance systems have evolved over centuries, often in response to corporate failures or systemic crises. The first well-documented failure of governance was the South Sea Bubble in the 1700s, which revolutionised business laws and practices in England. Similarly, much of the securities lawin the United States was put in place following the stock market crash of 1929. There has been no shortage of other crises, such as the secondary banking crisis of the 1970s in the United Kingdom and the US savings and loan debacle of the 1980s. The history of corporate governance has also been punctuated by a series of well-known company failures: the Maxwell Group raid on the pension fund of the Mirror Group of newspapers, the collapse of the Bank of Credit and Commerce International and Barings Bank. Each crisis or major corporate failure – often a result of incompetence, fraud, and abuse was met by new elements of an improved system of corporate governance.

Through this process of continuous change, developed countries have established a complex mosaic of laws, regulations, institutions, and implementation capacity in the government and the private sector. The objective is not to shackle corporations but rather to balance the spirit of enterprise with greater accountability. The systematic enforcement of law and regulations has created a culture of compliance that has shaped business culture and the management ethos of firms, spurring them to improve as a means of attracting human and financial resources on the best possible terms. This continuous process of change and adaptation has accelerated with the increasing diversity and complexity of shareholders and stakeholders. Globalisation, too, is forcing many companies to tap into international financial markets and to face greater competition. This has led to restructuring and a greater role for mergers and acquisitions and to expanded markets for corporate control.

The developing world has also faced its own corporate governance challenges. For instance, in Russia, a substantive share of the profits of an oil company was siphoned off by its controlling shareholder, leaving the company in debt to its creditors, employees, and the State. In the Czech Republic, thousands of small shareholders lost their investments as "tunneling" schemes by insiders stripped privatised companies of their assets. The economic crises in East Asia and other regions have demonstrated how

macroeconomic difficulties can be exacerbated by a systemic failure of corporate governance stemming from weak legal and regulatory systems, inconsistent accounting and auditing standards, poor banking practices, thin and unregulated capital markets, ineffective oversight by corporate boards of directors, and little regard for the rights of minority shareholders. Unfortunately, the brunt of the impact has been shouldered by the poor, setting back social and economic gains by a generation in some countries.

Increasingly for developing and transition economies, a healthy and competitive corporate sector is fundamental for sustained and shared growth sustained in that it withstands economic shocks, shared in that it delivers benefits to all of society. Countries realise that just as overall governance is important in the public sector, so corporate governance is important in the private sector. They also realise that good governance of corporations is a source of competitive advantage and critical to economic and social progress. With globalisation, firms must tap domestic and international capital markets in quantities and ways that would have been inconceivable even a decade ago. Increasingly, individual investors, funds, banks, and other financial institutions base their decisions not only on a company's outlook, but also on its reputation and its governance. It is this growing need to access financial resources, domestic and foreign, and to harness the power of the private sector for economic and social progress that has brought corporate governance into prominence the world over.

Source: The World Bank Group, *Corporate Governance: A Framework for Implementation* – Overview (2000).

IMPORTANCE OF CORPORATE GOVERNANCE

Box 4.2 has indicated the growing importance of corporate governance.

The Preface to the Birla Committee Report has highlighted the significance and need for good corporate governance. The salient points are reproduced in the following paragraphs:

It is almost a truism that the adequacy and the quality of corporate governance shape the growth and the future of any capital market and economy. The concept of corporate governance is no longer confined to the halls of academic and is increasingly finding acceptance for its relevance and underlying importance in the industry and capital markets. Progressive firms in India have voluntarily put in place systems of good corporate governance. Internationally also, while this topic has been accepted for a long time, the financial crisis in emerging markets has led to renewed discussions and inevitably focused them on the lack of corporate as well as governmental oversight. The same applies to recent high-profile financial reporting failures even among firms in the developed economies. Focus on corporate governance and related issues is an inevitable outcome of a process, which leads firms to increasingly shift to financial markets as the pre-eminent source for capital. In the process, more and more people are recognising that corporate governance is indispensable to effective market discipline. This growing consensus is both an enlightened and a realistic view. In an age where capital flows worldwide, just as quickly as information, a company that does not promote a culture of strong, independent oversight, risks its very stability and future health. As a result, the link between a company's management, directors and its financial reporting system has never been more crucial. As the boards provide stewardship of companies, they play a significant role in their efficient functioning.

Studies of firms in India and abroad have shown that markets and investors take notice of well-managed companies, respond positively to them, and reward such companies, with higher valuations. A common feature of such companies is that they have systems in place, which allow sufficient freedom to the boards and management to take decisions towards the progress of their companies and

to innovate, while remaining within a framework of effective accountability. In other words, they have a system of good corporate governance.

Strong corporate governance is thus indispensable to resilient and vibrant capital markets and is an important instrument of investor protection. It is the blood that fills the veins of transparent corporate disclosure and high-quality accounting practices. It is the muscle that moves a viable and accessible financial reporting structure. Without financial reporting premised on sound, honest numbers, capital markets will collapse upon themselves.

Another important aspect of corporate governance relates to issues of insider trading. It is important that insiders do not use their position of knowledge and access to inside information about the company, and take unfair advantage of the resulting information asymmetry. To prevent this from happening, corporates are expected to disseminate the material price-sensitive information in a timely and proper manner and also ensure that till such information is made public, insiders abstain from transacting in the securities of the company. The principle should be 'disclose or desist'. This, therefore, calls for companies to devise an internal procedure for adequate and timely disclosures, reporting requirements, confidentiality norms, code of conduct and specific rules for the conduct of its directors and employees and other insiders. However, the need for such procedures, reporting requirements and rules also goes beyond corporates to other entities in the financial markets such as Stock Exchanges, Intermediaries, Financial Institutions, Mutual Funds and concerned professionals who may have access to inside information.

Good corporate governance, besides protecting the interests of shareholders and all other stakeholders, contributes to the efficiency of a business enterprise, to the creation of wealth and to the country's economy. In a sense, both these points of view are related and during the discussions at the meetings of the Committee, there was a clear convergence of both points of view.

According to Charkham, good corporate governance is considered vital from medium- and long-term perspectives to enable firms to compete internationally in sustained way and make them flourish and grow so as to provide employment, wealth and satisfaction, not only to improve standard of living materially but also to enhance social cohesion.[5]

CORPORATE GOVERNANCE DETERMINANTS

There are a number of influencing factors shaping the corporate governance system (the corporate governance environment). Figure 4.1 highlights these factors and the benefits of corporate governance. [This figure, originally presented in this author's *Business Environment: Text and Cases*, has been reproduced by another author, without acknowledgement, in his books *Corporate Governance* and *Business Ethics and Corporate Governance* as 'Indian Corporate Governance Model'.]

As indicated in Figure 4.1, there are some *pre-requisites* for good corporate governance. They are:

- A proper system consisting of clearly defined and adequate structure of roles, authority and responsibility.
- Vision, principles and norms which indicate the development path, normative considerations, and guidelines for performance.
- A proper system for guiding, monitoring, reporting and control.

For a good corporate governance system, "what is needed is a combination of statutory regulation and self-regulation. The mix will vary around the world, but nowhere can statutory regulation alone promote effective governance. The stronger the partnership between the public and private sectors, the more soundly based will be their governance structures."[6]

External Determinants

Government Regulations. As the OECD Business Sector Advisory Group's Report on Corporate Governance (1988) has emphasised, while corporate governance should remain primarily a private sector prerogative, governments have a distinct and important responsibility in providing a regulatory framework that allows investors and enterprises to adapt corporate governance practices to rapidly changing circumstances. In other words, good corporate governance can best be achieved through a combination of regulatory and voluntary private actions.

On the regulatory side, the Report noted that government interventions are most effective when consistently and expeditiously enforced. They should focus on:

- **Fairness:** protecting shareholder rights and ensuring the enforceability of contracts with resource providers.
- **Transparency:** requiring timely disclosure of adequate information on corporate financial performance.
- **Accountability:** clarifying governance roles and responsibilities and supporting voluntary efforts to ensure the alignment of managerial and shareholder interests, as monitored by a board of directors—or in certain nations, a board of auditors—with some independent members.
- **Responsibility:** ensuring corporate compliance with the other laws and regulations that reflect society's values, including a broad sensitivity to the objectives of the society in which corporations operate.

The Report, however, stressed that regulatory measures, though necessary, are not sufficient to raise standards. Indeed, the strengthening of corporate governance standards has been advanced by many corporate leaders who recognise that prospering in the long-term requires balancing business objectives with society's concerns.

In India, the regulatory framework is provided mostly by the Companies Act, the SEBI and the stock exchanges which are regulated by the Securities Contracts (Regulations) Act. Also see the subsection *Legal Environment of Corporate Governance* in India under the section the *Indian Scenario*.

Other External Influences. Other external influences include codes/guidelines etc. pertaining to corporate governance brought out by industry associations like the CII, international developments in the field of corporate governance, including the several reports on corporate governance as indicated under the section *What is Corporate Governance*? Further, media and public opinion also play a role.

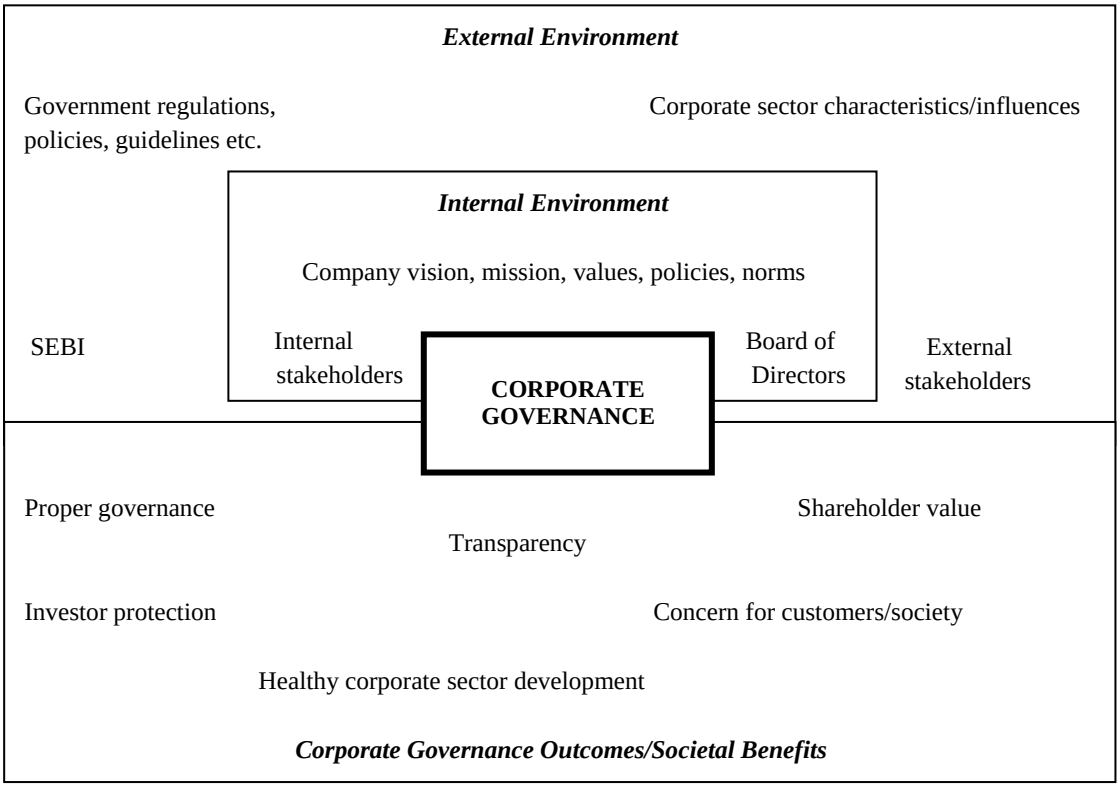

Fig. 4.1: Corporate Governance Environment and Outcomes

Internal Determinants

The corporate governance culture and practice of an organisation are shaped by factors such as its legacy, vision, mission, policies, norms, governance structure, powers and responsibilities of the key constituents, persons holding key positions in the organisation etc.

The Birla Committee has identified the three key constituents of corporate governance as the Shareholders, the Board of Directors and the Management and has attempted to identify, in respect of each of these constituents, the roles and responsibilities as also the rights in the context of good corporate governance. Fundamental to this examination is the recognition of the three key aspects of corporate governance, viz., accountability, transparency and equality of treatment for all stakeholders.

Board of Directors. The Birla Committee observes that the pivotal role in any system of corporate governance is performed by the board of directors. It is accountable to the stakeholders and directs and controls the Management. It stewards the company, sets its strategic aim and financial goals and oversees their implementation, puts in place adequate internal controls and periodically reports the activities and progress of the company in a transparent manner to the stakeholders.

For details about the role of the Board, see the sub-section *The Responsibilities of the Board* under the section *Principles of Corporate Governance*.

Shareholders. One of the primary purposes of corporate governance shall be the protection of interests of shareholders, who place their trust in corporations to use their investment funds wisely and effectively. The shareholders have a vital role in corporate governance by exercising their powers and rights. According to the Birla Committee, the shareholders' role in corporate governance is to appoint the directors and the auditors and to hold the board accountable for the proper governance of the company by requiring the board to provide them periodically with the requisite information, in a transparent fashion, of the activities and progress of the company. Also see the sub-section *The Rights of Shareholders and Key Ownership Functions* and *The Equitable Treatment of Shareholders* under the section *Principles of Corporate Governance.*

Management. The third key internal constituent of corporate governance is the management. The Birla Committee points out that the responsibility of the management is to undertake the management of the company in terms of the direction provided by the Board, to put in place adequate control systems and to ensure their operation and to provide information to the board on a timely basis and in a transparent manner to enable the Board to monitor the accountability of management to it.

BENEFITS OF GOOD CORPORATE GOVERNANCE

Several benefits of good corporate governance have already been described in Box 4.2 and in the section *Importance of Corporate Governance.*

Figure 4.1 shows the major outcomes or benefits of good corporate governance. The major benefits are stated very specifically below.

1. Good governance provides proper framework for efficient management of the organisation ensuring complete transparency, integrity and accountability of the management.
2. A well governed company protects the rights and interests of the shareholders and maximises long-term shareholder value. Indeed, one of the primary objectives of corporate governance is maximisation of the long-term value of the company for its shareholders and all other partners.
3. It leads to a socially justifiable efficient management of the company by striking a proper balance between the different stakeholders and the societal interests. "Corporate governance is concerned with holding the balance between economic and social goals and between individual and communal goals. The governance framework is there to encourage the efficient use of resources and equally to require accountability for the stewardship of those resources. The aim is to align as nearly as possible the interests of individuals, corporations, and society."[7]
4. Good corporate governance provides proper direction for the long-term development of the organisation.
5. Companies which are governed well enjoy the trust and goodwill of shareholders and other stakeholders. This will have its reflection in the capital market by active trading in the securities, better market capitalisation and ease of raising capital – both equity and debt. "Sound corporate governance is important not only to attract long-term "patient" foreign capital, but more especially to broaden and deepen local capital markets by attracting local investors – both individual and institutional. Unlike international investors who can diversify

their risk, domestic investors are often captive to the system and face greater risks, particularly in an environment that is opaque and does not protect the rights of minority shareholders."[8]

6. Companies which are governed properly often enjoy better relationships and terms with suppliers, buyers and marketing intermediaries.
7. Well governed companies are in a better position to attract foreign capital, technical collaborations and business.
8. As the Birla Committee has pointed out, strong corporate governance is indispensable to resilient and vibrant capital markets and is an important instrument of investor protection.
9. Good governance helps a company to attract and retain efficient independent directors, managerial and other human resources.

   Good governance will help gain goodwill of consumers and the public.

11. As pointed out in Box 4.1, as India gets integrated in the world market, Indian as well as international investors will demand greater disclosure, more transparent explanation for major decisions and better shareholder value.
12. As the Birla Committee has observed, good corporate governance, besides protecting the interests of shareholders and all other stakeholders, contributes to the efficiency of a business enterprise, to the creation of wealth and to the country's economy. As a *World Bank Report* observes, there is a growing recognition that "good governance of corporations is a source of competitive advantage and critical to economic and social progress."[9]

PRINCIPLES OF CORPORATE GOVERNANCE

In the context of growing awareness of the importance of good corporate governance, the OECD has developed a set of Principles of Corporate Governance, endorsed by OECD Ministers in 1999, which have since become an international benchmark for policymakers, investors, corporations and other stakeholders worldwide. They have advanced the corporate governance agenda and provided specific guidance for legislative and regulatory initiatives in both OECD and non-OECD countries.

These Principles represent a collective view of the most important core elements of a good corporate governance framework. However, they leave adequate flexibility for implementation according to specific circumstances, cultures and traditions in different countries. The Principles are non-binding. They are intended to serve as a reference point for governments as they review and refine their frameworks for corporate governance. They also provide guidance for stock exchanges, investors, private corporations and national commissions on corporate governance as they elaborate best practices, listing requirements and codes of conduct.

The OED document on Corporate Governance was revised in 2004. The revised document has laid down six principles of corporate governance as against five in the previous document. The addition is the requirement of an effective corporate governance framework. The areas covered by the six principles are:

- Ensuring the basis for an effective corporate governance framework.
- The rights of shareholders and key ownership functions.

- The equitable treatment of shareholders.
- The role of stakeholders.
- Disclosure and transparency.
- The responsibilities of the board.

These principles, thus, highlight the need for an effective governance framework and four values – equitable treatment, responsibility, transparency and accountability.

These Principles are intended to assist OECD and non-OECD governments in their efforts to evaluate and improve the legal, institutional and regulatory framework for corporate governance in their countries, and to provide guidance and suggestions for stock exchanges, investors, corporations, and other parties that have a role in the process of developing good corporate governance. The Principles are non-binding and do not aim at detailed prescriptions for national legislation. Rather, they seek to identify objectives and suggest various means for achieving them. Their purpose is to serve as a reference point. They can be used by policymakers as they examine and develop the legal and regulatory frameworks for corporate governance that reflect their own economic, social, legal and cultural circumstances, and by market participants as they develop their own practices.

The corporate governance regulations, codes/guidelines introduced in India by the recommendations of various Task Forces/Committees and put in place by SEBI and the Ministry of Corporate Affairs/Companies Act have drawn substantially from the OECD Principles.

The gist of the revised OECD principles are given below (*verbatim*, to a large extent).

1. Ensuring the Basis for an Effective Corporate Governance Framework

The corporate governance framework:

- Should promote transparent and efficient markets.
- Be consistent with the rule of law.
- Clearly articulate the division of responsibilities among different supervisory, regulatory and enforcement authorities.

To ensure an effective corporate governance framework, it is necessary that an appropriate and effective legal, regulatory and institutional foundation is established upon which all market participants can rely in establishing their private contractual relations. Such a corporate governance framework typically comprises elements of legislation, regulation, self-regulatory arrangements, voluntary commitments and business practices that are the result of a country's specific circumstances, history and tradition. The desirable mix between legislation, regulation, self-regulation, voluntary standards, etc. in this area will, therefore, vary from country to country. As new experiences accrue and business circumstances change, the content and structure of this framework might need to be adjusted.

2. The Rights of Shareholders and Key Ownership Functions

The corporate governance framework should protect and facilitate the exercise of shareholders' rights.

Basic shareholder rights should include the right to:

1. Secure methods of ownership registration.
2. Convey or transfer shares.

3. Obtain relevant and material information on the corporation on a timely and regular basis.
4. Participate and vote in general shareholder meetings.
5. Elect and remove members of the board.
6. Share in the profits of the corporation.

Shareholders should have the right to participate in, and to be sufficiently informed on, decisions concerning fundamental corporate changes such as: (1) amendments to the statutes, or articles of incorporation or similar governing documents of the company; (2) the authorisation of additional shares; and (3) extraordinary transactions, including the transfer of all or substantially all assets, that in effect result in the sale of the company.

3. The Equitable Treatment of Shareholders

The corporate governance framework should ensure:

- The equitable treatment of all shareholders, including minority and foreign shareholders.
- The opportunity for all shareholders to obtain effective redress for violation of their rights.

4. The Role of Stakeholders

The corporate governance framework should:

- Recognise the rights of stakeholders
- Encourage cooperation between corporations and stakeholders in creating wealth, jobs, and the sustainability of enterprises.

The governance framework should recognise that the interests of the corporation are served by recognising the interests of stakeholders and their contribution to the long-term success of the corporation.

The rights of stakeholders that are established by law (e.g., labour, business, commercial and insolvency laws) or through mutual agreements shall be respected and they shall have the opportunity to obtain effective redress for violation of their rights.

The OECD Principles emphasise that performance-enhancing mechanisms for employee participation should be permitted to develop. The degree to which employees participate in corporate governance depends on national laws and practices, and may vary from company to company as well. In the context of corporate governance, performance enhancing mechanisms for participation may benefit companies directly as well as indirectly through the readiness by employees to invest in firm specific skills. Examples of mechanisms for employee participation include: employee representation on boards; and governance processes such as works councils that consider employee viewpoints in certain key decisions.

Where stakeholders participate in the corporate governance process, they should have access to relevant, sufficient and reliable information on a timely and regular basis. Stakeholders, including individual employees and their representative bodies, should be able to freely communicate their concerns about illegal or unethical practices to the board and their rights should not be compromised for doing this. The corporate governance framework should be complemented by an effective, efficient insolvency framework and by effective enforcement of creditor rights.

5. Disclosure and Transparency

The corporate governance framework should ensure that timely and accurate disclosure is made on all material matters regarding the corporation, including the financial situation, performance, ownership, and governance of the company.

Disclosure should include, but not be limited to, material information on:

1. The financial and operating results of the company.
2. Audited financial statements showing the financial performance and the company objectives.
3. Major share ownership and voting rights.
4. Remuneration policy for members of the board and key executives, and information about board members, including their qualifications, the selection process, other company directorships and whether they are regarded as independent by the board.
5. Related party transactions. Related parties can include entities that control or are under common control with the company, significant shareholders including members of their families and key management personnel.
6. Foreseeable risk factors.
7. Issues regarding employees and other stakeholders.
8. Governance structures and policies, in particular, the content of any corporate governance code or policy and the process by which it is implemented.

The OECD Principles emphasise that information should be prepared and disclosed in accordance with high quality standards of accounting and financial and non-financial disclosure.

Channels for disseminating information should provide for equal, timely and cost-efficient access to relevant information by users. The corporate governance framework should be complemented by an effective approach that addresses and promotes the provision of analysis or advice by analysts, brokers, rating agencies and others, that is relevant to decisions by investors, free from material conflicts of interest that might compromise their integrity of their analysis or advice.

6. The Responsibilities of the Board

The corporate governance framework should ensure:

- The strategic guidance of the company.
- The effective monitoring of management by the board.
- The board's accountability to the company and the shareholders.

As the Birla Committee observes that the Board of a company provides leadership and strategic guidance, objective judgement independent of management to the company and exercises control over the company, while remaining at all times accountable to the shareholders. The measure of the board is not simply whether it fulfils its legal requirements but more importantly, the board's attitude and the manner it translates its awareness and understanding of its responsibilities. An effective corporate governance system is one, which allows the board to perform these dual functions efficiently. The board of directors of a company, thus, directs and controls the management of a company and is accountable to the shareholders.

The Committee further elucidates that the Board directs the company, by formulating and reviewing company's policies, strategies, major plans of action, risk policy, annual budgets and business plans, setting performance objectives, monitoring implementation and corporate performance, and overseeing major capital expenditures, acquisitions and divestitures, change in financial control and compliance with applicable laws, taking into account the interests of stakeholders. It controls the company and its management by laying down the code of conduct, overseeing the process of disclosure and communications, ensuring that appropriate systems for financial control and reporting and monitoring risk are in place, evaluating the performance of management, chief executive, executive directors and providing checks and balances to reduce potential conflict between the specific interests of management and the wider interests of the company and shareholders including misuse of corporate assets and abuse in related party transactions. It is accountable to the shareholders for creating, protecting and enhancing wealth and resources for the company, and reporting to them on the performance in a timely and transparent manner. However, it is not involved in day-to-day management of the company, which is the responsibility of the management.

Box 4.3

Composition of the Board

The **Birla Committee** has made the following observations regarding the composition of the board of directors. The composition of the board of directors is important inasmuch as it determines the ability of the board to collectively provide the leadership and ensures that no one individual or a group is able to dominate the board. The composition is also critical to the independent functioning of the Board. Good corporate governance dictates that the board be comprised of individuals with certain personal characteristics and core competencies such as recognition of the importance of the board's tasks, integrity, a sense of accountability, track record of achievements, and the ability to ask tough questions. Besides, having financial literacy, experience, leadership qualities and the ability to think strategically, the directors must show significant degree of commitment to the company and devote adequate time for meeting, preparation and attendance.

According to the **Companies Act 2013**, every company shall have a Board of Directors consisting of individuals as directors. Some important provisions of the Act are as follows.

Number of Directors: The Board shall have: (a) a minimum number of three directors in the case of a public company, two directors in the case of a private company, and one director in the case of a One Person Company; and (b) a maximum of fifteen directors. A company may appoint more than fifteen directors after passing a special resolution. The Act also lays down that for such class or classes of companies as may be prescribed by the Government, there shall be at least one woman director.

Independent Directors: At least one-third of the total number of directors of a listed public company shall be independent directors and the Central Government may prescribe the minimum number of independent directors in case of any class or classes of public companies.

(An independent director in relation to a company, means a director other than a managing director or a whole-time director or a nominee director: (a) who, in the opinion of the Board, is a person of integrity and possesses relevant expertise and experience; (b) (i) who is or was not a promoter of the company or its holding, subsidiary or associate company; (ii) who is not related to promoters or directors in the company, its holding, subsidiary or associate company; (c) who has or had no pecuniary relationship with the company, its holding, subsidiary or associate company, or their promoters, or directors, during the two immediately preceding financial years or during the current financial year.)

It may be relevant to point out here that the Board structures and procedures vary among nations and sometimes within a nation. Some countries have two-tier boards that separate the supervisory function and the management function into different bodies. Such systems typically have a "supervisory board" composed of non-executive board members and a "management board" composed entirely of executives. Other countries (including India, generally), have "unitary" boards, which bring together executive and non-executive board members. In some countries, there is also an additional statutory body for audit purposes. The Principles are intended to be sufficiently general to apply to whatever board structure is charged with the functions of governing the enterprise and monitoring management.

It may be appropriate to note in this context that, although it is the unitary board system that is widely followed in India, it is not without exception. For example, the Eicher Group has a two-tier Board. At the top is the Corporate Board, consisting of veterans, which examines issues related to ethics, mission, vision and long-term direction. Below this is the Management Board, of which the business heads are a part of, which oversees operations.

The OECD Principles specifically mention the following:

A. Board members should act on a fully informed basis, in good faith, with due diligence and care, and in the best interest of the company and the shareholders.

B. Where board decisions may affect different shareholder groups differently, the board should treat all shareholders fairly.

C. The board should apply high ethical standards. It should take into account the interests of stakeholders.

D. The board should fulfil certain key functions, including:

   1. Reviewing and guiding corporate strategy, major plans of action, risk policy, annual budgets and business plans; setting performance objectives; monitoring implementation and corporate performance; and overseeing major capital expenditures, acquisitions and divestitures.
   2. Monitoring the effectiveness of the company's governance practices and making changes as needed.
   3. Selecting, compensating, monitoring and, when necessary, replacing key executives and overseeing succession planning.
   4. Aligning key executive and board remuneration with the longer term interests of the company and its shareholders.
   5. Ensuring a formal and transparent board nomination and election process.
   6. Monitoring and managing potential conflicts of interest of management, board members and shareholders, including misuse of corporate assets and abuse in related party transactions. It is an important function of the board to oversee the internal control.
   7. Ensuring the integrity of the corporation's accounting and financial reporting systems, including the independent audit, and that appropriate systems of control are in place, in particular, systems for risk management, financial and operational control, and compliance with the law and relevant standards.
   8. Overseeing the process of disclosure and communications.

E. The board should be able to exercise objective independent judgement on corporate affairs.

1. Boards should consider assigning a sufficient number of non-executive board members capable of exercising independent judgement to tasks where there is a potential for conflict of interest. Examples of such key responsibilities are ensuring the integrity of financial and non-financial reporting, the review of related party transactions, nomination of board members and key executives, and board remuneration.
2. When committees of the board are established, their mandate, composition and working procedures should be well defined and disclosed by the board.
3. Board members should be able to commit themselves effectively to their responsibilities.

F. In order to fulfil their responsibilities, board members should have access to accurate, relevant and timely information.

THE INDIAN SCENARIO

An outline of this section is given in the sub-section entitled *The Evolution of Corporate Governance System in India – A Glimpse*.

The first institutional initiative in India in formulating a framework for Corporate Governance was taken by the Confederation of Indian Industry (CII) in 1996 by setting up a National Task Force with Rahul Bajaj, the then CII President, as the Chairman and including membership from industry, the legal profession, media and academia. The objective was to develop and promote a code for Corporate Governance to be adopted and followed by Indian companies, be these in the private sector, the public sector, banks or financial institutions, all of which are corporate entities.

This initiative by CII flowed from public concerns regarding the protection of investor interest, especially the small investor; the promotion of transparency within business and industry; the need to move towards international standards in terms of disclosure of information by the corporate sector and, through all of this, to develop a high level of public confidence in business and industry.

The Task Force brought out the final *Desirable Corporate Governance Code* in April 1998. This document outlined a series of voluntary recommendations regarding best-in-class practices of corporate governance for listed companies. It is claimed that the CII Code was the first and probably a unique instance where an industry association took the lead in prescribing corporate governance standards for listed companies. It is worth noting that most of the CII Code was subsequently incorporated in the Birla Committee Report and thereafter in Clause 49 of the Equity Listing Agreement.

On May 7, 1999, the Securities and Exchange Board of India (SEBI) appointed a Committee on Corporate Governance under the Chairmanship of Kumar Mangalam Birla, member, SEBI Board, to promote and raise the standards of corporate governance, with the detailed terms of reference are as follows:

(a) to suggest suitable amendments to the listing agreement executed by the stock exchanges with the companies and any other measures to improve the standards of corporate governance in the listed companies, in areas such as continuous disclosure of material information, both financial and non-financial, manner and frequency of such disclosures, responsibilities of independent and outside directors;

(b) to draft a code of corporate best practices; and

(c) to suggest safeguards to be instituted within the companies to deal with insider information and insider trading.

Many of the recommendations of the Birla Committee were mandatory. The Committee felt that, under Indian conditions, a statutory rather than a voluntary code would be far more purposive and meaningful, at least in respect of essential features of corporate governance. The Committee, however, recognised that a system of control should not so hamstring the companies so as to impede their ability to compete in the marketplace.

It was also made mandatory that the companies disclose separately in their annual reports, a report on corporate governance. The main pupose of this is to enable shareholders to know, where the companies, in which they have invested, stand with respect to corporate governance.

Based on the recommendations of the Committee, the SEBI had specified principles of Corporate Governance and introduced a new Clause, viz., Clause 49, in the Listing agreement of the Stock Exchanges in the year 2000. The mandatory recommendations were implemented through Clause 49 of the Listing Agreements, in a phased manner within specified dates, starting in the financial year 2000-2001, and all the listed companies with paid-up capital of ₹ 3 crores and above or net worth of ₹ 25 crores or more at any time in the history of the company, were covered as of March 31, 2003.

The objective of Clause 49 was to introduce some basic corporate governance practices in Indian companies. Clause 49 was the first formal regulatory framework for listed companies specifically aimed at improving corporate governance. A number of key changes in governance and disclosures were brought in by this Clause (many of which we taken for granted today).

Clause 49 of the Equity Listing Agreement consisted of mandatory as well as non-mandatory recommendations.

The *mandatory recommendations* were those recommendations which are absolutely essential for corporate governance, can be defined with precision and which can be enforced through the amendment of the listing agreement. Others, which were either desirable or which required change of laws, were, for the time being, classified as *non-mandatory*. However, the disclosures of the compliance with mandatory requirements and adoption (and compliance)/non-adoption of the non-mandatory requirements were to be made in the section on corporate governance of the Annual Report.

The **mandatory provisions** comprised of the following:

- Composition of Board and its procedure – frequency of meeting, number of independent directors, code of conduct for Board of directors and senior management.
- Audit Committee, its composition, and role.
- Provisions relating to Subsidiary Companies.
- Disclosure to Audit committee, Board and the Shareholders.
- CEO/CFO certification.
- Quarterly report on corporate governance.
- Annual compliance certificate.

The **non-mandatory provisions** consisted of the following:

- Constitution of Remuneration Committee.
- Despatch of Half-yearly results.
- Training of Board members.
- Peer evaluation of Board members.
- Whistle blower policy.

As per Clause 49 of the Listing Agreement, there should be a separate section on Corporate Governance in the Annual Reports of listed companies, with detailed compliance report on Corporate Governance. The companies should also submit a quarterly compliance report to the stock exchanges within 15 days from the close of quarter as per the prescribed format. The report shall be signed either by the Compliance Officer or the Chief Executive Officer of the company.

Apart from Clause 49 of the Equity Listing Agreement, there are certain other clauses in the listing agreement, which are protecting the minority shareholders and ensuring proper disclosures.

- Disclosure of Shareholding Pattern
- Maintenance of minimum public shareholding (25 per cent)
- Disclosure and publication of periodical results
- Disclosure of price-sensitive information
- Disclosure and open offer requirements under SAST

With the goal of promoting better corporate governance practices in India, the Ministry of Corporate Affairs, on 1st October, 2003 set up National Foundation for Corporate Governance (NFCG) in partnership with Confederation of Indian Industry (CII), Institute of Company Secretaries of India (ICSI) and Institute of Chartered Accountants of India (ICAI). The NFCG has been expanded later with the inclusion of ICAI and the National Stock Exchange.

The vision of NFCG is to be a catalyst in making India the best in corporate governance practices. Its mission consists of the following elements: (1) to foster a culture for promoting good governance, voluntary compliance and facilitate effective participation of different stakeholders, (2) to create a framework of best practices, structure, processes and ethics and (3) to make significant difference to Indian corporate sector by raising the standard of corporate governance in India towards achieving stability and growth.

SEBI was of the opinion that efforts to improve corporate governance standards in India must continue because these standards were themselves evolving, in keeping with market dynamics. It, therefore, felt that a need to review the existing code on corporate governance arose from two perspectives: (a) to evaluate the adequacy of the existing practices, and (b) to further improve the existing practices. Hence, the SEBI constituted a Committee on Corporate Governance (under the Chairmanship of N.R. Narayana Murthy, comprising representatives from the stock exchanges, chambers of commerce, investor associations and professional bodies with the following terms of reference to:

- to review the performance of corporate governance.
- to determine the role of companies in responding to rumour and other price-sensitive information circulating in the market, in order to enhance the transparency and integrity of the market.

The issues discussed by the Committee, which gave its report in February 2003, primarily related to audit committees, audit reports, independent directors, related parties, risk management, directorships and director compensation, codes of conduct and financial disclosures. The Committee's recommendations in the final report were selected based on parameters including their relative importance, fairness, accountability, transparency, ease of implementation, verifiability and enforceability.

The key mandatory recommendations focused on strengthening the responsibilities of audit committees; improving the quality of financial disclosures, including those related to related party transactions and proceeds from initial public offerings; requiring corporate executive boards to assess and disclose business risks in the annual reports of companies; introducing responsibilities on boards to adopt formal codes of conduct; the position of nominee directors; and stockholder approval and improved disclosures relating to compensation paid to non-executive directors.

Non-mandatory recommendations include moving to a regime where corporate financial statements are not qualified; instituting a system of training of board members; and the evaluation of performance of board members.

The Committee was of the belief that these recommendations codified certain standards of "good' governance into specific requirements, since certain corporate responsibilities are too important to be left to loose concepts of fiduciary responsibility. When implemented through SEBI's regulatory framework, they would strengthen existing governance practices and also provide a strong incentive to avoid corporate failures.

Based on the recommendations of the Narayana Murthy Committee, SEBI modified Clause 49 and the 'revised Clause 49' came into operation on 1st January, 2006. This carried further forward the protection of investors through enhanced governance practices and disclosures. Five very important aspects of this are the following. The independence criteria for directors have been clarified. The roles and responsibilities of the board have been enhanced. The quality and quantity of disclosures have improved. The roles and responsibilities of the audit committee in all matters relating to internal controls and financial reporting have been consolidated, and the accountability of top management — specifically the CEO and CFO — has been enhanced. Within each of these areas, the revised Clause 49 moves further into the realm of global best practices (and sometimes, even beyond). On 8th April, 2008, the SEBI amended Clause 49 of the Listing Agreement to extend the 50 per cent independent directors rule to all Boards of Directors where the Non-executive Chairman is a promoter of the company or related to the promoters of the company.

Recognising the critical importance of financial disclosures in corporate reporting, SEBI set up a Committee on Disclosures and Accounting Standards (SCODA) in September 2006 under the chairmanship of noted chartered accountant Y.H. Malegam. One of the major functions of this committee is to advise SEBI on issues related to disclosure requirements in the offer documents, application forms, advertisements and other mode of mass communication by the issuers. Besides, the SCODA also advises SEBI on issues related to the continuous disclosure requirements pertaining to listing of equity or debt of an issuer and on matters related to disclosure requirements of various market intermediaries.

With the support of the Standing Committee on Accounting Standards (Malegam Committee), the Institute of Chartered Accountants of India (ICAI) introduced Indian Accounting Standards which have put financial reporting practices in India almost on par with International Accounting Standards.

The CII set up a Task Force under the chairmanship of Naresh Chandra in February 2009 to recommend ways of further improving corporate governance standards and practices both in letter and spirit. The Committee endeavoured to enunciate additional principles that can improve corporate governance and its Report enumerated a set of voluntary recommendations with the objective of establishing higher standards of probity and corporate governance in the country.

In December 2009, Ministry of Corporate Affairs issued Voluntary Guidelines on Corporate Governance. These guidelines provide for a set of good practices, which will help the companies to strengthen their internal governance processes and may be voluntarily adopted by the Indian public companies.

In March 2012, Ministry of Corporate Affairs constituted a committee under the Chairmanship of Mr. Adi Godrej, Chairman, to formulate policy document on Corporate Governance. In September, 2012, the Committee submitted its document, specifying seventeen guiding principles on corporate governance.

Broadly, the regulatory framework in respect of corporate governance in India is almost in compliance with the said OECD Principles and the seventeen guiding principles, barring a few. The SEBI has brought out a Concept Paper entitled Consultative Paper on Review of Corporate Governance Norms in India for public comments. The objective is to explicitly specify the principles of Corporate Governance in the listing agreement, which are broadly based on the OECD Principles of Corporate Governance and the guiding principles of Corporate Governance specified by the Godrej Committee:

1. The company should seek to protect and facilitate the exercise of shareholders' rights.
2. The company should ensure the equitable treatment of all shareholders.
3. The company should frame its policies/procedures to facilitate shareholders to obtain effective redress for violation of their rights.
4. The company should recognise the rights of stakeholders in Corporate Governance and encourage cooperation between company and stakeholders.
5. The company should ensure timely and accurate disclosure on all material matters including the financial situation, performance, ownership, and governance of the company.
6. The company should strive to bring in diversity of thought, experience, knowledge, understanding, perspective, gender and age in the Board.
7. The company should have an induction/on-boarding program which should also address the unique legal and regulatory compliance issues facing the company and its industry.
8. The company should appoint an Independent Director as a Lead Director who shall chair the meetings of Independent Directors and act as a liaison between Independent Directors and Management/Board/Shareholder.
9. The company should facilitate and encourage direct conversations between the independent directors, and one-on-one meetings between a committee of independent directors with the auditors.
10. The company shall maintain minutes of the meetings which should explicitly record dissenting opinions, if any.

11. The company should encourage continuing Board training and education to ensure that the Board members are kept up-to-date.
12. The company should frame, monitor and review a Board Evaluation framework and disclose the same to shareholders periodically.
13. The company should formulate and implement an effective whistle blower mechanism and disclose the same.
14. The Board should provide the strategic guidance to the company, ensure effective monitoring of the management and should be accountable to the company and the shareholders.
15. The Board should set a corporate culture and the values by which executives throughout a group will behave.
16. The Board should have ability to 'step back' to assist executive management by challenging the assumptions underlying: strategy, strategic initiatives (such as acquisitions), risk appetite, exposures and the key areas of the company's focus.
17. The Board should ensure that, while rightly encouraging positive thinking, these do not result in over-optimism that either leads to significant risks not being recognised or exposes the company to excessive risk.
18. The Board should satisfy and balance the interests of a wider set of stakeholders and should try to balance performance with compliance.
19. The Board Chair, CEO and the rest of the board should work cohesively to identify as to what is the right mix of skills that is required for selecting the senior management.
20. Senior management must place the relevant information immediately/periodically before the board and shall also send the Board Agendas in advance so as to enable the Board to make well informed decision.
21. The Board and top management should conduct themselves so as to meet the expectations of operational transparency to stakeholders while at the same time maintaining confidentiality of information in order to foster a culture for good decision-making.
22. Board of a listed company should ensure that plans are in place for the orderly succession for appointments to the board and senior management.
23. The board should eliminate policies that promote excessive risk-taking for the sake of short-term increases in stock price performance and ensure that a risk/crisis management plan is in place.
24. All the directors of the company (including independent directors) shall exercise their duties with due and reasonable care, skill and diligence.
25. Incentives to the top management should be based on remuneration that aligns with the long-term interest of the company.
26. Executive directors and senior management should provide all the facilities for the independent directors to perform the role in a better manner as a Board member and also a member of a committee.

These principles will have overriding effect over the specific rules laid down in the listing agreement. All listed companies would be required to follow the above principles in the governance of the company.

Legal Environment of Corporate Governance in India

The legal framework of corporate governance in India is provided mostly by the Companies Act, 1956, which had been amended several times and which is to be replaced by the Companies Act 2012; the Securities and Exchange Board of India Act, 1992 and the Securities Contracts (Regulation) Act, 1956. Some other laws like the Depositories Act, 1996, and Competition Act, 2002, also have relevance to corporate governance.

The banking sector is regulated by the Reserve Bank of India (RBI) and the insurance companies by the Insurance Regulatory and Development Authority (IRDA), an autonomous body set up under the IRDA Act, 1999. The mission of IDRA is to protect the interests of policyholders, to regulate, promote and ensure orderly growth of the insurance industry and for matters connected therewith or incidental thereto.

The Telecom Regulatory Authority of India (TRAI), established under the Telecom Regulatory Authority of India Act, 1997, regulates the telecommunication, and services, and matters connected therewith or incidental thereto.

The Companies Act is administered by the Ministry of Corporate Affairs (MCA) and the provisions of the Companies Act are enforced by the Company Law Board.

The stock exchanges, regulated by the Securities Contracts (Regulation) Act, 1956, and the Equity Listing Agreement under it, have a substantial role in corporate governance. Every listed company needs to comply with the provisions of the listing agreement as per Section 21 of this Act. Non-compliance with the same would lead to delisting or monetary penalties under Act. Further, the Securities and Exchange Board of India (SEBI) can prescribe conditions for listing. As mentioned earlier, SEBI introduced the Clause 49 in the Listing agreement of the Stock Exchanges in the year 2000 to enforce and advocate a number of corporate governance norms and practices.

The stock market regulator SEBI, established under the Securities and Exchange Board of India Act, 1992, has a profound role in ensuring good corporate governance. The SEBI is empowered to regulate the business in stock exchanges and any other securities markets to protect the interests of investors in securities. See Appendix 4.1 for details of the functions of SEBI.

Companies Act, 1956, by amendments (particularly since 2000), has provided for basic framework for regulation of all the companies. Certain provisions were incorporated in the Act itself to provide for checks and balances over the powers of Board, viz.:

- Loan to directors or relatives or associated entities (need CG permission).
- Interested contract needs Board resolution and to be entered in register.
- Interested directors not to participate or vote.
- Appointment of director or relatives for office or place of profit needs approval by shareholders. If the remuneration exceeds prescribed limit, CG approval required.
- Audit Committee for public companies having paid-up capital of ₹ 5 crores.
- Shareholders holding 10 per cent can appeal to Court in case of oppression or mismanagement.

In Companies Act, 1956, SEBI has been given power to administer provisions pertaining to issue and transfer of securities and non-payment of dividend.

In the Companies Act 2013, which replaced the Companies Act, 1956, various new provisions have been included (which are not provided for in Companies Act, 1956) for better governance of the companies. Some of these new provisions are:

- Requirement to constitute Remuneration and Nomination Committee and Stakeholders Grievances Committee.
- Granting of more powers to Audit Committee.
- Specific clause pertaining to duties of Directors.
- Mode of appointment of Independent Directors and their tenure.
- Code of Conduct for Independent Directors.
- Rotation of Auditors and restriction on Auditors for providing non-audit services.
- Enhancement of liability of Auditors.
- Disclosure and approval of RPTs.
- Mandatory Auditing Standards.
- Enabling Shareholders Associations/Group of Shareholders for taking class action suits and reimbursement of the expenses out of Investor Education and Protection Fund.
- Constitution of National Financial Reporting Authority, an independent body to take action against the Auditors in case of professional misconduct.
- Requirement to spend on CSR activities.
- Provision that Central Government shall establish an office namely Serious Fraud Investigation Office to investigate frauds relating to a company.

The Companies Act, 2013, contains detailed provisions pertaining to corporate governance. The new Act would necessitate revisiting of the entire Clause 49 to make it consistent with the Companies Act. However, SEBI can impose more stringent conditions to the listed companies through listing agreement, than those envisaged in the Companies Act, considering the need to have better governance practices in the listed companies, provided those provisions are not derogatory to the provisions of the enactment.

Present Status of Corporate Governance in India

There has been a very commendable progress on the corporate governance scenario in India, prompted by the regulatory developments and enlightened by the propagation (by international and national organisations, including industry associations) of the need for and virtues of proper corporate governance.

Two sets of factors have contributed to the advances on the corporate governance front. *There is a necessitating set of factors and a facilitating set of factors.*

One important necessitating factor is the mandatory requirements, enforced since the recommendations of the Birla Committee on Corporate Governance set up by the SEBI.

Another necessitating factor has something to do with the liberalisation. The foreign investors, collaborators and buyers have been demanding more transparency in respect of the functioning of the Indian corporates.

Thirdly, the Indian investors have become more keen on good corporate governance.

An important facilitating factor is that there is a growing awareness and enthusiasm in the corporate India to embrace good corporate governance. Many captains of industry, corporate leaders and top executives have been keen to usher in good corporate governance. In fact, a few years prior to the formation of the Birla Committee, the path for good corporate governance was paved by the Draft Code on Desirable Corporate Governance drawn up by the Confederation of Indian Industries (CII).

The developments described in this section have put in place in India a corporate governance framework on par with the best in the world. The corporate governance system, however, continues to evolve across the world.

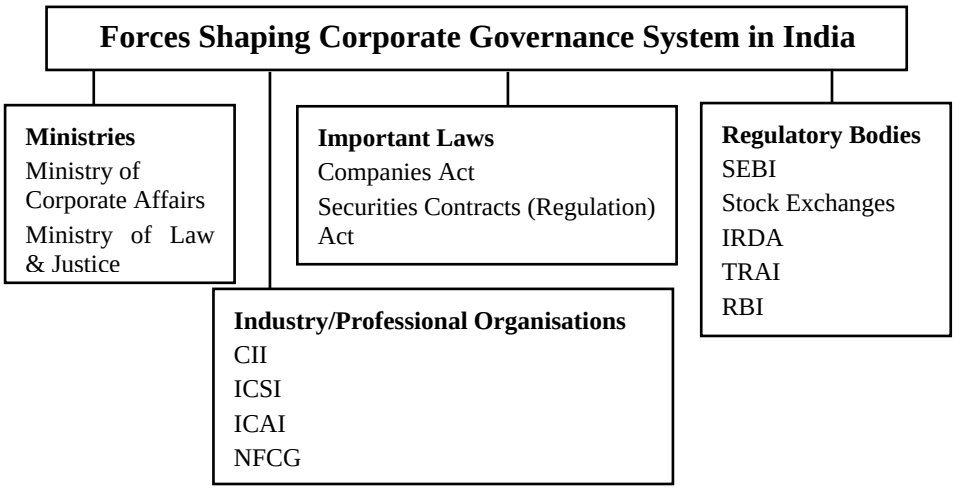

Fig. 4.2: The External Environment Shaping Corporate Governance in India

Evolution of Corporate Governance System in India – A Glimpse

The report of the National Task Force appointed by the Confederation of Indian Industries (CII) under the Chairmanship of Rahul Bajaj, entitled *Desirable Corporate Governance – A Code* (1998), was the clarion call for adoption of a good corporate governance system by India Inc. This report made a series of recommendations regarding best-in-class practices of corporate governance for listed companies. The recommendations were intended to be voluntarily adopted by companies. However, many of these recommendations in due course became mandatory when they formed part of the mandatory recommendations of the Birla Committee appointed by the SEBI in 1999 (a major feet in the development of a corporate governance framework in India) and got enforced by the incorporation in the Clause 49 that was added to the Equity Listing Agreement of the Stock Exchanges in 2000.

With a view to evaluate the adequacy of the existing corporate governance practices and to further improve them, the SEBI constituted a Committee on Corporate Governance (Narayana Murthy Committee). Based on the recommendations of this Committee (2003), SEBI modified the Clause 49 and further carried forward the investor protection through enhanced governance practices and

disclosures. As a result of these modifications, the independence criteria for members of the Board of Directors have been clarified; the roles and responsibilities of the Board have been enhanced; the quality and quantity of disclosures have been improved; and the roles and responsibilities of the Audit Committee in all matters relating to internal controls and financial reporting have been consolidated and the accountability of top management — specifically the CEO and CFO — has been enhanced. Within each of these areas, the revised Clause 49 has moved further into the realm of global best practices (and sometimes, even beyond).

With the goal of promoting better corporate governance practices in India, in 2003, the Ministry of Corporate Affairs set up National Foundation for Corporate Governance (NFCG) in partnership with Confederation of Indian Industry (CII), Institute of Company Secretaries of India (ICSI) and Institute of Chartered Accountants of India (ICAI). The NFCG has been expanded later with the inclusion of ICAI and the National Stock Exchange.

In February 2009, the CII set up a Task Force under the chairmanship of Naresh Chandra to recommend ways of further improving corporate governance standards and practices both in letter and spirit. The Committee, which submitted its report in December 2009, endeavoured to enunciate additional principles that can improve corporate governance and its Report enumerated a set of voluntary recommendations with the objective of establishing higher standards of probity and corporate governance in the country.

In December 2009, Ministry of Corporate Affairs issued Voluntary Guidelines on Corporate Governance. These guidelines provide for a set of good practices, which will help the companies to strengthen their internal governance processes and may be voluntarily adopted by the Indian public companies.

The report of the Adi Godrej Committee (2012), constituted by the Ministry of Corporate Affairs, specified seventeen guiding principles on corporate governance. Broadly, the regulatory framework in respect of corporate governance in India is almost in compliance with the OECD Principles dsecribed elsewhere in this chapter and the seventeen guiding principles, barring a few. The SEBI has brought out a Concept Paper entitled Consultative Paper on Review of Corporate Governance Norms in India for public comments. The objective is to explicitly specify the principles of Corporate Governance in the listing agreement, which are broadly based on the OECD Principles of Corporate Governance and the guiding principles of Corporate Governance specified by the Godrej Committee.

The external influences on the governance of a company is epitomised in Figure 4.2. The Companies Act 2013, which replaced Companies Act 1956, is a major step to improve the legal framework for corporate governance. Some of the important features of the new Act are the following: The role of Independent Directors (IDs) has been strengthened (Independent Director means a director other than a managing director or a whole-time director or a nominee director). Every listed public company shall have at least one-third of the total number of directors as independent directors who are persons of integrity, possessing relevant expertise and experience. All board resolutions must be approved by at least one ID. Small shareholders are ensured board participation by one director representing them.

The new Act gives a boost to transparency. Related-party contracts must be justified and fully disclosed in the Director's Report. (These approvals, however, are not required if the transactions are on arm’s length basis. Arm’s length transaction means a transaction between two related parties that is conducted as if they were unrelated, so that there is no conflict of interest.) The directors, promoters,

key management personnel and top 10 shareholders in listed companies must report any share purchase or sale within 15 days to the registrar.

Disclosure requirements to shareholders have been enhanced. The responsibility of the Audit Committee has been expanded to include monitoring of auditors' independence, their performance evaluation, approval of modification of related-party transactions, scrutiny of loans and investments, valuation of assets and evaluation of internal controls and risk management. It is required to establish a vigil mechanism and protection for any whistle-blower. The Committee shall have a majority of IDs. Large companies must mandatorily have professional internal auditors. The responsibility of auditors and penalty for negligence/wrongdoing has gone up. The Act stipulates extensive controls on related party transactions, investments, giving guarantee or providing security in connection with a loan to any other company or person etc.

Another important feature of the Act is the provision that Central Government shall establish an office namely Serious Fraud Investigation Office to investigate frauds relating to a company.

The above description makes it very clear that higly commendable efforts have been made by government organisations and non-government organisations to develop a proper corporate governance system in the country. "Indeed, it is fair to say that in terms of norms, guidelines and standards set for the board of directors, financial and non-financial disclosures and information to be shared by the management to stakeholders and the wider public, Indian corporate governance standards rank among the best in the world."[10]

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Appendix 4.1

SEBI

The Securities and Exchange Board of India (SEBI) plays a very important role in regulating and developing securities market and imposing proper corporate governance norms and practices.

The SEBI was constituted in 1988 by a resolution of Government of India and it was made a statutory body by the Securities and Exchange Board of India Act, 1992.

Objectives

According to the Act, the objectives of SEBI are to protect the interests of investors in securities and to promote the development of, and to regulate, the securities market for matters connected therewith or incidental therewith.

Powers and Functions

The SEBI Act casts upon SEBI the duty to protect the interests of investors in securities and to promote the development of and to regulate the securities market through appropriate measures. These measures provide for:

1. Regulating the business in stock exchanges and any other securities market.
2. Registering and regulating the working of stock brokers, sub-brokers, share transfer agents, bankers to an issue, trustees of trust deeds, registrars to an issue, merchant bankers, underwriters, portfolio managers, investment advisors and such other intermediaries who may be associated with securities market in any manner.
3. Registering and regulating the working of collective investment schemes, including mutual funds.
4. Promoting and regulating self-regulatory organisations.
5. Prohibiting fraudulent and unfair trade practices in securities market.
6. Promoting investor education and training of intermediaries in securities market.
7. Prohibiting insider trading in securities.
8. Regulating substantial acquisition of shares and takeover of companies.
9. Calling far information from, undertaking inspection, conducting enquiries and audits of the stock exchanges and intermediaries and self-regulatory organisations in the securities market.
10. Performing such functions and exercising such powers under the provisions of the Capital Issues (Control) Act, 1947, (subsequently repealed) and the Securities Contracts (Regulations) Act, 1956, as may be delegated to it by the Central Government.
11. Levying fees or other charges for carrying out the purposes of Section 11 of the Act.
12. Conducting research for the above purpose.
13. Performing such other functions as may be prescribed by the government.

The Board may, for the protection of investors, specify, by regulations, the matters relating to issue of capital, transfer of securities and other matters incidental thereto and the manner in which such matters, shall be disclosed by the companies.

The SEBI is also empowered to issue such directions as may be appropriate to certain person or class of persons or company, intermediary or other persons referred to in Section 12 (stock broker, sub-broker, share transfer agent, banker to an issue, trustee of trust deed, merchant banker, underwriter, registrar to an issue, investment adviser, portfolio manager etc.): (i) in the interest of investors, or orderly development of securities market; or (ii) to prevent the affairs of any intermediary or other persons referred to in Section 12, being conducted in a manner detrimental to the interests of investors or securities market; or (iii) to secure the proper management of any such intermediary or person.

CHAPTER

5

Business Environment

FIRM-ENVIRONMENT FIT

The relevance of business environment to strategic management is espoused by the fact that formulation of strategy is sometimes defined as establishing a proper *firm-environment fit.*

In Chapter 1, we have seen that determination of mission/vision is the first step in the formulation of strategy. Indewed, the mission/vision and objectives should be based on an assessment of the external environment and the organisational factors.

Just as the life and success of an individual depend on his innate capability, including physiological factors, traits and skills, to cope with the environment and the extent to which the environment is conducive to the development of the individual, the survival and success of a business firm depend on its innate strength — resources at its command, including physical resources, financial resources, skill and organisation — and its adaptability to the environment and the extent to which the environment is favourable to the development of the organisation. Equally important is that the individual or organisation shall have an inner urge to develop to the optimum potential.

In short, business decisions are influenced by, broadly, two sets of factors, viz., firm related factors (internal environment) and external influence (external environment).

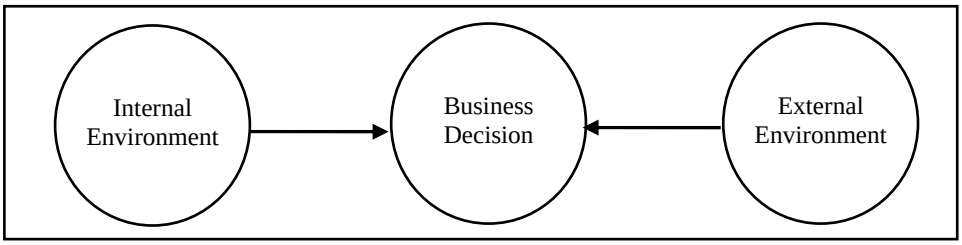

Fig. 5.1: Factors Influencing Business Decision

The external environment has, broadly, two components, viz., business opportunities and threats to business. Similarly, the organisational environment has two components: strengths and weaknesses of the organisation. Thus, strategy formulation is properly pitting the organisational factors (the internal environment) against the opportunities and threats in the external environment. In other words, business decisions are conditioned by two broad sets of factors, viz., the internal environment and the external environment.

That the environmental factors have a profound impact on business is very well indicated by the fact that SWOT analysis (analysis of the strengths and weaknesses of the organisation and opportunities and threats in the environment) is one of the first steps in the strategic management process. Business dynamics, in fact, is a dependent factor — it depends on, *inter alia*, the environmental dynamics. Hence, the importance of environmental analysis which is one of the first steps in strategic management/corporate planning process.

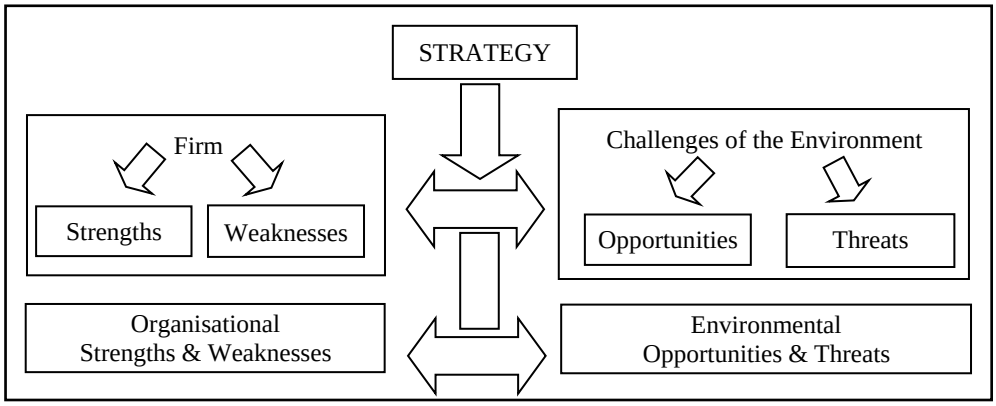

Fig. 5.2: Strategy: A Firm-Environment Fit

Environmental analysis is defined as "the process by which strategists monitor the economic, governmental/legal, market/competitive, supplier/technological, geographic, and social settings to determine opportunities and threats to their firms."[1]

"Environmental diagnosis consists of managerial decisions made by analysing the significance of the data (opportunities and threats) of the environmental analysis."[2]

Although the business environment consists of both the internal and external environments, the term business environment is generally used to refer to the external environment.

The internal factors are generally regarded as *controllable* factors because the company, generally, has control over these factors; it can alter or modify such factors as its personnel, physical facilities, organisation and functional means, such as the marketing mix, to suit the environment.

The external factors, on the other hand, are, by and large, beyond the control of a company. The external or environmental factors such as the economic factors, socio-cultural factors, government and legal factors, demographic factors, geo-physical factors etc. are, therefore, generally regarded as *uncontrollable* factors.

As the environmental (external) factors are beyond the control of a firm, its success will depend to a very large extent on its adaptability to the environment, i.e., its ability to properly design and

adjust the internal (the controllable) variables to take advantage of the opportunities and to combat the threats in the environment.

One of the most critical challenges is to cope up with the environmental dynamics of change which many a time assume the nature of turbulence. Kotler emphasises that "excellent companies take an *outside-inside* view of their business. They recognise that the marketing environment is constantly spinning out new opportunities and threats. These companies recognise the vital importance of continuously monitoring and adapting to the changing environment.

Too many companies, unfortunately, fail to think of change as opportunity. They ignore or resist critical changes until it is almost too late. Their strategies, structures, systems, and business culture grow increasingly obsolete and disfunctional."[3]

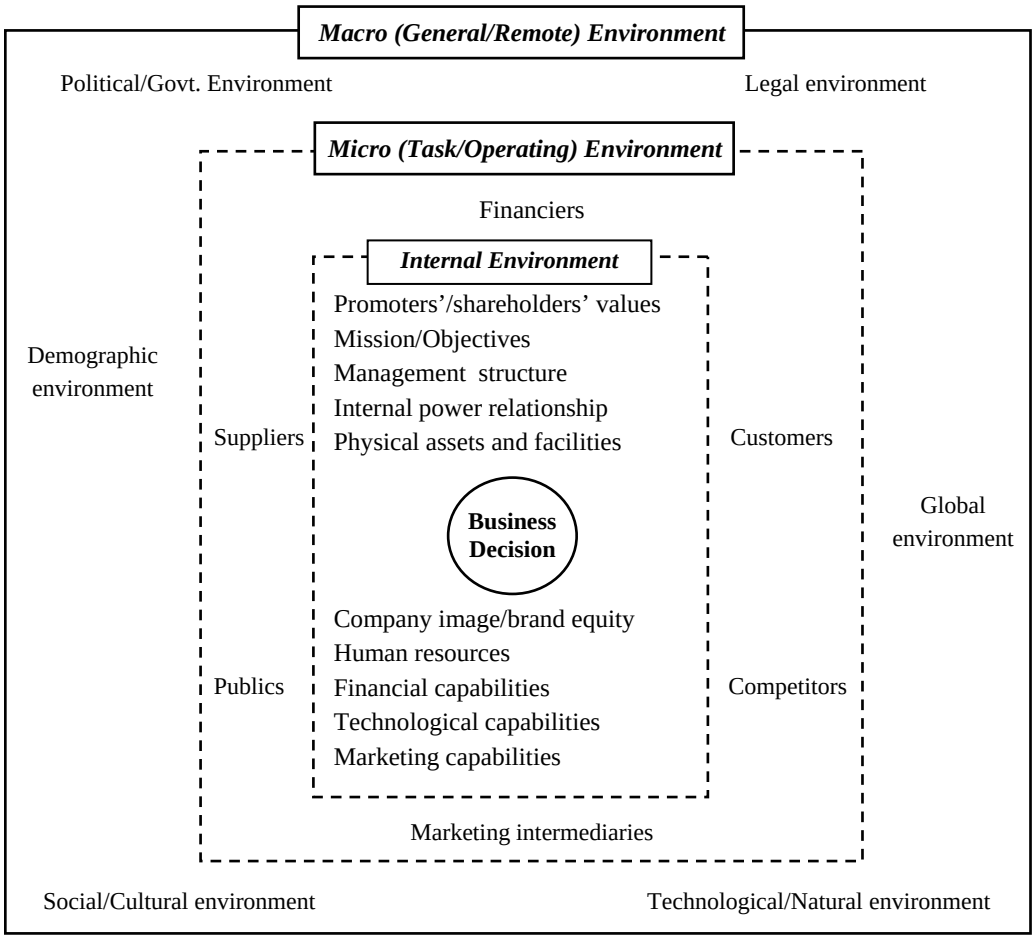

Fig. 5.3: Components of Business Environment

Figure 5.3 gives a summary view of the environmental factors which can influence business decisions, including corporate, business, functional and operating strategies. A detailed description of the business environment is available in this author's *Business Environment: Text and Cases* (Himalaya Publishing House). The treatment of the subject in this book is more oriented towards

strategic management by focusing on some of the important specific environmental factors and is very different from that in the other book. This chapter will specifically discuss, with: (1) a focus on their strategic implications for corporates, (2) economic transformation of India, (3) social transformation of India, (4) India's demographic dynamics, (5) global demographic trends, (6) political changes and their economic/business impacts, and (7) global economic power shift.

ECONOMIC TRANSFORMATION OF INDIA

India with its characteristic strengths and problems provide infinite business opportunities for firms with the right strategies.

India presents a mixed picture of strengths, prospects, weaknesses and problems. It is one of the largest economies in the world; but its per capita income is very low — in fact lower than the average for the developing economies. India is a nation with one of the largest number of rich people and the largest number of poor people in the world.

India, which had been a dominant economy in the world for a very long time (more than one-and-a-half millennium since the beginning of the Christian era), underwent a decline in its relative economic position in the world economy, particularly in the two-and-a-half centuries until the mid-1960s, unable to cope up with the drastic and far-reaching economic changes unleashed by the industrial and agricultural revolutions. The long colonial rule had a very deleterious effect on the Indian economy, although it had several beneficial effects too.

India which, with nearly one-third of the world population, accounted for about one-third of the global GDP at the dawn of the Christian era,[4] lost the premier position in due course and had come to own a very low share of the GDP of the world in the second half of the twentieth century but is projected to emerge as the second largest economy by the middle of the present century.

In 1500, the aggregate share of Western Europe, Eastern Europe, USA and Japan in world GDP was less than that of India or China. But in 1700, Western Europe had a 22.5 per cent share in global GDP compared to 24.4 per cent for India and 22.3 per cent for China. Even in 1950, only a small number of countries like Germany, UK, USA and USSR, other than China, had a higher GDP than that of India.

On the eve of the Industrial Revolution (around 1770), India was the second largest economy (little behind China) in the world, contributing more than 20 per cent of total world output. At the dawn of the 20th century, India accounted for about one-tenth of the global GDP but by the 1970s, after two centuries of relative economic stagnation, that share had fallen to 3 per cent, the lowest in its recorded history.[5]

Indian economy, however, has become very vibrant in the recent decades and is emerging as a powerhouse of the world economy. Different estimates show that the GDP and per capita GDP of India have grown faster than that of the average for the developing countries as well as the world as a whole. Despite the fast population growth, the per capita GNP growth of India was comparatively very good. See Table 5.1.

India, which is the 11th largest economy (fourth largest in purchasing power parity terms) in the world, is one of the largest producers of a number of goods, both primary and manufactured. In the

case of many agricultural commodities, the productivity is very low in India. The output can be increased substantially by productivity improvements.

Some of the Indian companies are among the largest ones in their industries. The number of listed companies in India is second only to that of USA.

Table 5.1: Economic Performance of India: A Comparison

	GNP Per Capita Annual Growth Rate (%) (1970-2008)
Developed Countries	
OECD	2.4
Non-OECD	2.2
Developing Countries	
Latin America & Caribbean	2.0
East Asia & Pacific	1.7
South Asia	3.8
Least Developed Countries	**2.0**
World	**2.1**
India	**3.6**

Source: UNDP, *Human Development Report* 2010.

Implications of Economic Reforms for Strategic Management

More than four decades of economic development of India until 1991 was characterised by very elaborate controls on the industrial sector. This period was described as controlled regime or period of licence/permit raj. During this period:

- The future development of 17 of the most important and strategic industries were exclusively reserved for the public sector and in the next 12 most important industries the public sector was assigned a dominant role and the role of the private sector was rather supplementary.
- A large number of industrial products were exclusively reserved for manufacture by the small-scale sector.
- The entry into business by private enterprises involving investment above a specified limit in general, and large industrial houses and big enterprises in particular, and the growth of private sector companies were subject to a lot of controls. They required prior permission to tap the capital market, foreign collaboration, imports etc.

Until the economic liberalisation ushered in 1991, economic policy and regulatory changes in India were, by and large, incremental or evolutionary. However, a discontinuous or revolutionary change was ushered in India's economic horizon with the announcement of a *New Industrial Policy* which marked a paradigm shift from the previous more than four decades of the controlled regime. Adjectives such as 'dramatic', 'revolutionary', 'drastic' etc. have been used to describe the nature of the change in the industrial policy.

Economic reforms in India have not been a one stroke or few strokes affair. It is rather a process which continues, influenced by lessons of hitherto experiences, debates, controversies, confusions and developments across the world.

The reforms which started with the industrial policy liberalisation gradually moved to other spheres like external sector (foreign trade, foreign exchange rate and currency convertibility, and foreign investment – both FDI and FPI), financial sector (banking sector, capital market etc.), price and distribution, and fiscal policy and taxation. No comprehensive reform has so far been attended in respect of some vital areas like agriculture and labour.

The scope for and relevance of strategic management was limited in the pre-1991 controlled regime characterised by limited scope for private corporates and absence of or little competition. It would be appropriate to reproduce here the observation of Kenichi Ohmae, cited in Chapter 1, that "without competitors, there would be no need for strategy, for the sole purpose of strategic planning is to enable the company to gain, as efficiently as possible, a sustainable edge over its competitors. Corporate strategy, thus, implies an attempt to alter a company's strength relative to that of its competitors in the most efficient way."

However, the Indian scenario has transformed since the early 1990s, characterised by a paradigm shift in government policies and regulations.

Table 5.2: Strategic Implications of Industrial Policy Changes

Pre-1991 Situation	Post-1991 Situation	Consequences/Implications of the Change
Private sector excluded from many important industries. In a number of other important industries, public sector had priority to establish new undertakings.	All but a few industries are open to the private sector.	Enormous scope for private investment. Considerable freedom to decide the portfolio strategy. Competition increases substantially and public sector loses its monopoly/dominant positions.
Entry, involving investment above specified exemption limit, was restricted by licensing.	All but a few industries are free from licensing.	Reinforces the above factors.
Entry of large firms was subject to MRTP Act restrictions, besides licensing.	No MRTP Act restrictions on entry.	Reinforces the above factors.
Licensing and MRTP Act restrictions on growth of existing undertakings.	All but a few industries are free from licensing restrictions on growth. No MRTP Act restrictions on growth.	Companies can grow organically and by acquisitions. Firms will grow in size and several industries will witness consolidation of firms. A small number of firms would eventually dominate the industry in several cases.
Limited scope for foreign capital and technology.	Foreign capital and technology policies have been substantially liberalised.	Entry of many foreign firms by green-field projects and acquisitions. Opportunity for Indian firms for acquiring technology and establishing joint ventures. Substantial increase in competition.
Highly restrictive import policy.	Imports substantially liberalised.	User industries can benefit by global sourcing. Import competing firms face stiff competition. Global competition emerges in the Indian

		market. Indian firms will have to improve their competitiveness and become more innovative to face the global competition.

Many favourable effects of the liberalisation are visible. Investment in the infrastructural and industrial sectors has increased substantially, industrial production has recorded good growth, competition has increased to the advantage of consumers, and export-GDP ratio and export intensity of companies (i.e., the ratio of export sales to total sales) have increased. Foreign investments, both portfolio and direct, have increased very substantially. Indian companies are expanding foreign business with a new vigour.

Since liberalisation, there has been significant improvement in the foreign exchange reserves position.

The composition of the financial inflows has changed very significantly. The proportion of the debt-creating flows has declined substantially. The debt service ratio, although still very high, has shown favourable change.

A large number of companies – Indian and foreign – saw enormous opportunities in these changes and have been prompted to design strategies to exploit them. At the same time, the threats unleashed by these changes have been tremendous, like the intensifying competition, demanding firms to develop strategies to combat them.

An organisation may have strengths or weaknesses on one or more dimensions like finance, operations, human resources, marketing, technology etc. To survive the competition and exploit the opportunities, a firm shall overcome the weaknesses and augment the strengths. If some critical weaknesses cannot be remedied, there may not be any option but to exit the business.

Table 5.3: Reliance's Envisioning of the Future

Reliance's Transformation*			
	1997 **Post-Industrial and Early Information Age**	**2002** **Mature Information Age**	**2010** **Biotech Age**
Net Sales	$ 2.5 billion	$ 10 billion	$ 40 billion
Business Portfolio	Polyester, Textile, Chemicals and Petrochemicals	Existing + Petroleum, Telecom, Power, Infrastructure, Agrotech	Existing + Healthcare, Insurance, Banking and Finance
Business Value	Manufacturing	Service	Well-being
Competency	Management capability	Management and organisational capability	Institutional capability
Organisation Structure	Central control Silos Structure	Corporate control	Cellular Network Organisation
System Architecture	Unified system with no tolerance for diversity	Diversified system with unity of purpose	Individual system with philosophic unity

Source: *Reproduced from *The Economic Times*, 21.9.1998.

Anticipating the future scenarios or environmental forecasting is vital for strategy formulation. Table 5.3 gives a very brief picture of envisioning of future by the Reliance. The actual developments might not have been exactly the same as depicted in the Table. The point is that an organisation shall endeavour to visualise the future scenario and its own position in that scenario, given its vision/mission and strengths and weaknesses. Strategies are expected to be flexible enough to accommodate changes when situation warrants.

It is very important to note that several of the businesses which figure in Table 5.3 were exclusively reserved for the public sector in the past. The opening up of the financial and insurance sectors has been slow. The company geared itself well in time to exploit opportunities as they unfolded.

Favourable Impacts of the Liberal Industrial Policy

1. The opening up of the industries exclusively reserved for the public sector to the private sector paved the way for faster growth of these industries by increased investment and expanded entrepreneurship. Unlike in the previous era, private enterprises now have enormous scope to decide their portfolio strategy (corporate strategy).
2. The liberalisation of foreign investment policy has helped to step up the investment in a number of industries, including several vital sectors. This poses threat to the existing firms in these industries, necessitating new strategies to cope up with the new environment.
3. The FII has invigorated the Indian capital market.
4. An important impact of the liberalisation is the faster development of the infrastructural sector driven by private investment, both domestic and foreign. However, the pace of infrastructure development is still quite unsatisfactory and this will be a major constraint in speeding up pace of overall development.
5. The removal of restrictions on entry and growth has been helping companies to rationalise their business portfolio and product mix, improve efficiency and to achieve faster growth.
6. The liberalisation, by delicensing, scrapping of MRTP restrictions and privatisation, has paved way for business consolidation, helping achievement of scale economies and efficiency improvements.
7. As implied in some of the points mentioned above, the new industrial policy enables corporates to restructure their portfolios, adding new business and/or exiting some of the old businesses.
8. The easy access to foreign technology, capital goods, intermediates and raw materials help improve the competitiveness of the Indian firms.
9. The increase in competition and the scope for global sourcing (as mentioned above) have increased the competitiveness of Indian firms. This is significantly encouraging globalisation of Indian firms, as is evinced by the increase in exports, setting up of greenfield enterprises abroad and cross-border mergers and acquisitions.
10. The increase in competition has helped to improve the efficiency and competitiveness of public sector enterprises.
11. The growth of large firms is encouraging growth of small-scale and medium-scale units by ancillarisation and outsourcing. Many such firms are getting technological and managerial support from the large firms, both domestic and foreign.

12. One of the greatest advantages of liberalisation is the benefits the consumers derive from the increasing competition. What were seller's markets in the past have been becoming buyer's markets, increasing the bargaining power of the buyers.

Consumers benefit from competition in the following ways:

- Choice of goods and services has increased fabulously.
- There is very substantial improvement in product quality and features.
- Competition keeps a lid on prices.
- Firms are becoming more and more innovative, introducing new and improved products.
- After-sales service is becoming increasingly important.
- Consumers are now getting much better credit and other facilities and incentives.

Adverse Effects of the Liberal Industrial Policy

1. **Competition between unequals:** Relatively small Indian firms have to compete with large foreign firms with huge resources and vast experiences.
2. **Market orientation:** The pattern and direction of development are determined mostly by market forces rather than by larger national interests.
3. **Unfair competition:** Large firms, particularly multinationals, may engage in unfair competition to the detriment of small and medium firms. The nation needs to effectively implement the Competition Law to check this.
4. **Income drain:** Increasing presence of foreign firms would cause drain of income from India to abroad. (At the same time, the increasing presence of Indian firms would have the opposite effect).
5. **Ecological Deterioration:** It is argued that delicensing could result in indiscriminate industrial location and resources depletion, causing ecological problems and heavy social costs. There are, however, government safeguards against this.
6. **Demonstration effect and conspicuous consumption:** The flood of all sorts of goods from all parts of the world and the marketing tactics (including unscrupulous) foster demonstration effect and encourage conspicuous consumption.
7. **Skimming the cream:** Increasing FII investment would mean that the Indian stock market is increasingly influenced by foreign players. This would also mean siphoning away of profits of Indian firms by foreign players.
8. **Neglect of social aspects:** Several important social aspects are ignored by liberalisation. Here, it may be pointed out that effective government intervention can help solve the problem. Not only that liberalisation does not mean absence of government intervention for societal benefits but also is a must for liberalisation to be efficient and beneficial.
9. India industry also suffers from absence of a level-playing field.

Impact of Liberalisation: Measures Needed for Improvement

Government needs to take certain measures to make the environment more conducive for faster and healthy development of the industry and economy. These include:

1. Rationalisation of policies and procedures to usher in more transparency and ease of doing business.

2. Ensuring a level playing field to put the Indian firms on equal footing with their foreign counterparts.
3. Effective implementation of the Competition Act to safeguard the Indian firms and consumers from unfair competition.
4. Effective policies and regulations for ecological protection.
5. Effective control over imports and smuggling to ensure that foreign goods enter the Indian market strictly as per government policies and regulations only.
6. Measures against dumping.
7. Effective monitoring and control of the imports through Free/Preferential Trade Agreement.
8. Adequate protection to Indian firms from unhealthy and unfair competitions. Wherever needed, infant industry protection shall be accorded on a rational basis.
9. Measures to improve the infrastructure and common support to the industries.
10. Reform of the administrative system to make it more efficient and business friendly.
11. Imposing a condition that foreign firms operating in India (except small trading and the like) list on Indian stock exchange so that Indian public can also share the prosperity of business of these firms.
12. Foreign goods shall be subject to rigorous quality and other mandatory checks.

Despite the late awaking, LPG meant 'India unbound'. India Inc. has been uncaged. LPG have released the latent energy of firms and individuals. It has been a time for them to prove the mettle. The record of performance has been impressive, despite absence of a level playing field and many adversities. India too has its share of the dark side and the adverse socio-economic impacts. We need to reorient the policy regulatory framework and gear up the implementation will and skill to make the environment fair and growth more inclusive. A nation shall have clear vision, strategy and proper regulatory system to benefit from LPG and to alleviate the adverse effect.

In India, there is a clamour for more liberalisation, particularly in respect of FDI. A thorough evaluation of all the possible impacts and implications of a liberalisation measure, or any policy decision for that matter, shall be carried out before the decision is made. The horrifying stories of corruption and nepotism that have been pouring out clearly indicate the possible vested interests that may influence government decisions. While more liberalisation may be desirable in some areas, there may also be need for review of the liberalisations already done.

There are indeed vital areas where effective government controls are needed, particularly to protect the interests of the vulnerable sections.

How Does Liberalisation/Globalisation Help Mitigate Weaknesses/Augment Strengths?

As pointed out earlier, the liberalisation is a double sided coin – one side represents almost infinite opportunities and the other side shows numerous threats. The fact, however, is that the liberalised environment facilitates the overcoming of several weaknesses. For example, technological weakness may be overcome by purchase of foreign technology (including capital goods) or technological collaboration. Capital shortage may be overcome by joint venturing or taping foreign capital market by ADR/GDR or commercial borrowing. Marketing weakness may be overcome by joint venturing or strategic alliance. Strategic alliance is common in operations management and R&D too. Global sourcing may be resorted to overcome supply bottlenecks, high cost and poor quality of inputs like raw materials and intermediates. Global sourcing of finished products for marketing is also

common. The intension of this paragraph is to highlight the fact that the liberalisation shall not be looked upon merely as a destructive factor. Indian firms and consumers can benefit from them in different ways. This does not mean that they are the only means or the right means to overcome weaknesses or consolidate or boost strengths. Examples of Indian firms, large and small, which have benefited from liberalisation and thereby strengthened themselves galore.

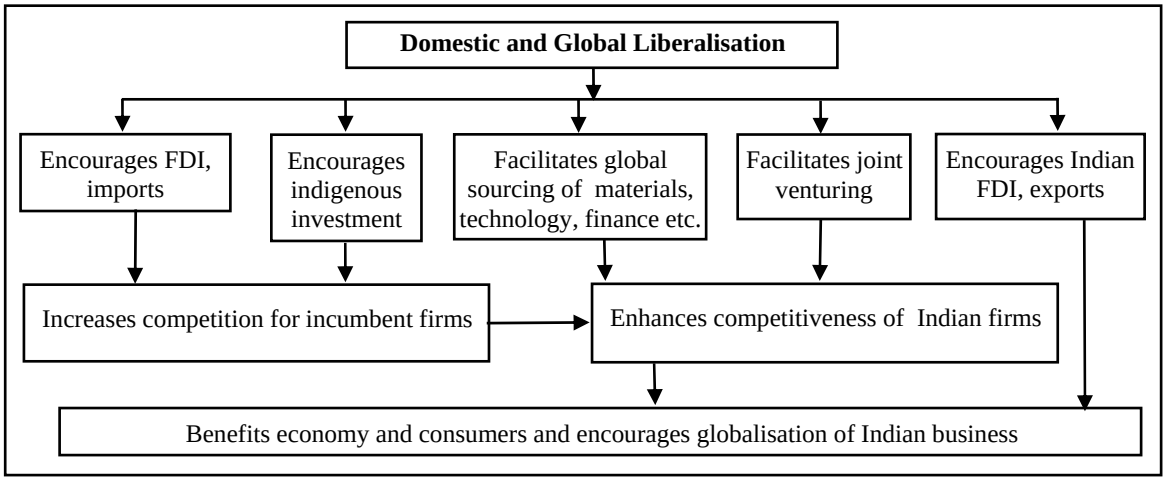

Fig. 5.4: Impact of Liberalisation on Industry

There are large Indian business houses (like A.B. Birla Group, Sterlite Group, Tata Group) which have bought firms or established greenfield enterprises abroad for the supply of raw materials and intermediates. There has been an increasing globalisation of the supply chain. Many Indian firms – large and medium – have become global players through organic and/or inorganic route and several of them are among the top firms in the respective industries. Acquisitions have enabled many companies to mitigate technological weakness or to strengthen technologically. Examples: Tata Motor's acquisition of Daewoo Commercial Vehicles and Crompton Greaves' acquisition of Pauwel of Belgium). Acquisitions have also enabled companies to strengthen their marketing position (like Tata Tea's – now Tata Global Beverages – acquisition of Tetley). Global forays have enabled a number of companies to improve their operational efficiency (Example: Tata Steel's acquisitions of Natsteel, Millennium Steel and Corus). Acquisitions have also enabled companies to fill product mix gap (Examples: Tata Motor's acquisition of Daewoo Commercial Vehicles; Godrej Consumer Products' acquisitions of several firms in Latin America, Asia, Africa and UK; Tata Tea's acquisitions of Good Earth, Eight O' Clock etc.)

The Emerging India

India is emerging as one of the largest markets in the world. It is indeed regarded as one of the growth markets of the future.

While the market for a number of products in the developed countries are saturating or declining as pointed out elsewhere in this chapter, India presents an expanding market because of the following factors.

- Existence of a large backlog of unsatisfied desires, like those for consumer durables
- Fast increase in population

- Rising income
- The communication revolution and changing social attitudes giving rise to a revolution of rising expectations and spurt in demand.

Table 5.4: Some Indicators of India's Position in the Global Economy

	Share (Percentage)	Rank
Population (2011)	17	2
GNI (2010)	2.5	9
GNI measured at PPP (2010)	5.5	4
Export of goods (2012)	1.6	19
Import of goods (2012)	2.6	10
Export of services (2012)	3.4	6
Import of services (2012)	3.0	7
Foreign Direct Investment Inflow (2009)	3.1	8

Source: Compiled/computed from different sources.

Drivers of India's economic growth gathered further momentum in the present millennium, tending to support Goldman Sachs' (GS) projections in the BRIC[6] studies that by the middle of the present century India will emerge as the second largest economy in the world.

It is observed that from a long-term perspective, the post-industrial economic decline of India (and China) is a historical aberration, driven to some extent by a lack of openness. After independence in 1947, India followed inward-looking and State-interventionist policies that shackled the economy through regulations, and severely restricted trade and economic freedom. The result was decades of low growth, pejoratively termed the *Hindu rate of growth.* Reforms beginning in 1991 gradually removed obstacles to economic freedom, and India has begun to play catch-up, steadily re-integrating into the global economy. Since 2003, India has been one of the fastest growing major economies, leading to rapid increases in per capita income, demand and integration with the global economy. It is argued that there has been a structural increase in India's potential growth rate since 2003 on the back of high productivity growth. The acceleration of India's growth momentum has prompted Goldman Sachs to revise, in 2007, its baseline projections for India's potential output growth that the economy can sustain to about 8 per cent annually until 2020, significantly higher than the 5.7 per cent that it projected in the original BRICs Paper (2003).[7]

According to GS projections, in 2050, India's GDP will be more than $ 40,000 and GDP per capita will be more than $ 20,000 (both in 2007 US dollars). In other words, India could be 40 times bigger by 2050 compared to 2008. The higher growth rate under GS new projections will have significant implications for demand in India. From 2007 to 2020, India's GDP per capita in US Dollar terms will quadruple (one-third higher than the original GS projections). Indians will also consume about five times more cars (up from 3.5 times) and three times more crude oil (up from 2.3 times).

Drivers of Growth

A very important contributor to the recent acceleration of India's growth is the resurgence of the industrial sector.

India's impressive performance is resulting from, among other things, the surge in productivity (i.e., the total factor productivity, or the manner in which all inputs are combined to achieve more output) which is likely to continue over the next decade. A key underlying assumption is that the government will continue to implement growth-supportive policies. As a GS Paper observes, turnaround in manufacturing productivity since 2003 has been crucial. India's growth performance since independence in 1947 has been well below potential, stymied by low productivity. From 1960 to 2000, annual total factor productivity (TFP) growth averaged a mere 0.25 per cent. Tentative steps to reform the economy in 1985, and then fundamental reforms since 1991, moved the economy up a gear, with growth averaging 6 per cent and TFP moving up to an average of 1.6 per cent per year.

The proximate cause is the increase in efficiency of private sector firms in the face of growing competition. The gradual opening up of the economy introduced a competitive dynamic, which forced the private sector to restructure during the relative slowdown in growth and corporate profitability during 1997-2002. GS observes that after the restructuring, the private sector emerged leaner, fitter and more productive. The underlying causes for the increase in efficiency of private firms have been trend accelerations in international trade, financial sector growth, and investments in and adoption of information and communication technology. These are also the cumulative effects of a decade of reforms.

According to GS, the reallocation of land, capital and especially labour from low-productivity agriculture to high-productivity industry and services is an essential dynamic behind sustained productivity growth. This process is being accelerated by higher returns in industry and services due to trade openness, cheaper credit, investments in IT and communications, and the building of highways. These processes are in their initial stages and have substantial distance left to run. Migration of labour from agriculture to industry and services have significantly contributed to productivity improvements. In India, labour is nearly four times more productive in industry and six times more productive in services than in agriculture, where there is a surplus of labour. Economic theory tells us that as labour moves from low-productivity sectors (such as agriculture) to high-productivity sectors (such as industry or services), overall output must improve. The GS research has estimated the output gains due to labour migration from agriculture to services and industry, and found that in recent years, this move has contributed upwards of 0.9 percentage points (ppt) to overall growth. The gains are roughly equally split between agricultural labourers moving to industry and to services.[38] The GS study, however, seems to have ignored the critical importance of the development of the agricultural sector in boosting India's economic growth as well as poverty eradication.

The liberalisation contributed to the efficiency improvement in more than one way. It facilitated global sourcing of technology and capital goods, raw materials and other inputs, finance etc. The increasing competition compelled firms to make their best efforts to improve their competitiveness in the environment of survival of the fittest. A number of Indian firms have gone global aggressively, by acquisitions and greenfield investments and exports. The recent rapid development of the financial sector has contributed to the jump in productivity. Increased financial intermediation improves resource allocation by effectively channeling savings into investment and raising productivity. There is considerable scope, with proper policy orientations, for further strides in the financial sector and financial deepening which can contribute to increases in productivity. The development of the IT sector has given a boost to the economy as a whole through its impact on productivity, exports and globalisation, expansion of high paid employment opportunities and technical education. The

importance given to infrastructure development, including the Golden Quadrilateral Highway project, is also a factor that contributed to the acceleration of the growth. Infrastructure development, however, continues to lag very much behind the requirement.

Pre-requisites

Goldman Sachs points out that if India can accumulate significantly more capital to add to its favourable demographics and ongoing productivity gains, the nation could reach a growth rate of 10 per cent by 2010 and sustain it thereafter. (There was a possibility of India achieving 10 per cent growth rate by 2010 but for the global economic crisis that struck in 2008 leading to a global recession and which, coupled with domestic political and other problems, caused a deceleration in India's growth rate.)

GS studies have highlighted ten key areas where reform is needed. In all likelihood, they are not the only ten, GS considers them to be the most crucial:

1. Improve governance
2. Raise educational achievement
3. Increase quality and quantity of universities
4. Control inflation
5. Introduce a credible fiscal policy
6. Liberalise financial markets
7. Increase trade with neighbours
8. Increase agricultural productivity
9. Improve infrastructure
10. Improve Environmental Quality

Conclusion

Even if India grows as projected or even a little better, in absolute terms India will remain a low-income country for several decades, with per capita incomes well below its BRIC peers. However, despite the low per capita income, as the GS Paper observes, if it can fulfil its growth potential, it can become a motor for the world economy and a key contributor to generating spending growth. Any kind of long-term projection is subject to a great deal of uncertainty, and we need to be mindful that India's growth transition is unlikely to be smooth or devoid of shocks. International development experiences are littered with examples of failure due to bad policies or simply bad luck. Having the potential and actually achieving it are two separate things. *The ten things for India to achieve its 2050 potential* referred to above also indicates India's weaknesses. In GS latest annual update to its Growth Environment Scores (GES), India scores below the other three BRIC nations, and is currently ranked 110 out of a set of 181 countries assigned GES scores. If India were able to undertake the necessary reforms, it could raise its growth potential by as much as 2.8 per cent per annum, placing it in a very strong position to deliver the impressive growth as projected.

Political opportunism, governance failures, corruption, lack of clarity and strong determination on the part of governments, terrorism and designs of other nations to upset India's growth strategies and potentials, including raising border disputes and encouraging terrorism and militancy etc., are

among the major challenges facing India. Added to this is the problems caused by global economic instabilities and political disturbances.

Because of factors such as governance problems, as reflected by the rampant corruption, political fluidity and unfairnesses, global economic problems, geopolitical problems etc., things now, however, do not look as rosy as depicted above in this section.

SOCIAL TRANSFORMATION OF INDIA

India has undergone far-reaching social transformation after she gained political independence from the foreign rule, particularly since the early 1950s with the coming into effect of the Indian Constitution and the advent of the development planning – the two major catalysts of political and socio-economic transformation of India. The social transformation has become more pronounced, acquiring new dimensions, in the last few decades, under the impetus of liberalisation and globalisation.

The important sources of this transformation are:

- The Constitution of India
- The Development planning
- The improvements in the educational levels
- The demographic transition
- The overcharging impact of media
- The liberalisation and globalisation

Socio-economic and Political Implications of the Constitution

The Indian Constitution incorporates a number of matters that are politically, socially and economically very significant and have far-reaching implications. The socio-economic and political objectives of the Indian Republic and the basic guiding principles of State functioning have been clearly laid down in the *Preamble* to the Constitution, the *Fundamental Rights* and in the *Directive Principles of State Policy*. The Constitution also outlines the economic powers and responsibilities of the Union Government and the State Governments.

The Preamble to the Indian Constitution states that, all citizens of the nation shall be ensured social, economic and political justice; liberty of thought, expression, belief, faith and worship; and equality of status and of opportunity. These are substantiated by the *Directive Principles of State Policy* and fortified by a number of *Fundamental Rights* enshrined in the Constitution.

The Directive Principles of State Policy, which is a unique feature of India's Constitution, are in the nature of directions to the legislature and executive that they should exercise their authority in such a manner as to ensure due respect for, and observance of, these principles. They have had a salutary influence on policy and law making in the country. That is the Directive Policy have been catalysts to bring about socio-economic transformation in India.

Some of the Constitutional directives quoted below highlight the socio-economic significance of the Directive Principles.

(a) The State shall strive to promote the welfare of the people by securing and protecting as effectively as it may a social order in which justice, social, economic and political, shall inform all the institutions of the national life [Article 38(1)].

(b) The State shall, in particular, strive to minimise the inequalities in income, and endeavour to eliminate inequalities in status, facilities and opportunities, not only among individuals but also amongst groups of people residing in different areas or engaged in different vocations [Article 38(2)].

(c) According to Article 39, the State shall, in particular, direct its policy towards securing:

1. That the citizens, men and women equally, have the right to an adequate means of livelihood.
2. That the ownership and control of the material resources of the community are so distributed as best to subserve the common good.
3. That the operation of the economic system does not result in the concentration of wealth and means of production to the common detriment.
4. That there is equal pay for equal work for both men and women.
5. That the health and strength of workers, men and women, and the tender age of children are not abused and that citizens are not forced by economic necessity to enter a vocation unsuited to their age or strength.
6. That children are given opportunities and facilities to develop in a healthy manner and in conditions of freedom and dignity and that childhood and youth are protected against exploitation and against moral and material abandonment (Article 39).

It may be noted that sections of Article 39 were quoted as the basis of certain policies and Acts.

(d) The State shall ensure that the operation of the legal system promotes justice, on a basis of equal opportunity, and shall, in particular, provide for legal aid, by suitable legislation of schemes or in any other way, to ensure that opportunities for securing justice are not denied to any citizen by reason of economic or other disabilities (Article 39-A).

(e) The State shall take steps to organise village panchayats and endow them with such powers and authority as may be necessary to enable them to function as units of self-government (Article 40).

(f) The State shall, within the limits of its economic capacity and development, make effective provision for securing the right to work, to education and to public assistance in cases of unemployment, old age, sickness and disablement, and in other cases of underserved wants (Article 41).

(g) The State shall make provisions for securing just and humane conditions of work and for maternity relief (Article 42).

(h) The State shall endeavour to secure, by suitable legislation or economic organisation or any other way, to all workers, agricultural, industrial or otherwise, a living wage, conditions of work ensuring a decent standard of life and full enjoyment of leisure and social and cultural opportunities and in particular, the State shall endeavour to promote cottage industries on an individual or cooperative basis in rural areas (Article 43).

(i) The State shall take steps, by suitable legislation or in any other way, to secure the participation of workers in the management of undertakings, establishments or other organisations engaged in any industry (Article 43-A).

(j) The State shall promote with special care the educational and economic interests of the weaker sections of the people, and, in particular, of the scheduled castes and the scheduled tribes, and shall protect them from social injustice and all forms of exploitation (Article 46).

(k) The State shall regard the raising of the level of nutrition and the standard of living of its people and the improvement of public health as among its primary duties and, in particular, the State shall endeavour to bring about prohibition of the consumption, except for medicinal purposes, of intoxicating drinks and of drugs which are injurious to health (Article 47).

(l) The State shall endeavour to organise agriculture and animal husbandry on modern and scientific lines and shall, in particular, take steps for preserving and improving the breeds, and prohibiting the slaughter of cows and calves and other milch and draught cattle (Article 48).

(m) The State shall endeavour to protect and improve the environment and to safeguard the forests and wildlife of the country (Article 48-A).

These Directive Principles make quite clear how important is the economic responsibility bestowed on the State by the Constitution.

Through constitutional amendments, new directives were added to provide a greater socialist orientation to development. For instance, in 1978, by the 44th Amendment, a new clause was added to Article 38; and this new clause contains a directive to strive to minimise the inequalities in status, facilities and opportunities. The 42nd Amendment incorporated a new Article, 43-A, to direct the State to take suitable steps to secure workers' participation in management.

In short, the Directive Principles of State Policy enunciated in the Indian Constitution has gone a long way to bring about a significant socio-economic and political transformation of the nation, particularly in improviving the socio-economic and political staus of the backward classes and weaker sections.

Another cornerstone of the Indian democracy is the Fundamental Rights guaranteed by the Constitution. It has been claimed that the Indian Constitution offers to all citizens, individually and collectively, the best fruits of democracy and those basic freedoms and conditions of life which alone make life significant and productive. The rights enumerated in Part III of the Constitution cover a wide range and are declared to be fundamental and justiceable.

The theory of fundamental rights implies limited government. It aims at preventing the government and the legislature from becoming totalitarian, and in doing so it affords the individual an opportunity for self-development. But these rights are not absolute; they are subject to limitations imposed by the State in order to secure rights for all individuals or to promote the greater interests of the community or the State, or to serve the ends of a planned society.

The Fundamental Rights enumerated in Part III of the Constitution are:

1. Right to Equality
2. Right to Freedom
3. Right against Exploitation
4. Right to Freedom of Religion
5. Cultural and Educational Rights
6. Right to Constitutional Remedies

The Constitution had also guaranteed the Fundamental Right to Property and had prohibited the deprivation of property of any person, save by authority of law, and for the deprivation of property compensation had been payable. But, in 1976, the 44th Amendment of the Constitution abolished the fundamental right to property. However, though the right to property is no longer a Fundamental Right, it has been retained as a Constitutional Right.

The Right to Equality prohibits discrimination against any citizen on grounds of religion, race, caste, sex or place of birth. In public employment, it ensures equality of opportunity to all citizens. This is, however, subject to certain limitations, such as the right of the State to reserve posts for backward classes which, in the opinion of the State, are not adequately represented in the services.

The Constitution guarantees the citizens the fundamental right to freedom to practice any profession, carry on any occupation, trade or business, subject to reasonable restrictions in the public interest, including specifying qualifications necessary for practising any profession or carrying on any trade, business, industry or service.

The Fundamental Right against Exploitation prohibits traffic in human beings, and beggary and other forms of forced labour; and any contravention of this provision shall be an offence punishable in accordance with the law. However, this does not prevent the State from imposing compulsory service for public purposes. In imposing such service, the State shall not make any discrimination on grounds only of religion, race, caste or class, or any of them.

Thus, the Fundamental Rights enumerated in the Constitution guarantee a number of economic rights or freedom to engage in any profession, trade or any other economic activity. The State, however, has the power to impose reasonable restrictions on such rights in the public interest. These rights have been very significant to the economic development of individuals and the nation.

Development Planning

Development planning has played a crucial role in the socio-economic development of India. The era of planned development dawned in India with the launching of the First Five Year Plan on April 1, 1951.

The main objectives of the Indian plans have been:

- Proper utilisation of the national resources in accordance with the socio-economic priorities for fast development of the economy.
- Alleviation and ultimate removal of unemployment and poverty.
- Improvements in the standard of living in general.

The avowed objectives of planning like rapid increase in income, generation of employment, social or redistributive justice, self-reliance etc. are obviously means to achieve the objectives or aspects of the objectives mentioned above.

There have been changes in the priorities of development and emphasis on objectives through the plans. For example, the development priority shifted from agriculture in the First Plan to basic and heavy industries in the Second Plan. The Third Plan recognised the importance of export promotion and the Fourth Plan emphasised *self-reliance* as an objective of development. *Growth with Social Justice* has been receiving added emphasis since the Fifth Plan. The Fifth Plan, which realised that *a direct attack on poverty* was necessary for rapid eradication of poverty, formulated a specific

package of programmes, known as the *minimum needs programme*, to improve the living conditions of the poor and these programmes have been continued, with modifications, in the subsequent plans.

A significant step-up in the rate of growth of the economy, strengthening the redistributive bias of the public policies and services in favour of the poor were among the major objectives of the Sixth Plan. The focus of the Seventh Plan was on food, work and productivity.

The Eighth Plan (1992-97) recognised "human development" as the core of all developmental effort. The priority sectors that were identified to contribute towards realisation of this goal were health, education, literacy and basic needs, including drinking water, housing and welfare programmes for the weaker sections. The focus of the Ninth Plan was *growth with social justice and equality*. It gave priority to agriculture and rural development with a view to generating adequate employment and eradication of poverty. The Tenth Five Year Plan (2002-2007) emphasised that the development strategy needs to include not only an adequate level of consumption of food and other types of consumer goods but also access to basic social services, especially education, health, availability of drinking water and basic sanitation.

The theme of the 11th Five Year Plan (2007-2012) was *Towards Faster and More Inclusive Growth.* It recognised that faster growth and target specific programmes aimed at eradication of poverty and alleviation of certain deprivations were needed to achieve fast reduction in poverty.

The broad vision and aspirations of the Twelfth Plan (2012-17) are *Faster, Sustainable, and More Inclusive Growth.*

Although there have been many drawbacks and deficiencies, India achieved more or less steady progress under the impetus of planning, as explained in the section *Economic Transition.*

The section *Economic Transformation of India* has given a general review of the economic performance of the nation through the planning era.

Education

Although illiteracy still prevails widely, there has been a very significant improvement in the educational levels and this facilitates better transmission of ideas, triggers changes in the attitudes and improves the scope of marketing. The literacy rates, however, varies widely between the different states, with Kerala achieving very high literacy while large states like Bihar, Uttar Pradesh, Madhya Pradesh and Andhra Pradesh lag behind.

In the government policies, special emphasis has been given, in accordance with the Directive Principles of State Policy enshrined in the Constitution, to improving the educational levels of backward and weaker sections like scheduled castes and tribes, other backward classes and women. This policy of upliftment of the backward classes has been taken further forward by reservation of jobs for them in the government sector (including public sector enterprises). There is, however, criticisms against this policy that it is denying due opportunities to the 'forward' classes (including economically very poor among them) and that even economically well off among the 'backward' classes are beneficiaries of this policy at the expense of the poor in these classes and other classes. While these criticisms are valid, the fact remains that the government policies have gone a long way in improving the socio-economic and political status of a large number of people of the backward classes, drawing them to the mainstreams. Several of these communities had been socially, economically and politically

suppressed for centuries. The improvement in the living conditions and social status contributed to the general expansion of market for many goods and services. It has trickle-down effects too.

Allowing a greater role for the private sector in higher education, particularly professional education, has a salutary effect on the socio-economic development of the new generation. This has significantly contributed to the development of India's knowledge economy and contributed to the acceleration of economic growth by expanding the supply of qualified human resource. The liberalisation of the educational sector enabled India to take very good advantage of the global IT boom. It gave a boost to India's foreign exchange earnings by increasing the service exports and remittances to India by Indian's working in the IT sector abroad. MBAs from good institutions, engineers and other professionally qualified youngsters are getting handsome salaries and benefits which could not have been dreamt of in the past. The expansion of the highly paid employment sector and the increase in income by remittances, growth of profitable entrepreneurship etc. have brought in revolutionary changes in consumption habits/demand patterns and has expanded the demand for a variety of goods and services – automobiles, white goods and other consumer durables, FMCG products, upmarket housing, hospitality business, credit and an array of services. The emerging consumer culture has been fostering the growth of corporate retailing and malls. Although the well-to-do consumers forms only a very small percentage of the total Indian population, their number is large and is growing fast. This class is shaking many a traditions, customs and values and a lot of cultural transmission is taking place.

This social transformation is driven to a significant extent by the *acculturation* and *sanskritisation* processes and the communication revolution brought in by the internet, mobile phones and cable TV. (Acculturation refers to the process of cultural and psychological change resulting from interaction between different cultures. It is a process in which members of one cultural group adopt the beliefs and behaviours of another group. Although acculturation is usually in the direction of a minority group adopting habits and language patterns of the dominant group, it can also be reciprocal. Common acculturation impacts include changes in language preference, food, clothing etc., adoption of common attitudes and values, membership in common social groups and institutions, and loss of separate political or ethnic identification. Sanskritisation, a term popularised by M.N. Srinivas, a famous sociologist, refers to a form of social change observed in India – the process by which castes placed lower or middle in the caste hierarchy seek upward mobility by emulating the customs, ritual, ideology and way of life of the upper or dominant castes.) Migration, education and social mobility of population and the resultant cross-cultural interaction are important influencers.

The improvement in the educational levels in India is happening at a time when a communication revolution is happening.

The social transformation is driven to a large extent by the overcharging impact of the internet, developments in the telecast sector, radio, mobile phones, etc. Increase in the educational levels has expanded the reach of the print media. Movies play a tremendous role, for good or evil, in the social life, particularly of the poor and less educated.

The developments in the communication sector has been adding newer and newer dimensions to promotion/marketing of products (including services and ideas) and social and political campaigning.

Online marketing is growing, supported by the expansion of internet banking, credit/debit card usage and courier service.

The influence of social media is growing, particularly among the youth.

The influence of the communication revolution is boosting the revolution of rising expectations (for example, the constant exposure to the influx of goods and services and amenities through movies and other media keep boosting an aspiration to possess them one day) and the demonstration effect (i.e., the tendency to imitate the lifestyles of the well-to-do).

Changes in the Family Environment

Very significant changes have taken place in the family structure and the internal dynamics of families.

The joint family system has, by and large, broken away. The decision-making process and consumption pattern of nuclear families remarkably differ from those in the joint families. Nuclear families are characterised by, generally, joint decision-making and relative freedom in consumption pattern.

Small family norm has become widespread. This tends to increase the discretionary income and leisure. Many families are double or multiple income households. The employment of women leaves her with very little time to engage in household chores. There is, thus, a necessitating factor (lack of time for the wife to attend to the household work) and a facilitating factor (better income) which in tandem increase the demand for consumer durables which substitute human effort and/or increase the convenience and comfort. Double/multiple income households also increase the demand for personal transport. These changes in the family environment also increase the demand for many consumer non-durables, including FMCG products, and a variety of services. Demand for packaged food, including ready-to-eat/heat and eat products, ready mix food ingredients etc. are on rapid increase. There is also a remarkable shift in the shopping habits.

Purchases of durables including houses and automobiles are boosted by credit expansion. Credit/debit cards and online marketing encourage and facilitate purchase of many goods and services.

Eating out and picnics/tours are growing fast.

The employment of women has increased their role in buying decision-making due both to the financial factor and information factor. Unlike in the past, when the head of the family was, in most cases, the ‘depository’ of information and knowledge, today the wife and children are equally, sometimes more, important possessors of information. Word-of-mouth communication and influence of reference groups play an important role.

These trends have important implications for corporate and marketing strategies.

HR Diversity and Cultural Diffusion

An important aspect of the social transformation is human mobility within the nation and across the borders. The internal and external migrations have been changing the characteristics of the human resources. The human resource diversity is increasing in many, particularly large, organisations. The HR diversity tends to increase as the geographical, particularly global, dispersal of the operations of an organisation increases.

In the unorganised sector, including agriculture and tiny business sector, labour migration and ethnic factors are assuming new dimensions in some regions. In Kerala, employment in agriculture,

construction sector, lower level jobs in micro and small enterprises etc. are largely by migrant labour from other parts of the country, including far-off places like Bihar, Orissa, and West Bengal etc.

The HR diversity leads to acculturation and sanskritisation and this has signifcant implications for business strategy formulation.

Box 5.1

Challenges of Managing HR Diversity

The human resources of a company in countries like India tends to be very diverse because of the socio-cultural and other demographic factors, political forces, government policies and regulations, market characteristics, company characteristics (like the scope of its business, nature of the businesses etc.) and so on.

The demographic diversity of India as exhibited in the enormous variety of castes and creeds, languages and dialects, religious and social practices, customs and traditions, educational levels and skills etc. is mind-boggling. Added to this is the problem of multiplicity of trade unions and political influences and the government policies and labour laws.

The challenges of managing the human resource diversity often increase as the diversity grows extensive and intensive with the growth of the business of the company, particularly by portfolio changes and geographical expansion, including globalisation. Acquisitions, particularly foreign, sometimes dramatically increases the HR diversity.

For example, The Tata Steel Group, the world's second most geographically diversified steel producer, has, presence in over 50 countries – particularly in developed European and fast growing Asian, with manufacturing operations in 26 countries and various ongoing projects in different parts of the world, employing over 80,000 persons across five continents. The huge HR sizes of IT majors like TCS, Infosys and Wipro are growing year after year, involving employees from many nationalities and different socio-economic and geographic strata within the country, expanding the HR diversity.

Globalisation has been leading to an expansion of the cross-cultural HR. Further, as indicated earlier, labour shortages which many countries face will encourage international migration.

As the diversity of human resources increases, various strategies need to be employed for achieving cultural fusion and promotion of the organisational culture, making the people to understand, appreciate, cherish and live up to the vision, mission, objectives, policies and value system of the company.

Today, diversity is being viewed as a key means to strengthen the human capital of an organisation and improve overall performance. Indeed, a diverse workforce offers a number of benefits, including different lines of strategic thinking and perceptions, diverse knowledge and experiences, and, increased flexibility and adaptability to the changing marketplace.

INDIA'S DEMOGRAPHIC DYNAMICS

As pointed out in the next section of this chapter, global demographic trend are influencing the business geography of the world. India occupies a central place in this demographic-geographic stage.

In terms of the number of consumers, India now is the second largest market in the world and it is set to become the largest market by early 2020s.

The largest increase in population in the world has been happening in India. During 2001-2011, the addition to the Indian population was 181 million persons and this figure was only a little lower than the total population of Brazil, the fifth most populous country in the world.[8] In 2010, there were

only five countries (excluding India) with a total population of more than 181 million – China, USA, Indonesia, Brazil and Pakistan.

The population of India in 2011, at 1210 million, was almost equal to the combined population of USA, Indonesia, Brazil, Pakistan, Bangladesh and Japan.

The total number of people of only four nations (excluding India) – China, USA, Indonesia and Brazil – is larger than the total number of households (about 193 million) in India.

Although the population growth rate in India has significantly come down, the addition to the Indian population every year (about 20 million) is more than or nearly equal to the total population of a number of countries. The annual addition to the Indian population is nearly equal to the combined total population of three developed nations, viz., Sweden, Norway and Denmark. In other words, in terms of the number of consumers, every year India is adding to itself a market as large as the above three markets put together.

The fast growing enormous size of the Indian population has given rise to a number of serious problems. The total population of only China, USA and, perhaps, Indonesia is larger than the total number of Indians below the poverty line. The number of unemployed in India is larger than the size of the labour force of many countries. The number of families in India without satisfactory housing is larger than the total number of households in many countries. To solve the basic problems, the additional number of children to be educated, the additional employment opportunities to be created, the additional houses to be built, the additional number of people to be provided with health and sanitation facilities, water supply etc. during one Five Year Plan in India are more than what many nations have done over centuries. While all these highlight the gigantic challenge facing a poor nation, they also indicate the enormous investment and business potentials.

While it is true that the number of Indians below the poverty line is larger than the total population of many countries, it is also a fact that the total number of the well-to-do Indians is larger than the total population of many countries. If one assumes that five per cent of the Indians are well off, their number will come to more than the total population of many of the developed countries. The size of the Indian middle class is larger than the total population of most of the countries.

Even if only a very small percentage of the Indian population can afford what may be called luxury goods according to the Indian standards, in absolute terms their number is significant. In several cases, their number will be as large or larger than the total number of consumers in many of the developed countries.

One of the very important basis of India's exciting growth potential described earlier under the subheading *The Emerging India* is her remarkable demographic advantage that has come to be widely described as the *demographic dividend*. According to the UN's projections, the increase in India's population between 2000 and 2020 will be 310 million, about the same size as the US population today and during this period India will create the equivalent of the combined working population of France, Germany, Italy and the UK.

According to the 2011 census, there were about 750 million people in India in the 15-59 age group. India has an younger population which is larger not only in comparison to advanced economies but also in relation to the large developing countries. As a result, the labour force in India is expected to increase by 32 per cent over the next 20 years, while it will decline by 4.0 per cent in industrialised countries and by nearly 5.0 per cent in China. This *demographic dividend* is expected to enable India

to achieve the highest GDP growth rate in the world in future, provided a conducive environment for growth is ensured and a big push is given for the development of infrastructure, health, education etc.

While India struggles with a burgeoning population of educated youth, the rest of the world, especially developed countries, faces a shortage of working-age people, caused largely by lower birth rates and an ageing working population. While the requirement for skilled workers in these markets is increasing in line with economic growth, the availability of skilled people simply isn't keeping pace. In professions like IT services, medicine, and education, the problems are already beginning to be felt.[9]

Developed countries, and even some developing countries such as China and Russia, will have a workforce shortage.[10]

Box 5.2

Highlights of India's Population Change

- India is the second most populous country but makes the largest contribution to the growth of the world population.
- India, which has been the second populous country, is expected to become the most populous by 2021, relegating China to the second position, and will remain so in the foreseeable future.
- Between 1901 and 2011, the population of India registered a five-fold (400 per cent) increase, from about 240 million to 1210 million.
- India's population is projected to grow to about 1400 million in 2021, 1692 million in 2050 and to decline to 1551 million by 2100.
- In 1950, China's population was 48 per cent higher that of India. By 2000, the gap declined to half of it (24 per cent). In 2050, India's population is expected to be about 30 per cent higher than that of China.
- During 1950-55, the average annual increase in India's population was about 7 million compared to nearly 12 million in respect of China but during 2005-10 when China's population increased by about 7 million annually, India's went up by about 17 million. During 2045-50, the annual increase in population is projected to be the highest in Nigeria (7 million) followed by India (5.5 million), Tanzania (3 million), Congo (2 million) and USA (nearly 2 million).
- In 1950, India was inhabited by about 15 per cent of the world population. It increased to nearly 18 per cent in 2011 and is projected to account for about 15 per cent in 2100, as the most populous country.
- India which shelters a whopping 18 per cent of the world population has only 2.4 per cent of the world surface area. Among the 10 most populous countries, only Bangladesh has a higher population density than India.
- China's population was higher than that of India by 23 per cent in 2001 and, 11 per cent in 2011, but by 2021 India's population is expected to surpass the Chinese and in 2050 India is projected to have about 24 per cent more inhabitants than in China (i.e., a just reversal of the 2001 situation) and by the end of the century this difference may increase to 40 per cent.
- During 2001-2011, for the first time, the urban population of India increased more than the rural population. The share of urban population in the total population increased from about 28 per cent in 2001 to 31 per cent in 2011.
- The population growth rate peaked to nearly 25 per cent during 1961-71 and 1971-81 and declined thereafter, falling to less than 18 per cent during 2001-2011.
- In 2011, about 30 per cent of the Indian population was below the age of 15 years, 62 per cent in the age group of 15-59 and nearly 8 per cent was 60 years and above.

Urbanisation

Urbanisation, besides fostering economic growth, trigers social changes which stimulates changes in the consumption and demand patterns conducive to a varierty of businesses. Urbanisation triggers acculturation and sanskritisation.

Although the level of India's urbanisation is relatively low, India has one of the largest urban populations in the world (377 million according to the 2011 census).

Level of urbanisation increased from 27.81 per cent in 2001 Census to 31.16 per cent in 2011 Census.

The urban population of India has been growing much faster than the rural. During 2001-2011, the urban population grew more than two-and-a-half times faster than the rural (31.8 per cent vs. 12.2 per cent). While the rural population increased by 90.4 million during this period, the urban population increased slightly more than this (91 million).

GLOBAL DEMOGRAPHIC TRENDS

Peter Drucker, who emphasises the tremendous economic and business implications of demographic changes, suggests that any strategy, that is any commitment of present resources to the future expectations, has to start out with demographics.[11]

Demographic Changes and Changing Global Business Geography

The demographics is rewriting the global business geography, as indicated by Box 5.3 and the descriptions in the following paragraphs. Companies need to factor in these trends while thinking corporate strategy.

Demographic factors such as size of the population, population growth rates, age composition, ethnic composition, density of population, rural-urban distribution, family size, nature of the family, income levels, sociological factors etc. have very significant implications for business.

Box 5.3

Highlights of World Population Change

- The world has been experiencing a population explosion for the last many decades and it will continue for another five decades or so.
- The 20th century witnessed substantial increase in world population. Despite the decline in the birth rate, world population will grow fast until the mid 21st century and is likely to grow slowly in second half of the century and would hit 10,000 million persons by the end of the century. This is about four times the population of the world in 1950. The increase in the population will be substantially higher if the decline in fertility projected by the United Nations in the medium variant fails to be realised. See Tables 5.6 and 5.7 for the alternate scenarios projected by the UN.
- Between 1950 and 2000, 3500 million inhabitants have been estimated to have added to the world and a nearly equivalent number (3250 million) will be added during 2000 to 2050, according to the medium projections of the UN. However, while the world population has more than doubled from 2532 million to 6054 million in the second half of the last century (an increase of about 140 per cent), the projected increase during the first half of the present century is about 54 per cent.

- Population increase during 1980-2010 was larger than the preceding three decades, although the annual population growth rate during the later period (about 1.45 per cent) was lower than the former period (1.88 per cent).
- The projected increase in world population during 2011-2050 is nearly equivalent to the total population the world had in 1950.
- During 1950-2011, developing countries accounted for 90 per cent of the growth in world population.
- The share of the developed countries in the world population declined from 32 per cent in 1950 to 18 per cent in 2011 and is projected to decline further to 14 per cent by 2050. On the other hand, the share of the developing countries correspondingly increased from 68 per cent to 82 per cent and is expected to reach 86 per cent in 2050.
- In 2011, the combined population of China and India alone was more than the total population the world had in 1950.
- During 2011-2050, developing countries would account for almost the entire increase in the population.
- Many developed countries and developing countries, notably China and India, are likely to experience decline in the population during 2050-2100.
- Global population growth rate which declined during the last four decades or so is expected to decline substantially and progressively over the rest of the century.
- The projected increase (medium variant) in the world population during the entire period of 2050-2100 (870 million) is only little more than the average annual increase during 1980-2011 (810 million).
- Fertility has been falling in the vast majority of countries. Fertility in most developed countries and in a number of developing countries is already below the replacement fertility (below 2.1 children per woman).
- World population is highly concentrated in a relatively small number of countries. In 2011, about half of the world population was in 6 countries (China and India jointly accounting for more than one-third of the total) and 25 countries accounted for 75 per cent of the population.
- In developed countries, deaths would exceed births over the foreseeable future, leading to a decline in the population if not counterbalanced by a net migration gain. The more developed regions are expected to receive large net migration over the century.
- A small percentage of the total number of the countries will account for the major part of the increase in the world population, generally the most populous. During 2011-2050, about half of the growth in the world population is projected to come from eight countries.
- Now, more than half of the world population is urban compared to less than 30 per cent in 1950 and it is expected to increase to nearly 60 per cent by 2030 and 70 per cent by 2050.
- As in the case of the total population, almost the entire future growth of the urban population in the world will be in the developing countries.
- The fall in the birth rates, drastic reduction in the mortality rates and the increase in the longevity have significant impact on the age structure of the population.
- The world population is ageing rapidly. The proportion of the world population aged 60 years or over is expected to double from 11 per cent in 2011 to 22 per cent in 2050. There is a very fast increase in the number of the oldest – old, i.e., persons aged 80 or over.

The demographic trends[12] portrayed in Box 5.3 will have far-reaching socio-economic and business impacts. Advanced countries, particularly with large population, have been generally attractive markets. The major part of the international trade and foreign investments have been taking place between these nations. Because of the large potential of these markets, competition is generally strong in them. The demographic trends, however, are changing the dynamics of the global business geography.

Declining Birth Rate

The birth rate is falling in both developed and developing countries; but it is highly alarming in the developed countries. Peter Drucker has observed in the *Management Challenges for the 21st Century* that because of the *collapsing birth rate* in the developed world, many developed countries are drifting toward collective national suicide by the end of the 21st century. By then Italy's population, for instance—now 60 million—might be down to 20 or 22 million; Japan's population—now 125 million—might be down to 50 or 55 million.

The declining birth rate poses a problem for many businesses. Because of the fall in the birth rates and the consequent fall in the size of the baby population, the market for baby products has shrunk in a number of countries. This has prompted some companies, such as Johnson & Johnson, to reposition their products (originally introduced as baby products) and to pay more importance to international business.

The declining birth rate has, however, been a boon to certain industries. For example, industries such as airlines and hotels restaurants have benefited from the fact that young childless couples have more time and income for travel and dining out. Small families also have similar advantages when compared with large families.

It is obvious that business should necessarily ponder over whether the falling birth rate and the shrinkage in the number of young people—and especially of people under eighteen, that is, babies, children and teenagers—is a threat or an opportunity.

As Drucker points out, for a business that makes its living making goods for small children, the collapsing birth rate may be an opportunity. It is conceivable that having fewer children means that the child becomes more and more precious and that a larger share of the disposable income is spent on it. This apparently has already happened in China where a majority of families have only one child. Many families, there, despite their poverty, apparently spend more on the single child than they used to spend on three or four children. There are signs in other countries like Germany, Italy and even in the United States of similar developments.[13]

That the populations of the developed countries are stagnating or declining means that these are stagnant or declining markets for many products and that companies will have to seek markets elsewhere to grow or to maintain the level of business. That the future growth in population will be in developing countries indicates that the incremental demand for many products in future will have to come, by and large, from the developing countries. Developing countries with large and growing population, fast economic growth and conducive social and political environment, like the BRICS and N-11, are becoming increasingly attractive markets. In other words, the developing countries are the future markets. No wonder, the MNCs are paying greater and greater attention to the developing countries. The share of the developing countries in the global FDI inflows in recent years exceeded 50 per cent, compared to a low share in the fast.

Surging World Population and Regional Demographic Shifts

Despite the decline in the birth rate, world population will grow fast until the mid-21st century and is likely to grow slowly in second half of the century and would hit 10000 million by the end of the century. This is about four times the population the world had in 1950. According to the medium variant, the world population is projected to reach 9.3 billion persons by 2050, that is, 2.3 billion more than in 2011 – nearly equivalent to the total population of the world in 1950. The world population in 2050 would be substantially higher if the decline in fertility projected in the medium variant fails to be realised. See Table 5.5.

Table 5.5: Population of the World, Major Development Groups and Major Areas, 1950, 1980, 2011, 2050 and 2100 According to Different Variants

Major area	Population (Millions)			Population in 2050 (Millions)				Population in 2100 (Millions)			
	1950	1980	2011	Low	Medium	High	Constant	Low	Medium	High	Constant
World	2532	4453	6974	8112	9306	10614	10943	6177	10125	15805	26844
More developed regions	811	1081	1240	1158	1312	1478	1252	830	1335	2037	1090
Less developed regions	1721	3372	5734	6955	7994	9136	9691	5347	8790	13768	25754
Least developed countries	196	394	851	1517	1726	1952	2434	1772	2691	3954	12430
Other less developed countries	1525	2978	4883	5437	6268	7184	7257	3576	6100	9813	13325
Africa	230	483	1046	1932	2192	2470	2997	2378	3574	5198	14959
Asia	1403	2638	4207	4458	5142	5898	5908	2624	4596	7522	9530
Europe	547	693	739	632	719	814	672	405	675	1056	482
Latin America and the Caribbean	167	362	597	646	751	869	863	385	688	1154	1252
Northern America	172	254	348	396	447	501	444	342	526	777	512
Oceania	13	23	37	49	55	62	60	42	66	98	110

Source: Population Division of the Department of Economic and Social Affairs of the United Nations Secretariat (2011), *World Population Prospects: The 2010 Revision*, United Nations, New York, 2011.

Some of the implications of the growth trends of population are obvious. The number of consumers in the world today is about three times the figure in 1950 and between 2011 and 2050 the size of the consumers would increase by about one-third. India and China alone have more consumers than the whole world had in 1950.

The geographic spread of the population, i.e., consumers, their economic and other demographic characteristics are of vital importance for business.

Almost the entire increase in the world population during this century would occur in the developing countries. According to the medium population projection of the UN, between 2011 and 2050, the population of the MDRs will remain largely unchanged at 1.3 billion inhabitants, but the population of the less developed regions is projected to rise from 5.7 billion in 2011 to 8 billion in

2050. At the same time, the population of the least developed countries is projected to more than double, from 851 million inhabitants in 2011 to more than 1.7 billion in 2050.

In 2011, nearly half of the world population inhabited China, India, United States of America, Indonesia, Brazil and Pakistan. China and India alone had well over one-third (37 per cent) of the world population. No wonder, China and India are important locations in the strategy map of multinationals.

The massive increase in the population of some developing countries and their rise in the global ranking on population size since 1950 are particularly noteworthy (Tables 5.6A and 5.6B).

Table 5.6: Percentage Distribution of the World Population by Development Group and Major Area, Estimates and Projections According to Different Variants, 1950-2100

Major area				2050				2100			
	1950	1980	2011	Low	Medium	High	Constant	Low	Medium	High	Constant
More developed regions	32.0	24.3	17.8	14.3	14.1	13.9	11.4	13.4	13.2	12.9	4.1
Less developed regions	68.0	75.7	82.2	85.7	85.9	86.1	88.6	86.6	86.8	87.1	95.9
Least developed countries	7.7	8.8	12.2	18.7	18.6	18.4	22.2	28.7	26.6	25.0	46.3
Other less developed countries	60.2	66.9	70.0	67.0	67.4	67.7	66.3	57.9	60.2	62.1	49.6
Africa	9.1	10.8	15.0	23.8	23.6	23.3	27.4	38.5	35.3	32.9	55.7
Asia	55.4	59.2	60.3	54.9	55.3	55.6	54.0	42.5	45.4	47.6	35.5
Europe	21.6	15.6	10.6	7.8	7.7	7.7	6.1	6.6	6.7	6.7	1.8
Latin America and the Caribbean	6.6	8.1	8.6	8.0	8.1	8.2	7.9	6.2	6.8	7.3	4.7
Northern America	6.8	5.7	5.0	4.9	4.8	4.7	4.1	5.5	5.2	4.9	1.9
Oceania	0.5	0.5	0.5	0.6	0.6	0.6	0.5	0.7	0.7	0.6	0.4

Source: Same as for Table 5.5.

A small percentage of the total number of the countries will account for the major part of the increase in the world population, generally the most populous. During 2011-2050, about half of the growth in the world population is projected to come from eight countries—India, Nigeria, Pakistan, Tanzania, USA, Congo, Ethiopia and Philippines, listed according to the size of their contribution to global population growth. During this period, the populations of 32 countries, the majority of which are least developed, will triple or more. Among them, the populations of Burkina Faso, Malawi, Mali, Niger, Somalia, Uganda, Tanzania and Zambia are projected to increase by 500 per cent or more by 2100.

On the other hand, the populations of 49 countries or areas (including many developing countries) are expected to decrease between 2011 and 2050, 44 of which are expected to continue to decrease between 2050 and 2100. Including those 44 countries, the populations in a total of 123 countries or

areas are expected to decrease between 2050 and 2100, 22 of which are expected to see their populations decline by at least 20 per cent in that period.

When the population is very large, even if the country is generally poor, there could be a sizeable market even for those goods and services which are regarded luxuries in these countries. For example, if just five per cent of the Indian population is well to do, the absolute number (more than 60 million) is nearly equal to or larger than the total population of many of the high income economies. India, with a number of poor people larger than the total population, every country of the world except China and USA is one of the largest and fastest growing markets in the world even for luxury and premium products. And the *fortune at the bottom of the pyramid* is wonderful.

High population growth rate also implies an enormous increase in the labour supply. When the Western countries experienced industrial revolution, the population growth was comparatively slow. Labour shortage and rising wages encouraged the growth of labour-intensive methods of production. Capital-intensive technologies, automation, and even rationalisation, are opposed by labour, and many sociologists, politicians and economists in developing countries. Cheap labour and a growing market have encouraged many multinationals to invest in developing countries. Many companies in the developed countries have relocated their production facilities, wholly or partially, in the developing countries to reduce the labour costs.

By 2050, five least developed countries—Bangladesh, the Democratic Republic of the Congo, Ethiopia, the United Republic of Tanzania and Uganda—will be among the twenty most populous countries in the world. By 2100, among the twenty most populous countries in the world, nine will be least developed countries—the United Republic of Tanzania, the Democratic Republic of the Congo, Uganda, Bangladesh, Ethiopia, Zambia, Niger, Malawi and Sudan.

The population size of some countries is massive. For example, the combined population of China and India in 2011 was larger than the total population of the world in 1950. In 2011, about half of the world population was in 6 countries and 25 countries accounted for 75 per cent of the population.

Tables 5.7A and 5.7B show that there was a fall in the concentration of the world population during 1950-2011 and this trend is projected to continue in future.

Table 5.7A: Countries Accounting for about 75 Per Cent of the World Population Ordered by Population Size, Estimates and Medium Variant, 1950 and 2011

Rank	Country	Population in 1950 (Millions)	Cumulated Percentage	Rank	Country	Population in 2011 (Millions)	Cumulated Percentage
1	China	551	21.8	1	China	1348	19.3
2	India	372	36.4	2	India	1241	37.1
3	United States of America	158	42.7	3	United States of America	313	41.6
4	Russian Federation	103	46.7	4	Indonesia	242	45.1
5	Japan	82	50.0	5	Brazil	197	47.9
6	Indonesia	75	52.9	6	Pakistan	177	50.4

7	Germany	68	55.6	7	Nigeria	162	52.8
8	Brazil	54	57.8	8	Bangladesh	150	54.9
9	United Kingdom	51	59.8	9	Russian Federation	143	57.0
10	Italy	46	61.6	10	Japan	126	58.8
11	France	42	63.2	11	Mexico	115	60.4
12	Bangladesh	38	64.7	12	Philippines	95	61.8
13	Nigeria	38	66.2	13	Vietnam	89	63.1
14	Pakistan	38	67.7	14	Ethiopia	85	64.3
15	Ukraine	37	69.2	15	Egypt	83	65.5
16	Vietnam	28	70.3	16	Germany	82	66.6
17	Spain	28	71.4	17	Iran (Islamic Republic of)	75	67.7
18	Mexico	28	72.5	18	Turkey	74	68.8
19	Poland	25	73.5	19	Thailand	70	69.8
20	Egypt	22	74.3	20	Dem. Republic of the Congo	68	70.7
				21	France	63	71.6
				22	United Kingdom	62	72.5
				23	Italy	61	73.4
				24	South Africa	50	74.1
				25	Republic of Korea	48	74.8

Source: Same as for Table 5.5.

The other side of the country-wise concentration of world population is that most of the countries have small populations. Thus, 73 per cent of the 229 countries or areas covered by the *2010 Revision* of the UN's *World Population Prospect* had populations with fewer than 20 million inhabitants in 2011 and, as a group, they account for 10 per cent of the world's population.

Table 5.7B: Countries Accounting for about 75 Per Cent of the World Population Ordered by Population Size, Estimates and Medium Variant, 2050 and 2100

Rank	Country	Population in 2050 (Millions)	Cumulated Percentage	Rank	Country	Population in 2100 (Millions)	Cumulated percentage
1	India	1692	18.2	1	India	1551	15.3
2	China	1296	32.1	2	China	941	24.6
3	United States of America	403	36.4	3	Nigeria	730	31.8

4	Nigeria	390	40.6	4	United States of America	478	36.5
5	Indonesia	293	43.8	5	United Republic of Tanzania	316	39.7
6	Pakistan	275	46.7	6	Pakistan	261	42.2
7	Brazil	223	49.1	7	Indonesia	254	44.8
8	Bangladesh	194	51.2	8	Dem. Republic of the Congo	212	46.9
9	Philippines (Dem. Republic of the)	155	52.9	9	Philippines	178	48.6
10	Congo	149	54.5	10	Brazil	177	50.4
11	Ethiopia	145	56.0	11	Uganda	171	52.1
12	Mexico United Republic of	144	57.6	12	Kenya	160	53.6
13	Tanzania	138	59.1	13	Bangladesh	157	55.2
14	Russian Federation	126	60.4	14	Ethiopia	150	56.7
15	Egypt	123	61.7	15	Iraq	145	58.1
16	Japan	109	62.9	16	Zambia	140	59.5
17	Vietnam	104	64.0	17	Niger	139	60.9
18	Kenya	97	65.1	18	Malawi	130	62.1
19	Uganda	94	66.1	19	Sudan	128	63.4
20	Turkey	92	67.1	20	Mexico	127	64.7
21	Sudan	91	68.0	21	Egypt	123	65.9
22	Iran (Islamic Republic of)	85	69.0	22	Russian Federation	111	67.0
23	Iraq	83	69.9	23	Afghanistan	111	68.1
24	Afghanistan	76	70.7	24	Yemen	99	69.0
25	Germany	75	71.5	25	Burkina Faso	96	70.0
26	United Kingdom	73	72.3	26	Madagascar	94	70.9
27	France	72	73.0	27	Japan	91	71.8
28	Thailand	71	73.8	28	Vietnam	83	72.6
29	Colombia	62	74.5	29	Mali	81	73.4
				30	France	80	74.2
				31	Turkey	79	75.0

Source: Same as for Table 5.5.

Migration and Ethnic Aspects

While the population will be declining in many developed countries, which may also lead to labour shortage, population pressure will be mounting in developing nations. As a consequence, to prevent migration pressure, as Drucker observes in the book referred to above, is like preventing the law of gravity. The demographic trends have caused significant changes in the attitude and policy of nations towards immigration.

The trends in the fertility and death rates indicate that in developed countries deaths would exceed births over the foreseeable future leading to a decline in the population if not counterbalanced by a net migration gain.

The more developed regions are expected to receive large net migration over the century. During 2010-2050, the net number of international migrants to more developed regions is projected to be 87 million, whereas the excess of deaths over births is 11 million, implying an overall growth of 76 million. During 2050-2100, the net number of international migrants to more developed regions is projected to be 49 million, whereas the excess of deaths over births is 24 million, indicating an overall growth of 25 million.

Thus, but for the net migration from developing to developed countries, their population would have declined to 1.11 billion. However, the population of the MDRs is expected to change minimally, passing from 1.24 billion in 2011 to 1.34 billion in 2100 thanks to the net migration from developing countries which is projected to average 2.2 million persons annually from 2011 to 2050 and 0.8 million from 2050 to 2100.

The impact of migration in preventing a decline in population is already evident in the case of a number of countries. In 2005-2010, net migration in three countries or areas, *viz-à-viz* Italy, Portugal and Japan, more than doubled the contribution of natural increase (births minus deaths) to population growth. In addition, in a further 29 countries or areas, net migration counterbalanced totally the excess of deaths over births.

In terms of annual averages, the major net receivers of international migrants during 2010-2050 are projected to be the United States, Canada, Spain, Italy, and the United Kingdom. The major countries of net emigration are projected to be China, India, Mexico, Pakistan, Indonesia, the Philippines, and Bangladesh. During 2050-2100, the major net receivers of international migrants are projected to be the United States, Italy and Canada; whereas the major net senders are projected to be China, India, Pakistan, the Philippines and Bangladesh.

The US has been receiving very large number of migrants. The fertility rates are comparatively high among the migrants.

The increase in the number and diversity of the migrants increase the multicultural complexity, throwing up new challenges and opportunities for marketing.

The good old dictum be a *Roman when in Rome* hardly happens. Although the US was originally called a *melting pot*, immigrants have been found to retain their identity rather than melting. As Kotler observes,[14] now the US is called a *salad bowl* society with ethnic groups maintaining their ethnic differences, neighbourhoods and cultures. Each specific group has certain specific wants and buying habits. Several food, clothing and furniture companies in the US have directed their products to one or more of these groups. For instance, Sears is taking note of the preferences of different ethnic groups.

Colgate Palmolive has successfully promoted its toothpaste within the Hispanic community through ads that place less emphasis on health and more emphasis on appearance. Marketers must, however, be careful not to over-generalise about ethnic groups because within each ethnic group consumers who are different from each other.

CHANGES IN GLOBAL POLITICAL ENVIRONMENT AND THEIR ECONOMIC/BUSINESS IMPACTS

Major economic policies are often rooted in political thinking. The political environment of business is mind-bogglingly diverse between nations. There is also significant differences in the political environment within many countries too.

While there are no radical differences in the philosophies of major political parties in some countries, the situation is quite different in some others. The government system in a number countries, including several countries which are making rapid economic progress and having liberal policies towards foreign capital and technology, is not very democratic. That does not mean that they are not good to make business with. As a matter fact, in several such countries, the procedures are simpler and decisions are quicker than in some of the democratic countries.

Changes in Political Environment

Until the political and economic changes ushered in the late 1980s and in the early 1990s in the Eastern Europe and erstwhile USSR, these countries were a separate block by themselves with several common characteristics. Private enterprises were very limited and State trading, particularly counter trade, was the rule. There were a lot of restrictions on imports and foreign business. This did not, of course, mean that the communist system was unsurmountable for multinationals or other foreign firms. Under such a system, in several instances, winning over the top brass of the party or government was a strategy to obtain business. It may be noted at a time when companies like Coca Cola and PepsiCo were kept out of India they were going better with countries like USSR.

In the past, public sector was assigned a very important role in many non-communist, particularly the developing, countries too. In India, for example, where the industrial policy wanted the public sector to gain *control over the commanding heights* of the economy, limited the scope of the private enterprise, both domestic and foreign. Even in areas where foreign capital was allowed, there was ceiling on the foreign equity participation.

Further, in the past, foreign firms in many developing countries were under the fear of nationalisation.

The clock, however, has turned a full circle in most of the communist and many other countries. Privatisation has progressed at an amazing speed. The erstwhile communist countries and the Peoples' Republic of China where the communist party is still in power, are on the rapid road from mark to the market. China is the largest receipients FDI among the developing countries and the second largest in the world. It has become the paradise of MNCs. In India, the economic policies of governments of States ruled by communist and leftist parties now compete with other States to woo national and foreign private capital.

Although the trend of the direction of government policies across the world appears to be broadly one of convergence, there are lots of differences in the restrictions and regulations of business, scope of foreign business, trade policies, procedures, incentive systems and so on.

Coalition governments of different political parties are becoming common. Sometimes the constituents of the coalition are parties with very different economic ideologies, making the scenario complex or confusing/uncertain.

Some political leaders are so powerful that they wield enormous control over the party. The vision and ideology of such leaders have stupendous implications for business.

Changes in the nature of State's role or extent of State's involvement in the economy can affect the business environment. When public sector was assigned a major role in the industrial development and industrial licensing was very widely applicable, the Central Government in India had an imposing position in deciding the location of projects and type and size of enterprises. However, the substantial reduction in the role of the public sector and delicensing drastically changed the situation and now State Governments have a much greater role and freedom than in the past in the industrial development, including promotion of FDI.

There has been a universal trend towards political decentralisation and democratisation.

FDI and International Production

The universal liberalisation of economic policies – liberalisation, privatisation and globalisation (LPG) – paved the way for massive foreign investment flows. As UNCTAD's *World Investment Report 2011* observes, foreign direct investment is a key component of the world's growth engine.[15] There has been surge in FDI flows since the late 1980s, as Figure 5.4 shows. Indeed, the growth of FDI has been more rapid than either production or international trade – even though this growth has been volatile, with dramatic falls as well as rises over this period. This is the impact of the economic liberalisations worldwide.

FDI inflows increased about four-fold between early 1980s and 1990 and more than six times between 1990 and 2000. FDI inflows increased by 44 per cent between 2000 and 2007 (two years of peak flows). The decline in FDI in 2008 was the result of global economic crisis. Because of the fragile economic conditions across the world, FDI flows remained below the peak level of 2000 for a several years, as Figure 5.4 reveals.

Figure 5.5 reveals that FDI flows to developed countries fluctuate violently; it is comparatively stable to developing countries and that their share in the total has increased significantly in recent years. The developing and transition economies received more than half of the FDI inflows in recent years. In 2012, FDI outflow from developing and transition economies reached a record 35 per cent of the world total. The BRICS countries (Brazil, the Russian Federation, India, China and South Africa) continued to be the leading sources of FDI among emerging investor countries, accounting for 10 per cent of the world total. In the ranks of top investors, China moved up from the sixth to the third largest investor in 2012 (the first and second being the United States and Japan).

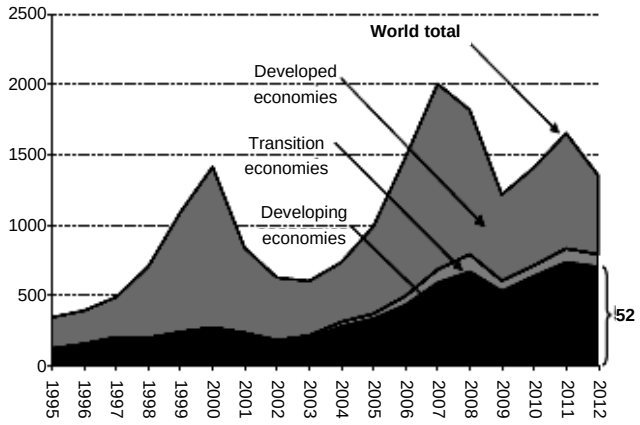

Fig. 5.5: FDI Inflows, Global and by Group of Economies, 1995-2012 (Billions of Dollars)

Source: UNCTAD's *World Investment Report*, 2013.

In 2012, 11 of the 20 largest recipients of FDI were developing and emerging economies, including 4 of the top 5 (India's rank was 15 compared to 8 in 2009). 8 of the largest suppliers of FDI were from this category. India which ranked 20th in 2010 did not figure in this list in 2012.

As a result of the huge FDI flows, there has been a substantial increase in the FDI stock as a percentage of the GDP. For example, the world FDI inward stock-GDP ratio increased from about 11 per cent in 1995 to about 31 per cent in 2009. FDI now contributes about one-tenth of the global capital formation.

A corollary of the surge in FDI has been the fast proliferation of multinational corporations (MNCs) across the world, particularly in the present and erstwhile communist and socialist countries. According to UNCTAD's *World Investment Report* (WIR) 1997, there were about 45,000 MNCs with about 282,000 foreign affiliates (FAs), but according to the WIR 2011, the number of MNCs was more than one lakh and of FAs nearly 9 lakhs. Developing countries now account for nearly 30 per cent of the transnational corporations (TNCs) worldwide, compared to less than 10 per cent in 1992. Majority of the FAs of TNCs are in the developing countries. Interestingly, nearly half of the FAs in the world and about 85 per cent of the total number of located in the developing countries are in communist China. (The terms MNC and TNC are used as synonyms in this chapter.)

With the proliferation of MNCs and rapid rise in FDI, the share of multinationals in global production has been on the increase. According to the estimates of UNCTAD, value added by TNCs worldwide, in their operations both at home and abroad, accounted for more than a quarter of global GDP in 2010. In 2010, foreign affiliates accounted for more than one-tenth of global GDP and one-third of world exports. In 2012, foreign affiliates of TNCs employed about 72 million people, compared to about 21 million in 1990.

Growth of Global Trade

Global trade has grown fantastically in the last three decades, impacted by, among other things, political developments that led to trade and investment liberalisation. When considered in volume terms

(i.e., accounting for changes in prices and exchange rates), world merchandise trade recorded a more than four-fold increase between 1980 and 2011. Trade has grown much faster than the GDP resulting in a significant rise in the trade-GDP ratio as revealed by Figure 5.5. When GDP rises, trade often rises fast and when GDP declines trade tends to respond very strongly. During 1950 to 2007, when world GDP (real) registered an annual growth of 3.8 per cent, the trade growth was 6.2 per cent.[16]

The export-GDP ratio which reached a peak in 2007 declined drastically in the following years because of the decline in trade. In 2009, trade contracted by about 12 per cent, reacting to the global economic crisis that became severe in 2008.

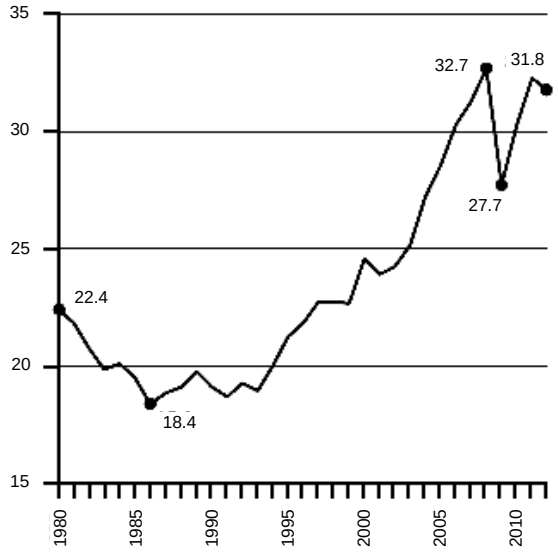

Fig. 5.6: Ratio of World Exports of Merchandise and Commercial Services to World GDP, 1980-2012

Source: WTO, *World Trade Report*, 2013.

What Figure 5.6 indicates is that about 32 per cent of domestic production is exported and about that percentage of the domestic consumption is met by imports (global average). In other words, an economy is about two-thirds foreign dependent by trade alone. To this, we have to add the foreign dependency by financial flows. There are many countries with very high trade-GDP ratio. It may be noted that trade of the developing economies has been growing faster than that of the developed ones. Further, their trade-GDP ratio is higher than that of the developed, implying that they are more integrated with the world economy by trade than the developed nations.

The fast growth in trade was driven by several factors such as the trade liberalisation (i.e., reduction/dismantling of trade barriers); globalisation of supply chain management and fragmentation of production process; technological developments which dramatically reduced the cost and time of movement of goods, improved the safety and life of goods; changing tastes and preferences of people across the world giving rise to demand for goods and services not available domestically; price differences between countries, and so on.

The value of trade is inflated by double/multiple counting, resulting from production sharing/ fragmentation of production process. For example, assume that a firm in country B manufactures TV

sets using components worth $ 100 million imported from country A. The firm in country B exports the TV sets for a value of $ 110 to country C. Although the real entire value addition in this case is only $ 110 million (i.e., the value of the finished products – TV sets), the value of international trade recorded will be $ 210 million [value of components traded between countries A and B ($ 100 million) and value of trade between B and C ($ 110 million)].

The developing countries have been integrating faster into the global economy by trade because of their faster trade growth. See Boxes 5.4 and 5.5.

Box 5.4

Some Key Facts and Findings about Global Trade

- Dramatic decreases in transport and communication costs have been the driving forces behind today's global trading system. Geopolitics has also played a decisive role in advancing and reinforcing these structural trends.
- In the last 30 years, world merchandise and commercial services trade have increased by about 7 per cent per year on average, much higher than the increase in world production of goods and services. When trade is measured in value-added terms, services play a larger role.
- Between 1980 and 2011, developing economies raised their share in world exports from 34 per cent to 47 per cent and their share in world imports from 29 per cent to 42 per cent. Asia is playing an increasing role in world trade.
- For a number of decades, world trade has grown on average nearly twice as fast as world production. This reflects the increasing prominence of international supply chains and hence the importance of measuring trade in value-added terms.
- Simulations show that in a dynamic economic and open trade environment, developing countries are likely to outpace developed countries in terms of both export and GDP growth by a factor of two to three in future decades. By contrast, their GDP would grow by less than half this rate in a pessimistic economic and protectionist scenario, and export growth would be lower than in developed countries.

Courtesy: WTO, *World Trade Report*, 2013.

Globalisation

A profound impact of the sweeping political changes across many parts of the globe since the late 1970s is the boost to globalisation, i.e., the cross-border flow of goods, services, labour, technology finance and ideas. From a corporate point of view, globalisation is a way of corporate life necessitated, facilitated and nourished by the transnationalisation of the world economy and developed by corporate strategies. Globalisation is an attitude of mind – it is a mind-set which views the entire world as a single market so that the corporate strategy is based on the dynamics of the global business environment. International marketing or international investment does not amount to globalisation unless it is the result of such a global orientation.

Globalisation encompasses the following:

- Doing, or planning to expand, business globally.
- Giving up the distinction between the domestic market and foreign market and developing a global outlook of the business.

- Locating the production and other physical facilities on a consideration of the global business dynamics, irrespective of national considerations.
- Basing product development and production planning on the global market considerations.
- Global sourcing of factors of production, i.e., raw materials, components, machinery/ technology, finance etc. are obtained from the best source anywhere in the world.
- Global orientation of organisational structure and management culture.

Companies which have adopted a global outlook stop "thinking of themselves as national marketers who venture abroad and start thinking of themselves as global marketers. The top management and staff are involved in the planning of worldwide manufacturing facilities, marketing policies, financial flows and logistical systems. The global operating units report directly to the chief executive or executive committee, not to the head of an international division. Executives are trained in worldwide operations, not just domestic or international. Management is recruited from many countries, components and supplies are purchased where they can be obtained at the least cost, and investments are made where the anticipated returns are the greatest."[17]

A truly global corporation views the entire world as a single market – it does not differentiate between domestic market and foreign markets. In other words, there is nothing like a home market and foreign market – there is only one market, the global market.

Box 5.5

A Borderless and Flat World

Some candid indications of the increasing integration and globalisation of the world economy and the factors which foster them are given below.

The value of foreign trade (goods and services) as a percentage of world GDP increased from about 42 per cent in 1980 to 62 per cent in 2007 (in 2008 and 2009, the figures were lower, impacted by the global economic crisis).

Foreign direct investment (FDI) has increased tremendously in the last few decades and has been playing an increasing role in investment in a growing number of countries. More information on this is provided in the following sub-section.

The foreign portfolio investment (FPI), like the foreign institutional investment (FII), has surged and it plays a very important role in the capital markets of developing countries.

Thomas L. Friedman in his highly acclaimed *The World is Flat*[18] explains that a combination of technological, market, and geopolitical events at the end of the twentieth century had levelled the global economic playing field in a way that was enabling more people than ever, from more places than ever to take part in the global economy – and, in the best of cases, to enter the middle class. The combination of the important factors which contributed to this flattening are:

1. The proliferation of the personal computer, which enabled individuals to create words, data, spreadsheets, photos, designs, videos, drawings, and music etc. on their own PCs in the form of bits and bytes, which, in its turn, could be shaped in many more ways and distributed to many more places.
2. The power of the PC has been propelled to globalisation by the Internet, the World Wide Web, and the Web browser — a set of tools that enabled individuals to send their digital content anywhere in the world virtually for free and to easily display or access that content via Web pages.

3. The third flattener was a quiet revolution in software and transmission protocols, which Friedman calls the "work flow revolution" because of how it made everyone's computer and software interoperable—thus enabling work to flow farther and faster through internal company networks, the Internet, and the World Wide Web. This enabled organisations and individuals across the world to link together for efficient R&D and supply chain management.
4. These flatteners were given a substantial thrust by a big geopolitical flattener — the collapse of Communism resulting in the elimination of a huge physical and political roadblock on the global economic playing field. The collapse of communism has given an impetus to liberalisation in a number of other countries including India.

Friedman observes that, put all these flatteners together and what we have is a much more seamless, unobstructed global marketplace. In this global agora, millions and millions of new consumers and producers were able to buy or sell their goods and services—as individuals or companies—and were able to collaborate with more people in more places on more things with greater ease for less money than ever before. That is what Friedman means by a flat world.

However, there are many, particularly in the context of rethinking globalisation against the background of the global economic turmoil, that we have not reached the end of history or geography and that the world is not as flat as some people want us to believe. World Bank's *World Development Report* 2009, for example, argues that the world is not flat. According to the Report, development is neither smooth nor linear—at any geographic scale. Growth comes earlier to some places than to others. Geographic differences in living standards diverge before converging, faster at the local scale and slower as geography exercises its influence. These are the stylised facts, based on the experiences of successful developers over the last two centuries. Technological progress and globalisation have increased market potential in the leading areas of developing countries, intensifying concentration and amplifying spatial disparities.

TECHNOLOGICAL REVOLUTION

As indicated in Box 5.5, technology is one of the very important flattners which promote a borderless world.

Rapid technological developments which have reduced the cost of transportation and communication dramatically and improved the speed and efficiency revolutionarily have been driving far-reaching social and economic changes across the globe. The global economic integration and globalisation of supply chain management have been driven fast by technological developments. Internet, cable TV etc. have contributed substantially to cultural diffusion globally, both good and bad. Technological developments have facilitated the emergence of the 'global village'. Several cost and time-saving innovations and emergence of new technologies in a number of other areas such as preservation of perishables gave a substantial boost to global trade and internationalisation of trade.

The internet has facilitated direct contact between producers/suppliers and buyers and this has empowered even small firms and individuals, overcoming the power of intermediaries.

It is pointed out that China could not have become the new "workshop of the world" without the trans-Pacific "conveyer belt" provided by breakthroughs in containerisation after the 1970s. India could not be a new global services hub without the invention of fibre optics and broadband. It is because of these technological forces that the nature of the global economy is profoundly changing, and with it the political, social and institutional structures needed to sustain and legitimise it. The unprecedented integration and expansion of the world economy … is a testament not just to the

enduring power of underlying technological and market forces but to the success of the post-war political order that has been so critical to harnessing and managing these forces.[19]

As a WTO Report observes, two broad questions emerge from this discussion. First, will the same shaping factors that have given rise to today's global trade system likely continue in the immediate and longer-term future? In particular, will transport and communication costs continue their dramatic, linear decline as a result of continued incremental technological improvement or even the introduction of entirely new technologies? Or will marginal improvements begin to diminish in the future, making declining transport and communications costs a less salient shaping factor for world trade – even leading to a slowing of trade growth? Secondly, to what extent can we expect future political shocks to the trading system? And can these shocks be anticipated and hopefully avoided? One of the lessons from the last two centuries is that geopolitics has a decisive impact – for good or ill – on underlying technological and structural trends. The current globalisation phase began in 1945 with the rise of US hegemony and the advent of the Bretton Woods System, and then accelerated with China opening upto the world in 1979 and with the end of the Cold War in 1989. What kind of international political accommodation or system is needed for the future?[20]

Technology increases productivity, efficiency and ease of operations facilitates operations at different scales and places and helps accelerate economic growth and globalisation.

GLOBAL ECONOMIC POWER SHIFT

A very important environmental analysis highly relevant for strategy formulation, particularly by MNCs, is the global economic power shift.

For a long time now, the economic growth rate and the export growth rate of the developing economies, for instance, have been significantly higher than those of the developed economies and this trend is expected to continue in the future. When developed countries suffered an economic recession or stagnation during 2007/2008, several developing countries, notably China and India, performed comparatively very well.

The developing countries (according to the World Bank's *World Development Report* 2011, there were 144 low and middle income economies, each with a population of more than 30,000) in general, have been growing faster than the developed ones. They are inhabited by about 84 per cent of the world population but has a share of only 28 per cent of the global GDP. In purchasing power parity terms, however, they account for about 44 per cent of the global. There are four developing countries (China, Brazil, India and Russia) among the 10 largest economies of the world. GNP measured at PPP, China is the second and India the fourth largest economies.

The trade of the developing countries has been growing much faster than that of the developed countries. Several developing economies have trade surplus with developed countries. A number of developing countries are now among the major exporters of the world.

In fact, developing country firms are making inroads into developed country markets.

This does not mean that all the developing countries will grow at high rates. The impressive picture of overall performance of the developing countries is the result of the very good performance of a small number of them – like China, India, South-East Asian economies, Russia, South Africa and some Latin American countries. Many developing economies present a very poor picture of performance – even very pathetic in a large number of cases.

Encouraged by the liberalisation, foreign investment flow to the developing countries has been surging.

The increasing attractiveness of the developing countries' capital markets is reflected in their faster market capitalisation.

While developed economies are experiencing a stagnation or shrinking of the population, it is still growing fairly fast in developing economies.

The fast rising income and population indicate the growing importance of the developing countries in the globalising world economy. No wonder, they are receiving increasing attention by MNCs and investment inflows to them have been surging, as pointed out in the preceding section.

According to the *BRIC Report* by the global consulting firm *Goldman Sachs*, at the end of the present century, China will be the largest and India the second largest economies in the world. A major part of the additional income and demand in future will come from the BRIC (Brazil, Russia, India and China – with the addition of South Africa to this group it is now BRICS). There are also several other developing countries with high growth potential. For example, *Goldman Sachs* refers to the *Next Eleven (N-11)* – a very diverse grouping that includes Bangladesh, Egypt, Indonesia, Iran, Korea, Mexico, Nigeria, Pakistan, Philippines, Turkey and Vietnam.

It is expected that the global economic share of the developing countries will increase and they will play an increasingly important role in international business.

Box 5.6

South Vs North

The South* has risen at an unprecedented speed and scale. For example, the current economic takeoffs in China and India began with about 1 billion people in each country and doubled output per capita in less than 20 years—an economic force affecting a much larger population than the Industrial Revolution did. By 2050, Brazil, China and India combined are projected to account for 40 per cent of world output in purchasing.

During these uncertain times, countries of the South are collectively bolstering world economic growth, lifting other developing economies, reducing poverty and increasing wealth on a grand scale. They still face formidable challenges and are home to many of the world's poor. But they have demonstrated how pragmatic policies and a strong focus on human development can release the opportunities latent in their economies, facilitated by globalisation.

To the casual observer, the state of affairs in 2013 may appear as a tale of two worlds: a resurgent South—most visibly countries such as China and India, where there is much human development progress, growth appears to remain robust and the prospects for poverty reduction are encouraging—and a North* in crisis—where austerity policies and the absence of economic growth are imposing hardship on millions of unemployed people and people deprived of benefits as social compacts come under intense pressure. There are also deeper problems, shared by North and South: growing inequality in many countries, both developed and developing, which threatens global recovery and the sustainability of future progress and limits poverty reduction, as well as serious concerns about the environment.

Developing countries, particularly in Asia, have made rapid strides. Between 1980 and 2010, they increased their share of world merchandise trade from about 25 per cent to 47 per cent and their share of world output from 33 per cent to 4 per cent. Today, developing countries account for a third of value added in world production of manufactured goods.

Courtesy: UNCTAD, *Human Development* Report, 2013.

**South* refers to developing countries and *North* to developed countries.

While the developed country markets are shrinking ferociously, the developing world is experiencing a population explosion and demand boom. The surging population and GDP make the developing economies the future markets. Interestingly, their GDP is rising faster than the recent estimates of impressive growth. For example, in their 2001 paper, Goldman Sachs (GS) argued that the BRIC economies would make up more than 10 per cent of world GDP by the end of the decade. However, by the end of 2007, their combined weight was already 15 per cent of the global economy. China has already overtaken Germany and Japan to become the second largest economy in the world. According to the 2003 GS BRIC Report, these countries together could overtake the combined GDP of the G7 by 2035; the 2007 revised figures predict that this will happen in 2032. According to the predictions of Goldman Sachs (GS), by now the sizes of the incremental demand in G6 (USA, Japan, Germany, UK, France, Italy), and BRIC are almost equal. By 2030, the incremental demand in BRIC would be about 2.5 times that in the G6 and by 2050 it would be about four times. These are very indicative of the vital considerations in the mapping of markets and product portfolio in corporate strategies.

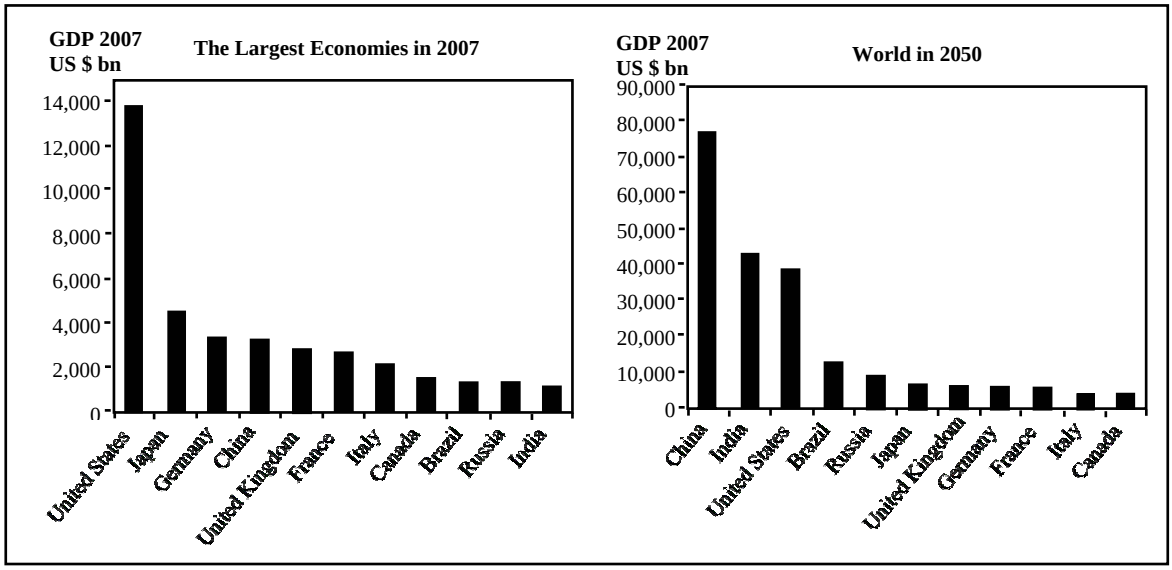

Fig. 5.7: The Economic Power Shift

Source: Economic Research from the GS Institutional Portal at https://portal.gJim O'Neill and Tushar Poddars.com, June 16, 2008, *Ten Things for India to Achieve its 2050 Potential* (Global Economics Paper No. 169).

From 2007 to 2020, India's GDP per capita in US $ terms is expected to quadruple. The fast increase in income and population in a number of other developing countries, besides the BRIC, also need to be considered here.

Box 5.7

Global Economic Shift Favours India

The Planning Commission of India observes that the changes taking place in the world economy, with a shift in economic strength towards emerging markets and especially in Asia, are inherently favourable for India. Table 5.8 presents a projection of world economy until 2025. Industrialised countries are likely to grow at about 3.5 per cent per year in nominal US Dollar terms between 2010 and 2025, while developing and emerging economies are projected to grow at around 8.0 per cent. Within this group, developing Asia is projected to grow, again in nominal US Dollar terms, at around 10 per cent per year. These projections are, of course, subject to the usual qualifications that attend long-term forecasts, but they are not out of line with the current perceptions. The advanced economies' share in global GDP is projected to fall from 65.0 per cent in 2011 to 51.0 per cent by 2025, while the share of emerging economies is projected to increase from 35.0 per cent to about 49.0 per cent over the same period.

Table 5.8: Structure of Global GDP (in Current US $ Trillion)*

	2000	2011	2016	2020	2025
World GDP	32.2	68.7	90.5	110.5	140.5
Advanced Economies	25.7 (79.7%)	44.4 (64.6%)	53.3 (58.9%)	61.1 (55.3%)	71.7 (51.1%)
Developing and Emerging Economies	6.5 (20.3%)	24.3 (35.4%)	37.2 (41.1%)	49.4 (44.7%)	68.8 (48.9%)
of which					
Developing Asia	2.3 (7.3%)	10.5 (15.2%)	17.4 (19.3%)	26.6 (24.1%)	40.7 (28.9%)
of which India	0.5 (1.5%)	1.9 (2.8%)	3.6 (4.0%)	5.8 (5.2%)	10.0 (7.1%)
Sub-Saharan Africa	0.3 (1.0%)	1.2 (1.8%)	1.7 (1.9%)	2.5 (2.2%)	3.9 (2.8%)
West Asia and North Africa	0.8 (2.5%)	2.8 (4.0%)	3.8 (4.2%)	5.0 (4.5%)	7.1 (5.0%)
Latin America and Caribbean	2.1 (6.6%)	5.5 (8.0%)	7.4 (8.2%)	9.7 (8.2%)	13.3 (9.5%)

[Figures in parentheses denotes share of world GDP]

** The World Economic Outlook database of the International Monetary Fund. This data up to 2010 in most cases (up to 2009 and earlier in a few) is actual data. Thereafter the figures up to 2016 are projections by the IMF. The projections for India and other countries beyond 2016 have been made internally in the DPPP Division of the Planning Commission.*

The important point emerging from these projections is that India has the potential to become the third largest GDP in the world in two decades. However, to realise this potential, we must ensure sustained rapid growth. China has grown around 10.0 per cent per year in real terms for 30 years and is now expected to slow down. India is currently behind China, but the evidence suggests that India has now developed the potential for sustained rapid growth over the next two decades, provided

appropriate supportive policies are put in place. These policies must promote and support changes in many sectors.

Our infrastructure, industrial sophistication, management of cities, and also management of a whole range of knowledge promoting institutions, particularly the universities, will have to change dramatically.

Institutional changes will be necessary. These changes take time to bring about, but it is important to begin now if we want the Indian economy to occupy its rightful potential in the world.

Courtesy: Planning Commission of India, *Approach to the 12th Five Year Plan.*

The New Competition

Driven by several economic, social (particularly demographic) and political forces, the business landscape of the world has been fast changing, as has been described in the preceding subsections and sections, and by the middle of this century the global economy will have undergone a far-reaching restructuring.

Gone are the days when large well established companies from the developed countries (described as 'incumbents' by Sirkin, Hemerling and Bhattacharya in the book *Globally Competing with Every One for Everything*) dominated the global business scenario. Firms from the developing economies (termed as 'challengers' by the above authors) are challenging the dominance of the incumbents and increasing their share in many industries.

While it is argued, on the one side, that liberalisation created a situation of the home country firms of developing countries having to compete with mighty foreign firm without a level-playing field, on the other side it is pointed out that globalisation has been leveling the playing field.

The last few decades have seen the rapid and widespread rise of new enterprises in developing countries and many old firms, large and others, have grown dynamically and expanded globally. As a reflection of these, the number of developing country firms in the *Global Fortune 500* has been on the rapid rise. In the 2014 *Fortune 500*, a developing country (China) had the second largest number (95 – up from 89 in the previous year) of firms. India, which made an entry into the *Fortune 500* in the recent past with Indian Oil Corporation, had 8 companies in 2011 consisting of 5 public sector and 3 private sector firms. India has not made any improvement in the number of Fortune 500 companies in the recent years. Indeed, 'go global' has become a mantra even with numerous medium and small enterprises of developing countries. Further, policies of governments of several of these countries supported the growth of the domestic firms, both State owned and private, into MNCs. An important objective behind conferring the *Rathna* status by Government of India on well-performing public enterprises by giving them greater functional and financial autonomy was to encourage them to emerge as global giants.

A salient feature of the current global business environment is the unprecedented access to everyone, everywhere and everything thanks to the universal liberalisation and technological revolution. This level-playing field liberates the firms of developing countries (the 'challengers') from several handicaps which would have otherwise affected them. In other words, the challengers are enjoying several benefits which were not available to the 'incumbents' of the developed countries during their development stage. There is, however, no denying the fact the global liberalisation has substantially benefited the incumbents by enabling them to leverage their dominance and strengths so as to find alternatives to the domestic market constraints and to exploit the expanding opportunities of the

emerging and developing markets. They are also benefiting by accessing the talent pool, low cost labour and other resources of these economies. To a significant extent, the incumbents have sought to fight the challengers by accessing the low cost environment and growth impulses of the emerging and developing markets, by restructuring the supply chain and business process and collaborating with challengers.

Sirkin, Hemerling and Bhattacharya describe the current global business environment as globality – "a different kind of environment, in which business flows in every direction. Companies have no centres. The idea of foreignness is foreign. Commerce swirls and market dominance shifts. Western business orthodoxy entwins with eastern business philosophy and creates a whole new mindset that embraces profit and competition as well as sustainability and competition."[21]

In short, gone are the days when large well established companies from the developed countries (the incumbents) dominated the global business scenario. Firms from emerging and developing economies are increasing their global share in many industries.

The geographical shift in the industrial dominance is indeed a historical phenomenon. The dominance of Great Britain and other developed European nations was overshadowed by USA by the Second World War. The American supremacy, however, had to face increasing challenge from the European nations later. Since the 1970s, Japan emerged as strong power to be reckoned by America and Europe. Of late, it has become the turn of the Asian tigers, the BRICS and several other developing countries.

In the present wave of new competition, powerful companies from developing countries are strongly slashing at the incumbents. "It is like a tsunami – a series of low powerful waves caused by an undersea disruption that crashed against the shore and surge for inland – than the single sharp crest of a tidal wave".[22] They are fast growing, hungry, and have access to all the world's markets and resources. The challengers are showing up everywhere – in each other markets throughout the world, in markets that are less developed than their own, and, increasingly, in the developed markets of Japan, western Europe and the United States.[23]

The home markets of the incumbents are increasingly invaded by the challengers at a time when these markets are showing signs of saturation or decline in many industries. That is, the challenges are eating away an increasing share of even the shrinking cakes at a time when at least maintaining the aggregate level of sales is often essential for survival.

The challengers in many cases is well pitched than the incumbents – low cost domestic environment, fast expanding domestic market, increasing supply of human resources of all categories – unskilled, skilled and talented – entrepreneurial dynamism, etc. The easy access to foreign capital and technology help level the playing field.

The situation for the developed country firms today is very different from the past when they could expand into the developing markets with hardly any challengers. The incumbents today face a dual challenge: defending the home market from the challengers and effectively competing with the challengers in the foreign market.

The developing country firms are no more the typical labour incentive, low-tech producers. Many of them are highly innovative.

The categorisation of industries into glooming sunset and booming sunrise industries has not deterred the developing country firms from building up strength in the sunset industries while many

incumbents appear to have preferred to exit these industries. The challengers have grown enormously by acquiring such businesses of incumbents and also organically so that they have become major global players in several of these industries. The good fortune of the challengers is that in their home markets most industries are growth industries. Several of the challengers have been globally consolidating their commodity business. Challengers have been globally expanding their business organically and inorganically in the sunrise industries and knowledge economy too.

In all categories of economies – low, middle and high income – major part of the incremental income and employment are generated by the service sector. Developing country firms present an impressive performance in sectors like IT and ITES (incumbent – challenger differentiation is irrelevant in such industries). Not only that Indian firms like TCS, Infosys, Wipro and several others are globally well known, a significant part of the requirement of the IT professionals of multinationals (both in their home market operations and offshore businesses) are supplied by developing countries like India.

While several large and well-known incumbents in the financial sector collapsed and weakened under the global financial crisis of the last years of the previous decade, the financial sector of countries like India has shown great resilience, strength and substantial growth impulses. Several banks from developing countries, including State Bank of India, are in the global *Fortune 500*.

The aggressive foreign thrust by the developing country firms is reflected in the booming FDI outflow from them, as pointed out in the sub-section *FDI and International Production* in the preceding section. The outward FDI has been boosted by rising volumes of cross-border M&As. Many developing country firms have been on an overseas buying spree.

TNCs from developing countries share a number of common features. The *World Investment Report* 2010, for example, highlight the following points in respect of the TNCs from BRIC:[24]

- They have developed various ownership-specific advantages that allow them to be competitive in foreign markets as well as in their own markets.
- Initially, firms tend to expanded mainly into their own region, often into countries with which they had close cultural links. A growing number of TNCs have ventured further a field, however, in search of new markets and resources.
- A large number of TNCs from BRIC are motivated by strategic considerations rather than by short-term profitability, reflecting the role of State-owned enterprises in the outward FDI of the group.
- Many of the TNCs have become truly global players, as they possess – among other things – global brand names, management skills and competitive business models.
- Supportive government policies have backed the rise of outward FDI.

Recent developments like the global economic crisis, Eurozone crisis, geopolitical problems, growing corruption, terrorism, internal political disturbances etc. indicate that it is doubtful whether the developing countries can develop at the fast pace projected by Goldman Sachs and others.

CONCLUSION

The Indian and global socio-economic, technological, political and geographic environments of business have undergone substantial changes. The playing fields are changing, industry boundaries are

redrawn and business strategies are reworked. The transformation of the business environment is a continuous process.

Triggered by the changes in the political environment, economic liberalisation has swept across economic systems of all political colours and shades and economies in all income or development levels. All these countries have had their share of adverse effects of the LPG too.

The global changes have flattened the world to a new playing field in which the players from everywhere can try their chance. A nation shall have clear vision, strategy and proper regulatory system to benefit from LPG and to alleviate the adverse effect.

The dominance of developed countries and the 'incumbents' are declining and the role of developing countries and the presence of the 'challengers' are increasing.

Only firms which understand the highly dynamic environment and continuously establish a proper fit with the environment will have long-term success. In the emerging environment, the powerful, dynamic and strategically proactive will be winners and the weak or those do not effectively respond will be losers. This is true of nations, firms and individuals.

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CHAPTER

6 Environmental Forecasting and Analysis

RELEVANCE

Adequate and reliable information is a prerequisite for managerial decision making. That Strategic Management is establishing the right 'firm-environment' fit and further that strategic decisions involve committing resources today for tomorrow make clear the importance of environmental analysis, including environmental forecasting, to strategic management.

In short, "when executives develop corporate strategy, they nearly always begin by analysing the industry or environmental conditions in which they operate. They then assess the strengths and weaknesses of the players they are up against. With these industry and competitive analyses in mind, they set out to carve a distinctive strategic position where they can outperform their rivals by building a competitive advantage."[1]

The previous chapter has provided a broad outline of the important environmental forces and has given an indication, either implicit or explicit, of their many implications for business.

Business decisions, particularly strategic ones, need a clear identification of the relevant variables and a detailed and in-depth analysis of them.

A good amount of information is available about the past, recent, present, ensuing and future events and developments in respect of many matters. However, there are a number of things about which information is scantily or not readily available at all. To generate adequate information in such areas, research, discussion and forecasting, including scenario building, may be necessary.

There are many pieces of vital information available in respect of a number of matters. Such information should be analysed to understand the impact on and implications for the organisation. For example, what is the impact of the different aspects of liberalisation on a company? What are the implications of the liberalisation for the company? In other words, what are the threats posed by liberalisation and what are the opportunities unfolded by liberalisation? A thorough analysis of the environment is necessary for finding answers to these.

Anticipating the future is essential for identifying the future threats and opportunities and for formulating strategic plans. Table 5.3 given in Chapter 5 shows, for example, how Reliance planned its future development of business, based on its envisioning of the future opportunities. The actual situation/developments might not have been exactly the same but it demonstrates a case of environmental forecasting and formulation of corporate strategy based on it.

TECHNIQUES FOR ENVIRONMENTAL ANALYSIS

Techniques for environmental analysis refer to the methods of gathering the relevant information for appraising the environment.

William Glueck mentions four techniques for environmental analysis: Verbal and Written Information; Search and scanning; Spying; and Forecasting and Formal Studies.[2]

Verbal and Written Information

A lot of documented information, published or unpublished, is available on many matters. However, people may not like to put on record certain types of information which they may be prepared to divulge orally, some times on condition of anonymity or confidentiality. Tact and proper approach are required to obtain such information. Verbal information is significant in several other situations. The situation might have changed after the documentation of the information, necessitating personally contacting knowledgeable people to get the latest information. Personal contacts will be helpful in getting more details of the written information. Personal contacts will also be useful in obtaining diverse views of different people.

There are indeed many matters on which written information is non-existent or scanty. All these highlight the importance of verbal information in environmental analysis.

While using written information, several factors such as the purpose for which it was prepared, the methodology used for collection of the information, reliability of the sources of information, the ideology/orientation of the individual/organisation that prepared the information etc. need to be evaluated. Such cautions should also be exercised while going in for verbal information.

Sources of verbal information also include electronic media, seminars, workshops etc.

Search and Scanning

Even when the required information exist somewhere, it may not become readily available. Search and scanning are, therefore, needed, many a time, to identify the sources of information and to manage the timely availability of the required information.

A number of organisations have *clipping service* which constantly scan newspapers, periodicals etc. and prepare clippings containing information required by different departments/executives of the organisation.

Many organisations have Management Information System for systematic gathering, processing, storing and disseminating information. An MIS is generally regarded as very useful.

Spying

Spying, *albeit* regarded unethical by many, is not very uncommon in business. This has been used to a considerable extent to obtain secret information regarding defence and space research. There are many instances of industrial espionage also. This is used mostly to gather competitive information.

Forecasting and Formal Studies

The fourth approach to environmental analysis is formal studies and forecasting. This is explained in the following para of this chapter.

STEPS IN/APPROACHES TO ENVIRONMENTAL FORECASTING

The steps in environmental forecasting are similar to the steps in formulating and executing a research project. The important steps in environmental forecasting are the following.

Identification of Relevant Environmental Variables

The first most important step in environmental forecasting is identification of the environmental variables critical to the firm. All environmental variables do not have the same relevance to all the industries or firms. A variable that is relevant to one industry may not be relevant for another. Again, important developments in some market may not have any implications for some other markets. For example, the high level of penetration of microwave ovens in some of the developed countries like USA is a critical variable as far as food processing industry in that market is concerned; but it is not relevant in markets where the microwave ovens have not penetrated — if microwaveable packaging increases the cost of the product it could be a negative factor in such markets. Similarly, a factor relevant in one technological environment may not be relevant in a different environment. Diesel price is a critical factor for railways which use that energy source but not for those which depend on electricity (assuming that there is no competition between those depending on these two different energy sources).

Some demographic trends have implications for certain business. A falling birth rate is a threat to several businesses (for example, for companies like Johnson & Johnson, which depends heavily on the baby segment of the market). The increase in the longevity and the resultant increase in the number of aged generates good demand for several goods and services.

To envision the future environment, it is essential to identify the critical environmental variables and to predict their future trends. Omission of any critical variable will affect the assessment of the future environment and strategies based on that premise. Similarly, inclusion of variables which are not adequately relevant could have misleading effects.

Pearce and Robinson point out that the list of key variables that will have make or break consequences for the firm can be kept to manageable size by limiting key variables in the following ways.[3]

1. Include all variables that would have a significant impact although their probability of occurrence is low. Delete others with little impact and low probability.
2. Disregard major disasters, such as nuclear war.
3. Aggregate when possible into gross variables (e.g., a bank loan is based more on the dependability of a company's cash flow than on the flow's component sources).
4. If the value of one variable is based on the value of the other, separate the dependent variable for future planning.[4]

Collection of Information

The key environmental variables having been determined, the next important step is the collection of the needed information. This involves identification of the sources of information,

determination of the types of information to be collected, selection of methods of data collection and collection of the information.

Selection of Forecasting Technique

The dependability and usefulness of the forecast depend a lot on the appropriateness of the forecasting technique used.

The choice of forecasting technique depends on such considerations as the nature of the forecast decision, the amount and accuracy of available information, the accuracy required, the time available, the importance of the forecast, the cost, and the competence and interpersonal relationships of the managers and forecaster involved.[5] One issue often debated is the *quantitative techniques versus qualitative techniques*. The fact is that each has its own merits and limitations. Some people have a mistaken notion that quantitative techniques are highly dependable and qualitative techniques are often too subjective that they are not reliable. The dependability of the quantitative techniques is affected by the accuracy/reliability of the data used. It is pointed out that the difference in the predictions using each type of approach is often minimal. Additionally, subjective or judgement approaches may often be the only practical method of forecasting political, legal, social, and technological trends in the remote external environment. The same is true of several trends in the task environment, especially customer and competitive considerations.[6]

Monitoring

The characteristics of the variables or their trends may undergo changes. Further, new variables may emerge as critical or the relevance of certain variables may decline. It is, therefore, necessary to monitor such changes. Sometimes, the changes may be very significant so as to call for a re-forecasting.

TYPES OF FORECASTING

Forecasts of the important business environments, viz., economic environment, social environment, political environment etc. would be useful in formulating plans and strategies.

Economic Forecast

The fact that economic environment is a very critical determinant of business prospects underscores the importance of economic forecasts.

Important economic factors often considered include general economic conditions, GDP growth rate, per capita income, distribution of income, structural changes in GDP, investment and output trends in different sectors and subsectors/industries, price trends, trade and BOP trends etc.

The macroeconomic forecasts serve as a base for deriving industry and company forecasts.

There are indeed a number of sources of short-, medium- and long-term forecasts. International organisations like World Bank, IMF, UNCTAD, UN, WTO etc. and regional organisations like Asian Development Bank have periodic and occasional publications which provide, *inter alia*, economic forecasts. A long-term forecast of the trends in GDP for the world and the major grouping of countries, for example, is given in Table 5.8 in the previous chapter. The section *Global Economic Power Shift* in Chapter 5 gives some important forecasts of future economic scenario.

The Planning Commission and several other bodies like, for example, National Council of Applied Economic Research (NCAER) and Confederation of Indian Industry (CII) make macro-economic estimates and forecasts of the Indian economy. Sector-specific organisations do such things for the concerned sectors.

Reliable forecasts give very useful picture of the future scenario helpful to planning and strategy. For example, details of power development would indicate the scope of investment in the power sector itself and the prospects of related industries like generators, transformers, cables, switch gears, other electrical goods and materials used by power projects etc. Plans of rural electrification will give some indication of the additional demand for pump sets and certain categories of consumer durables and non-durables.

Short-term economic forecasts are very useful for demand and sales forecasting and marketing strategy formulation.

Both quantitative methods such as econometric methods, and time series models and qualitative techniques like judgement models can be used for economic forecasts.

Social Forecast

There are a number of social factors which have profound impact on business. It is, therefore, very essential to forecast the possible changes in the relevant social variables. Important factors include population growth/decline, age structure of population, ethnic composition of population, occupational pattern, rural-urban distribution of population, migration, factors related to family, life style, income levels, expenditure pattern, social attitudes etc.

As in the case of economic factors, there is a wealth of published and unpublished data of forecasts of social trends available. International organisations like the UN and its organs, World Bank etc., academic organisations and government organisations do considerable work in these areas. For example, a considerable amount of data is available regarding future trends in birth and death rates and population size, age structure, ethnic composition etc. of different nations. Some very comprehensive forecasts of the future global population trends are given in Chapter 5 under the section *Global Demographic Trends.*

Social trends have significant implications for business strategy.

Quantitative techniques like time series analysis, econometric methods and qualitative methods like Delphi method or a combination of both quantitative and qualitative techniques may be used for social forecasts. One of the most popular methods is scenario building which involves drawing up alternative future scenarios, based on different assumptions or predictions of developments.

Political Forecast

Political forecast has an important part in envisioning properly the future scenario of business. There are even chances of a country undergoing a drastic shift in the political system (Example: USSR and Eastern Europe in the late 1980s). Changes in the relative power of political parties, political alliances and political ideologies are important factors which may be embedded in social factors.

Political forecasts also cover industrial policy, commercial policy and fiscal policy.

Some political changes are sudden and unpredictable. There are, however, several changes which are reasonably predictable. For example, the sweeping political and economic changes in the erstwhile

USSR and Eastern Europe and the general liberalisation trend in many other countries could be regarded as an indicator that liberalisation would set in India too. The liberalisation ushered in 1991 indicated that there would be privatisation (which even at the end of 1990s has not assumed a serious intent and real earnest in India) and other liberalisation. The discussions on decentralisation and government pronouncement on this enabled the prediction of administrative decentralisation in several States in India. With the decentralisation, decision-making process in the government has changed and this has important implications for business.

Pre-election opinion polls may help certain political forecasts.

There are several factors which have international or global overtones. Sanctions, formal or informal, which have serious consequences for business are not very rare. Increasing world interdependence makes it imperative for firms of all sizes to consider the implications of such developments on their strategies.

Companies, research organisations and consultants have developed a variety of approaches to international forecasts of which political factors are an important component. Harner's Business Environmental Risk Index, for instance, monitors a number of economic and political variables in many countries. The World Economic Forum brings out annually a *Global Competitiveness Report* based on a number of sets of factors including government, openness and institutions. The World Bank's annual publication *Doing Business* gives several indices of ease of doing business in respect most of the countries (it covered 185 economies in 2013).

Technological Forecast

Innovation and other technological developments can drastically alter the business environment. Technological forecasts, therefore, assumes great significance.

Technological forecast encompasses not only technological innovations but also the pace and extent of diffusion and penetration of technologies and their implications. For example, what will be the pace and extent of penetration of PCs and the internet and their implications for business? How far can and will the existing and new technologies be applied in diverse areas and what are their implications?

It may be noted that one of the eight components of the world competitiveness index used in the *World Competitiveness Report* is technology which measures computer usage, the spread of new technologies, the ability of the country to absorb new technologies and the level and quality of Research and Development.

The Technology Information, Forecasting and Assessment Council (TIFAC) established in 1988 has done considerable work to draw up a Technology Vision 2020 for India. It is among the tasks of TIFAC to look ahead at the technologies emerging worldwide and pick those technology trajectories which are relevant for India and should be promoted.

Brainstorming and Delphi methods are popular in technology forecasting.

TECHNIQUES OF ENVIRONMENTAL FORECASTING

As mentioned earlier, there are a number of quantitative and qualitative techniques used in environmental forecasting. Some important techniques are mentioned below.

Econometric Techniques

Econometric techniques involve casual models to predict major economic indicators.

When there is a well established relationship between two or more variables, that casual relationship can be used to forecast the future. For example, if demand is a function of consumer income, the impact of an increase in consumer income on demand can be predicted using the equation representing the relationship between these two key variables.

The econometric models may "utilise complex simultaneous regression equations to relate economic occurrences to areas of corporate activity. They are especially useful when information is available on casual relationships and when large changes are anticipated."[7]

The most commonly used econometric environmental forecasting techniques are multiple regression analysis and time series regression models.

Trend Extrapolation

Time series models assume that the past is a prologue to the future and extrapolate the historical data to the future. The technique may use simple linear relationship or more complex non-linear relationships to forecast trends.

Scenario Development

A very popular and useful forecasting method is development of alternative scenarios.

When it is not possible to accurately forecast the future, the alternative scenarios help managers to formulate strategies to cope up with different possible future situations. See Box 6.1 for an illustration.

The global population projections by the United Nations, described in Chapter 5, three alternate scenarios based on low, medium and high population growth rate variants. See, for example, Tables 5.5 and 5.6 in the Chapter 5.

"Scenario analysis is a technique used to forecast the occurrence of complex environmental events. It is particularly useful for forecasting events in which many variables play a role. Scenarios allow the integrated consideration of these multiple variables in explaining the emergence of future conditions. A scenario is a detailed description of how certain events may occur in the future and their consequences for the organisation."[8]

The following steps are suggested to develop scenarios.[9]

1. Identify strategic environmental issues that are likely to affect the industry/firm. Prioritise these issues in order of their importance to the firm.
2. Select the most important issues as the focus for scenario development. List the organisational assumptions with respect to these issues and identify the possible variations in these assumptions.
3. Prepare a preliminary description of these issues and how they evolved. Include the key economic, social, political, and cultural influences that affect them. Do this with the help of outside industry experts.
4. Draw out the implications of the issue for organisational performance. What has the organisation done and what can it do to cope with the issues? Identify those variables

shaping the issue that the management can control and partially control. Also, identify those variables over which management has no control.

5. Develop detailed descriptions of the future in the form of scenarios. Scenarios are constructed under a worst case, best case, and most likely case set of assumptions. Draw out the implications of these scenarios for future performance of the company.
6. Discuss the scenarios with top management and refine them.
7. Develop contingency action plans for each scenario.

Box 6.1

Scenario Planning at Royal Dutch Shell

Royal Dutch Shell, the world's largest oil company, is well known for strategic planning involving the generation of a series of "what if" scenarios which helps the company to forecast/envision alternate possible future scenarios and think strategies to cope up with such scenarios. The scenario-based planning exercise which the Shell undertook in the 1980s is particularly widely acclaimed.

In the early 1980s, the price of a barrel of oil hovered at around $30 when the industry-average exploration and development costs were at about $ 11 per barrel. The oil industry was generally very bullish and many predicted that oil prices would increase to around $ 50 per barrel by 1990. However, one of the scenarios that Shell chartered at that time was the possibility of a breakdown of the OPEC oil cartel's agreement to restrict supply and consequent oil glut leading to a drop in oil prices to $ 15 per barrel. In 1984, Shell instructed the managers of its operating companies to ponder over what should be done if the crude price crashed $ 15 per barrel. This triggered a very serious thinking that led to the initiation of several measures that would help the Shell to keep its head up if such an eventuality occurred. By early 1986, such measures encompassed efforts to cut exploration costs by pioneering advanced exploration technologies, massive investments in cost-efficient refining facilities, and a process of weeding out the least profitable service stations. When this rethinking and reorientation was happening in Shell, most other oil companies were busy diversifying outside the oil business rather than trying to improve the efficiency of their core operations.

The inevitable happened in 1987 – oil price began to crash in January. By February 1, oil was down to $ 17 per barrel and by April the price nose-dived to $ 10 per barrel. As Shell had zeroed in a scenario of crash in oil price and initiated measures to cope up, it was in a much better position than the other oil majors like Exxon, BP, Chevron, Mobil, and Texaco to encounter the new environment. In 1989, Shell's average oil and gas exploration costs were less than $ 2 per barrel, compared with an industry average of $ 4 per barrel. In the crucial refining and marketing sector, Shell made a net return on assets of 8.4 per cent in 1988, more than double the 3.8 per cent average of the other oil majors.

Methods of Scenario Building

Premising Method: In this method, a series of premises is drawn up from which projection of the future scenarios is made. The premises might consist of basic assumptions about certain important variables, current trends etc. Sometimes, extreme projections may also be made focusing on a few tendencies and extrapolating their evolution. For example, the estimates of the possible GDP growth rates during the a Five Year Plan are based on certain assumptions about important factors like savings rate investment rate, current account balance etc. See Table 6.1 for illustration.

Table 6.1: Sectoral Growth Rates – Previous Plans and Target for 12th Plan of India

		IXth Plan	Xth Plan	XIth Plan	XIIth Plan	
					9.0	9.5
1	Investment Rate (Gross Capital Formation adjusted for errors and omissions)	24.6	31.8	36.4	38.7	41.4
2	Fixed Investment	23.2	28.4	30.9	33.5	35.5
	of which					
	Household Sector	9.9	11.7	11.6	12.0	12.0
	Private Corporate Sector	6.6	9.6	11.0	12.4	13.5
	Public Sector	6.6	7.1	8.3	9.1	10.0
3	Savings Rate	23.7	31.7	34.0	36.2	38.9
	of which					
	Household Sector	20.5	23.2	23.2	24.0	24.5
	Private Corporate Sector	4.0	6.4	8.2	8.5	9.2
	Public Savings *of which*	–0.8	2.0	2.5	3.7	5.2
	Government Administration	–4.9	–2.6	–1.3	–0.5	0.8
	Public Enterprises	4.0	4.6	3.8	4.0	4.5
4	Current Account Balance	–0.6	0.0	–2.4	–2.5	–2.5
	of which					
	Trade Balance	–2.6	–2.5	–5.0	–4.5	–4.5
	Capital Account Balance	2.1	3.5	3.8	5.0	5.0
5	WPI Inflation Rate	4.9	5.0	6.0	4.5–5.0	5.0–5.5

Source: Planning Commission, *An Approach to 12th Five Year Plan (2012-17).*

For forecasting the GDP or population for different future time points, it is common to assume constant, high, medium and low annual growth rates (i.e., different scenarios). For example, the United Nations uses low, medium and high variants to forecast population growth.

Premising method may also be used for political forecasting, social forecasting etc., for example, the extreme possible outcome of some political or ethnic issues in a country.

Systems Diagram Method: The systems diagram method seeks to explore policy and strategic options based on the present system of the organisation's activities. For example, a newspaper firm may think of entering other media, extending the publication business, starting information service business etc. using and developing its existing capabilities.

Critical Site Method: This method which bases the scenario projection on the policy making structure of an organisation identifies the key decision-making points and dynamics of the system focuses on the critical site where the key decisions are taken, such as the meeting of the Board of a company, the national convention or the meeting of the policy decision-making body of the relevant political party, critical meetings of organisations like OPEC or WTO etc. Scenarios are drawn up

based on the anticipation of the possible critical decisions made at such sites and their future implications.

The Newspaper Headline Method: In this method, the scenario writer posits one or more hypothetical headlines for some future date such as: "Global automobile major to increase its share of the Indian market to 25 per cent by 2020." The scenario writer then tries to map out the possible developments in the industry during the course and chart out a strategy for the company to successfully navigate through.

Logical Possibilities Method: This method which generates alternative scenarios based on those already developed is used as a supplement to other methods.

Judgemental Models

Judgemental models involve the use of opinion of people who have intimate knowledge of relevant factors. For example, sales force's opinion of the sales potential, competitive challenges, customer behaviour etc. Another method is juries' executive opinion which "combine estimates made by executives from marketing, production, finance and purchasing and then average their views."[10]

The Delphi method described below is a refined judgemental model.

Brainstorming

Brainstorming is a creative method of generating ideas and forecasts. Under this method, a group of knowledgeable people are encouraged to generate ideas, discuss them and to make forecasts on the basis of that. With a view to encouraging throwing up new ideas without any reservation, the discussion and evaluation of the ideas generated is often done only after the idea generation process is over.

Brainstorming is a popular technique of technological forecasting.

Delphi Method

The Delphi method, which is also a common technique of technological forecasting, is a more systematic technique than brainstorming.

This method uses a panel of experts on the subject from whom opinions are gathered, may be by using a semi-structured questionnaire and/or interview. The opinions of the experts are documented and consolidated and circulated among the panel members, preferably anonymously, for their evaluation and comments. The experts are requested to review their opinion in the light of the feedback. This process may be continued until a consensus view is arrived at.

The RAND Corporation which pioneered the use of this technique used it to predict the impact of the formation of the OPEC on oil supplies and oil prices. Other applications of this technique included assessing trends in terrorist activities and their influence on international businesses and prioritising domestic social programmes.

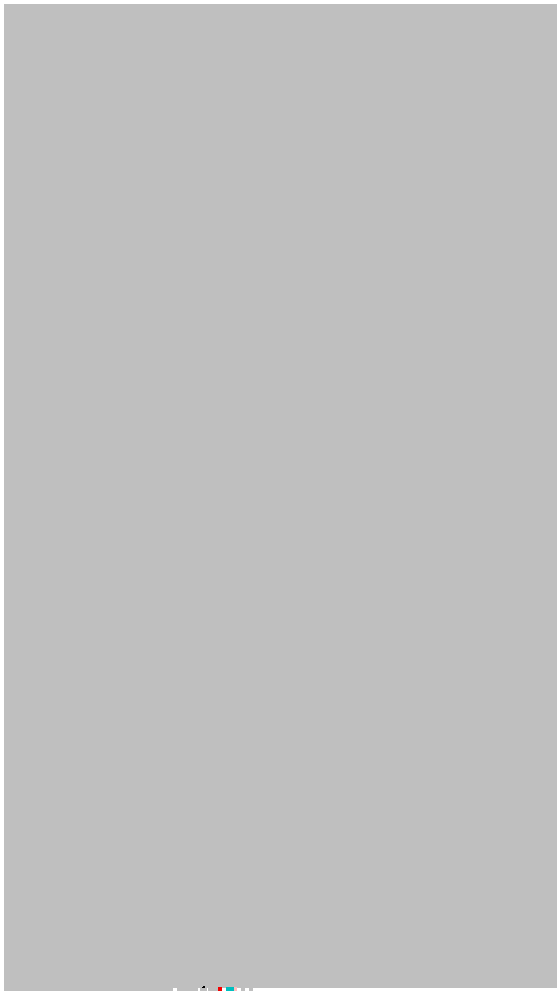

Fig. 6.1: Epitome of Environmental Forecasting

Figure 6.1 provides a summary view of the salient aspects of environmental analysis and forecasting.

Strategic Issues Analysis

Strategic issue analysis is a qualitative technique that can be used for assessing emerging strategic environmental issues. It consists of systematic monitoring of social, regulatory and political changes that can affect corporate performance and identifying their impact on the company. For example, companies which were doing business in South Africa used this technique to assess the impact of racial tensions there on their worldwide business. Similarly, chemical companies, such as DuPont, Monsanto, and Stauffer Chemicals have used this techniques for assessing the impact of environmental movement on the cost of doing business.[11]

BENEFITS/IMPORTANCE OF ENVIRONMENTAL ANALYSIS

Environmental analysis has several benefits like those mentioned below.

1. The very idea of environmental analysis makes one aware of the environment-organisation linkage.
2. A corollary of the above is that (environmental analysis helps) an organisation to identify the present and future threats and opportunities.
3. Environmental analysis will provide a necessary and very useful picture of the important factors which influence the business.
4. Environmental analysis helps to understand the transformation of the industry environment.
5. Technological forecasting will indicate some of the future opportunities and challenges.
6. A very important benefit of environmental analysis is its contribution to identification of risks.
7. Environmental analysis is a pre-requisite for formulation of right strategies — corporate, business and functional.
8. Environmental monitoring helps suitable modifications of the strategies as and when required.
9. Environmental analysis keeps the managers informed, alert, and often dynamic.

LIMITATIONS OF ENVIRONMENTAL FORECASTING

Environmental forecasting has several limitations. Some of the limitations arise from the forecasting techniques used.

Further, there are also chances of certain errors affecting the reliability of the forecasts. Errors may occur.[12]

1. The selection of the variables included in the predictive model.
2. The selection of the functional form for linking these predictor variables to the variable(s) being predicted.
3. The estimation of the ‘correct’ values for the predictor variables.

Several techniques use opinions of people and they may be affected by subjectivity.

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CHAPTER

7

SWOT Analysis and Strategy Formulation

Strategic management is concerned with establishing the proper organisation-environment fit or matching the organisational factors with the environmental factors, as depicted in Figure 5.2 in Chapter 5.

Strategic management, therefore, involves an analysis of the organisational factors (i.e., the strengths and weaknesses of the organisation) and the environmental factors (i.e., the threats and opportunities in the business environment).

SWOT ANALYSIS

SWOT analysis is one of the prime and primary steps in strategic management.

Several other terms and respective acronyms related to SWOT analysis are in use. Terms such as WOTS-up analysis, SCOT (Strengths, Constraints, Opportunities and Threats), internal analysis (analysis of strengths and weaknesses of the firm), external analysis (analysis of environmental threats and opportunities), ETOP (Environmental Threats and Opportunities Profile), EFE (external factor evaluation) Matrix, IFE (Internal Factor Evaluation) Matrix etc. are also used in this context (in the case of IFE/EFE Matrix, the key internal/external factors are identified, they are assigned weightages and weighted scores are obtained by multiplying the weights with the respective ratings).

Another term is PEST (Political, Economic, Social and Technological) analysis. It is confined to certain external environmental factors and does not encompass the analysis of the organisational factors. Extensions or variations of PEST have also been emerging. Some have proposed the inclusion of legal environment and termed it as SLEPT. Another modification is the inclusion of environmental factors and describing it as PESTEL or PESTLE. It has also seen extensions to STEEPLE and STEEPLED, adding Ethics and Demographic factors. Another avathar is STEER (Socio-cultural, Technological, Economic, Ecological, and Regulatory) analysis.

What are S, W, O, and T?

Strengths are internal competencies of a firm, particularly in comparison with those of its competitors. Weaknesses are those factors which tend to decrease the competitiveness of the firm, particularly in comparison with its competitors.

Many people, particularly students, confuse weakness as threat and *vice versa* and strength as opportunity and *vice versa*.

An acid test to determine whether a factor is weakness or threat and strength or opportunity is to examine whether it is an internal factor or external factor.

As mentioned earlier, weaknesses and strengths are invariably factors internal to the organisation, i.e. they are organisation specific. Threats and opportunities are essentially external to the organisation (external environmental factors) but are factors which affect the organisation. Figure 5.2 in Chapter 5 portrays this.

S W	O T
Internal (Organisational) Strengths Weaknesses	External (Environmental) Opportunities Threats

Fig. 7.1: The SWOT

The weaknesses and strengths of an organisation need to be evaluated at two levels, viz., a comparative level (horizontal analysis) and an absolute level.

Comparative analysis is evaluation of the strengths or weaknesses of an organisation in comparison with other organisations. This is an essential exercise for strategy formulation. However, an organisation will be proactive and forward looking only if it makes an evaluation of the strengths and weaknesses at the absolute level also.

When the weaknesses are evaluated at the absolute level, in addition to the comparative evaluation, the gap between the existing and the best possible is measured. For example, an organisation may be strong on a factor in comparison with competitors. But if we make an absolute analysis, i.e., measure the gap between the present level and the best possible level, it may be revealed that there is a lot of scope for improvement. This means that even if an organisation appears to be strong on some factor in comparison with competitors, the organisation is really weak on this factor in absolute terms.

The company shall endeavour to close this gap and keep improving. Such an approach will help the company to achieve sustainable development. It may be noted that Tata Steel, which had several serious weakness has not only overcome them but also emerged as the top performer globally on several parameters and “to be the world’s steel industry benchmark” is an essential part of its vision today.

It is observed that many a time some people take a very peripheral look at certain factors and classify them as weakness or strength without really making an in-depth examination. For example, some people regard large number of employees as a strength. But in some cases, in effect, it will be weakness if the organisation is characterised by surplus labour. Similarly, there is a tendency to describe a very broad product mix as strength. But, it will really be a weakness, if there are product lines or items which cause loss or if the multiplicity leads to inadequate attention paid to all lines or items of the product mix. To improve management and performance, it may become necessary to

minimise/overcome the weaknesses by dropping unprofitable/marginal products, customers, markets or even certain business(es). These are common.

Strengths may encompass the company image, brand image, business synergies, and functional areas such as marketing, finance, personnel, production and R&D.

Weaknesses may include poor product quality, obsolete technology, high production costs, lack of R&D backup, poor distribution infrastructure, poor financial position, weak management etc.

Table 7.1 provides a brief illustrative list of typical strengths and weaknesses.

Table 7.1: Strengths and Weaknesses

STRENGTHS	WEAKNESSES
Marketing	
Strong brand image Strong distribution network Deep product mix Efficient and motivated sales force High quality product	Poor brand image Weak distribution Narrow product mix Poor sales force Poor product quality
Production	
Economies of scale State-of-the-art technology Efficient input sourcing Efficient inventory management Strong R&D support	High cost due to small size Obsolete technology Inefficient input sourcing Poor inventory management No R&D support
Finance	
Comfortable debt-equity ratio Large internal accruals High dividends and market capitalisation High credit rating	Lop-sided capital structure Very high interest payments Poor reserves Low credit rating Poor receivables management
Human Resource	
Qualified and experienced human resource Motivated human resource Good industrial relations Good human resource management	Redundant human resource Excess manpower Poor morale Poor industrial relations Poor human resource management
Management	
Efficient Board of Directors Efficient and motivated managers	Inefficient Board of Directors Unhealthy conflict between members of Board Conflict between members of Board and top managers Inefficient managers

Table 7.2 provides an illustrative list of threats and opportunities.

Several factors figure under opportunities as well as threats. This is because what is an opportunity for some firms is a threat for some others.

Table 7.2: Opportunities and Threats

OPPORTUNITIES	THREATS
Regulatory / Political	
Delicensing Dereservations MRTPA relaxations Import liberalisation Price decontrol Liberalisation of foreign investment and technology policy Capital market reforms	Delicensing Dereservations MRTPA relaxations Import liberalisation Liberalisation of foreign investment and technology policy Political instability
Economic	
Economic boom Steady and fast increase in income	Recession Economic instability
Social/Demographic	
Favourable change in consumer attitude Increasing population Change in age composition of population Growth of consumerism Growth of environmentalism	Unfavourable change in consumer attitude Stagnating/declining population Change in age composition of population Growth of consumerism Growth of environmentalism

Some clarification regarding the opportunities and threats listed under the Regulatory/Political Environment in Table 7.2 may be in order. The same factors/developments are listed under both opportunities and threats. Take, for example, *delicensing.* It is an opportunity for those firms which could not enter an industry or expand its business because of licensing regulation; it can now enter that industry or expand its business in that industry, if any. At the same time, it is a threat to the established firms (whom we may call incumbents) in the industries which were controlled by licensing earlier. New firms can now enter these industries and the incumbents have to face increasing competition from new entrants, as is the case in the two-wheeler industry, motor car industry, several white goods and other consumer goods industries, industrial goods industries and so on.

Similarly, MRTP Act liberalisations were a threat to the incumbents, including MRTP companies, but an opportunity for the MRTP companies which were denied entry to certain industries. Although MRTP Act liberalisations were a threat to the incumbent MRTP firms because of the threat of new competition; at the same time, it opened opportunities to them also because the MRTP restrictions on M&As and business expansion were scrapped.

Liberalisation of foreign investment and technology policy is an opportunity for foreign firms to enter India or expand the existing business but a threat to incumbents because of the increase in competition resulting from the policy change. While this policy change poses threats to the

incumbents; at the same time, it offers opportunities too to them. They can overcome certain weaknesses by forming joint ventures with foreign firms or by importing required technologies. It may also enable a firm to exit a business if it so desires. Similarly, while import liberalisation is a threat to import competing industries, it is an opportunity for some other firms to obtain materials/technology cheaply. See the sections *Implications of Economic Reforms for Strategic Management* and *How Does Liberalisation/Globalisation Help Mitigate Weaknesses/Augment Strengths*? in Chapter 5 for more information.

Table 7.3 provides SWOT of Tata Steel. It is based on general information from secondary sources – not based on any in-depth analysis. Further, SWOT identified at a particular time are likely to change over time. Tata Steel itself is a best example. The Tata Steel of today is very much different from the Tata Iron and Steel Company (TISCO) of the pre-liberalisation period.

Table 7.3: SWOT of Tata Steel

Strengths	Weaknesses
Lowest cost producer of steel in the wold Global steel industry benchmark on several parametres Cutting edge technology and wide knowledge of steel making Globally one of the most geographically diversified steel companies with operations in 26 countries and commercial presence in over 50 countries Global supply chain Favourable product mix changes	Huge debt Huge accumulated loss of Tata Steel Europe Time and cost overruns in execution of projects Raw material supply bottlenecks Unsatisfactory post-acquisition integration
Opportunities	**Threats**
Trend of increasing demand for steel Scope for global supply chain management and efficiency gains Global marketing	Increasing competion Cyclical nature of industry compounded by persistant recession or economic slowdown Environmental issues

RELATING SW AND OT

Strategy formulation involves relating organisational strengths and weaknesses to environmental threats and opportunities. Table 7.4 gives some illustration.

Table 7.4: Matching SWOT and Strategy

Strengths/Weaknesses	Opportunities/Threats	Strategy
Large internal accruals and high credit rating	Fast future growth of industry A	Acquire firms/establish green-field enterprises in industry A
Gaps in product mix	A competitor firm whose products can fill the gap is for sale	Acquire the competitor firm
Obsolete technology	Increasing competition	Acquire modern technology/ form joint venture

Accumulating losses and no chance of improvement in one of the businesses	Increasing competition	Divest
Have technology and production capability, low production costs, but no international marketing capability.	Good foreign demand for the product	Strategic alliance with or acquisition of foreign firm having marketing muscle

TOWS MATRIX

The TOWS Matrix, introduced by Heinz Weihrich, is an important strategy formulation-matching tool.

The TOWS Matrix postulates the following four alternative strategies.

WT Strategy

The WT or the *mini-mini* strategy seeks to minimise the weaknesses and threats. Some of the weaknesses may be overcome or minimised. For example, managerial weakness may be solved by change of managerial personnel, training etc. Weakness due to excess manpower may be addressed by restructuring and retirement schemes. External threat may be met by strategic alliance, or other types joint ventures.

The acquisition of Daewoo, Jaguar and Land Rover enabled Tata Motors to overcome some of its technological weaknesses and weaknesses (gaps) in the product lines.

Daewoo and Tata could leverage their strengths to mitigate weaknesses. Daewoo provided Tata access to a number of foreign markets. The improvement of the technological capabilities and product portfolio enables Tata Motors to fight competition in the domestic market better, including that from the foreign players. Several measures taken by Tata Steel to improve operational efficiency (including development of global supply chain facilitated by foreign acquisitions) and addressing the problem of surplus labour enabled the company to overcome several serious weaknesses. Foreign acquisitions, particularly the Corus, minimised its threat from competitors.

In some cases, an unprofitable business that cannot be revived or businesses which are not worth the trouble may be given up. There are any number of such examples (see the chapter on *Portfolio Strategy*).

WO Strategy

The WO or *mini-maxi* strategy aims at minimising the weaknesses and maximising (i.e., taking maximum advantage of) the opportunities. For example, for a textile machinery manufacturer in India, the main weaknesses were dependence on foreign firms for technology and the long time taken to execute an order. The solutions were to give thrust to R&D to develop technology and measures to reduce the time lag so as to be in a better position to exploit to the maximum the growing demand.

A major weakness of Tata Tea in going global was its poor global marketing experience and absence of marketing infrastructure abroad. This weakness was overcome by a strategic alliance with Tetley, the second largest tea marketer in the world. Subsequently, Tata acquired Tetley. Leveraging the marketing strength of Tetley, Tata is harvesting the global opportunities.

When foreign firms severed their collaboration with some Indian two wheeler firms, they were deprived of the tecnological backing given by the foreign firms. Companies like TVS, Hero and Bajaj have sought to overcome this problem by sprouting up their R&D and operational efficiency and they continue to grow in the expanding domestic and foreign markets.

ST Strategy

The ST or *maxi-mini* strategy attempts to use the organisation's strengths to deal with the environmental threats. For example, a company may use its technological, financial and marketing strengths to combat a new competition. For example, Hindustan Unilever has been employing this strategy to fight the increasing competition from companies like P&G, Nirma etc. Maruti Suzuki is fighting the threat of increasing competition using its strengths – financial, technological, marketing etc. – introducing newer models in different segments and strengthening the servicing. Reducing its weaknesses and consolidationg the strengths, Life Insurance Corporation of India (LIC) has been figting back the competion caused by liberalisation.

Table 7.5: TOWS Matrix

Internal Factors / External Factors	Internal Strengths [S] 1…….. 2……. 3……. 4……..	Internal Weaknesses [W] 1…… 2…… 3…… 4……
External Opportunities [O] 1……. 2…… 3…… 4……	**SO (Maxi-Maxi) Strategy** [Maximise Strengths and Opportunities]	**WO (Mini-Maxi) Strategy** [Minimise Weaknesses and Maximise Strengths]
External Threats [T] 1…….. 2……. 3…….. 4……..	**ST (Maxi-Mini) Strategy** [Maximise Strengths and Minimise Threats]	**WT (Mini-Mini) Strategy** [Minimise Weaknesses and Threats]

SO Strategy

The SO or *maxi-maxi* strategy, which is the most desirable and advantageous strategy, seeks to mass up a firm's strengths to exploit the opportunities. Situation 1, depicted in Table 7.4, is an example. For instance, Hindustan Lever augmented its strengths (by measures such as the merger of BBLIL into HLL and takeover of firms in the food business) to exploit the growing potential of the food business. Confronted with a bleak future for its traditional core business, tobacco, ITC has been impressively diversifying its business portfolio using its financial, R&D, operational, technological, marketing and managerial strengths. Table 5.3 (Chapter 5) shows how the Reliance had planned to transform itself, leveraging its strengths to seize the opportunities of the emerging future environment.

Foreign firms like Honda, Hyundai, Samsung, LG etc. are exploiting the opportunities of the growing Indian market deploying their varied strengths. Similarly, many Indian firms are growing their foreign business. For example, using the low-cost advantage, several Indian pharmaceutical firms are tapping well the generic markets in several countries. A number of other examples have been cited in many places in this book.

PROCESS OF SWOT ANALYSIS

SWOT analysis may be done by people within the organisation or by external experts like consultants. Analysis by external experts may be preferable in certain cases as it would not be influenced by internal biases, conscious or unconscious. However, even when it is done by external experts, close interaction with people within the organisation and giving due weightage to their views are essential.

Often, opinions of other knowledgeable people, like industry analysts, external stakeholders like suppliers, customers, marketing intermediaries, financiers etc. are also sought. Former executives could be a very important source of information.

While taking the opinions, various people are useful, the analysts have to make their own judgement to separate the chaff from the grain.

In the SWOT analysis, it is common to conduct brainstorming sessions involving, in particular, top and middle level executives to generate views regarding the strengths and weaknesses of the different departments and the organisation as a whole.

In the subsequent sessions, the strengths and weaknesses already listed are subjected to detailed discussion and the most important ones are identified and what shall be discarded are discarded.

Opinions of lower level employees are also important. Sometimes very significant information/ideas emerge from them.

BENEFITS AND PITFALLS OF SWOT ANALYSIS

Proper SWOT analysis is very beneficial to organisations in several ways. At the same time, it has several limitations/pitfalls.

Benefits

SWOT is a pre-requisite for proper strategic planning.

1. Analysis of strengths and weaknesses is a real introspection of an organisation. It gives an in-depth understanding of the strengths and weaknesses. It will indicate measure to be taken overcome/minimise the weakness. Even when a company appears not weak on horizontal evaluation, the absolute evaluation will help it to understand the gap between the potential and existing.

2. One advantage of analysis of the weaknesses is that sometimes it would reveal that certain weaknesses are so severe that it becomes necessary to exit certain business or business function to make the organisation healthy.

3. Similarly, analysis of the strengths will sometimes reveal that an organisation is underutilising the resources/strengths. This should trigger new thinking on further development/improvement of the business.

4. SWOT is very helpful in determining the portfolio strategy which involves decisions regarding:

- Whether the company should continue with all the existing businesses or should it exit any of the businesses?
- Whether the company should enter any new business?

If the decision is to continue an existing business, SWOT is helpful in determining whether the company should follow a:

- Stability strategy, or
- Growth strategy, or
- Retrenchment strategy or
- Combination strategy

If the decision is to enter a new business, SWOT helps the decision as to:

- Which specific segments/space of the business to enter?
- What should be the entry strategy (for example, acquisition or greenfield enterprise; wholly owned enterprise or joint venture etc.)
- What business functions should the company carry out (for example, all the phases of the business – i.e., product development to marketing or only some functions, like marketing but the product is outsourced or some of the marketing functions are ousourced.

In short, SWOT analysis helps an organisation to:

- Understand the weaknesses and explore ways and means to overcome/minimise them.
- Understand the strengths and ponder over how best they can be used for further development of the organisation, like strengthening its existing business, entering new business etc.
- Understand the threats so that appropriate measures can be taken to combat the threats by using the strengths, minimising/overcoming the weaknesses or restructuring (including portfolios restructuring).
- Understand the opportunities so that the organisation can ponder over how best the opportunities can be taken advantage of using/augmenting its strengths.

Limitations/Pitfalls

1. As mentioned earlier, a SWOT profile reflects the position at the time it is done. The situation some times changes quickly and drastically. Hence, there shall be regular review of the internal and external environments. Otherwise, the SWOT profile could become misleading in the changed situation.
2. There are chances of subjectivity in the SWOT analysis. There could be differences in the perception of a particular thing by different people.
3. Vested interests or biases affecting SWOT analysis also cannot be ruled out.

4. SWOT analysis demands in-depth knowledge about the company, the industry in its global setting and the business environment as a whole. The implication is that if the analysis is not done by a team with the required expertise, the SWOT profile that emerges would not be the right one.
5. SWOT analysis has tremendous strategic implications. An improper SWOT analysis can land an organisation in very serious trouble.

CHAPTER

8 Strategy Implementation

Implementation of the strategy is as important as the formulation of the strategy. A good strategy by itself does not ensure success. The success depends, to a very large extent, on how it is implemented. Many strategies fail to produce the expected results because of the failure in properly implementing the strategy.

Strategy is a blueprint indicating the courses of action to achieve the desired objectives. The objectives are achieved by proper activation of the strategy. The activation or implementation step in the strategic management encompasses the formulation of the operational details to translate the strategy into effective practice.

Operationalising the strategy requires transcending the various components of the strategy to different levels; mobilisation and allocation of resources; structuring authority, responsibility, tasks and information flows; establishing policies; and, evaluation and control.

DIFFERENCES BETWEEN STRATEGY FORMULATION AND STRATEGY IMPLEMENTATION

There are several fundamental differences between strategy formulation and strategy implementation. As Fred David succinctly puts it:[1]

- Strategy formulation is largely an intellectual process, whereas strategy implementation is more operational in character.
- Strategy formulation requires good conceptual, integrative and analytical skills but strategy implementation requires special skills in motivating and managing others.
- Strategy formulation occurs primarily at the corporate level of an organisation, while strategy implementation permeates all hierarchical levels. Strategy formulation requires coordination among a few individuals, but strategy implementation requires coordination among many.
- In all but the smallest organisations, the transition from strategy formulation to strategy implementation requires a shift in responsibility from strategists to divisional and functional managers. Implementation problems can arise because of this shift in responsibility

especially if strategy formulation decisions come as a surprise to middle and lower level managers.

Further, while the basic process of strategy formulation does not differ greatly between different types and sizes of organisation, the implementation process can vary considerably.

COMPONENTS OF STRATEGY IMPLEMENTATION

Strategy implementation, often described as the action phase of the strategic management process, covers strategy activation and evaluation and control.

Strategy activation encompasses communicating and motivating; setting goals; formulating policies and functional strategies; organisational structuring; leadership implementation and resource allocation.

Some writers break the strategy implementation phase into three components, viz.,

1. Institutionalising the strategy (organisational structuring and leadership implementation).
2. Operationalising the strategy (communicating strategy, setting annual objectives, developing divisional strategies and policies, and resource allocation).
3. Evaluation and control of the strategy.

Fig. 8.1: Components of Strategy Implementation

STEPS IN STRATEGY IMPLEMENTATION

The important steps in strategy implementation are described below. The steps given below do not necessarily follow the sequential order. The sequences may vary depending on the nature of the company, nature of the strategy, approach to implementation etc. Further, sometimes several steps have to be taken simultaneously.

Leadership implementation

Leadership implementation refers to ensuring the right people in positions responsible for implementation of the strategy. It encompasses the chief executive officer (CEO) and the key managers.

"The first dimension of leadership implementation is to make sure that the right strategists are in the right positions for the strategy chosen for the SBU or firm."[2]

The ability, integrity and commitment of the CEO and other top executives are very critical to the successful implementation of the strategy. "Because the very definition of enterprise strategy implies new corporate directions, implementing this strategy requires a leader who can drive an organisation, energize its operations, and inspire its people. This kind of leader must personify the organisation's purpose – through sheer personal magnetism, vitality and force. There is no substitute for the pronounced personal style and strong interpersonal skills that most effective leaders possess. This style and skill reflect the quality of a leader's values, thinking and character – all necessary to inspire commitment to the strategy and goals of the leader and to secure the allegiances required to make any bold purpose succeed."[3]

The critical role of the leader in strategic management is clear from the fact that major changes in strategy are often preceded by or quickly followed by a change in the CEO.

For more information, see the section *Role of Leadership in Strategic Management* towards the end of this chapter.

Communicating the Strategy

As indicated earlier, strategy implementation involves a number of people at different levels. Many of them might not have taken part in the strategy formulation. This highlights the importance of communicating the strategy. Even those who are not directly involved in strategy implementation need to be informed about the strategy because everybody in the organisation should know what are the future plans for the organisation, what changes are affecting the organisation, why these changes or strategy, what are the objectives and implications etc. It is essential to instill a feeling of belongingness to the organisation. Absence of such communication would create a feeling of alienation in the employees causing morale and motivation to dampen and would also cause resistance to the strategy.

In several cases, it would also be desirable to communicate the strategies to people outside the organisation but related to it like marketing intermediaries, consumers etc. "Through the communication process, the CEO interacts with the various internal and external stakeholders of the corporation – employees, shareholders, suppliers, customers, legislators, advocates, and the public at large. Moreover, the CEO uses communications to formulate, test and disseminate his or her vision for the future of the enterprise."[4]

Proper communication of the strategy is a pre-requisite for successful implementation of the strategy. "A clear understanding of the strategy gives purpose to the activities of each organization member. It allows the individual to link whatever task is at hand to the overall organizational direction." This is mutually enhancing and gives meaning to the task. It also provides the individual with general guidance for making decisions and enables him/her to direct efforts toward activities that count."[5]

It does not, however, mean that all strategies or all the details of the strategy should be or can be communicated. For example, it will be suicidal to allow the competitors to know of certain strategies of the company. "The wider the dissemination of information concerning strategic decisions, competitive moves, or shifting emphasis, the greater the likelihood it will reach a competitor who could subvert the move, decision, or shift. A strategy that will provide or exploit an unpublicised

advantage may be kept undisclosed....If the strategy will divulge proprietary information, it should be shared only on a need-to-know basis."[6]

Communicating certain matters in advance may cause resistance or other problems within the organisation.

Formulation of SBU Strategy

In multi-SBU companies, the corporate strategy is implemented through SBU strategies, which are formulated to achieve the corporate strategy. Figure 8.2 summarises the process of formulation of SBU strategies.

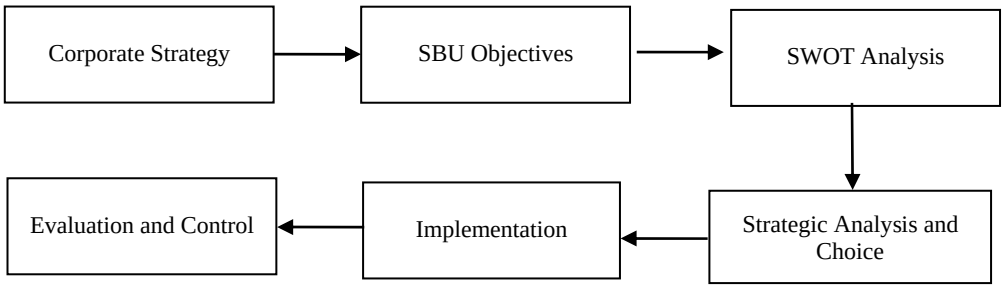

Fig. 8.2: Process of Formulation of SBU Strategy

Annual Objectives

Annual operating objectives designed to contribute to the long-term objectives is a critical step in strategy implementation.

Long-term objectives indicate the planned long-term positioning of the organisation. Short-term objectives like annual objective lay down the specific goals and targets to be achieved within the specific time frame so that the long-term objectives would be achieved.

While long-term objectives are very broadly stated, annual objectives very specifically lay down the annual goals for the business, functional areas or subunits.

"Annual objectives should be measurable, consistent, reasonable, challenging, clear, communicated throughout the organisation, characterised by appropriate time dimension and accompanied by commensurate rewards and sanctions."[7]

As annual objectives are formulated for a number of functional areas, units etc., consistency, coordination and integration are very critical factors.

Annual objectives may also need to be prioritised due to timing considerations and relative impact on strategic success.

Annual objectives provide several benefits.

1. "Systematic development of annual objectives provides a tangible, meaningful focus through which managers can translate long-term objectives and grand strategies into specific action. Annual objectives give operating managers and personnel a better understanding of their

roles in the business's mission. This *clarity of purpose* can be a major force in effectively mobilising the 'people assets' of a business."[8]

2. Annual objectives help objective resource allocation.
3. They become basis for monitoring the progress toward achieving the long-term objectives.
4. When annual objectives are developed by participation of managers responsible for their accomplishment, "they provide an 'objective' basis for addressing and accommodating conflicting political concerns that might interfere with strategic effectiveness. Effective annual objectives become the essential link between strategic intentions and operating reality."[9]

Functional Strategies

Functional strategies, which are short-term game plans for the key functional areas, are the means to accomplish the annual plans.

Functional strategies by clearly specifying the various measures to be taken in different functional areas in different time horizons help operationalise the grand strategy. In other words, functional strategies provide the short-term operational details for accomplishing the long-term objectives systematically.

"Functional strategies help in implementation of grand strategy by organising and activating specific subunits of the company (marketing, finance, production, etc.) to pursue the business strategy in daily activities. In a sense, functional strategies translate thought (grand strategy) into action designed to accomplish specific annual objectives. For every major subunit of a company, functional strategies identify and coordinate actions that support the grand strategy and improve the likelihood of accomplishing annual objectives."[10]

Operationalising the corporate strategy requires the development of functional strategies in key areas like marketing, production, R&D, finance and human resources.

Figure 8.3 illustrates annual objectives and functional strategies.

The annual objective is to increase sales by ₹ 86 crores. Strategies for this include, for example, increasing the sale of division A by ₹ 38 crores, division B by ₹ 30 crores, division C by ₹ 18 crores, developing a new product, intensifying promotion by increasing the size of the field sales force, increasing the number of dealers etc.

The functional strategy for marketing must cover all the factors of the marketing mix. Mutually consistent strategies for each of the factors must be developed to help achieve the annual marketing objective.

R&D strategy may involve improving product or packaging, developing new product etc.

Similarly, every key functional area must develop strategies to achieve the annual objectives.

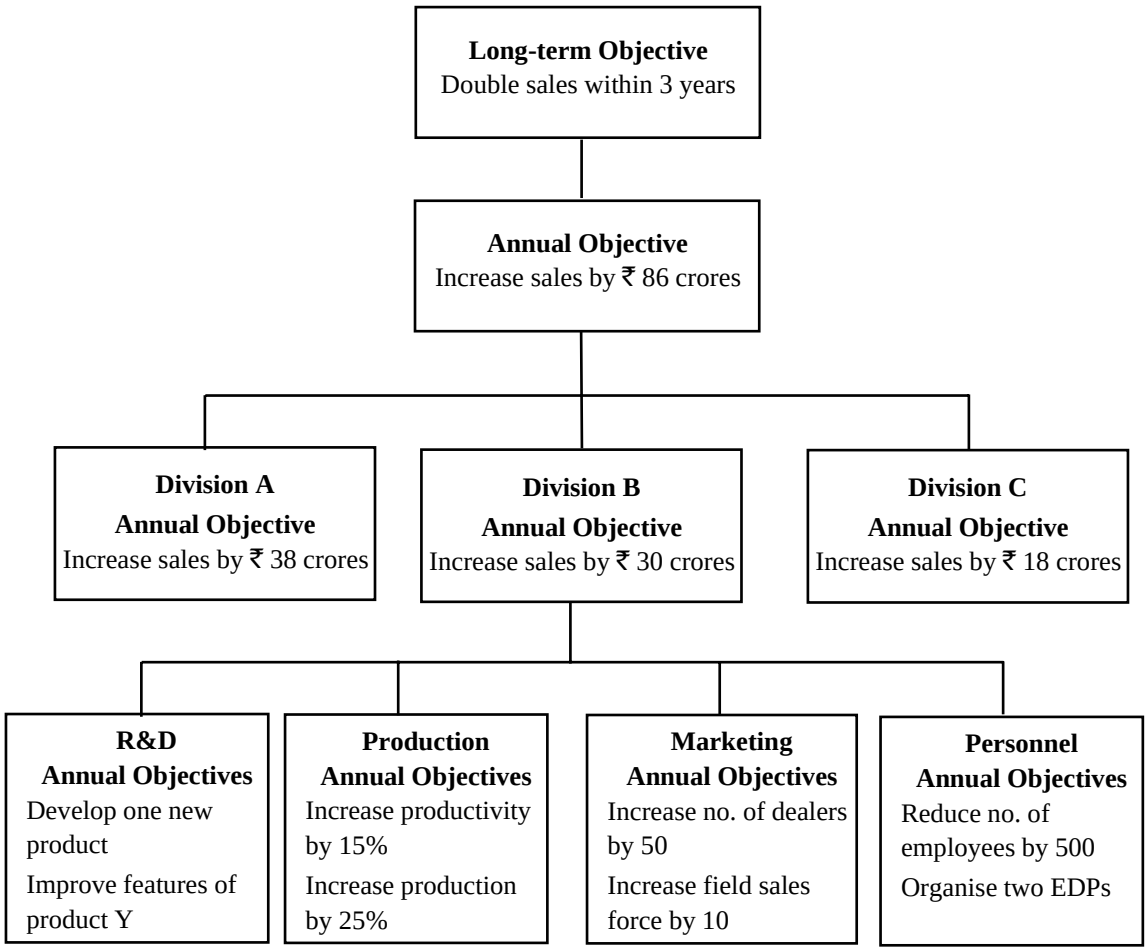

Fig. 8.3: Annual and Functional Objectives

Resource Allocation

Making sufficient resources (financial, human, material, technological, facilities, etc.) available in time is an essential requirement for effective implementation of the strategy.

Top management's commitment to the strategy will be reflected in the resource allocation. Objectivity is a pre-requisite of efficient resource allocation. Personal whims and fancies shall not affect the allocation of resources to SBUs, divisions, functions or executives. It is well known that one of the major reasons for the failure of implementation of many public sector projects in India is associated with resource allocation.

The resource allocation process is summarised in Figure 8.4.

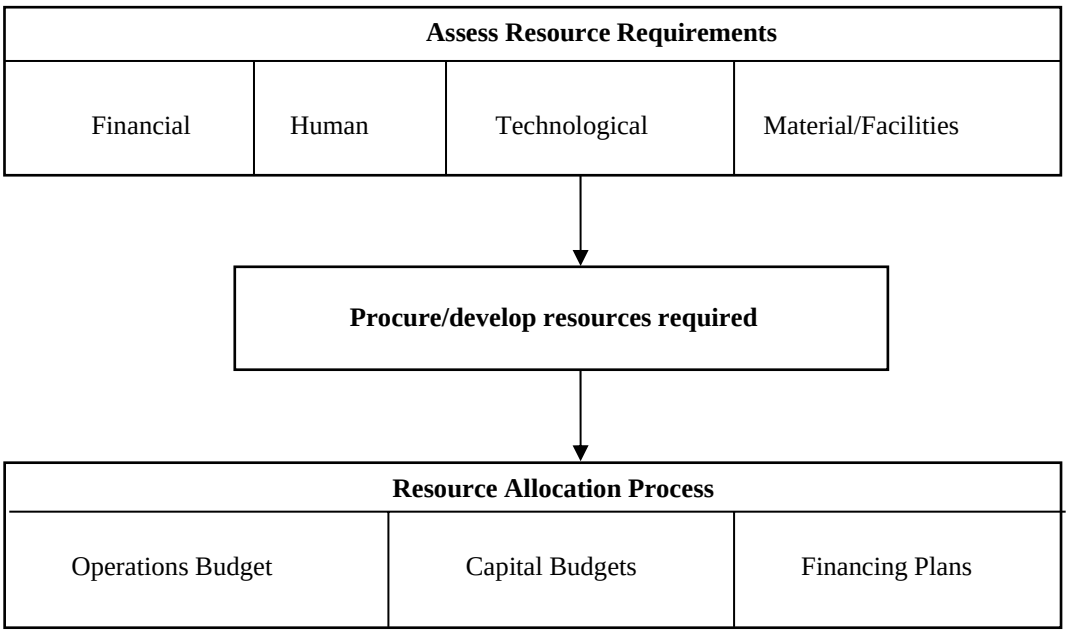

Fig. 8.4: Resource Planning and Allocation Process

Development of Policies

Effective implementation of strategy requires formulation of policies. "A policy is a broad, general guide to action which constrains or directs goal attainment ... Thus, policies serve to channel and guide the implementation of strategies."[11]

"The critical element, the major analytical exercise involved in policy making, is the ability to factor the grand strategy into policies that are compatible, workable ... It is not enough for managers to decide to change the strategy. What comes next is at least as important. How do we get there, when and how efficiently? This a manager does by preparing policies to implement the grand strategy."[12]

The important benefits of policies are the following.

- Policies make clear what and how everybody is expected to do and they make coordination, evaluation and control easier. They also help reduce the time managers spend on supervision and decision making.
- Policies are of immense help in conducting the regular activities of an organisation smoothly and efficiently. Policies provide clear guidelines for carrying out activities and thereby avoid confusion and discretionary misuse.
- Policies help delegation because the clarity of procedures etc. enable the work to be carried out independently.
- They help to avoid delay in decision-making.
- Clear policies help minimise conflicting practices and establish consistent patterns of action because policies clarify what work is to be done by whom.

There are, generally, three types of policies in an organisation. They are:

- *Corporate Policies* that apply throughout the organisation.
- *Divisional Policies* which apply to the division.
- *Departmental Policies* which apply within the department.

Organisational Implementation

A strategy cannot be effectively implemented unless there is a suitable organisation. It is, therefore, essential to ensure the right organisational structure for the strategy. It is relevant to recall here the well known conclusion of Alfred Chandler that *structure follows strategy*.

Many strategies call for changes in the organisational structure. Organisational restructuring is common throughout the world. It has become widespread in India since the liberalisation. Organisational implementation is dealt with in detail in a separate chapter.

Evaluation and Control

To help implement the strategy effectively, it is essential to have an effective system of evaluation and control. The objective is to examine whether the strategy as implemented is meeting its objectives and if not to take corrective measures. Evaluation and control is dealt with in detail in a separate chapter.

Reward System

Effective implementation of the strategy also depends on the motivation of executives and others associated with the implementation. It is, therefore, necessary to have a system to reward superior performances so as to motivate people to perform very well. Reward system may consist of monetary rewards like pay rises, bonuses, promotions, lump sum payments, etc. or non-monetary rewards like awards, special acknowledgments etc. or both.

Designing an appropriate reward system is often difficult for various reasons. When strategy implementation involves individuals, groups of individuals and divisions, measuring the exact contribution of each may be difficult. The results of strategy may be spread over a long period. In case of long-term strategy, it normally takes long period to fully realise the effectiveness of implementation and people responsible would have changed in some cases.

APPROACHES TO STRATEGY IMPLEMENTATION

Effective implementation of strategy needs, first of all, a clear and appropriate approach to the implementation. It should be based on such factors as an assessment of change, structure, and culture variables.

Based on their research on management practices in a number of companies, Brodwin and Bourgeois have identified five fundamental approaches to implementing strategies.[13] These five approaches are the Commander approach, the Organisational Change approach, the Collaborative approach, the Cultural approach, and the Crescive approach. These approaches range from simply asking the subordinates to implement the strategy that has been formulated to empowering the subordinates to formulate and implement sound strategies on their own.

Commander Approach

The Commander approach, as the term suggests, is a top-down approach. The strategy is developed by the top management and it is passed along to subordinates with instructions to execute it. The top management takes a back seat in implementing the strategy but oversees it.

An important limitation of this approach is that as those who implement the strategy are not involved in the development of the strategy. They may not have the required emotional commitment to see the strategy successful. This lack of self-motivation would affect the utilisation of their full potential and the realisation of the strategic objectives. The Commander approach considers only the economic factors and ignores the political, social and behavioural dimensions of strategy development and implementation.

This approach, however, is very common, particularly in small companies and companies within stable industries. It is suggested that this approach works best when the strategy to be implemented requires relatively little change.

Further, this approach is suitable when the strategy is to be formulated confidentially or quickly or when the behavioural aspects do not favour other approaches.

Organisational Change Approach

Under the Organisational Change approach (or simply the Change approach), strategy formulation resembles the Commander approach but differs substantially in the approach to implementation of the strategy.

The Organisational Change approach, as the term indicates, emphasises on bringing about the required organisational change to implement a strategy.

Many strategies which are substantially different from the old one require significant changes in the organisational structure and staffing to focus attention on the organisation's new priorities, planning and control systems etc. This underscores the importance of the Organisational Change approach to strategy implementation.

It is pointed out that as the Change approach employs powerful behavioural tools, it is often more effective than the Commander approach, and it can implement more difficult strategies.

The Change approach, however, has several limitations. This approach considers the economic and political factors but does not pay enough attention to the social and behavioural aspects. It has the same motivational problems as under the Commander approach as the strategy is dictated top down. Further, sometimes, organisational changes take time and this approach can backfire in uncertain or rapidly changing conditions.

Collaborative Approach

The Collaborative approach views strategy development as a collective endeavour that should consider the views of all the managers in the organisation who can contribute to this vital task.

Under this approach, brainstorming sessions are usually employed to formulate strategy and implementation tactics. Many companies have found this a very useful approach.

The Collaborative approach has several advantages. This approach, in which the goals and strategies are negotiated among the top team, overcomes two key limitations of the Commander and

Change approaches. By providing a forum to share and evaluate information and views contributed by various managers closer to operations, it presents a better strategy development process. It involves economic, social and political dimensions. The involvement of different sections in the strategy formulation enhances the commitment to its implementation.

The Collaborative approach, however, has several limitations. This approach is often time-consuming. If some of those who participated in the strategy negotiation feel that there views were not heeded, they may become emotionally detached with the strategy. A negotiated strategy may sometimes turn out to be a compromise rather than the best strategy. In some other cases, vested interests of the dominant members or the majority of the team may give rise to a skewed strategy, sacrificing the proper strategic perspective. It is pointed out that sometimes a negotiated strategy is likely to be less visionary and more conservative than one developed by a Commander approach.

Cultural Approach

The Cultural approach extends the democratic element of the Collaborative approach further to include lower levels in the organisation.

In this approach, the organisational vision and mission are well communicated to the employees so that they become the guideposts to develop strategies. The employees are empowered and encouraged to design their own work activities in pursuit of the mission. Once the strategy is formulated, the manager plays the role of coach, giving general directions but encouraging individual decision-making on the operating details of executing the strategy.

For the implementation of the strategy, the Cultural approach uses what may be called *third order control techniques*, i.e., it seeks to influence behaviour by shaping the norms, values, symbols, and beliefs on which managers and employees base day-to-day decisions. (First-order control is direct supervision whereas second-order control involves using rules, procedures, and organisational structure to guide behaviour). The third-order control is regarded as more subtle and, potentially, more powerful.

"The Cultural approach appears to work best in organisations that have sufficient resources to absorb the cost of building and maintaining supportive value systems. Often, these are high-growth firms in high-technology industries."[14]

The Cultural approach has several advantages. "It partially breaks down the barriers between the thinkers and doers, because each member of the organisation can be involved to some degree"[15] in both formulation and implementation of strategy. As people at different levels are involved in the development of the strategy, they should be expected to be dedicated to the implementation of the strategy.

The Cultural approach too has its share of limitations. People at lower levels may not have the perspective vision, knowledge and expertise to develop strategies. Developing these qualities is time-consuming and very difficult. Further, "companies with excessively strong cultures often suppress deviance, discourage attempts to change, and foster homogeneity and inbred thinking. To handle this conformist tendency, some companies (such as IBM, Xerox, and GM) have segregated their ongoing research units and their new product development efforts, sometimes placing them in physical locations far enough from other units to shield them from the corporation's dominant culture."[16]

Crescive Approach

The Crescive approach addresses strategy formulation and strategy implementation simultaneously. (*Crescive* means increasing or growing.)

The Crescive approach is a bottom-up approach — instead of pushing the strategy downward from top management or a strategy group, it moves upward from the doers (salespeople, engineers, production workers) and lower middle-level managers and supervisors. Thus, under this approach, instead of the top management taking on itself the entire task of developing the strategy, the subordinates are empowered to develop and implement sound strategies on their own. Goals are stated loosely from top and refined from bottom. "The top management team shapes the employees' premises, that is, the employees' notions of what would constitute supportable strategic projects and functions more as a judge evaluating the proposals rather than as a master strategist."[17]

Of all the approaches, the Crescive approach considers the broadest set of factors — economic, social, political and behavioural.

According to Brodwin and Bourgeois, the Crescive approach is suitable for large, complex, diversified organisations where the CEO cannot know and understand all the strategic and operating forces that affect each division.

The Crescive approach has certain merits. It has a down-to-earth orientation. Equally important is the fact that because of their involvement in the formulation of the strategy, the emloyees will be committed to implement the strategy very earnestly. Further, this approach would help increase the motivation and morale and to realise the potentials of people at different levels.

ROLE OF LEADERSHIP IN STRATEGIC MANAGEMENT

We have seen that leadership implementation is a very important aspect of strategy implementation. Indeed, leadership has a great role in strategic management, from causing the strategy formulation to its successful implementation. In this context, it is very relevant to consider the different levels of leadership and their role in Strategic Management.

Organisational and Leadership Levels

A large organisation typically has the following three broadly defined levels:

- Top (strategic) level
- Middle (organisational) level
- Bottom (production- or action-oriented level)

Leaders at the lower levels are responsible for accomplishing more or less well-defined tasks within given frameworks, rules, policies, guidelines/directions. Compared with leaders at topmost levels who are thinkers and visionaries, leaders at the lower levels are doers or action-oriented who have little discretion about the decisions they make, the procedures they use, and the degree of innovation they may implement.

The mid-levels are responsible for setting near and mid-term goals and directions, and for developing the plans, procedures and processes, budgeting and allocating major resources which are major tools for directing, coordinating and controlling, used by the lower levels. The mid-levels are

also responsible for prioritising missions and allocating major resources to tailor capability at the lower levels.

Top-level leaders are strategic leaders; they are responsible for setting the strategic direction of the organisation within the context of the dynamic environment which is increasingly becoming global, even for educational institutions. The major functions performed by increasingly higher levels of the organisation are increasingly indirect, complex, and ill-defined.

Strategic Leadership

As mentioned above, strategic leaders are people at the topmost level of the organisation who are responsible for setting the strategic vision and establishing a proper organisation-environment fit within the context of the organisational strengths and environmental dynamics.

Strategic leadership is described as "the ability to anticipate, prepare, and get positioned for the future. It is the ability to mobilise and focus resources and energy on things that make a difference and will position you for success in the future. It is the courage to think deeply about what you want to do. Applied strategic leadership is about creativity, intuition, and planning to help you reach your destiny. Strategic people think and act before they have to, before they are forced to take up a defensive or reactive position."[18]

Strategic leaders shall be visionaries who can foresee the possible changes in the long future and can architect a strategic position for the organisation in the future scenario. Leaders at the topmost level require high conceptual clarity, excellent analytic skills, smart creative thinking skills, highly motivated innovative orientation and a positive disposition towards risk bearing.

Strategic leadership is pragmatic rather than "head in the clouds". The strategies developed will lead to tactics which will need to engage with, and succeed in, the real world. These strategies must therefore be based on a realistic appraisal of the environment in which the organisation finds itself, the resources at its disposal and the opportunities that exist.

Characteristics of Strategic Leaders

Important characteristics of strategic leaders include the following:

- Proactive approach, eagerness to constantly update knowledge, analytical skills, strategic and creative thinking, entrepreneurial and innovative mindset and institution building capabilities.
- Ability to forecast and envision future scenarios and being alert and ready to seize right opportunities.
- Ingenuity to picture a range of strategic possibilities several stages ahead of the current phase of organisational development. Like a good chess player, it was said of Napoleon that he could envisage several steps ahead, with the various permutations of competitive response.
- A great understanding of timing – the ability to choose the right time to make a major intervention and the boldness to strike decisively when the moment is right.
- Habit of investing time in developing people and capability for the future of the organisation as well as managing the current needs of the organisation.

Role and Functions of Strategic Leadership

The important role and functions of strategic leaders are:

- **Forecasting the future environment of the respective business:** This shall encompass the changes in the nature and scope of the business, including the technological dimensions, competitive environment, government policy and regulatory environment, global environment etc.
- **Setting a vision for the organisation:** This includes strategic positioning of the organisation in the future scenario and envisaging the required transformation of the organisation.
- **Formulation of mission and objectives towards accomplishment of the vision:** Mission and objectives provide clear idea and specific requirements to translate the vision into practice.
- **Formulation of strategy:** To accomplish the vision/mission and objectives, a unified, comprehensive and integrated plan of action needs to be put in place.
- **Activation of the strategic plan:** Several critical steps need to be taken to effectively implement the strategy. These were described in section *Steps in Strategy Implementation* in this chapter.

Besides the CEO, other top executives have a critical role in the strategy implementation. It is, therefore, essential to ensure that such key positions are held by the right people.

Creative and Generous Strategists. According to Henry Mintzberg, "great strategists are either creative or generous. We have too few of either type. We call the creative ones visionaries — they see a world that others have been blind to. The generous ones, in contrast, bring strategy out in other people. They build organisations that foster thoughtful inquiry and creative action. The creative strategists reach out from the centre of that circular organisation to touch the edges, while the generous ones strengthen the whole circle by turning strategic thinking into a collective learning process."

Symbolic and Substantive Roles. It is aptly said that in strategic management, the nature of the CEO's role is both *symbolic* and *substantive.*

The symbolic role is very important to instill confidence and to inspire. In an organisation which is in bad shape, characterised by inefficiency, extravagance, corruption etc., a new CEO known for his ability, integrity and commitment would be a pointer to the initiation of cultural change and dawn of a new era. Personal austerity of the CEO and austerity measures within the organisation has made employees willing to accept financial sacrifices in several beleaguered firms. The image of the CEO and other top executives would have a lot of impact on the organisation and outside.

The substantive nature of the CEO's role will be reflected in the amount of interest the CEO has in the strategy and the amount of time he invests in implementing the strategy.

As indicated earlier, in many firms, there was a new CEO behind major strategic changes and substantial increase/improvement in the business. This is true of turnaround cases and substantial growth/improvement of profitable firms. There are many well-known such leaders from Lee Iaccoca (Chrysler Corporation) down to CEOs of national and local firms.

Integration of Roles and Activities of Different Levels of Leadership with the Organisational Vision and Strategy

Strategic leadership is a process wherein the top leaders set long-term directions for their organisation and obtain, through consensus building, the energetic support of key constituencies necessary for the commitment of resources. Indeed, leadership is an interactive process, so that the collective energy of a group or organisation is focused on the attainment of a common purpose. Leadership gives the required clarity of purpose, direction, motivation means and integration. The following table gives some indication of the integration of the role/functions of the three leadership levels for the well planned development of the organisation.

Function	Strategic Leadership	Organisational Leadership	Direct Leadership
Vision	Create the Vision	Create the Plans	Execute the Plans
Teamwork	Integrate Structure/Purpose	Design Interdependencies	Forge Teamwork
Values	Articulate Cultural Imperatives and Values	Set Command Climate	Model and Reinforce Values
Information	Establish Concept Base for Information Systems	Engineer Information Systems	Generate/Apply Information

Fig. 8.5: Dimensions of Leadership Levels

Source: National Defense University (USA), *Strategic Leadership and Decision Making*.

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CHAPTER

9

Strategy and Structure

The organisational structure has an important role in the implementation of strategy. Major changes in strategy are likely to lead to changes in administrative requirements, calling for a new or refashioned structure for the successful implementation of the new strategy. In other words, strategy can rarely succeed without an appropriate structure. It is, therefore, very important to ensure that a structure most suited to the strategy is in place.

STRATEGY-STRUCTURE RELATIONSHIP

Alfred Chandler who has investigated the relationship between strategy and structure defines structure as the design of the organisation through which strategy is administered. Some authors have elaborated structure as "the division of tasks for efficiency and clarity of purpose, and coordination between the interdependent parts of the organisation to ensure organisational effectiveness. Structure balances the need for specialisation with the need for integration. It provides a formal means of decentralising and centralising consistent with the organisational and control needs of the strategy."[1]

Chandler's landmark study revealed that new organisational forms are no more than a derivative of strategy.

Chandler's *Structure Follows Strategy* thesis was based on case studies of large American conglomerates that dominated their industry from the 1920s onward. It was a time when businesses were developing from single-unit, centrally managed operations into umbrella-type structures where a number of comparatively autonomous units shared certain overheads, in particular the strategic planning function. He found that companies shifted their designs from a simple centralised pattern to a more elaborate divisionalised pattern following changes in population, national income, technological innovations, expanding product lines etc. Chandler described how the chemical company DuPont, the automobile manufacturer General Motors, the energy company Standard Oil of New Jersey and the retailer Sears Roebuck managed a growth and diversification strategy by adopting the revolutionary multi-division form. The M-Form is a corporate federation of semi-independent product or geographic groups plus a headquarters that oversees the corporate strategy and coordinates interdependencies.

Box 9.1

Thesis, Antithesis and Synthesis

In his classic book *Strategy and Structure*, published in 1962, Alfred Chandler propounded the renowned theory that *structure follows strategy* and argued that all successful companies must have a structure that matches their strategy (and not, as many had assumed until then, the other way round).

Chandler's study has revealed a common strategy-structure sequence. Choice of a new strategy leads to administrative problems and decline in performance. This triggers a shift to an organisational structure more in line with the strategy's needs, facilitating improved profitability and strategy execution. The moral of the story is that such administrative problems and decline in performance can be avoided if the right structure for the strategy is adopted in the beginning itself.

There have, however, been strong disagreements of Chandler's view. The contradictory view of David J. Hall and Maurice A. Saias has been particularly popular in this category: They have inverted Chandler's thesis, suggesting that *Strategy Follows Structure*. According to them, strategy, structure, and environment are closely linked. Whereas men may build the structure of an organisation, in practice, it is this very structure which later constrains the strategic choices they may make. For example, they pointed out that a multi-divisional structure biases a firm towards a conglomerate strategy.[2]

Commenting on Chandler's reasoning, Tom Peters, however, observes that he thinks that Chandler "got it exactly wrong. For it is the structure of the organisation that determines, over time, the choice that it makes about the market it attacks…A McKinsey or EDS or CNN choose to do what it does – i.e., continually reinvent itself, with apparent case – because of its "structural" shape much more that its chosen strategy.[3]

Henry Mintzberg offered a balanced view, arguing that the relationship between strategy and structure is reciprocal. "Structure follows strategy ... as the left foot follows the right."

Besides the characteristics of the strategy, structure depends on a number of factors like the size of business, nature of business like the diversity, characteristics of the market, future plans etc.

The strategy chosen is the primary explanatory variable for organisational structure. The influence of strategy on structure may be expressed as follows:[4]

- Strategy determines organisational tasks.
- Strategy influences the choice of technology and people responsible for accomplishment of those tasks and these, in turn, influence the appropriate structure.
- Strategy determines the specific environment within which the organisation will operate.

Organisational structure may undergo changes as the size of the business changes, as the business diversifies, as the company expands its business into new markets like foreign markets, as the business is restructured, as the business environment changes etc. For example, when a company, which hitherto was confined to the domestic market, takes up exports seriously it may establish an export department and as the business grows it may establish an export marketing subsidiary. As the company becomes multinational and global, the organisational structure will undergo further changes. Ranbaxy, which was a major Indian pharmaceutical firm, repositioned itself as a research-based international pharmaceutical corporation, transcending the traditional dichotomy between home and overseas markets, abolished its international marketing division and divided the world into four regions, each under a Regional Director with plants, marketing set-ups and joint ventures. India is just one of the countries falling under one of these regions.

Organisational structures need to be flexible. It is said that organisation chart and job descriptions create the graveyard of an organisation.

The rigidity of rules and procedures and lack of discretion and the consequent red tapism and the grievous delays in action often degenerate Government departments and organisations into inhuman, inefficient and irresponsible systems. What are needed in many situations are organisational flexibility and not procedural rigidity, responsibility and authority for accomplishing tasks and not mere job descriptions.

A long hierarchy or many layers in the administrative system delays decision. Such a hierarchical and rigid system is a serious handicap in a fiercely competitive environment where the company has to be close to the customer and where the decisions and actions have to be quick. One of the major handicaps of IBM was the too much delay in decision-making and responding to the market needs.

It is argued that an organisation should be like an amoeba capable of quickly changing its shape as and when required.

With a view to enabling the organisation to quickly and effectively respond to the demand of the market, the organisational structure of many companies has been made flexible. Task groups are formed for specific tasks and once the task is accomplished, the particular group may dissolve and new groups may be formed for new tasks. David Nadler has recommended organisational architectures in which the corporate structure revolves around autonomous work teams.

CRITERIA FOR SUCCESS (7–S FRAMEWORK)

Tom Peters and Waterman in their famous book *In Search of Excellence: Lesson from America's Best-run Companies* point out that the success of an organisation depends on a number of mutually supporting variables, besides strategy and structure. Their research has shown that any intelligent approach to organising had to encompass, and treat as interdependent, at least seven variables: *structure, people, management style, systems and procedures, guiding concepts* and *shared values* (i.e., culture). They defined this idea more precisely and elaborated what came to be known as the McKinsey 7-S Framework.[5] See Figure 9.1.

This framework has caught on around the world as a useful way to think about organising and has helped in forcing explicit thought about not only the hardware – strategy and structure – but also about the software of organisation – style, systems, staff (people), skills, and shared values.[6]

Their exposition has led to the realisation that real change in large institution is a function of at least seven hunks of complexity. This also indicates the difficulty of changing a large institution in any fundamental way.

Their study of America's best-run companies has identified eight attributes that characterise most nearly the distinction of the excellent, innovative companies. They are as follows:[7]

1. A Bias for Action. In many companies, they employ a host of practical devises to maintain corporate fleetness of foot and counter the situation that almost inevitably comes with size. Even though the best-run companies may be analytical in their approach to decision-making, they are not paralysed by that fact.

2. Autonomy and Entrepreneurship. The innovative companies foster innovation and leadership throughout the organisation. And they encourage practical risk taking, and support good tries.

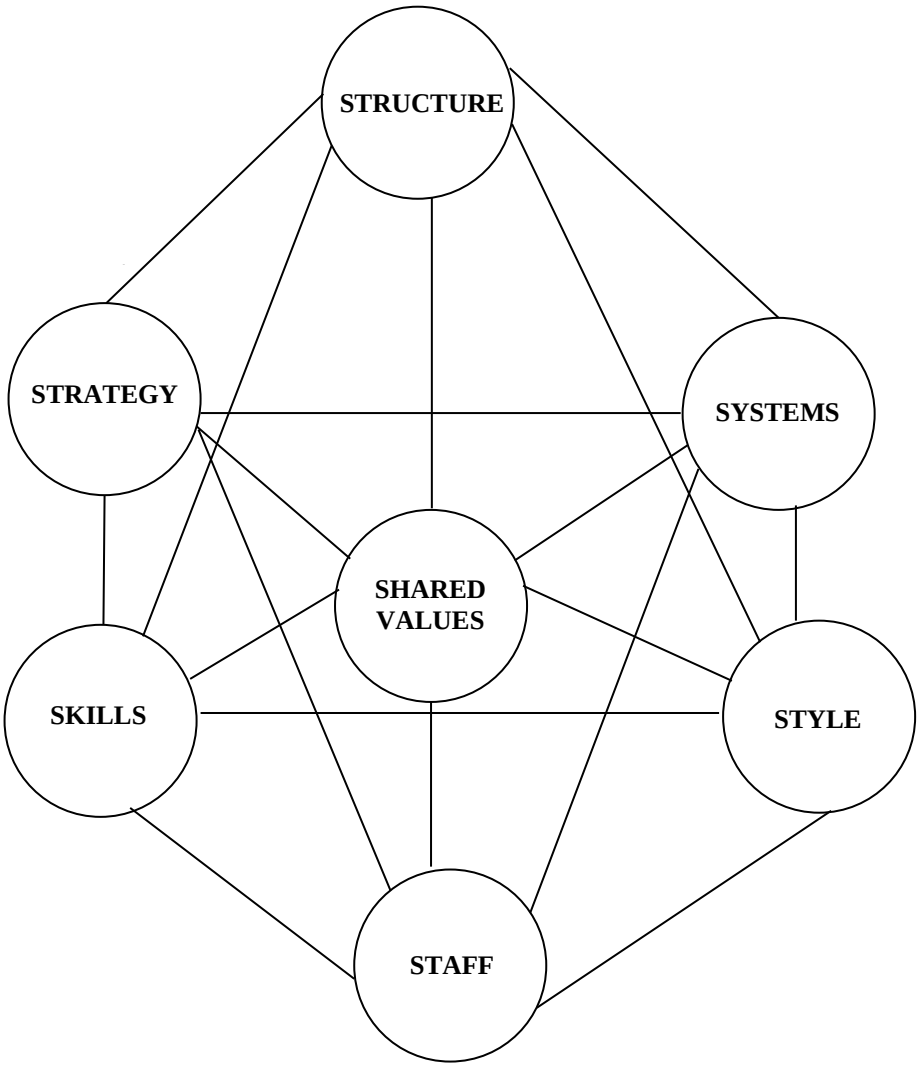

Fig. 9.1: McKinsey 7-S Framework

3. Productivity through People. An excellent company treats the rank and file as the root source of quality and productivity game.

4. Hands-on, Value-driven. It is held that the basic philosophy of an organisation has far more to do with its achievements than do resources or strategic factors.

5. Stick to the Knitting. Although there are exceptions, excellent performance, often, seem strongly to favour those companies that stay reasonably close to businesses they know.

6. Lean Simple Form, Lean Staff. The underlying structural forms and systems in excellent companies are elegantly simple and the top-level staffs are.

7. Simultaneous Loose – Tight Properties. The excellent companies are both centralised and decentralised. For the most part they, have pushed autonomy down to the shop floor or product management team. On the other hand, they are frantic centralists around the few core values they hold.

ORGANISATIONAL RESTRUCTURING AND TRANSFORMATION

According to Michael Hammer who advocates the re-engineering for success, narrowly-defined jobs will be eliminated in the re-engineered corporation. Re-engineering which entails organising work around outcomes rather than tasks, requires a flat organisation. In Asea Brown Boveri (ABB), all the profit centres (5000 in number) have their own profit and loss statements and balance sheet, own assets and serve customers directly.

Box 9.2

Impact of Competition and Information Technology on Organisational Structure

Peter Drucker had predicted the demise of the organisational man of the 1950s, represented by tall pyramidal corporate structures and suggested its replacement by flat structured firms. Drucker in his *The New Realities* published in 1990 bleakly prophesied that only companies that quickly crashed their bloated hierarchies would be able to survive the 1990s.[8]

Around the mid-1980s when Drucker pointed out that the information-based organisation needs far fewer levels of management than the traditional command-and-control model, it was treated as a sensational news. But, by five years since then, a great many – may be most – large American companies have cut management levels by one-third or more. In his *Managing for the Future*, Drucker counsels that business tomorrow will follow two rules. One, to move work to where the people are, rather than people to where the work is. Two, to farm out activities that do not offer opportunities for advancement into fairly senior management and professional positions into an outside contractor. The corporation, in stock market jargon, will be unbundled. One reason for this is that this century has acquired the ability to move ideas and information fast and cheaply. At the same time, the great nineteenth century achievement, the ability to move people, has outlived its usefulness.

Information systems expert Peter Keen makes the following explication: "The traditional concept of an "organisation" is no longer useful to managers or students of organisations. It is dominated by models of structure and physical identity at a time when telecommunications has eroded the boundaries between firms and changed the nature of coordination across geographic locations.

The traditional view of the organisation as a structure with clearly stated goals and a clearly defined industry in which it competes…does not easily mesh with the emergence of electronic links. These links serve as the base for managing businesses and coordinating activities across time zones and within global marketplaces where the limits on trading are set by technology, not organisational structures and procedures.

Clearly, the resulting electronically linked "organisation" cannot be defined by its formal hierarchy with a clear physical identity or boundary that separates it from other organisations. Nor is the organisation a unitary "actor", defined by its goal, mission or "strategy."[9]

McKinsey is a huge company which performs well without any traditional hierarchy or organisational charts. See Box 10.1 (Chapter 10).

As Stalk, Evans and Shulman have pointed out in their HBR article "*Competing on Capabilities: The New Rules of Corporate Strategy*", competition is now a 'war of movement' in which success depends on anticipation of market trends and quick response to changing customer needs. Successful competitors move quickly in and out of products, markets, and some times even entire businesses – a process more akin to an interactive video game than to chess. In such an environment, the essence of strategy is not the structure of a company's products and markets, but the dynamics of its behaviour.[10]

Decentralisation of decision-making has become inevitable to survive in many competitive businesses. There has been an universal trend toward delayering or flattening of the corporation and restructuring of decision-making pattern to allow for greater speed and flexibility and effectiveness of management. Organisational structure has assumed a very critical importance in strategic management. Tom Peters in the Preface to his *Liberation Management* states: "Organisational structure comes first in this book, customers last". This is quite a switch from his earlier best sellers *In Search of Excellence, A Passion for Excellence* and *Thriving on Chaos*. "Structure" issues accounted for about 2 per cent of those books, but take over 50 per cent of *Liberation Management*. Many companies have done necessary reorganisation to thrive on the chaos, many are and will be doing it.

The growing realisation of the failure of tall pyramidal organisational structures to quickly respond to the dynamic environment due to their inflexibility and delays has set in a trend toward lean and flat organisations.

A classic example of flattening is the ABB that is in a large number of Business Areas in several major business segments operated by hundreds of independently incorporated companies in approximately 100 countries. All these companies together have several thousands of autonomous profit centres. At the "bottom", the profit centres are reorganised into 10-person, multi-function High Performance Teams. ABB employs about 150,000 people. The average profit centre is led by a "management team" of a small group – a chief and few colleagues.

It would be interesting to note that the mammoth ABB has just *three* layers of management. Below the 13-member Executive Committee which runs the show are 250 senior executives including the Country Managers and most of the Business Area chiefs, and then the 5000 profit centre managers with their management teams. That is, only two layers ordinarily between the big chiefs and the High Performance Team members on the shop floor. The credit for the great de-organisation of the ABB goes to its CEO Percy Barnevik who almost overnight cut the corporate staffing by 95 per cent to a 150 person contingent.

Major Shifts

In short, the emerging trends confirm the observation of Ms. Rosabeth Moss Kanter, CEO, Goodmeasure Inc., that six important shifts of emphasis are shaping the organisation of the future. They are:[11]

From Fat to Lean which makes organisation more flexible and cost-efficient.

From Vertical to Horizontal. Increasingly, work is being done in cross-functional or cross-departmental project teams. People are encouraged to look horizontally across the organisation for influence and collaboration rather than upward to their bosses.

From Homogeneity to Diversity. Women and minorities are increasing their proportions in positions in which they are rare. The human resource is increasingly becoming diverse from the point

of social and cultural background. Drucker observes: "any business that operates beyond its own national boundaries will have to make one radical change: it will have to build a transnational top management in which people of different nationalities, with different background and different experiences, work together as a team".[12] There are already examples like Nestle, Coca-Cola and Citibank.

From Status and Command Rights to Expertise and Relationship. As hierarchies are de-emphasised the formal authority derived from hierarchies is less important than professional expertise in gaining the respect required for influence and leadership.

From Company to Project. The new organisation is characterised by weaker attachments to the company and stronger attachments to one's own profession or project team.

From Organisational Capital to Reputational Capital. In the traditional corporation, the accumulation of organisational capital by one's experience in the organisation charted the career path. But today, people rely primarily on their human capital and they need portable career assets.

The importance of organisational transformation in business success has been widely recognised and organisational restructuring has become almost ubiquitous. The danger is that restructuring is largely mistaken as a panacea for the problems facing the company while the real problem is much deeper. Restructuring alone would not solve the crucial problem – lack of real competitiveness and capability to lead the industry transformation. As Hamel and Prahalad emphasise in their best seller *Competing for the Future*, the pertinent question is whether the company is pursuing growth and new business development with as much passion as it is pursuing operational efficiency and downsizing? When a competitiveness problem finally become inescapable, a company may attempt organisational transformation which typically includes delayering and downsizing, overhead reduction, employee empowerment, process redesign and portfolio rationalisation. As important as these initiatives are, their accomplishment cannot restore a company to industry leadership, nor ensure that it intercepts the future.[13]

Particularly since the economic liberalisation ushered in 1991, delayering has been a serious agenda of corporate India. A number of companies have already made their organisations flatter and leaner. For example, Godrej and Boyce has cut the number of their management grades from 13 to 9. Hindustan Lever's restructuring aimed at reducing the number of tires from nine to five, of companies under the RPG group from 10-12 to 5-6, of Ballapur Industries from 10 to 5.[14] Following suggestions of global consultants Booz Allen and Hamilton, the Industrial Development Bank of India (IDBI) put in place a committee-based structure for greater organisational efficiency which is a must in the emerging liberal business environment.

ORGANISATION: PRINCIPLES AND TYPES

When different tasks are to be achieved by different sets of people, it is necessary that the responsibility for achieving each of the tasks is clearly assigned to specific persons and the required authority commensurate with the responsibility are given. It is also necessary that there is a proper flow of information between the different levels and divisions to carry out the tasks efficiently. In other words, a suitable organisational structure is necessary for proper coordination of the diverse activities required for achieving the objectives.

Koontz and O'Donnel describe organising as the "grouping of activities necessary to attain objectives, the assignment of each grouping to a manager with authority to supervise it, and provision for coordination horizontally and vertically in the enterprise structure. An organisational structure should be designed to clarify the internal environment so that everyone knows who is to do what and who is responsible for what results; obstacles to performance caused by confusion and uncertainty of assignment are removed; and there is furnished a decision-making communication network reflecting and supporting enterprise objectives".[15]

The above statement brings out the following points about an organisation.

1. The purpose of organsing is to help the achievement of the objectives of the enterprise efficiently.
2. Organising involves grouping of activities.
3. The responsibility for each group of activities is assigned to a manager who has authority to carry out the activities.
4. An organisational structure provides for coordination horizontally (i.e., between the same levels) and vertically (i.e., between different levels).
5. An organisation structure should make clear the role, responsibility and authority of everyone in the organisation.
6. There should be proper flow of communication within the organisation for the smooth and efficient functioning of the organisation.

PRINCIPLES OF ORGANISATION

The important principles for making the organisation purposive and effective are the following:

1. Determine Objectives: One of the first steps in designing an organisation is the determination of the objectives of the enterprise because the nature of the organisation depends on the objectives. For example, the organisational structure most suitable for an enterprise whose primary objective is growth may be different from the one suitable if the primary objective is profit miximisation. Similarly, the organisational structure of an international enterprise would be different from that of a purely domestic enterprise.

2. Clarify Authority and Responsibility: For the effective functioning of the organisation, it is necessary to clearly establish the responsibility and authority of everyone concerned. When responsibility is assigned to a person, commensurate authority should also be delegated. As Lundy observes, "to assign a man responsibility without also delegating him the requisite authority is to place that man in an impossible position".[16]

3. Develop Organisation around Tasks: For the organisation to be effective, it should be developed around tasks and not people, because people may come and go any time.

4. Maintain Short Span of Control: Span of control refers to the number of people reporting directly to a given position. If the span of control is very large, it may adversely affect the effectiveness of control. However, the optimum span of control may vary from position to position in a company depending on the nature of duties. If the nature of work performed by the subordinates is routine, not normally subject to considerable error and less likely to involve complicated decision-

making, direction, or coordination, the span of control could be longer than if the situation were otherwise.

5. Keep Lines of Authority Short: Long lines of authority (i.e., large number of levels of authority) tends to cause delays and inefficiency. Flat organisation (i.e., very limited number of layers or levels) is becoming more and more popular. Many companies in India and abroad are restructuring their organisations to make them more flat.

6. Provide for Flexibility of Communication: An organisation chart shows limits of authority and responsibility. An organisation chart does not, however, necessarily always represent lines of communication. Operational communications which do not conflict with established policy are not controversial, or do not jeopardize the position of one's superior.

7. Use the Exception Principle: This means that a person needs to contact his superior only in the event of exceptional circumstance.

The above points indicate the pre-requisites for an effective organisation.

According to Koontz and O'Donnell, an organisational structure is effective "if it facilitates the contribution of individuals in the attainment of enterprise objectives and if it facilitates accomplishment of objectives (that is, if effective) with minimum unsought consequences or costs."[17]

TYPES OF DEPARTMENTALISATION/ORGANISATIONAL STRUCTURE

Departmentation refers to the formal structure of the organisation composed of various departments and managerial positions and their relationships to each other.

There are different types of departmentation or organisational structure. The nature of the organisational structure depends on a number of factors like the size of the enterprise, objectives of the enterprise, nature of the business, marketing characteristics, social factors etc. The organisational structure of an enterprise may undergo changes when there are changes in such factors as the size of the enterprise, nature of business, marketing characteristcs, etc.

Some of the common types of organisational structure are given below.

Simple Organisational Structure

The widely prevailing organisational structure found in respect of very small enterprises is a simple one. All the authority and decision-making is concentrated in the owner manager who often directly supervises all the activities.

Advantages

The main advantages of the simple structure are the following:

1. The owner manager gets invested with a complete knowledge of his organisation and its business.
2. Decision-making is very quick.
3. Helps to maintain an intimate relationship with every body in the organisation.

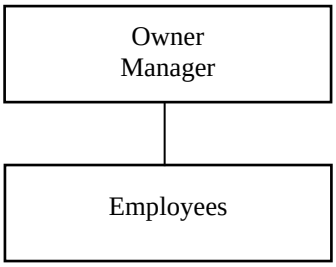

Fig. 9.2: Simple Structure

Disadvantages

1. Taking everything on one's head has its own risks and disadvantages.
2. It does not encourage development of future managers.
3. The simple structure becomes inadequate as the business grows.

Functional Structure

Under the functional structure, the organisation is designed on the basis of the basic functions, namely, production, finance and accounting, marketing and personnel.

The functional structure is commonly found in small companies and also in large companies with single product line or narrow product ranges. A typical functional structure is shown in Figure 9.3.

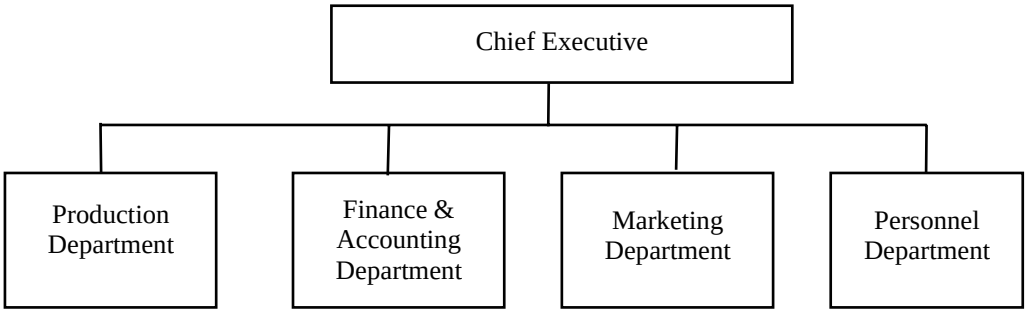

Fig. 9.3: Functional Structure

Advantages

The major advantages of the functional type of organisation are the following:

1. It provides for a clear definition of functions and responsibilities.
2. All major functions are under the direct control of the chief executive, making control easy and effective.
3. It follows the principle of occupational specialisation and is a logical reflection of the basic functions.
4. It helps to maintain the power and prestige of the major functions.
5. It simplifies training.

Disadvantages

The major disadvantages of the functional structure are the following:

1. It tends to overburden the senior managers with routine matters.
2. It could result in interdepartmental conflicts or lack of coordination between the functions.
3. It is likely that the senior managers, confined mostly to their own functions, may neglect strategic issues.
4. It is not suitable for enterprises with very diverse lines of businesses.
5. It tends to encourage overspecialisation, narrowing viewpoints of key personnel and limit the development of general managers.

Departmentation by Product

The departmentation by product places all the responsibility and authority under one manager to get the product (or service) produced and marketed. This is common with multi-product companies with diverse business lines. Figure 9.4 illustrates a product-based organisational structure.

Advantages

The major advantages of the product organisation grouping are the following:

1. Each product line or product group gets concentrated attention.
2. It places responsibility for profits at the divisional level.
3. It facilitates measurement of unit performance.
4. It encourages general management development.
5. Coordination of functional activities related to a product line is easy under this structure.

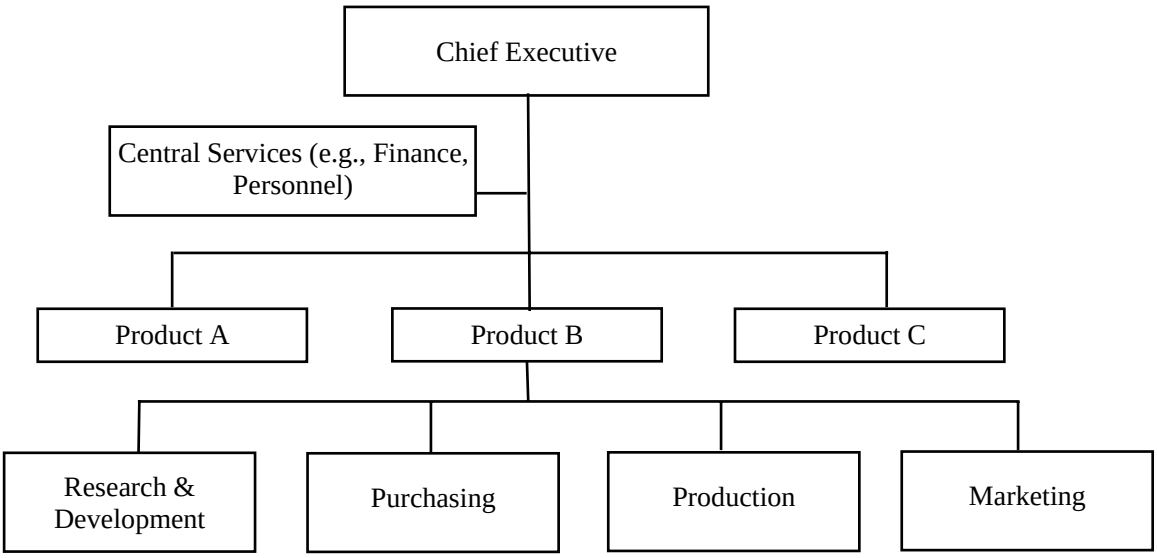

Fig. 9.4: Product-based Structure

Disadvantages

The important disadvantages of the departmentation by product are the following:

1. If there are too many divisions, coordination becomes complex and difficult.
2. This structure presents increased problems of top management control.
3. Divisions may grow too large impairing managerial efficiency.
4. It may give rise to conflicts between divisions.

Territorial Departmentation

Departmentation by territory is commonly found among enterprises having business spread over a vast geographical area. For example, a large company having business throughout India may departmentalise its business by the major geographical regions (Example: Southern India, Northern India, Western India, Eastern India and Central India). Figure 9.5 provides an example of the territorial organisational structure.

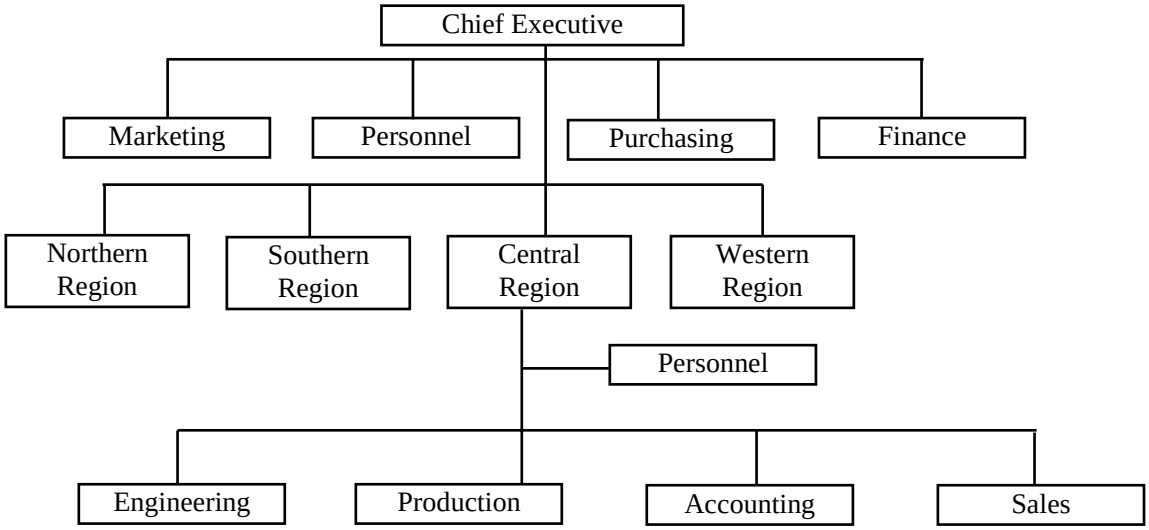

Fig. 9.5: Territorial Structure

Advantages

The major advantages of departmentation by territory are the following:

1. It enables the company to cater to the needs of the different regions more effectively.
2. It has some of the advantages of decentralisation.
3. It is very useful where proximity to the local market can result in cost reduction.
4. It enables an organisation to quickly and effectively respond to changes in regional conditions.
5. The division can be made responsible for volume of business and profitability.
6. It facilitates measurement of unit performance.
7. It encourages general management development.

Disadvantages

The main disadvantages of the territorial structure are the following:

1. It requires more persons with general management abilities.
2. It may sometimes cause fragmentation and duplication of functions.
3. It increases problems of central management control.
4. Maintenance of economical central services is sometimes very difficult.
5. It may make coordination difficult.
6. As the emphasis under this structure is generally on the total volume of business in the regions, some business lines may not get the required attention.

Matrix Structure

The different organisational structures described above have their own advantages and disadvantages. None of them is effective in certain situations. The matrix structure, which is a combination of structures, has, therefore, become popular. It may take the form of combining product and geographical divisions or functional and divisional structures, operating *in tandem*. Figure 6.6 illustrates a matrix structure that combines the product and geographical structures.

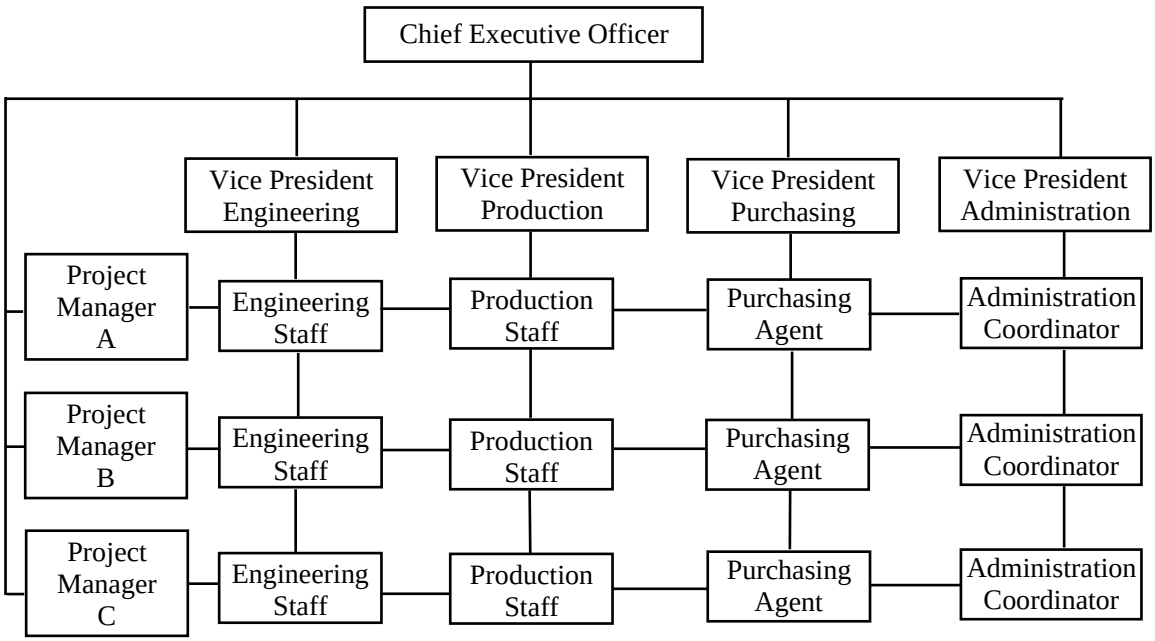

Fig. 9.6: Matrix Structure

Advantages

The matrix structure has the following advantages:

1. Where there are conflicts of interests, the quality of decision-making is enhanced by matrix structure.

2. Under this structure, direct contact replaces bureaucracy.
3. It promotes development of managers through increased involvement in decision-making.
4. It combines the advantages of different alternative structures.

Disadvantages

The important disadvantages of the matrix organisation are the following:

1. It may take more time to take a decision.
2. Under this structure, there could be confusion regarding job and task responsibilities.
3. Cost and profit responsibilities may not be very clear in the matrix organisation.
4. There is scope for conflicts.
5. It may encourage bureaucratisation.

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CHAPTER

10

Strategy Evaluation and Control

WHY CONTROL?

Even when the strategy is excellent, the strategy may not achieve its objectives if the implementation falters. Therefore, the evaluation of the implementation of the strategy and taking corrective measures, if needed, is essential to ensure success of the strategy.

There are different approaches to strategy evaluation and control.

The traditional approach to control is to compare the actual performance with the standards established and to take corrective measures if there are deviations. This reactive measure is not sufficient to control a strategy that takes a long period for implementation and to produce results. The uncertain future environment makes continuous evaluation of the planning premise and strategy implementation necessary.

As Hamel and Prahalad point out, competition for future (with which corporate strategy is concerned) is different from competition for the present in two ways: (1) it often takes place in unstructured arenas where the rules of competition have yet to be written, and (2) it is more like a triathlon than a 100 metre sprint.[1] It is , therefore, necessary to exercise *strategic control* which is "concerned with tracking the strategy as it is being implemented, detecting problems or changes in underlying premises, and making necessary adjustment. In contrast to post-action control, strategic control is concerned with controlling and guiding efforts on behalf of the strategy as action is taking place and while the end result is still several years into the future."[2]

Box 10.1

Beyond Controls

While the need for a proper framework for formal controls cannot be overemphasised, self-control too is all the more important. For example, there are some autonomous educational/research institutes in India, where the faculty does not have attendence register but members of faculty are known for their commitment and hardwork much beyond any regular working hours whereas the discipline or adherence to the regulatory framework is palpably low in respect of several teachers/researchers in a number of institutions (for example, some universities). McKinsey is an interesting case of flexibility and self-regulation. Tom Peters points out that McKinsey is a huge company, but there's no

traditional hierarchy. There are no organisation charts. No job descriptions. No policy manuals. No rules about managing client engagements. No rules about setting budgets for such engagements (which could easily run to millions of dollars). No guidelines that tell you how to get promoted or how to go about firing somebody. No set procedures for the all-important recruiting process. And yet all these things are well understood—make no mistake, McKinsey is not out of control.[3]

However, a some clear framework of structure is always desirable to be at least a guidepost in times of confusion or conflict. There is no guarantee that the McKinsey paradigm will continue smoothly for ever.

There are, thus, two broad types of control, viz.,

- Strategic control, and
- Operational control.

Strategic control augmented by operational control makes strategic implementation more effective.

STRATEGIC CONTROL

Pearce and Robinson point out that there are four basic types of strategic control, viz., premise control, implementation control, strategic surveillance and special alert control.

Premise Control

Strategies are often based on premises, i.e., assumptions or predicted conditions. A strategy may be valid only as long as the planning premises remain valid. Hence, the importance of the premise control which "*is designed to check systematically and continuously whether or not the premises set during the planning and implementation process are still valid*."[4]

A strategy may be based on certain premises related to the industry (like the industry structure and competition) and other environmental factors like government policies and regulations, socio-demographic factors, economic conditions etc. Changes in the vital premises may necessitate changes in strategy.

Hamel and Prahalad point out that in the case of many companies who were industry leaders, "the foundations of past success were shaken and fractured when, in all too many cases, the industrial terrain changed shape faster than top management could refashion its basic beliefs and assumptions about which markets to serve, which technologies to master, which customers to serve and how to get the best out of the employees."[5]

An early detection of the invalid premises is necessary for making valid changes in the strategy. For example, following the recommendation of a consultant, the IDBI had undergone a total restructuring through the setting up of a committee-based structure and was to go ahead with a strategy to maintain its leadership in the market, but two developments had overtaken the strategy. The Reserve Bank of India threw open the world of short-term financing and Tarapore Panel suggested capital account convertibility (CAC) of the rupee within three years. These called for a change in the complexion of IDBI's business strategies. Following the liberalisation of the external commercial borrowing, in 1997 July, the Reliance Industries refinanced its entire $ 150 million seven-year

syndicated loan arranged in July 1995, resulting in the company saving close to ₹ 10 crores in interest costs, besides other advantages.

The Apollo tyres 'reworked' its strategic alliance with Continental AG of Germany for production of passenger car radial tyres in view of the slowdown in economy and changed demand in the tyre industry.

Implementation Control

In several cases, the implementation of a strategy may not progress as planned or the cost, sales volume, revenue etc. may be at considerable variance with the planned ones. The lessons of the first phases of the implementation could be helpful in the implementation of the subsequent phases. For example, take the case of a company implementing a project involving a chain of holiday resorts in a phased manner. The experienced gained from implementing the resort in the first phase would help to make the implementation of the subsequent phases more efficient.

Similarly, when a product is planned to be launched nationally in a phased way, the experience with the early launches could help better the launches in the remaining sectors of the national market. For example, the phased launch of pagers in India enabled Motorola to redefine its target consumers and modify its promotion strategy as it expanded the market coverage.

In short, "*implementation control is designed to assess whether the overall strategy should be changed in the light of unfolding events and results associated with incremental steps and actions that implement the overall strategy*". [6]

Strategic Surveillance

"*Strategic surveillance is designed to monitor a broad range of events inside and outside the company that are likely to threaten the course of the firms strategy*".[7] The strategy of a company could be defeated by certain such events. It is, therefore, necessary that the company exercise surveillance for timely detection of such developments and corrective action.

The success of Arvind Mills' *Ruf & Tuf* encouraged rampant sale of furious products under the same brand name compelling the company to form vigilance squads to crack down on the unscrupulous businessmen.

Special Alert Control

Sudden and unexpected developments like alliance between competitors, takeover/mergers, a political coup, a major competitive move by competitor etc. could have serious impact on a firm's strategy. A "*special alert control is the need to thoroughly, and often suddenly, reconsider the firm's basic strategy based on a sudden, unexpected event*".[8]

In the wake of the consolidation of the market power by Hindustan Lever by taking over Tomco and the growing competition by the global majors, Godrej Soaps felt insecure and forged an alliance with Procter and Gamble.

OPERATIONAL CONTROL

Strategic controls by which top management monitors and steers the basic direction of the company should be supplemented by a control system at the operational level of strategy

implementation. "Operational control systems guide, monitor, and evaluate progress in meeting annual objectives. While strategic controls attempt to steer the company over an extended time period (usually five years or more), operational controls provide post-action evaluation and control over short time periods – usually from one month to one year."[9]

The operational control system involves the following steps:

1. Establishing criteria and standards
2. Measuring and comparing performance
3. Performance gap analysis
4. Taking corrective measures.

Establishing Criteria and Standards

Criteria and standards provide the basis for evaluation.

"Criteria for evaluating strategies should be measurable and easily verifiable. Criteria that predict results may be more important than those that reveal what already has happened may. For example, strategists do not want to find out that sales last quarter were 20 per cent under what were expected. More importantly, they need to know that sales next quarter may be 20 per cent below standard unless some action is taken to counter the trend. Really, effective control requires accurate forecasting.[10]

Selection of the criteria for evaluation depends on a number of factors such the purpose of evaluation, the accuracy required, the critical importance of the variable evaluated, the strategy, internal and external environment, management philosophy etc. For example, the evaluation criteria appropriate for stability strategy may not be appropriate for growth strategy or retrenchment strategy.

There are broadly two types of criteria, viz., quantitative and qualitative. Quantitative factors are those results which can be measured in precise quantitative terms such as ROI, profitability, market share, growth rate etc. Qualitative criteria are rather subjective and are not amenable to precise quantitative measurement. Such factors includes company image, employee morale/motivation, customer satisfaction etc.

Having decided the criteria for evaluation, the next step is to establish standards (i.e., the planned level of performance). It should be ensured that the standards set are realistic.

Measuring and Comparing Performance

The actual performance is measured and compared with the standards to identify the shortfalls, if any.

Performance Gap Analysis

Performance gap is the difference between the actual performance of a given organisational unit and the planned performance of that unit.

If there is any performance gap, it is necessary to identify the reasons for the gap to determine the appropriate corrective measure. In other words, performance gap analysis is a diagnostic step.

Corrective Measures

Performance gap analysis will reveal the reasons for the gap and will help decide the corrective measures.

Corrective measures will depend on the reasons for the gap, the extent of the gap and, in some cases, a reassessment of the SWOT.

Depending on the nature and characteristics of the performance gap, corrective measures may include any one or more measures such as steps for more effective implementation of the strategy, modification of the objectives, strategy, standards, etc.

Continuous monitoring of the environment and implementation of the strategy is essential. In Figure 10.1, the loop connecting the evaluation and control to the starting point of the strategic management process indicates that strategic management is a continuous process, the evaluation providing the feedback for modifications.

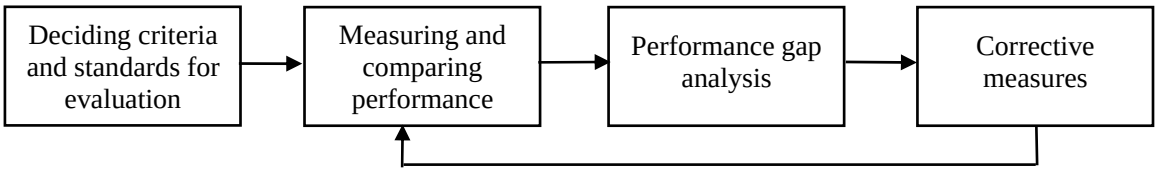

Fig. 10.1: Strategy Evaluation and Control Process

TYPES OF OPERATIONAL CONTROL

There are three important types of operational control systems, namely budgeting, scheduling and focusing on key success factors.

Budgeting

Budgeting system is a forerunner of strategic management. With the emergence of strategic management, it has become an important tool to translate strategic plans to concrete activities.

A budget is a statement of planned or estimated expenditure or receipts in respect of a specific purpose or function over a specific period of time. Budgets themselves do not control anything but they set standards against which performance can be compared.

Budgeting may be done in respect of all important activities. For example, there may be sales budgets estimating sales for a future period, territory-wise, product-wise, salesperson-wise, customers/customers group-wise, etc Similarly, there could be corresponding sales expenditure budgets. Resource allocation for projects/fixed assets is done by capital budgeting.

Budgets may be in financial or physical terms or both. Production budgets are often in physical terms. Sales budgets may have both physical and revenue estimates.

Scheduling

Scheduling is a very important planning tool for allocating the use of a time-constrained resource or arranging the sequence of interdependent activities. Scheduling helps optimum utilisation of facilities. It also helps operation with minimum inventory and to adhere to delivery schedules. Scheduling is very important in project implementation.

Key Success Factors

Another important way to effect operational control is to focus on key success factors, i.e., critical factors that contribute to success such as productivity, quality, employee morale and market share.

PERT/CPM

Some network techniques, notably PERT (Programme Evaluation and Review Technique) and CPM (Critical Path Method) have come to be widely used in project management. They are very useful in the basic management functions of planning, scheduling and control. These techniques can be applied in wide diverse kinds of projects like construction of a building or a highway, planning and launching of a new product, large maintenance projects, scheduling ship construction and repairs, end-of-the-month closing of accounting records, large research projects, etc.

For the purpose of application of PERT/CPM, a project is conceived as a collection of independent activities of *jobs*. If one job has to be completed before another can begin, the first job is described as an *immediate predecessor* of the job following or in other words, the latter is an *immediate successor* of the former.

Two types of graphs are used in PERT/CPM. They are:

- Activity on the Arrow (AOA) system.
- Activity on Node (AON) system.

In the AOA system, or the Arrow Diagram Method, an activity is graphically represented by an arrow. The tail end of the arrow represents the start and the head represents the finish or end of an activity. The description of the activity is written alongside the arrow. In Figure 10.2, for example, ‘a’ and ‘b’ describe activities. (For example, in building construction, ‘a’ may be used to denote an activity like excavation and ‘b’ to denote concreting). Alternatively, the activity can be denoted by the numbers of the nodes. For example, activity ‘a’ can also be denoted as (1, 2) and activity ‘b’ as (2, 3).

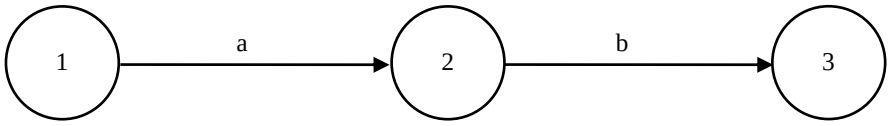

Fig. 10.2: AOA

An *activity* is the actual performance of a task and it consumes time and resources. An *event is* the start or completion of a task and it does not consume time or resources. For example, machine installation is an activity whereas start of machine installation is an event. Similarly, completion of machine installation is an event.

The length of the arrow in a network diagram does not bear any relationship to the time which the activity takes or the resources which the activity consumes. The direction of the arrow indicates the direction of the work flow. The usual practice is to go from left to right.

All events must be numbered. The same number cannot be used for more than one event.

In the AON system, activities are represented by circles or nodes and arrows are used to show only the dependency relationship between the activity nodes as shown in Figure 10.3.

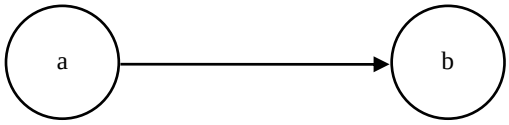

Fig. 10.3: AON

In the AOA diagram, the time required for an activity is indicated alongside the arrow and in the AON diagram the time is indicated in the circle.

For example, if activity ‘a’ requires 10 days and ‘b’ requires 12 days, they may be indicated as shown in Figures 10.4 and 10.5.

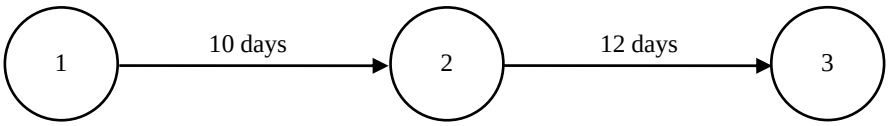

Fig. 10.4: AOA showing time required for activity

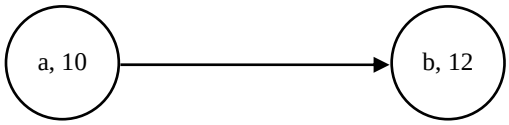

Fig. 10.5: AON showing time required for activity

It becomes necessary to introduce *dummy job(s)* in constructing the network diagram if two or more activities in the project have identical immediate predecessors and successors or if two or more jobs have some, but not all, of their immediate predecessors in common. A dummy is an artificial activity introduced in a network to maintain a unique numbering system for the different activities and to keep the logical sequence of activities and their interrelationships correct. A dummy job takes zero time to perform and is used solely to illustrate precedence relationship.

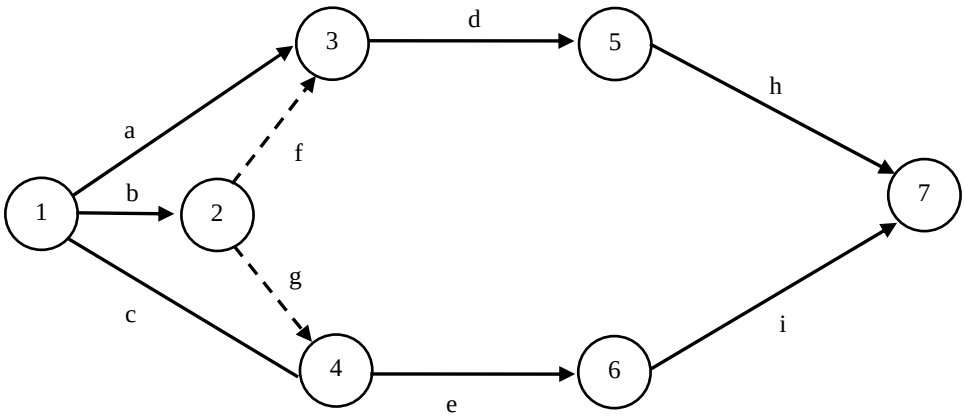

Fig. 10.6: CPM showing dummy activities

Figure 10.6 illustrates the use of dummy jobs. Activity ‘b’ is a common immediate predecessor of both ‘d’ and ‘e’ while ‘a’ is an immediate predecessor of ‘d’ alone, and ‘c’ is one of ‘e’. Hence, two dummy jobs ‘f and ‘g’ are introduced to indicate the precedence relationship.

To illustrate the CPM technique, let us take a very simple example of a small research project. The project is decomposed into the following activities, viz., preparation of questionnaire for consumer survey, preparation of questionnaire for dealer survey, conducting the surveys and processing and interpretation of the data collected by the dealer survey, processing and interpretation of the data collected by the consumer survey.

Job Identification	Job Description	Immediate Predecessor	Time Required to Perform the Job
a	Preparation of dealer questionnaire	—	10 days
b	Preparation of consumer questionnaire	—	10 days
c	Dealer survey	a	20 days
d	Consumer survey	b	60 days
e	Processing and interpretation of dealer survey data	c	10 days
f	Processing and interpretation of consumer survey data	d	30 days

This is represented on Figure 10.7.

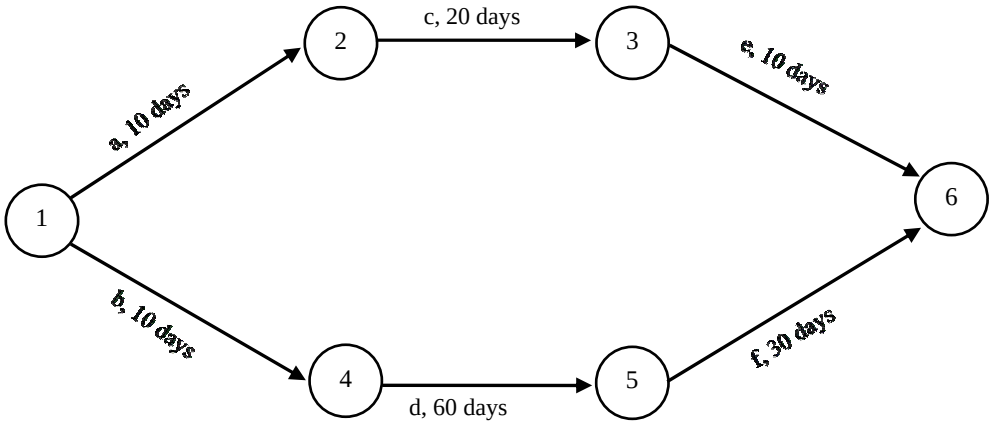

Fig. 10.7: Critical path

Criticial Path

The critical path is the longest path in a project network.

A path is a set of nodes connected by arrows which begin at the initial node of a network and end at the terminal node. In Figure 10.7, there are two paths: 1-2-3-6 and 1-4-5-6 where the number refer to nodes. The length of a path in a network is the total time it takes to travel the path. This time is calculated by adding this individual times between connected nodes on the path.

The longest path in the network diagram here is the one connecting the nodes 1-4-5-6 because it takes I (X) days compared to the path connecting the nodes 1-2-3-6 which takes only 40 days. The jobs on the critical path are critical in determining the project's duration and hence they are called

critical jobs or critical activities. The critical path is represented by thick lines. Alternatively, it may be represented by double lines.

It is clear that even if the preparation of dealer questionnaire, dealer survey and the processing of the dealer survey data are delayed by a total of 60 days, the total duration of the project will not be affected. This extent of delay that can be caused to jobs on the non-critical path without affecting the total duration of the project is known as *stack*. In our example, the *slack* is 60 days.

The concept of critical path makes it clear that if we want to reduce the total duration of a project we should be able to reduce the time taken by activities on the critical path. For example, if we want to complete the research project of our example earlier, we have to reduce the time taken by any one or more of the activities on the critical path (b, d and f). For example, we may reduce the time for the consumer survey by increasing the number of people employed for this purpose. Similarly, the data processing may also be done quickly.

Needless to add, any delay in an activity on the critical path will lead to a delay in the completion of the project.

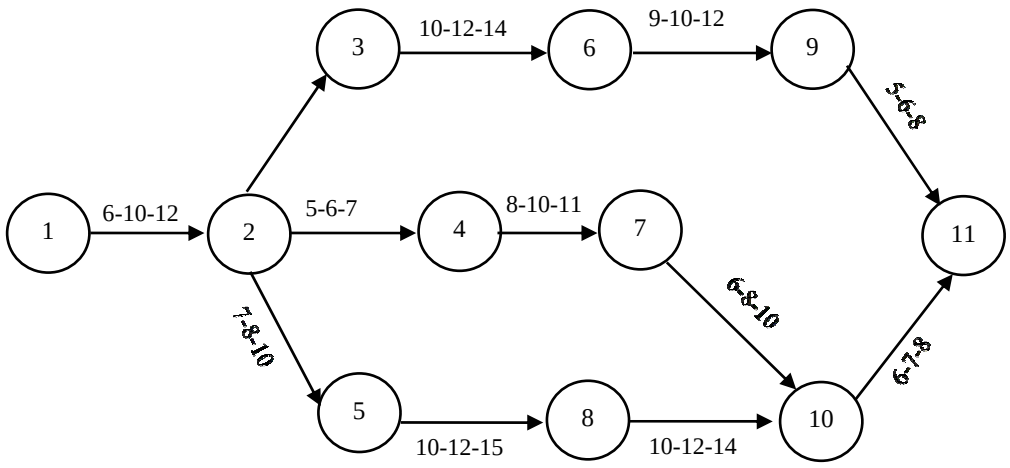

Fig. 10.8: PERT Network

Difference between PERT and CPM

The methods of start, finish, critical path of PERT and CPM are similar.

However, there are some important differences between them.

While CPM is an activity-oriented technique, PERT is often event-oriented; in activity-oriented networks, the arrows representing activities or jobs are labelled with some description of the activity, while in the event-oriented networks, the events are the objects of interest and are appropriately described. As stated earlier, an activity is the actual performance of a task and it consumes time and resources; while an event is the start or completion of task and it does not consume time or resources.

Another difference is that CPM has one-time estimate while PERT has three-time estimates, namely, optimistic time, most likely time and pessimistic time. PERT is often applied to research projects and the uncertainties associated with research projects may call for different time estimates. Figure 10.8 shows a PERT diagram with three-time estimates.

PREVENTIVE CONTROL

Weihrich and Koontz advocate preventive control[11] as an alternative to the direct control, to improve the control system. In direct control, the cause of an unsatisfactory result is traced back to the persons responsible for it to get them to correct their practices. The principle of preventive control is that *the higher the quality of managers and their subordinates, the less will be the need for direct control*. This suggests the need to develop better managers who will skillfully apply concepts, techniques, and principles and who will look at managing and managerial problems from a systems point of view, thus eliminating undesirable results caused by poor management.

According to Weihrich and Koontz, the desirability of preventive control rests on the following three assumptions:

1. Qualified managers make a minimum of errors.
2. Managerial performance can be measured, and management concepts, principles and techniques are useful diagnostic standards in measuring managerial performance.
3. The application of management fundamentals can be evaluated.

The great advantage of preventive control is that it is preventive in nature. According to Weihrich and Koontz, the preventive control has the following advantages.

1. Greater accuracy is achieved in assigning personal responsibility.
2. Preventive control should hasten corrective action and make it more effective.
3. Preventive control may lighten the managerial burden now caused by direct controls.
4. The psychological advantages of preventive control is impressive because subordinate managers know what is expected of them, understand the nature of managing, and feel a close relationship between performance and measurement.

ESSENTIAL FEATURES OF AN EFFECTIVE EVALUATION AND CONTROL SYSTEM

There are some essential requirements for an evaluation system to be effective. They are the following.

Objective Based: Clarity about the purpose of evaluation is very much essential for choosing the appropriate evaluation system. Only such an objective based system will provide adequate, useful and timely information for effective control.

Economic: The strategy evaluation system must be economical, i.e., the costs must be justifiable with its utility. "Too much information can be just as bad as too little information, and too many controls can do more harm than good."[12] It must at the same time be ensured that the concern about the cost does not affect the objective and adequacy of the evaluation system.

Objectivity: The evaluation system must be reality oriented. For example, the standard or targets must reflect the internal and external realities. For instance, a recession or boom or changes in the competitive environment must receive due consideration in setting or revising standards.

Pervasiveness: A strategy evaluation system must be pervasive in the sense that the need for it is appreciated throughout the organisation in general and by the functional area concerned and people

directly associated with it in particular. It is necessary to take the people into confidence to dispel possible misunderstanding and suspicion about the purpose or need for evaluation and control. "The strategy evaluation process should not dominate decisions; it should foster mutual understanding, trust, and common sense! No department should fail to cooperate with another in evaluating strategies."[13]

Simplicity: The extent of simplicity or complexity of the strategy evaluation system depends on a number of factors like the purpose of evaluation, the variables to be monitored and measured, accuracy required, size of the organisation and diversity of the activities etc. The principle, however, is that the evaluation system should be simple to the extent possible. "Strategy evaluations should be simple, not too cumbersome, and not too restrictive. Complex strategy evaluation systems often confuse people and accomplish little. The test of an effective evaluation system is its usefulness, not its complexity."[14]

Communication and Involvement: The importance of communication has already been indicated under pervasiveness above. It is necessary to take people into confidence to ensure their positive and active involvement at both the mental and activity level. They should also be helped to know the factors contributed to the success or failure in achieving the objective. It is important to note that the "the key to an effective strategy evaluation system may be ability to convince the participants that failure to accomplish certain objectives within a prescribed time is not necessarily a reflection of their performance."[15]

Congruence: As Drucker observes,[16] measurements have to be congruent with the events measured. The scope, range, magnitude and accuracy of measurement should be related to the objective and usefulness.

Operational: As Drucker points out, controls "must be focused on action. Action rather than information is their purpose."[17] The findings of the control must reach the persons responsible to take needed action in time.

CONTINGENCY PLANNING

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

- If an important player is taken over by another important firm, what strategy should the company employ to deal with the new situation?
- If the Government lowers the import barrier, how will the company face the competitive forces unleashed by it?
- How will the company face a collective boycott of its products (as did by the traders in Kerala in respect of the HLL products)?
- If the pruning down of government allocation to a sector or project, due to financial stringency or other reasons, affect the demand for the company's products, what should the company do?

- If an expanded/new opportunity is provided by government policy/budgetary allocations, how can the company exploit it?
- If a natural calamity or a strike by truckers/railwaymen dislocates transportation, how can the company cope up with the situation?
- What strategy shall the company employ if there will be a recession/boom?
- If there will be a power cut, how can the problem be overcome?
- If the market is affected by a short supply, should, and will the company be able to, increase supply to take advantage of the situation.
- How will the company face a technological breakthrough or new product launches by competitors?

The advantage of contingency planning is that "when external opportunities occur, contingency plans could allow an organisation to capitalise on them quickly"[18]. Linneman and Chandran report that contingency planning gives users three major benefits: "it permits quick response to change, it prevents panic in crisis situations, and it makes managers more adaptable by encouraging them to appreciate just how variable the future can be."[19] They suggest that effective contingency planning involves a seven-step process as follows:

1. Identify the beneficial and unfavourable events that could possibly derail the strategy or strategies.
2. Specify trigger points. Calculate about when contingent events are likely to occur.
3. Assess the impact of each contingent event. Estimate the potential benefit or harm of each contingent event.
4. Develop contingency plans. Be sure that contingency plans are compatible with current strategy and are economically feasible.
5. Assess the counter-impact of each contingency plan. That is, estimate how much each contingency plan will capitalise on or cancel out its associated contingent event. Doing this will quantify the potential value of each contingency plan.
6. Determine early warning signals for key contingency event. Monitor the early warning signals.
7. For contingent event with reliable early warning signals, develop advance action plans to take advantage of the available lead time.[20]

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CHAPTER

11

Portfolio Strategy

One of the most important major long-term corporate decisions pertain to the scope of the business or the portfolio strategy. *Portfolio strategy answers the question: in which businesses shall we be; while competitive strategy answers the question how shall we succeed in each.*[1]

There are several factors that influence the portfolio strategy of a firm. Following a SWOT analysis, a firm may drop some or the entire existing portfolio and/or add new ones.

To determine the strategy in respect of the existing portfolio, an evaluation of the portfolio is needed.

BUSINESS PORTFOLIO ANALYSIS

Portfolio analysis is the analysis of a company as a portfolio or collection of different businesses with a view to identifying the status and potentials of the various businesses with regard to resource use and resource generation. The objective is to help the company to formulate appropriate portfolio strategy, which involves such issues as: *Should there be a change in the current portfolio? Which businesses should be developed further? Which are the businesses to be harvested?* The portfolio analysis, thus, is an important tool assisting the formulation of corporate strategy, which is concerned with generation, and allocation of corporate resources. "The firm's portfolio of businesses are, to varying degrees, the generators and recipients of these resources. The portfolio approach provides a simple, visual way of identifying and evaluating alternative strategies for the generation and allocation of corporate resources."[2]

Several models have been developed for the evaluation of business portfolio. These include Boston Consulting Group (BCG) Matrix, GE Multifactor Portfolio Matrix, Shell's Directional Policy Matrix and Hofer's Product/Market Evaluation Matrix. The first two, the most popular among these, are discussed below.

BCG MATRIX

The Boston Consulting Group (BCG) model, popularly known as the BCG Matrix and Growth Share Matrix, is based on two variables, viz., the rate of growth of the product market and the market share in that market held by the firm relative to its competitors.

The market growth rate is an indicator of the attractiveness of the industry and the relative market share is an indicator of the strength of the firm in that industry relative to its competitors.

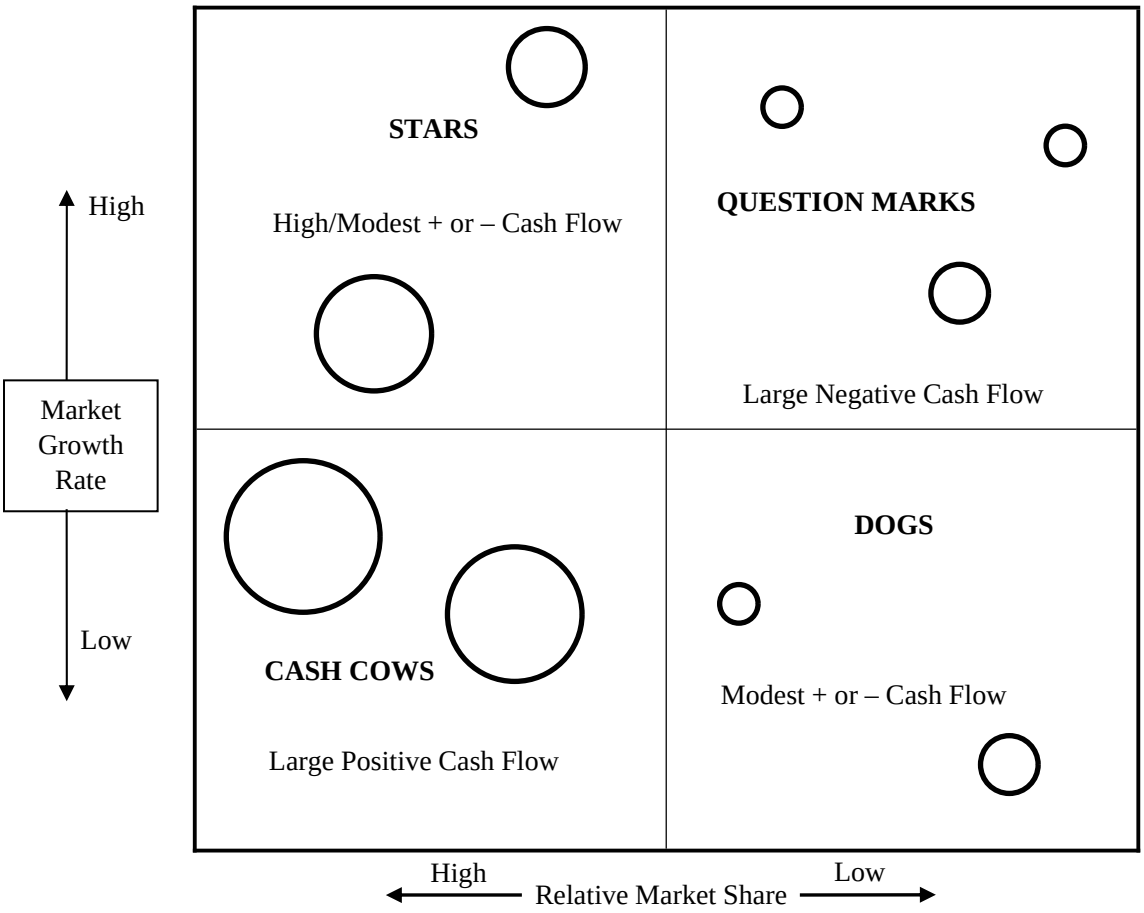

Fig. 11.1: BCG Matrix

In Fig. 11.1, the vertical axis measures the annual growth rate of the market and the horizontal axis shows the relative market share of the firm. Each of these dimensions is divided into two categories of high and low, making up a matrix of four cells. These four cells are described below.

The size of the circles represent the size of the businesses of the company.

High Growth-Low Market Share

Products in this cell are in fast growing markets but their relative market shares are low. They are, therefore, aptly described as *question marks* – the company confronts the critical question of whether to make further investments in these businesses to build up market share or to divest and get out.

A question mark may call for heavy investment and other capabilities to increase its market share and become a star. If the company has the strength to increase its market share, the right strategy would be to *build*, i.e., to build up the market share so that the question mark becomes a star. Achievement of this strategy may even necessitate foregoing short-term profits.

If the company does not have the strength to build up a question mark to a star or if the resources can be put to better use elsewhere, divestment may be an appropriate strategy.

A company which is in a number of businesses may have several question marks (In Fig. 8.1, there are three). Some of these may be right for building up and it may be prudent to drop some. In some cases where a company has a number of question marks, it may face resource crunch to build up all these businesses.

If a company has a number of question marks, it does not necessarily mean that it will have to build up some and drop others. In some cases, the right strategy could be to build all. The other extreme could also be true in some cases. There could also be cases of the sole question mark a company has to be dropped. Further, it also does not mean that all question marks that cannot be built up should be dropped. There could be products in high growth markets with low market share, capable of making net cash flows without requiring any significant additional investment.

High Growth-High Market Share

Products in this cell are called *stars*. They are promising products because they have a relatively high market share and the market is growing fast. Stars are usually profitable and would be the future cash cows. Many stars call for substantial investment to maintain their market share in the fast growing market. This may necessitate reinvestment of internal accruals and sourcing external funds. Several stars, therefore, may not produce cash flow for the company until the market matures and the stars become cash cows.

In Figure 11.2, there are two stars.

The appropriate strategy for stars often is to *hold*, i.e., to maintain the market share that usually requires, as indicated above, large investments to increase supply and to fight competition.

Low Growth-High Market Share

As the market matures or when the market growth rate becomes low, the stars would become *cash cows*. Cash cows are, thus, high market shares businesses in slow growth industries. Being in slow growth industries, they do not normally require significant reinvestment. Cash cows generate lot of cash that may be used to finance the development of other businesses of the company like stars and question marks. A company that does not have cash cows would find it difficult to develop its businesses.

The strategy often employed in respect of weak cash cows (i.e., those that do not have long-term prospects) is to *harvest*, i.e., to increase the short-term cash flow regardless of the long-term effects. In case of strong cash cows (i.e., those with long-term prospects), some reinvestment may be required to keep them in good stead for harvesting for long.

Low Growth-Low Market Share

Businesses with low market share in low growth industries are described as *dogs*. Dogs may produce low profits or loss.

If a dog does not generate satisfactory return and if there is no chance of improving it, one may be tempted to advocate divestment. However, in several cases, dogs may be retained in the portfolio due to several reasons. In some cases, dogs may be providing crucial inputs to stars, question marks or

cash cows. Some dog product may have to be retained to complete the product range and provide a credible presence in the market. They may be held for defensive reasons – to keep competitors out. Sometimes dogs may be retained due to reasons like goodwill, sentimental factors etc.

A dog may be harvested before liquidation.

As time passes, SBUs may change their position in the growth share matrix. "Successful SBUs have a life cycle. They start as question marks, become stars, then cash cows, and finally dogs toward the end of their life cycle. For this reason, companies should examine not only the current positions of their businesses in the growth-share matrix (as in a snapshot) but also their moving positions (as in a motion picture). Each business should be reviewed as to where it was in past years, and where it will probably move in future years. If the expected trajectory of a given business is not satisfactory, the company should ask its business's manager to propose a new strategy and the likely resulting trajectory. Thus, the growth-share matrix becomes a planning framework for the strategic planners at company headquarters. They use it to try to assess each business and assign the most reasonable objective."[3]

GE MULTIFACTOR PORTFOLIO MATRIX

The GE Multifactor Portfolio Matrix, also known as *Business Attractiveness Screen*, developed in the 1970s by the General Electric of USA, is a three by three matrix which rates each SBU against two critical variables, viz., industry attractiveness and business strength.

The vertical axis in Figure 11.2 indicates industry attractiveness and the horizontal axis shows the business strength in the industry. Each dimension is a composite measure of several component factors. One superiority of the GE matrix over the BCG matrix, thus, is that while the BCG matrix bases industry attractiveness on a single variable (industry growth rate), in the GE matrix industry attractiveness is measured by a number of factors like size of market, market growth rate, industry profitability, competitive intensity, technological requirements etc. Similarly, the business strength is rated considering a number of factors such as market share, market share growth rate, profitability, distribution efficiency, brand image etc.

Kotler observes that these two factors (*market attractiveness* and *business strength*) "make excellent marketing sense for rating a business. Companies will be successful to the extent that they go into attractive markets and possess the required business strengths to succeed in those markets. If one or the other is missing, the business will not produce outstanding results. Neither a strong company operating in an unattractive market nor a weak company operating in an attractive market will do very well."[4]

Each of the dimensions (industry attractiveness and business strength) is classified into three categories of high (strong), medium, and low (weak), thus creating nine cells. This is another refinement of the four-cell BCG matrix.

Every factor on each of the dimensions is assigned a weight. The choice of the factors and the weights assigned to the factors may vary from business unit to business unit. For example, the relative importance of technology, brand image, distribution efficiency, after-sales service, pricing etc. may vary from industry to industry.

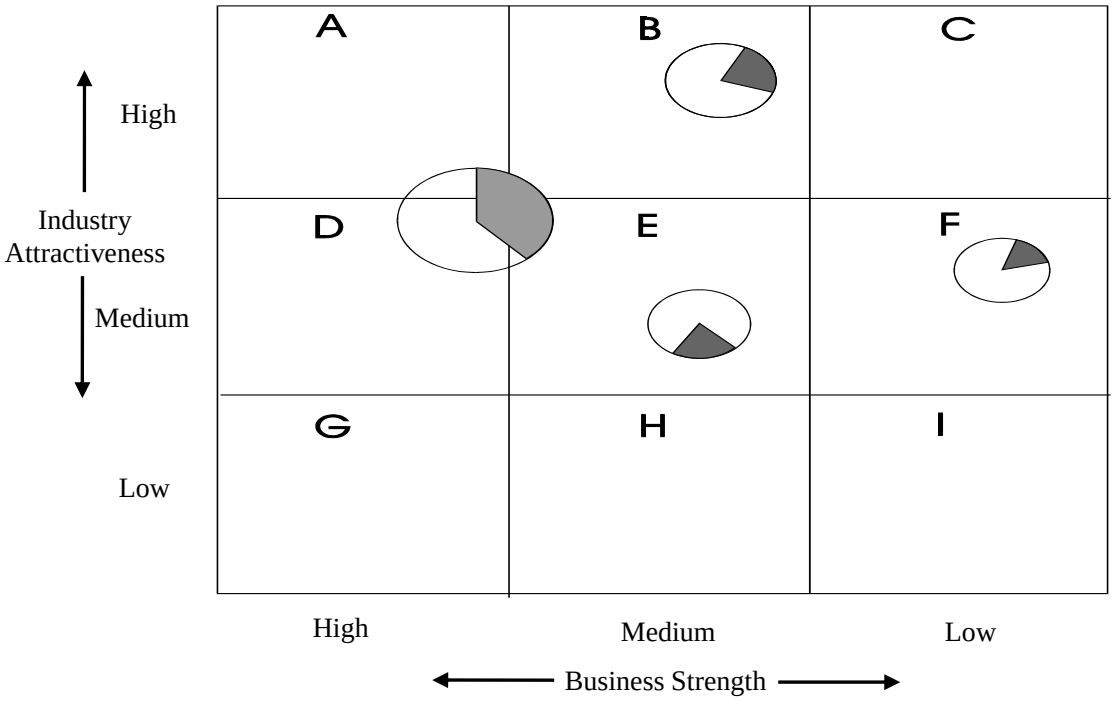

Fig. 11.2: GE Matrix

The choice of factors determining the industry attractiveness and business strength and the determination of weights are very critical in this analysis. Therefore, they often involve a lot of research.

Table 11.1 gives a hypothetical illustration of rating of industry attractiveness and business strength. Each factor is assigned a weight. Each factor is also rated on a 10-point scale. Rating of 1 to 4 is considered as low; 4 to 7 medium and 7 to 10 high.

Table 11.1: Industry Attractiveness

Factors	Weight	Rating (1 - 10)	Value	
Availability of inputs	0.20	7	0	1.4
Overall market size	0.15	8	0	1.2
Annual growth rate of market	0.15	6	0	0.9
Profitability	0.15	7	5	1.0
Competitive intensity	0.15	6	0	0.9
Technological requirements	0.10	7	0	0.7
Capacity utilisation	0.10	6	0	0.6
Total	1.0		5	6.7

In the hypothetical case illustrated in Tables 11.1 and 11.2, the total score for market attractiveness is 6.75 and for business strength is 7.55 out of the maximum possible score of 10 for each. In other words, the industry attractiveness is medium and the business strength is high.

All the businesses of a company are shown in Fig. 11.2. The size of the circles represents the size of the relevant markets (not the size of the company's business as in the BCG matrix). The shaded area represents the company's market share in each of the business.

The position of the business in the matrix would suggest the appropriate strategy for the business. There are three possible strategies. Along the lower left to upper right diagonal (cell G, E and C) representing SBUs which are medium in overall attractiveness, selective investment may be appropriate (i.e., investment based on their potential, and within each selected business, selecting skill areas, products and functions in which marginal investments are likely to yield the highest returns).

The three cells below the diagonal (H, I and F) represent SBUs that are low in overall attractiveness. The appropriate strategy for them would be harvesting or divesting. The three cells at the upper left (A, B and D) indicate SBUs that are high in overall attractiveness. These are businesses in which company should invest further and grow.

Table 11.2: Business Strength

Factor	Weight	Rating (1 - 10)	Value	
Market share	0.15	5	5	0.7
Market share growth rate	0.20	7	0	1.4
Brand image	0.05	8	0	0.4
After-sales service	0.05	7	5	0.3
Pricing	0.10	7	0	0.7
Distribution capacity	0.10	9	0	0.9
Capacity utilisation	0.10	9	0	0.9
Product quality	0.10	8	0	0.8
Technology	0.15	9	5	1.3
Total	1.00		5	7.5

AN EVALUATION OF PORTFOLIO MODELS

The benefits produced by the portfolio models have been succinctly adumbrated by Kotler: "The models have helped managers to think more futuristically and strategically, to understand the economics of their businesses better, to improve the quality of their plans, to improve communication between business and corporate management, to pinpoint information gaps and important issues, and to eliminate weaker businesses and strengthen their investment in more promising businesses."[5]

It must at the same time be noted that these models have their own limitations.

The fact that the BCG model bases market attractiveness entirely on growth rate and business strength entirely on relative market share limits its relevance.

One of the limitations of the BCG matrix lies in "categorising the dimensions of industry growth rate and market share that vary along a continuum; having only two categories (high and low) is simplistic. Such binary divisions lose much information that is contained in actual market share numbers. Moreover, without huge amounts of comparative and historical statistics, the cut-off points between high and low tend to be arbitrary."[6]

The applicability of the portfolio model depends on a number of conditions, some of the most important of which are summarised by Porter as follows:[7]

- The market has been defined properly to account for important shared experience and other interdependencies with other markets. This is often a subtle problem requiring a great deal of analysis.
- The structure of the industry and within the industry are such that relative market share is a good proxy for competitive position and relative costs. This is often not true.
- Market growth is a good proxy for required cash investment. Yet profits (and cash flow) depend on a lot of other things.

The relevance of the GE model depends on the appropriateness of the selection of factors and their weights determining market attractiveness and business strength. Similarly, the accuracy of the rating is a critical factor. There is scope for biases to creep in. It is less precisely quantifiable than the BCG approach and lends itself for subjective judgements.

Both these analysis can be one component of a competitor analysis when combined with other kinds of analysis.

These matrices "be used very carefully, with full understanding of the underlying assumptions. If products are differentiated, if SBUs share costs, or if product lines cannot be divided into reasonable number of SBUs, the matrices may not produce good alternatives. Portfolio models should be viewed as one tool for generating strategic alternatives, but choice should be tempered by managerial judgement not by mechanical application of planning matrices."[8] If these models are not used cautiously, "they may lead the company to place too much emphasis on market share growth and entry into high growth business, to the neglect of managing the current business well."[9]

Another important problem is that these models "fail to delineate the synergies between two or more businesses, which means that making decisions for one business at a time might be risky. There is a danger of terminating a loosing business unit that actually provides an essential core competence needed by several other business units."[10]

Despite these limitations, the portfolio models "have improved the analytical and strategic capabilities of managers and permitted them to make tough decisions on a more data-oriented and hard-nosed basis than mere impressions would permit."[11]

PORTFOLIO RESTRUCTURING

The portfolio models give indications of the strategies to be followed in respect of the different businesses in the current portfolio. Analysis of the current portfolio is not, however, the only basis for deciding the portfolio strategy of a company. There are many internal and external factors to be analysed, including current portfolio, to determine the portfolio strategy. Such analysis may even

suggest, sometimes, that the portfolio strategy suggested by the portfolio model in isolation is not the appropriate one.

Environmental changes may favour addition of new businesses or dictate deletion of existing businesses or both.

Economic liberalisation in India and outside has vastly changed the business environment provoking many companies to change their portfolios. The abolition of public sector monopoly or dominance in many industries, delicensing and amendment to the MRTP Act opened up enormous new vistas of opportunity for the private sector. At the same time, several businesses of many companies that were profitable under the protected regime became unattractive in the liberalised environment making divestment the right strategy.

TRENDS IN PORTFOLIO STRATEGY

In the last several decades, there has been a trend all over the developed world to reduce the breadth of the portfolio and towards greater focus. The concept of *core competence* has greatly influenced this trend. For example, Glaxo Holding (UK) divested its milk-based products and decided to concentrate on prescription drugs. The Anglo-Dutch Multinational Unilever gave up its peripheral businesses, packing and transportation. The Pearsons Group (UK) which had a host of businesses decided to focus on the media and entertainment businesses. These are but a few examples of *unbundling* of the portfolios.

Al Ries in his recent book *Focus: The Future of Your Company Depends on It* provides numerous examples of corporate disasters resulting from unfocusing. Encouraged by the ambition to grow fast and certain perceptions regarding business stability and optimisation of resource use, for several decades companies expanded into many diverse businesses. Ries observes that a successful company usually starts out highly focused on an individual product, service, or market. Over time, the company becomes unfocused. It offers too many products and services for too many markets at too many different price levels. It loses its sense of direction. It doesn't know where it's going or why. Its mission statement loses its meaning.[12]

Box 11.1

Portfolio Fads

Al Ries observes that every recent decade has had its own management fad that history proves to have been misguided at best. In the sixties, it was *conglomerisation*, the notion that a professional manager could manage anything. According to the *Wall Street Journal*, "the conglomerate theory held that companies operating in many different businesses would be less vulnerable to downturns in individual sectors and could benefit from centralised management." In the seventies, it was *diversification*, the notion that every company needed a countercyclic business to balance out its business cycle. In the eighties, it was synergy, the notion that a company could exploit the similarities between certain products. The fad of the nineties has been *convergence*, the notion that digital technologies are coming together. So naturally companies have to merge or set up alliances in order to take advantage of this powerful trend.[13] Identifying and developing core competency and focus have then become a trend.

Many companies entered diverse areas by establishing greenfield enterprises and acquisitions. The objectives and expectations, however, took a rude beating; the effects on bottom lines and

shareholder values were disastrous or distressing. A number of companies sold more of their acquisitions and businesses than they chose to hold. A study of acquisitions/divestitures since around mid-l980s to mid-l990s by Ries shows the existence of a six-year itch, i.e., most of the acquisitions were divested after a period of around six years.

For several years until 1992, the number of *Fortune 500* companies losing money went on increasing, reaching 149 in 1992 from 42 in 1988. There was, however, an improvement in the subsequent years. One of the reasons for this, according to Ries, might be the change from diversification to focus.[14]

Ries also observes that corporate disasters are more in Europe than in America because of the fact that, *inter alia*, most European companies have a much broader product line. According to him, one reason for the several years of economic slump in Japan in the l990s was that Japanese companies, to a large extent, had product lines that were much too broad. Of the top ten corporation in the US, only one (General Electric) is a classic conglomerate. Of the top ten corporations in Japan, eight are conglomerates, only two are not (Toyota and Nippon Telegraph and Telephone). The situation is worse in countries like South Korea. Ries believes that, in the long run, Japanese conglomerates are going to be no match for narrowly focused companies with strong brand names and even stronger bottom-lines.[15]

Ries observes that the stock market does not appear to be favouring unfocused companies and that focused companies have much better market capitalisation than their unfocused counterparts.[16]

It may be noted that the above remark of Ries is based on the observation of certain periods and certain countries/companies and is irrational to generalise it universally. Diversification too is a powerful growth driver in some environments, like the fast growing developing countries, as in India since liberalisation (although a number of companies have adopted the strategy of focusing on the core businesses). Companies like Reliance grew very rapidly entering new businesses. ITC has been on a very fast growth track thanks to its aggressive expansion into the FMCG sector – faster than its rival Hindustan Unilever (HUL) in the FMCG space which has been less aggressive in diversification. ITC's market capitalisation in the 13 years since 2000 was more than twice that of Sensex and about four times that of HUL.

While emphasising on focus, Ries also cautions, focus is not for ever. Sooner or later even the most powerful focus becomes obsolete. That is when a company must refocus itself. On the other hand, focus is not a fashion that ought to be changed a very few years. The time frame is like decades rather than years. Then too, it depends on the industry. Rapidly changing high technology industries will wear out a focus much faster than low technology industries will.[17]

Case for Focusing

Mr. T. Thomas, Chairman, Glaxo India Ltd., in his speech in one of the Annual General Meetings of the company, has very lucidly and succinctly described the rational of focus and vision in business. The nine factors elaborated by him are the following.

1. Specialised Knowledge and Management Skills: In the increasingly globalising markets characterised by growing competition, a firm needs high quality management that has an adequate depth of specialised knowledge and skills in that specific industry. If attention, skills and other

resources are dissipated over a very diverse portfolio, it will be very difficult to gain competitive advantage.

2. Adequate Concentration of Investment: To compete successfully globally, and even domestically, massive investments are required in fixed assets, marketplace and R&D so that the scale of investments in individual global product groups has reached such proportions that firms have to concentrate their investment in a select number of areas.

3. Market Dominance: By concentrating resources in one business or in a few select areas of business, a company can gain dominance nationally and globally in those areas. In a properly managed company, the profit margins will be higher with higher volumes and market share.

4. Stronger Intra-business Links: A strong intra-business link (marketing-R&D link, for example), necessary for success in a highly competitive industry, is possible only if a company focuses itself on select areas of businesses.

5. Greater Commitment of Managers: In a highly diversified business, managerial efficiency and commitment suffer because of movement of managers across business and differing fortunes and prestige of businesses. In a more focused firm, the management will be more uniformly committed to each part of a more cohesive business, thereby ensuring its success and growth.

6. Minimising Errors of Judgement: In a diversified business, the top management will find it increasingly difficult to understand each of the individual business and, therefore, may make errors of commission and omission with regard to judgement of competition and the marketplace.

7. Avoiding Central Bureaucracy: A highly diversified company tends to have a central bureaucracy which acts as a link between the management, its central supporting groups (operational and functional) and the corresponding people in each individual business group and location. This central bureaucracy often tends to distort efficient decision-making process, besides adding unproductive costs. By focusing on select business segments, the linkage between top management and operations will be more direct and the organisation will be leaner and more agile and far more efficiently responsive to change without the hindrance of a central bureaucracy.

8. Realising the Full Potential of Each Business: When several businesses are clubbed together in a large diversified group, the real potential of some of the businesses may not be fully realised. Focus would help realise such potential as has been proven by companies like Glaxo, ICI and ITT.

9. Parent/Subsidiary Harmonisation: When the parent company becomes a focused one, it would be appropriate for the subsidiary to fall in line and harmonise objectives and strategy for better results as has been done by Glaxo India.

FACTORS INFLUENCING PORTFOLIO STRATEGY

There are a number of factors – historical, personal, strategic, environmental etc. – which influence portfolio strategy. Some of the important factors are given below.

1. Mission/Vision: The mission of the company is one of the most important factors that influence the portfolio strategy because the mission defines the scope and purpose of the company.

As has already been pointed out earlier in this chapter, formulation of clear vision about the future has led to restructuring the portfolio of several companies like Glaxo.

2. Value System: A factor very much complimentary to the mission that influences the portfolio strategy is the value system of the promoters or major stockholders. After the Murugappa Group took over the EID Parry, the liquor business of the EID Parry Group was sold off as the Murugappa Group management felt that it was unethical to be in the liquor business.

3. Future of Current Business: The future prospects of the current business are a very important factor influencing the portfolio strategy. If a current business, particularly the most important one, has a bleak future, a company would be tempted to divest or diversify into growing businesses. Having felt that the future of the tobacco business would be very bleak, the ITC diversified into speciality paper, packaging and printing, hotels, agribusiness, financial services and international business etc. and today the non-tobacco businesses contribute a considerable share of the total turnover of ITC. (Some of these diversifications, however, have not been successful and the company has, therefore, decided to concentrate more on its core business – tobacco.)

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

As pointed out in the earlier sections of this chapter, several Indian companies, like the CEAT, have decided to drop businesses which are peripheral or which are not important in terms of business volume or are not otherwise satisfactory in terms of performance and which do not hold out promises for the future of the company. They have adopted the strategy of focusing on the core business(es).

5. Government Policy: Government policy sometimes is an important determinant of portfolio strategy. As has already been pointed out, the pre-1991 regulatory regime did not permit many companies, particularly large ones and foreign firms, to pursue the type of growth and diversification strategies they would have followed in an environment of business freedom, resulting in distorted portfolios. The liberalisation has very significantly transformed the environment. The grant of more autonomy to the *Miniratnas, Navaratnas* and *Maharatnas* provided them with considerable leeway for charting out their future growth.

6. Competitive Environment: The competitive environment too has its influence on the portfolio strategy of many companies. When competition is absent or limited, as in a protected market, even firms that are inefficient may be able to thrive. The protection itself may prompt firms to enter such businesses.

However, as the market becomes competitive, as has been happening in India because of the liberalisation, things may undergo drastic changes. Many firms that survived or flourished in the protected regime would not be able to survive the competition. Further, for various reasons mentioned under *The Case for Focusing*, it would become necessary to focus on the core business.

7. Company Resources: The resources and strengths of the company, undoubtedly, are important factors influencing the portfolio strategy.

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

9. Competitive Moves: Some firms have a tendency to imitate the growth pattern of the established popular firms. There are firms that follow almost the same portfolio strategies of competitors. Some firms resort to portfolio change as a counter-competitive move. For example, if firm A enters an important business of firm B, the latter may retaliate by entering the business of the former. There are also cases of firms refraining from certain businesses for fear of such retaliations.

10. Portfolio Strategy of Parent: The portfolio strategy of subsidiaries may be influenced by the portfolio strategy of the parent as has been the case with companies like Glaxo India, ICI and Hindustan Lever.

11. Business Environment: The business environment, in general, is an influencer of the portfolio strategy and, quite obviously, significant changes in business environment have important implications for portfolio strategy.

THE INDIAN SCENARIO

Many Indian companies and business groups favoured very widely diversified portfolio in the past. There were many reasons for that. Straddling up many businesses was regarded as providing bases for fast growth and very prestigious. Further, diversified portfolio was believed to spread business risks and provide stability.

The pre-1991 controlled economic regime also contributed to the trend towards diversified portfolio. The restrictions on the growth of large companies/houses and FERA companies to grow in businesses where they were dominant players made them seek their growth in other businesses. In the protected economy, there was a tendency to procure licences in as many businesses as possible. As licence was difficult to obtain, there was also a tendency to add new businesses by acquisitions (even of sick units). In many cases, even inefficient firms could be profitable in a protected market.

Referring to the past diversification of the Birla Group, it was observed that "because of the MRTP Act in its original form, and the size of the market, you had to diversify if you had to grow beyond a particular size."[18]

The liberalisation, which substantially dismantled the restrictions on growth, expansion and competition, has dramatically changed the business environment necessitating many companies to restructure their portfolio. 1990s witnessed a substantial shake out in corporate India. See *Appendix 11.1* at the end of this chapter for elaboration.

In short, the liberalisation has greatly impacted the portfolio strategy of Indian companies. Being the immediate period after the control regime, it was only natural that corporate restructuring struck in a big way in the 1990s. Corporate restructuring, however, is a normal thing in a competitive environment and, therefore, has been a continuing phenomenon and will be part of the corporate strategy of many companies in future too.

Although the post-liberalisation period witnessed a trend towards focusing on core business(es) by many companies/industrial houses, diversification – related and conglomerate – responding to the new environment has also been very conspicuous.

The following strategies have been common:

- Exiting some of the existing businesses.
- Adding new business.
- Both exiting some of the existing businesses and adding new business.

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Appendix 11.1

PORTFOLIO RESTRUCTURING IN THE 1990S: SOME EXAMPLES

As mentioned earlier, following the industrial policy liberalisation, the 1990s witnessed widespread corporate restructuring in India. One important trend has been to focus on the core business and to withdraw from businesses where the company does not have competitive strength. The Glaxo India, for example, withdrew from Dempo Diary, Hindustan Foods, Vegepro and K.G. Gluco Biols in which the company had invested in the 1980s and which were incurring losses. Further, as part of the fundamental strategy to focus on the core pharmaceutical business, the business of the parent company, Glaxo India divested the home products (like *Complan*, *Farex* and *Glucon D*) division. Similarly, the CEAT divested its four non-tyre businesses and has decided to concentrate on its core business, tyre.

The sale of the loss-making welding and explosives business brought in considerable cash for the Indian Oxygen (IOL) and caused the profits to jump by 85 per cent. IOL then expanded into hydrogen and carbon dioxide.

The sale of the fertilizer and polyester filament yarn business saw the sales of ICI in 1994-95 falling to half the level of the previous year but profits rising ten-fold. The ₹ 210 crores generated by these sales enabled the company to repay the debts and cut interest costs and to pump in money for expanding its core paints, explosives, pharmaceuticals and speciality chemicals businesses. Moreover, this has aligned ICI's business portfolio with that of its British parent, ICI Plc.

The Hindustan Ciba-Geigy sold its Bhandup (Mumbai) pharmaceutical plant, shut for two long years, and the 14 acres of land on which it was located to Great Eastern Shipping and its oral care (Cibaca toothpaste and tooth brushes) division to Colgate-Palmolive. The ₹ 173.5 crores generated by these two deals was used for working capital and funding new products and new projects.

Voltas, which went in for a broad diversification in the past, decided to concentrate on four broad categories (consumer durables, industrial products, textile machinery and agro chemicals) and to withdraw from the rest (like agrofoods and beverages and distributing others' products).

The SPIC which had a furious pace of diversification in the last five years announced in mid-1997 that it would restructure its business by focusing on and consolidating its core business of fertilizers, through divestiture of its stake in the petrochemicals project, hiveing off unrelated activities – SPIC SMO and Biotech division – into joint ventures, and the merger of Manali Petrochemicals, SPIC Organics and Tuticorin Alkalies and Chemicals with SPIC. However, SPIC would still retain interests in a slew of unrelated businesses – pharmaceuticals, heavy chemicals and electronics. The diversification had created problems for the company. Between 1991-92 and 1996-97, the debt component in SPIC's capitals employed increased from ₹ 522 crores to ₹ 1356 crores. Implementation delays necessitated continuous infusion of funds into ongoing projects. This has kept up pressure in the fund flows and the company's debt servicing ability steadily deteriorated.

Portfolio restructuring, involving divestment, has become widespread in India. The *Business World*, 1-15 May 1997, in its cover story *Up for Sale* observes: "Vast chunks of Corporate India are up for sale. Slammed by high interest rates, falling import duties, increased competition, a languishing

capital market and sub-optimal capacities, Indian businessmen are quickly learning the benefits of sticking to core competencies and quitting other business areas. Urging them to shift out non-core areas are strategy consultants, industry analysts and financial institutions. And Indian industrialists are no longer sentimental about selling businesses". The story tells that "the great Indian Corporate Heat is on, and indications are that the fun and deals have just begun. The initial list itself is a formidable one. Liquor baron Vijay Mallya has sold his sake in Berger International, UB Mec, Best & Crompton and Hindustan Polymers, and continues to seek buyers for some of his other group companies; Calcutta-based industrialist Gouri Prasad Goenka has sold Gujarat Carbon to elder brother Rama Prasad; Arvind Maftlal has already disposed of group company Maftlal Micro Machines and, according to press reports, is urgently seeking takers for his other companies like Gujarat Gas, Maftlal Micron, Maftlal Frazenius and even flagship Nocil (though the group has officially denied the reports); Jaiprakash Gaur of Jaiprakash Industries wants to sell his cement and hotel businesses; DCM Shriram Mills chairman Bansi Dhar has put Hindon River Mills on the block; even film star Amitabh Bachchan has reportedly sold his 36% stake in pharmaceuticals outfit IPCA." The non-tyre businesses of CEAT – glass fibre, electronics, nylon tyre chord and photocopiers – had been acquired as part of the RPG Group's strategy of diversified growth with the hope that they could be revived under the RPG banner. Considerable amounts of resources were spent on these divisions expecting that they would break-even and make CEAT a strong diversified company. However, as the expectations were belied and as they became a drag on CEAT, it was decided to drop them. Sale of the non-tyre businesses provided the much-needed infusion of funds for strengthening the CEAT tyres. These are but some examples of a vast array.

Some businessmen who sought to expand their business domain in the past by M&A, like Vijay Mallya, have later to sell several of them due to various reasons. The revival plan for Shaw Wallace (SWC) drawn up in 1997 proposed the sale of its non-core businesses like Calcutta Chemicals and Detergents India, Shaw Wallace Gelatine, the Colombo based Shaw Wallace & Hedges and agro-chemicals divisions. Their sale was estimated to bring in about ₹ 60 crores.

Exploiting the new opportunities provided by the opening up to the private sector of a number of industries which had been reserved for the public sector; delicensing; removal of MRTP restrictions on entry, M&As and growth; relaxation of the foreign collaboration and investment policy etc., a number of companies have added new businesses to their portfolios. The liberalisation also enables the strengthening of the core business by organic and inorganic (external, like acquisition) growth.

The Modi Xerox repositioned itself by transforming from a photocopier company to a document company reflecting the redefinition of its business. The Godrej Group decided to add a range of white goods such as microwave ovens, cooking ranges, washing machines, dishwashers, air conditioners etc. Acquisitions also contributed to the diversification of Godrej Group. The Hindustan Lever strengthened some of its existing businesses and added new ones by M&As. Groups/Companies like BPL, Videocon etc. also diversified their portfolios. Several commercial banks and finance companies too diversified their portfolios For example, some commercial banks entered housing finance, merchant banking, leasing etc. and ICICI entered commercial banking and, later, insurance business as it opened up. With the long held monopoly coming to an end, the LIC drew up plans to diversify its activities through divisionalisation of operations. The LIC intended to shift its focus from life insurance to financial services, offering products and services ranging from life insurance to financial

services both within and outside the country. The Corporation's plan for 1996-2001 included setting up a joint venture for pension funds.

Following the grant of more autonomy to the *Navaratnas*, (nine well performing public sector units – Bharat Heavy Electricals Ltd. (BHEL), Bharat Petroleum (BPCL), Hindustan Petroleum (HPCL), Indian Oil Corporation (IOC), National Thermal Power Corporation (NTPC), Oil and Natural Gas Commission (ONGC), Indian Petrochemicals Ltd. (IPCL), Steel Authority of India Ltd. (SAIL) and Videsh Sanchar Nigam Ltd. (VSNL)), they have started strategic planning including diversification of business.

In the light of the setback to MMTC's business due to the decanalisation of a number of products as part of liberalisation, the Corporation reoriented its strategy and ventured into a number of diversified businesses which included a ₹ 2,500 crore steel project, ₹ 326 crore coke oven project, fertilizers berth, joint venture shipping company, textile project, a bank in Moscow in collaboration with the SBI and Exim Bank of India and warehouses in Russia. As a result, the turnover of MMTC went up from about ₹ 6,600 crores in 1995-96 to more than ₹ 28,400 crores in 2013.

CHAPTER

12

Competitive Analysis and Strategies

Analysis of the competitive environment is a pre-requisite for strategic management.

STRUCTURAL ANALYSIS OF INDUSTRIES

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

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

Porter's analysis, thus, shows that competition in an industry goes well beyond the established players. "Knowledge of these underlying sources of competitive pressure highlights the critical strengths and weaknesses of the company, animates its positioning in its industry, clarifies the areas where strategic changes may yield the greatest payoff, and highlights the areas where industry trends promise to hold the greatest significance as either opportunities or threats. Understanding these sources will also prove to be useful in considering areas for diversification, though the primary focus here is on strategy in individual industries. Structural analysis is the fundamental underpinning for formulating competitive strategy."[1]

Figure 12.1 depicts the five forces competitive structure of industry. The diagram is a slightly modified presentation of the one provided by Porter. The arrows in the diverse directions indicate opposing forces. For example, just as the buyers and suppliers may have bargaining power over the firm, the firm may also have some bargaining power over the buyers and suppliers.

Threat of Entry

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

Following are some of the important common entry barriers.

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

2. Economies of Scale. Economies of scale can deter entry in two ways: it keeps out small players and discourages even potentially large players because of the risk of large stakes.

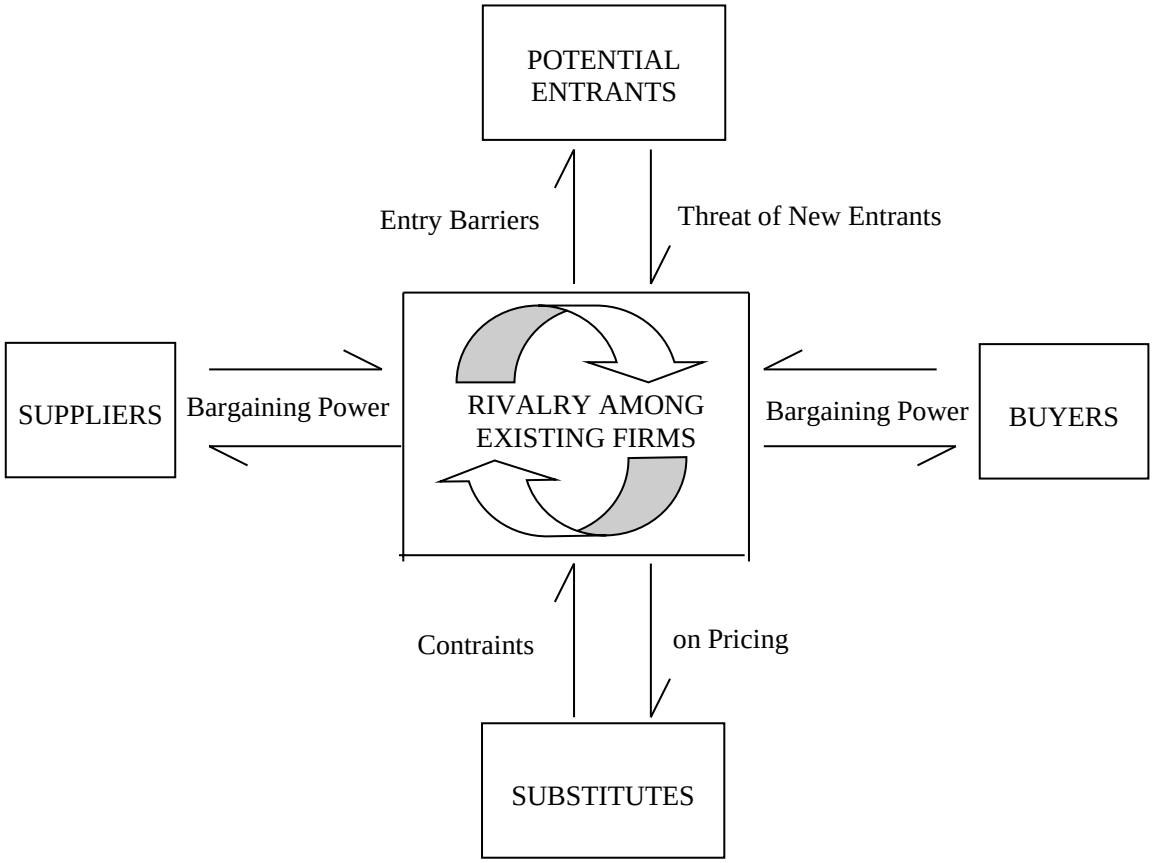

Fig. 12.1: Forces Driving Industry Competitors

3. Cost Disadvantages Independent of Scale. Entry barrier may also arise from the cost advantages, besides that of economies of scale, enjoyed by the established firms which cannot be

replicated by new firms, such as proprietary product technology, learning or experience curve, favourable access to raw materials, favourable location, government subsidies etc.

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

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

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

Rivalry among Existing Competitors

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

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

1. *Number of firms* and their *relative market share, strengths* etc.
2. *State of growth of industry.* In stagnant, declining and, to some extent, slow growth industries, a firm is able to increase its sales only by increasing its market share, i.e., at the expense of others.
3. *Fixed or storage costs.* When the fixed or storage costs are very high, firms are provoked to take measures to increase sales for improving capacity utilisation or reducing storage costs.
4. *Indivisibility of capacity augmentation.* Where there are economies of scale, capacity increases would be in large blocks necessitating, in many cases, efforts to increase sales to achieve capacity utilisation norms.
5. *Product standardisation and switching costs.* When the product of different firms are standardised, price, distribution, after-sales service, credit etc. become important strategic variables of competition. Absence of switching costs makes firms more vulnerable.
6. *Strategic stake.* Rivalry in an industry becomes more volatile if a number of firms have high stakes in achieving success there. For example, a firm which regards a particular industry as its core business will give great importance to success in that industry.
7. *Exit barrier.* High exit barriers (for example, compensation for labour, emotional attachment to the industry etc.) tend to keep firms competing in an industry even though the industry is not very attractive.
8. *Diverse competitors.* Rivalry becomes more complex and unpredictable when competitors are very diverse in their strategies, origins, personalities, relationships to their parents etc.
9. *Switching costs.* In some cases, a barrier to entry is created by switching costs (i.e., one-time costs facing the buyer of switching from one supplier's product to another's) such as cost of retraining the employees, cost of new ancillary equipment etc.

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

Threat of Substitutes

An important force of competition is the power of substitutes. "Substitutes limit the potential returns in an industry by placing a ceiling on the price firms in the industry can profitability charge. The more attractive the price performance alternative offered by substitutes, the firmer the lid on industry profits."[2]

Firms in many industries face competition from those marketing close or distant substitutes. Porter points out that substitute products that deserve the most attention are those that (1) are subject to trends improving their price-performance trade-off with the industry's product, or (2) are produced by industries earning high profits.[3]

Bargaining Power of Buyers

For several industries, buyers are potential competitors – they may integrate backward. Besides, they have different degrees of bargaining power. "Buyers compete with the industry by forcing down prices, bargaining for higher quality or more services, and playing competitors against each other – all at the expense of industry profitability."[4]

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

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

Box 12.1

Bargaining Power of Producers Versus Retailers

There has been a power shift in the market for many products, characterised by the large retailers gaining in bargaining power at the expense of manufacturers.

Large retail chains have been increasing their share of the retail business making even mighty companies highly dependent on them to move their goods to the consumers. In several of the recent years, Wal-Mart was the largest global company. The large retailers use their hold over the market to get better bargain with the producers. Even giants like P&G, the largest FMCG company in the world and Nestle, the world's largest food multinational, have been severely bitten by the retail biggies.

Besides the giant size and vast spread, the bargaining power of the retailers is augmented by the *store brands*. Store brands, also known as private label/brands, refer to the retailers' brands.

National brands (i.e., the brands of manufacturers) have been facing increasing competition from private brands, undermining the market power of the national brands. Large companies, particularly multinationals, dominated the market in the past. However, their market domination has been eroding as the share of the store brands in the retail trade has been growing. According to a recent estimate, globally private brands contribute about 17 per cent of the retail sales.

Store brands have been expanding the business by having product variants in different quality-price space.

Store brands are manufactured either by the retailers or joint ventures or are outsourced.

Retailers tend to squeeze their suppliers – not only the small and medium private label manufacturers but also very large firms, including multinationals.

In-house brands account for a large share of the sales of several global retailers. For example, it was reported to be about 40 per cent in respect of Wal-Mart and 55 per cent for Tesco. Private labels are estimated to contribute about seven per cent of modern trade in India. Private labels' share is generally very high in the food and grocery category. In Future Group's Big Bazar and Food Bazar, store brands contribute about 44 per cent of toilet cleaners, 45 per cent of glass cleaners, 36 per cent of ghee, 26 per cent of tooth brush, and 55 per cent of macroni/pasta.

Many years ago, the retailers' association in Kerala boycotted the products of Hindustan Lever on the issues of poor retailer margin. Although initially the boycott was almost complete, it did not meet with ultimate success. The company could make the products available in a limited way through the public distribution retail outlets of State's Civil Supplies Corporation which was spread throughout the State to distribute essential consumer goods. HLL also pressed into operation vans in a small way to sell its products. After a few weeks, retailer started secretly selling HLL products to regular customers. On a customer's plea, a court of law declared the boycott illegal. Collective boycott amounted violation of MRTP Act.

Power of Suppliers

The important determinants of supplier power are the following:

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

STRUCTURAL ANALYSIS AND COMPETITIVE STRATEGY

The purpose of the structural analysis is to diagnose the competitive forces and to identify the strengths and weaknesses of the firm *vis-à-vis* the industry, to help formulate an effective competitive strategy that "takes offensive or defensive action in order to create a defendable position against the five competitive forces".[5]

Structural analysis would enable a firm to answer such questions as:

1. How vulnerable is the firm against potential entrants? In other words, are there or how insurmountable are the entry barriers? Or, what measures can it take to ward off new entrants?
2. How serious is the threat of substitutes? What strategies should the firm employ against them?
3. What is the nature of supplier power? How to combat it?
4. How powerful are the buyers? How to deal with their bargaining power?
5. What are the strengths, weaknesses and strategies of the established competitors and how to cope with them?

In order to create a defendable position against the five competitive forces, Porter suggests the following competitive strategies:[6]

1. Positioning. This means making such positioning of the firm that its capability provides the best defence against the existing array of competitive forces. This strategy can take the form of building defenses against the competitive forces or finding positions in the industry where the forces are weakest.

2. Influencing the Balance. The strategy here is to improve the firm's relative position through strategic moves that influence the balance of forces. As against positioning, where the strategy is basically defensive, here the strategy is offensive. In other words, this strategy seeks to do more than merely cope with the forces themselves; it is meant to alter their causes. For example, capacity expansion and scale expansion can enhance entry barriers.

3. Exploiting Change. The approach is to adopt appropriate strategy for the changing environment ahead of the rivals.

COMPETITOR ANALYSIS

Competitor analysis is necessary for formulating right strategies and determining the right positioning for the firm in the industry.

Competitor analysis seeks to find answers to certain basic questions such as:

1. Who are the competitors of the firm?
2. What are the current strategies of the competitors?
3. What are their future goals and likely strategies?
4. What drives the competitor?
5. Where is the competitor vulnerable?
6. How are the competitors likely to respond to the strategies of others?

Porter has suggested a framework for competitor analysis, consisting of four diagnostic components, viz., *future goals, current strategy, assumptions* and *capabilities.*

As Porter observes, "its goals, assumptions, and current strategy will influence the *likelihood, timing, nature,* and *intensity* of competitor's reactions. Its strengths and weaknesses will determine its *ability* to initiate or react to strategic moves and to deal with environmental or industry events that occur."[7]

Competitor Response Profile

An analysis of these components will help to formulate what Porter calls competitor's response profile, i.e., answers to critical questions such as: What moves or developments will provoke the competitor and how is the competitor likely to respond or retaliate?

The competitor response profile seeks to predict the competitor's offensive moves and defensive capabilities.

Future Goals

Analysis of future goals would be helpful to identify the attitude and behaviour of the competitor and likely strategies. As Porter observes, "a knowledge of goals will allow predictions about whether or not each competitor is satisfied with its present position and financial results and, thereby, how likely that competitor is to change strategy and the vigour with which it will react to outside events.... or to moves by other firms?"[8]

Knowledge of competitor's goals may help to predict its reactions to strategic changes.

Goals of both the business unit and corporate parent need to be examined.

In 1996, the CEO of ICI had revealed that it wanted to increase the contribution of its Asian operations from 15 per cent to 25 per cent of the total and earmarked 800 million pounds for investment in Asia, including 200 million for India. It was believed that a part of it would go for acquisitions. Similarly, the CEO of Hidustan Lever revealed the intention to raise the company's contribution to the Unilever's global turnover from about 5 per cent to 10 per cent within a decade. Falling in line with the parent's portfolio strategy, HLL identified the processed food business as a major thrust area. It was, thus, clear that the HLL would go for massive capacity expansion, including M&A.

Assumptions

It is critical to understand:

- The competitor's assumptions about itself.
- The competitor's assumptions about the industry and the other companies in it.

A firm may perceive itself as a socially conscious organisation, the industry leader, quality conscious firm, highly ethical etc. Such assumptions will, obviously, guide the way the firm behaves, including reactions to competitors' moves.

A firm would also have assumptions about the industry and competitors, like the industry prospects; competitors' goals, capabilities and weaknesses; competitors' possible behaviours and reactions etc.

The strategies and moves of a firm will be influenced by the above two assumptions. The assumptions may or may not be correct.

Current Strategy

Identification of the current strategies of the competitors is a very important component of competitor analysis. "A competitor's strategy is most usefully thought of as its key operating policies in each functional area of the business and how it seeks to interrelate the functions."[9]

Capabilities

The ability of a firm to accomplish its goals and to respond to competitor's moves depends on its strengths and weaknesses. Analysis of the strengths and weaknesses of the competitors is, therefore, very important.

STRATEGIC GROUPS

The analysis of an industry within the framework of the five forces model will give a general picture of the competitive forces. Useful as this analysis is, it is not sufficient enough for formulating competitive strategies. More in-depth knowledge of the competitive situation is needed because the competitive environment and competitive strategies of different firms within an industry may not be the same. The size, resources and strengths of the firms etc. may differ between firms. Again, firms differ with respect to portfolio strategy, product mix in each business, market segments targeted, marketing mix strategy, backward or forward integration, extent of outsourcing, intra-corporate linkages, parent-subsidiary relationships etc. The strategic dimensions for a particular firm usually form an internally consistent set. An industry normally has firms with a number of different, though internally consistent, combinations of dimensions. Hence, analysis of the strategic dimensions of the homogeneous sets of firms in a heterogeneous industry is an important step in structural analysis of industry. In other words, it is necessary to identify the various strategic groups within an industry.

The term 'strategic groups' was coined by M.S. Hunt in 1972, following his observation, while doing an analysis of the home appliances industry in the US, that there existed performance differences *between* groups of firms within the same industry as well as across industries. He defined strategic groups as "a group of firms within the industry that are highly symmetric with respect to cost structure, the degree of vertical integration, and the degree of product differentiation, formal organisation, control systems, management rewards/punishments, and the personal views and preferences for various possible outcomes."[10]

Michael Porter broadened his structural analysis of the industry incorporating the concept strategic group. He defines strategic group as "the group of firms in an industry following the same or a similarstrategy along the strategic dimensions."[11] According to Cool and Schendel, a strategic group is "a set of firms competing within an industry on the basis of similar combinations of scope and resource commitments."[12] The implication is that firms in a strategic group compete adopting similar strategies and resources, leading to intra-industry segmentation.

Normally, a small number of strategic groups capture the essential strategic differences among firms in the industry although one may even think of the extreme cases of an industry having only one strategic group (i.e., all the firms are similar *vis-à-vis* the strategic dimensions) on the one end and each firm in an industry amounting to a strategic group on the other end. For example, in advanced countries like USA, there are two significant strategic groups in the pharmaceutical industry, namely, the proprietary group (i.e., firms that concentrate on patented drugs and who expend enormous resources on R&D), and the generic group (i.e., firms depending on off-patent drugs).

In India, in many industries there are, at a very broad level, firms in the organised sector and firms in the unorganised sector. Competitive strategies of the unorganised sector firms are often different from those in the organised sector (it is possible that there are more than one strategic group in each of these sectors). Organised sector firms are normally national or at least regional players whereas the unorganised sector firms, by and large, are local or at best regional player. The direct and

major competitors and market/target customers of these groups would be different and, therefore, the marketing strategy would be different. In the furniture industry, for example, there are chains of national and international players. Some deal only with wooden or similar products. Some have both steel and wooden products. The numerous firms in the unorganised sector in this industry are largely local players and they cater mostly to price-sensitive customers. In the hotel and restaurant industry, the competitors of a five star hotel are mostly other five star hotels and they have many common strategic dimensions. The five star hotels, therefore, form one strategic group. Similarly, three star hotels constitute another strategic group. Firms within a strategic group sell similar products or services to the same customer segments and more or less are in direct competition with each other.

Strategic Group Analysis

A strategic group analysis (SGA) is a pre-requisite for effective strategy formulation.

A SGA is an in-depth examination and evaluation of the common and individual characteristics and strategic behaviour of the members of the strategic group.

Parametres of SGA

Factors commonly considered for identification of SGA include:

- Portfolio of business of the firm.
- Market segmentation strategy and market segments served.
- Other marketing strategies, including product, promotion price and distribution strategies.
- Extent of vertical integration.
- Cost structure.
- R&D capabilities.
- Size of the company.
- Financial structure.
- Operational strengths.
- Ownership structure and interconnections.
- Technological capabilities.
- Human resource characteristics.
- Management culture and dynamism.

Significance of SGA

Important benefits of strategic group analysis include:

- Strategic group analysis helps to get good picture of the competitive structure of the industry.
- It helps a firm to understand who are its direct and most relevant competitors.
- A thorough analysis of strategic groups will help a firm to get some idea of the potential of firms in different SGs to migrate to other SGs (i.e., the threat of new entrants).
- SGA will enable a firm to evaluate whether it can and whether it should enter other SGs.
- SGA can also be helpful for benchmarking.

Mobility Barriers

Porter extended Hunt's original idea to include indirect effects leading to different strategies between firms, notably the existence of market entry barriers.

There may be barriers to shifting strategic position from one strategic group to another. Such barriers are referred to as mobility barriers. For example, an assembler of personal computers may encounter several barriers to shift to the position of a fully integrated computer manufacturer, such as barriers of technology, capital investment, human resources and organisation, brand image and market standing of established firms etc. Similarly, there are several barriers to entering the proprietary group by generic drug firms, such as capital investment, research facilities, human resources, high risks of investment on R&D etc. In contrast, it is easier for a proprietary drug firm to enter the generic group.

Implications of Strategic Groups

The concept of strategic groups has implications for industry analysis and identification of opportunities and threats. A company's immediate competitors are firms within the same strategic group.

Second, the nature and intensity of competition and business prospects vary from strategic group to strategic group. The choice of strategic group is, therefore, very important.

Third, high mobility barriers normally help insulate the group from new entrants and facilitate high profitability. "The firms in strategic groups with high mobility barriers will have greater profit potential than those in groups with lower mobility barriers. These barriers also provide a rationale for why firms continue to compete with different strategies despite the fact that all strategies are not quickly successful"[13]

Fourth, "just like entry barriers, mobility barriers can change; and as they do (such as if the manufacturing process becomes more capital intensive) firms often abandon some strategic groups and jump into new ones, changing the pattern of strategic group. Mobility barriers can also be influenced by firm choices of strategy. A company in an undifferentiated product industry, for example, can attempt to create a new strategic group (with higher mobility barriers) by investing heavily in advertising to develop brand identification…Or it can try to introduce a new manufacturing process with greater economies of scale."[14]

Fifth, the competitive standing of the different strategic groups would be different with respect to each of the 5 competitive forces. For example, the threat of new entrants is less in respect of the proprietary group compared to the generic drug group. The bargaining power of the buyers is also weak for patented drugs because of no or limited alternative. Such is the case with competition from substitutes. Players in the strategic group of fully integrated firms may not be subject to as much supplier power as other firms because of their lesser dependence on the outside suppliers. (The fact that in a number of cases or integrated outstsourcing firms have advantage is not ignored this.)

Limitations of Porterian Models

The five forces and strategic group models provide very useful frameworks for analysing the nature of competition in an industry. These models, however, suffer from two important shortcomings mentioned below.

In many industries, competition is a process driven by innovation and industry structures are very significantly changed by innovation. In a later work, Porter has recognised the role of innovation in revolutionising industry structure. Innovations, according to him, can unfreeze and reshape industry structure. He holds that after a period of turbulence triggered by innovation, the structure of an industry once more settles down to a stable pattern. Once the industry stabilise in its new configuration, the five forces and strategic group concepts can once more be applied. This view of the evolution of industry structure is often referred to as punctuated equilibrium. The punctuated equilibrium view holds that long periods of equilibrium, when industry's structure is stable, are punctuated by periods of rapid changes when industry structure is revolutionised by innovation. Thus, there is an unfreezing and refreezing process.

VALUE CHAIN

Porter points out that a firm's value chain is an important determinant of competitive advantage.

Value is the amount buyers are willing to pay for what a firm provides them. The total revenue reflects the value. Creating value for buyers that exceeds the cost of doing so is the goal of any generic strategy.

The value chain displays total value and consists of value activities and margin. Value activities are the physically and technologically distinct activities a firm performs.

There are, broadly, two types of value activities, namely, primary activities and support activities. Figure 12.2 presents a summary of these activities. A firm gains competitive advantage by performing these strategically important activities more cheaply or better than its rivals. As Porter counsels, a firm should strive to understand not only its own value chain activities but also of the competitors', distributors' and suppliers'.

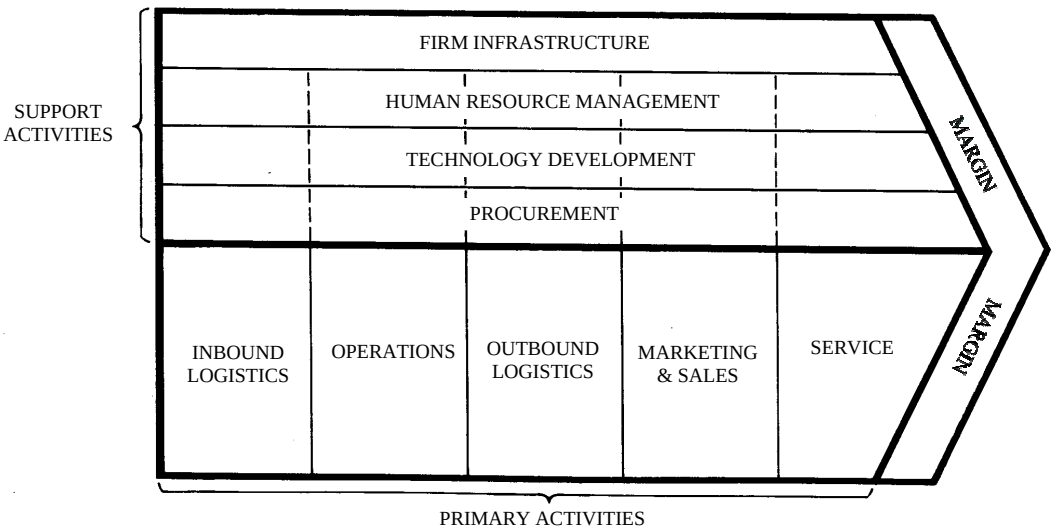

Fig. 12.2: The Generic Value Chain (Adopted from, Michael Porter, *Competitive Advantage*)

Primary activities include: (i) inbound logistics (activities associated with receiving, storing and disseminating inputs to products); (ii) operations (processing activities); (iii) marketing and sales; and (iv) services.

Support activities include: (i) procurement (purchasing of inputs); (ii) technology development, (iii) human resource management, (iv) firm infrastructure (includes general management, planning, finance, accounting, legal and government affairs and quality management).

Each of the these activities may be subdivided into several activities. For example, marketing and sales include activities such as advertising, sales promotion, sales force management, marketing research etc.

A firm gains competitive advantage by performing these strategically important activities more cheaply or better than its rivals. A firm should strive to understand not only its own value chain activities but also of the competitors', distributors' and suppliers'.

BUSINESS LEVEL GENERIC COMPETITIVE STRATEGIES

Competitive strategies refer to business strategies to succeed in the chosen business. The essence of it is "taking offensive or defensive actions to create a *defendable* position in an industry, to cope successfully with the five competitive forces and thereby yield a superior return on investment for the firm."[15]

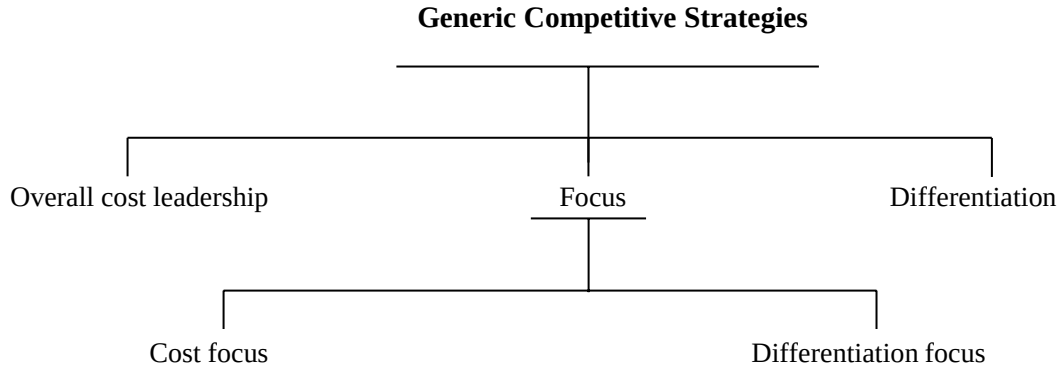

Fig. 12.3: Generic Competitive Strategies

Michael Porter in his landmark book *Competitive Strategy* has identified, at the broadest level, three internally consistent generic strategies (which can be used singly or in combination) for creating such a defendable position in the long-run and outperforming competitors in an industry. Figure 12.3 depicts these three strategies.

Porter has suggested these three general strategies as alternative, viable approaches dealing with the competitive forces. Sometimes, the firm can successfully pursue more than one approach as its primary targets, though this is rarely possible. He cautions that a firm failing to develop its strategy in at least one of the three directions – a firm that is "stuck in the middle" – is in an extremely poor strategic situation.

Overall Cost Leadership

The strategy of cost leadership is to become the lowest cost producer in the industry through a set of functional policies aimed at this basic objective.

Porter points out that cost leadership requires:

1. Aggressive construction of efficient scale facilities.
2. Vigorous pursuit of cost reduction from experience.
3. Tight cost and overhead control.
4. Avoidance of marginal customer accounts.
5. Cost minimisation in areas like R&D, services, sales force, advertising and so on.

Porter also observes that the low-cost firm "has a broad scope and serves many industry segments, and may even operate in related industries – the firm's breadth is often important to its cost advantage."[16] This is true of the Reliance Industries, as would be clear from the references to it later in this chapter.

Low-cost position yields the firm above-average returns in industry. This may enable the firm to reinvest and improve further its position in the industry.

Porter states that a cost leadership strategy can sometimes revolutionise an industry in which the historical bases of competition have been otherwise and competitors are ill-prepared either perceptually or economically to take the steps necessary for cost minimisation.

Being the low-cost producer enables the firm to defend it against each of the five competitive forces.

As regards the intensity of rivalry, the cost leader is in a better position to survive a price war and, hence, competitors normally dare not engage in a price competition. Further, under a recession, the cost leader is in a better position to maintain sales by discounts, trade promotion and the like. Again, the higher profits may enable the firm to reinvest and improve further its position in the industry.

The effect of buyers' bargaining power on the cost leader would be lower than on the competitors as the buyers can exert power only to drive down prices to the level of the next most efficient rival.

The cost leader has more flexibility than the rivals to cope with the increase in input prices by suppliers.

Further, the cost leader is in a better position than competitors to ward off threats from substitutes.

Finally, the low cost acts as an entry barrier.

Thus, "a low-cost position protects the firm against all five competitive forces because bargaining can only continue to erode profits until those of the next most efficient competitor are eliminated, and because the less efficient competitors will suffer first in the face of competitive pressures."[17]

Cost leadership, however, has several risks.

1. Other firms may imitate the cost leader so that the cost leadership is lost.
2. Technological changes may result in the firm losing cost leadership.
3. Cost focusers may achieve even lower cost in segments.
4. Competition on bases other than cost may become more important.

Certain natural advantages which India possesses, like cheap labour, provides a basis for successfully building up cost leadership. Exploitation of this natural advantage requires building manufacturing capacities of global scale very efficiently, benchmarking every component of the cost structure against the international leaders, reengineering the processes to improve efficiency, employing TQM as a tool for lowering the cost of poor quality etc.

Indeed, low cost is the most important competitive advantage enjoyed by all of India's five companies among the Asia's top 20 most competitive ones (Reliance Industries, Ranbaxy Laboratories, Sundaram Fasteners, Arvind Mills and Bajaj Auto).[18]

Reliance is the lowest-cost polyester producer in the world today. Its capital cost, labour cost and selling costs are substantially lower than its global competitors including those from the developing countries. Its conversion cost is only about 53 per cent of what it is for European companies and 62 per cent of what it is for North American companies. Critical to Reliance's cost competitiveness is its investment in scale, project management capabilities, and manufacturing prowess. Also central is its ability to compress project implementation time. Thus, the company's 60,000 tonnes per annum (tpa) polyester filament yarn (PFY) plant in Hazira went on stream within 14 months – faster than even its technology collaborator DuPont's benchmark. Its method empower technical teams to take critical decisions at the work site.

Although it doesn't have even a single competitor in terms of scale and integration – fighting with different rivals in different segments – Reliance has further consolidated its position through strategic locationing. All 20 of its plants are centred in four locations: Patalganga and Narora in Maharashtra, and Jamnagar and Hazira in Gujarat. Such a cluster strategy has created cost-benefits in terms of savings in sales tax, octroi, and transportation costs.

It is pointed out that Reliance's real achievement in manufacturing is, of course, its command over process technology since its products do not need cutting-edge hi-tech. Not only has it acquired and honed this process technology consistently, Reliance is also using it to push its production beyond the normal capacity of a plant. Even as a new plant is commissioned, its engineers simultaneously develop superior processes to increase the utilisation and cost-efficiency levels. Just after a polymer plant went on-stream in early 1997, a team of engineers succeeded in increasing capacity utilisation by 10 per cent by developing a water-treatment process.

Cost leadership as the main plank of global competitive strategy, Ranbaxy works with multiple cost-cutting tools simultaneously. While economies of scale and low-cost research help, much of the advantage comes from a holistic approach to costs. Instead of trying to cut costs at each stage without factoring in possible increases in downstream costs, the company employs the concept of total activity cost to optimise its expenses. Many of the cost benefits also flow from benchmarking against international competitors. Cost data from the world's four most competitive generic drugs manufacturers – Mylan and Ivax of the US, Teva of Israel, and Doffar of Italy – is constantly fed to the process design, manufacturing, and product development teams. It is pointed out that one of Ranbaxy's greatest strengths lie in the fact that it is vertically integrated through five stages of the value chain, which helps it manage cost and quality across the chain. Naturally, this ensures that the benefits from efficiencies can be soaked up from every activity in the chain. Thus, raising capacities is a natural way of maximising the gains from vertical integration. But high capacities also need large-enough markets to sustain them, which is why Ranbaxy operates in a large number of countries. And by raising scale and redesigning processes, Ranbaxy has been able to cut the costs of production of

some of its key bulk drugs by half. According to Parvinder Sing, CEO, "Cost leadership is a function of scale and technology. By upgrading technology, Ranbaxy will continue to be a cost leader."

The cost advantage, which Sundaram Fasteners enjoys as a global player based in India, has compounded by applying TQM to cut wastage and thereby costs and by driving down the rejection rates. Further, reengineering the production process enabled it to get most out of its large capacity.

The substantially low labour cost (2.9 per cent of total cost compared to 29 per cent for US-based manufactures) and input costs (5.4 per cent for dyes and chemicals compared to 9.3 per cent in the US) and efficiency improvements through process engineering have been contributing to Arvind Mills cost leadership. That the company, which is the third largest denim producer in the world (the capacity having expanded 40 times between 1987-96), is likely to be the biggest producer by 2000 speaks of its scale of operations.

Bajaj Auto, with global scale production capacities, has streamlined its manufacturing operations to glean cost efficiencies by introducing five specific programmes: technology development, which identifies new technologies; product development, which oversees new launches; product upgradation, which attends to product changes; field quality improvement, which resolves design-related problems; and value engineering, which manages inventory costs. The idea is to target and tackle inefficiencies in each area so that overall costs stay in check.

Differentiation

In differentiation strategy, "a firm seeks to be unique in its industry along some dimensions that are widely valued by key buyers. It selects one or more attributes that many buyers in an industry perceive as important, and uniquely positions itself to meet those needs. It is rewarded for its uniqueness with a premium price."[19] It is essential for the success of this strategy that the price premium is greater than the cost of differentiating.

There can be different bases for differentiation. The basis may be the product itself, the delivery system, the marketing approach, credit facilities, after-sales service etc.

There are some common requirements for successfully carrying out the differentiation strategy. They include:

1. Creative flair
2. Engineering skills
3. R&D capabilities
4. Innovative marketing capabilities
5. Motivation for innovation
6. Corporate reputation for quality or technological capabilities

Differentiation often requires a perception of exclusivity. This may sometimes preclude gaining a high market share.

The differentiation strategy also involves a number of risks, which include the following:

1. Imitation erodes differentiation.
2. If the price difference between the differentiating firm and others is very great, it may become very difficult to get enough demand.

3. Changes in consumer needs/tastes may make the differentiating factor less significant.
4. *Differentiation focusers may achieve even greater differentiation in segments.*

The successful differentiation strategy would enable a firm to earn above-average returns in the industry because it places the firm in strong position to cope with the five competitive forces. The brand loyalty and resultant low price sensitivity associated with differentiation provides insulation against existing competitive rivalry. This would also act as an entry barrier. The higher margin differentiator imparts it insulation against supplier power. Differentiation, by its exclusivity, mitigates the buyer power. Similarly, differentiation also places the firm in a better position, than its competitors, *vis-à-vis* substitutes.

The Indian companies cited above are pursuing differentiation and/or focus with cost leadership.

Although the commodity nature of most of its products precludes meaningful differentiation, Reliance has skillfully leveraged its strengths – its ability to offer an entire range, a strategic advantage that it enjoys over the competitors.

In fact, that was one of the main purposes behind the company's vertical integration, which allows it to manufacture several products along the value-added line: polymers and chemicals, fibres and fibre intermediates, textiles, and, ultimately, branded ready-mades. Even within each genre, Reliance showcases variety: in PFY, for instance, it offers several products like flat yarns, bright yarns, and fancy yarns. Thus, it is the product basket that is differentiated.

Ranbaxy is differentiating itself by designing Novel Drug Delivery Systems (NDDS). The NDDS – an unconventional way of administering a drug such as helper compounds or polymer implants – makes differentiation easier to achieve than developing innovative new drugs would. It is also cheaper and quicker, taking between ₹ 72 crores and ₹ 108 crores, and between three and five years to develop, versus an average of ₹ 1,800 crores and between 10 and 12 years for a new drug. Moreover, it offers an opportunity for Ranbaxy to leverage a competence it does possess.

In the case of Arvind, while its basic product remains undifferentiated denim, Arvind is furiously stuffing value-added products into its portfolio in order to offer a menu of choices that distinguishes it from its rivals. The added pay-off: these value-added products – such as ring denim, overdyed denim, and stretch denim – not only yield higher value, but are also price inelastic.

Bajaj Auto's USP is value for money.

Focus

The focus strategy rests on the choice of a narrow competitive scope within an industry which the focuser can serve better than the competitors.

Focus can take many forms. The focus may be on a particular consumer segment, a segment of the product line, a geographical area etc.

As indicated in Fig. 12.1, the focus strategy has two variants.

1. Cost Focus where a firm seeks a cost advantage in its target segment.
2. *Differentiation Focus* where a firm seeks differentiation in its target segment.

As Porter observes,[20] while the low cost and differentiation strategies are aimed at achieving their objectives industry-wide, the entire focus strategy is built around serving a particular target very well, and each functional policy is developed with this in mind. The strategy rests on the premise that the

firm is thus able to serve its narrow strategic target more effectively or efficiently than competitors who are competing more broadly. As a result, the firm achieves either differentiation from better meeting the needs of the particular target, or lower costs in serving this target, or both. Even though the focus strategy does not achieve low cost or differentiation from the perspective of the market as a whole, it does one or both of these positions *vis-à-vis* its narrow market target.

The focus strategy requires for its success a number of factors. They are the same common factors required for the success of the cost leadership and differentiation, related to the focus strategy, directed at the particular target market.

The focus strategy is also vulnerable to a number of risks. Important risks are the following.

1. Competitors may imitate.
2. Competitors may focus on sub-markets within the strategic segment and outperform the focuser.
3. The basis of focus may erode.
4. Customer characteristics and base may shift.

Several Indian companies have been pursuing focus strategy in their global game plan. For example, Ranbaxy, globally, is determinedly focused on generic molecules, and refuses to venture into other areas. That naturally gives it a sharp focus (In the domestic market, where it is the second largest player, it, however, takes the conventional route of branded products). All the products of Sundaram Fasteners are aimed at the auto industry, in keeping with Porter's prescription of targeting one precisely defined customer segment even if it means giving up others. Arvind Mills vision to achieve global dominance in select businesses built around its core competencies through continuous product and technical innovations and customer orientation with a focus on cost-effectiveness is indicative of its focus strategy.

The company has steadfastly refused to expand its portfolio beyond related value-added products despite the obvious temptation of leveraging its distribution depths in international markets.

For Bajaj Auto, cost leadership and focus are two sides of the same strategic coin; it refuses to enter businesses where its cost advantage will have to be sacrificed.

STRATEGIC POSITIONING

Michael Porter has later carried the understanding of the generic strategies which "characterise strategic options at the simplest and broadest level" to "a greater level of specificity" by elaborating the concept of strategic positioning.[21]

The logic of strategic positioning is that "competitive strategy is about being different. It means deliberately choosing a different set of activities to deliver a unique mix of value. In other words, "the essence of strategy is in the activities – choosing to perform activities differently or to perform different activities than rivals."

Types of Positioning

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

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

2. Needs-based Positioning: In needs-based positioning, the focus is on all or most of the needs of a particular group of customers. This strategy is appropriate when there are groups of customers with differing needs, and when a tailored set of activities can serve those needs best. Obviously, this strategy comes closer to the strategy of targeting a particular segment of consumers.

Porter also points out that a variant of the need-based positioning arises when the same customer has different needs on different occasions or for different types of transactions.

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

See the sub-section *Strategy/Strategic Management* in Chapter 1 for some comments on Positioning Strategy.

Trade-offs

Porter emphasises that choosing a unique position, however, is not enough to guarantee a sustainable advantage. There are two more essential conditions for ensuring sustainable advantage by preventing imitations. These are *trade-offs* and *fit.*

Trade-offs create the need for choice and purposefully limit what a company offers. Fit locks out imitators by creating a chain that is as strong as its strongest link.

Instead of committing itself fully to the chosen strategic position, if the company tries to mix with it tactics or elements of some other strategy, it would become self-defeating. Therefore, trade-offs that create the need for choice and purposefully limit what a company offers are essential to strategy.

Porter points out that trade-offs arise for three reasons. The first is *inconsistencies in image or reputation.* For example, if a company, which has a customer base because of a particular image, adds a line, which has a different image, it may confuse customers and may affect its credibility. Secondly, *trade-offs arise from activities themselves.* Different positions with their tailored activities require different product configurations, different equipment, different employee behaviour, different skills and different management system. Finally, trade-offs arise from limits on internal coordination and control – many differing customer groups, activities and approaches make coordination and control difficult. Porter concludes that "strategy is trade-offs in competing. The essence of strategy is choosing what *not* to do".

Fit

Porter explains that positioning choices determine not only which activities but also how activities relate to one another. The different activities must complement one another in ways that create real economic value. Such a fit locks out imitators by creating a chain that is as strong as its strongest link.

Porter identifies three types of fit, although they are not mutually exclusive. One is simple consistency between each activity (function) and the overall strategy. For example, if the strategy is a low-cost strategy, all the activities should align with this strategy. The second order fit occurs when

activities are reinforcing. For example, all the elements of the marketing mix should be mutually consistent and reinforcing. The third order fit goes beyond activity minimisation to what Porter calls *optimisation of effort*. The most basic types of effort optimisation are coordination and information exchange across activities to eliminate redundancy and minimise wasted effort. Examples of higher level optimisation include product design choices which eliminate the need for after-sales service or make it possible for customers to perform service activities themselves.

Competitive advantage grows out of the fit among the entire system of activities which substantially reduces costs or increases differentiation. Porter points out that while operational effectiveness in achieving excellence in individual activities, or functions, which may be easily copied, strategy is about *combining* activities which is fundamental not only to competitive advantage but also to the sustainability of that advantage – it is harder for a rival to match an array of interlocked activities than it is merely to imitate a particular activity or approach.

FOUR ROUTES TO STRATEGIC ADVANTAGE

Kenichi Ohmae in his *The Mind of the Strategist* observes: "A good business strategy is one by which a company can gain significant ground on its competitors at an acceptable cost to itself. Finding a way of doing this is the real task of the strategist."[22] He suggests the following four ways of strengthening a company's position relative to that of its competitors.

Strategy Based on KFS

In every industry or business, there would be some *key factors for success* (KFS). For example, in some industries like uranium where the finished product and its price are standardised among the firms, raw material sourcing is critical to success because the price of ore and the quality of the ore, which affects processing cost, are very important. In some industries, the critical factor is the production and/or marketing costs. In industries where the product is standardised, the critical factor of success may be price, distribution or after-sales service.

The method of business strategy based on KFS is to identify such critical factors and concentrate resources on them to gain strategic advantage over the competitors.

According to Ohmae, "if you are fighting with a competitor who has equal qualifications, effective and persistent execution in critical functional areas may be the only differentiating factor."[23]

This strategy has several risks. Competitors may catch up. Secondly, KFS may change over time. Finally, competitors may succeed in changing the ground rules of competition.

Strategy Based on Relative Superiority

The method of business strategy based on relative superiority avoids head on competition and seeks to exploit competitors' weaknesses.

Even when the competitors are very strong on the whole, there may be some critical factors or market segments where the company enjoys relative superiority that it can build into a strategic advantage.

The relative superiority may be in respect of technology, cost, product quality, suitability of the product to market environment, distribution, after-sale service, customer relations, cultural factors etc.

For example, if the product quality is superior, highlighting the superior quality and selling at price similar to that of the competitors (if cost factors permit that) could be a strategy. Or if the cost of production is significantly lower, the competitive strategy may be based on lower price.

Despite all its drawbacks, the *Ambassador* car has a relative superiority that it is suited to the Indian conditions and spare parts are cheap and easily available. Is it possible for the company to build upon this superiority, make design and other engineering improvements and strengthen its competitive position? Haldirams has the relative superiority over the multinationals that it has expertise and experience in ethnic foods. The relative superiority of some products is their herbal base and absence/low level of chemical ingredients.

The limitations of this strategy are that (1) competitors may imitate and may even gain greater superiority, and (2) market conditions and nature of competition may change.

Strategy Based on Aggressive Initiative

Ohmae points out that when the competitors are so well established that it may be hard to dislodge, "sometimes the only answer is an unconventional strategy aimed at upsetting the key factors for success on which the competitor has built an advantage. To arrive at such a strategy, the starting point is to challenge the accepted assumptions governing the way of doing business in the industry or markets in question with a view to seeing whether it may be possible to change the rules of the game, upset the status quo, and thereby gain a novel and powerful competitive advantage."[24]

The method of this strategy is to challenge the prevailing assumptions with a simple question *why*? For example, why should be the design of a particular product be as it is? Why should a particular process or method of doing is so? As Ohmae points out, this way bottlenecks to fundamental improvement are identified, and major breakthrough in achieving the objectives of the business become possible.

Strategy Based on SDF

The fourth route to superior competitive performance is to exploit the strategic degrees of freedom (SDF). Ohmae suggests that this mode of thinking is particularly relevant for consumer goods companies and cost-conscious industrial goods manufacturers.

This strategy for success in the competitive struggle rests on successful deployment of innovations. "These innovations may involve the opening up of new markets or the development of new products. Both lines of action involve exploitation of the market by vigorous measures in particular areas untouched by competitors."[25]

For example, a company may think of increasing the market share of its car by improving the mechanical system and/or by improvements in industrial engineering aspects if there is sufficient degree of strategic freedom for such moves.

Similarly, there may be scope for innovations in marketing, including exploitation of new markets.

In case of this strategy also, there is the chance of competitors following the same thing unless there are barriers like patent protection or technological barriers. For sustaining the superiority gained, the company may have to keep expending attention and resources.

In the words of Ohmae, "in each of these cases, the principal concern is to avoid doing the same thing, on the same battleground, as the competition. The aim...is to attain a competitive situation in which your company can (1) gain a relative advantage through measures its competitors will find hard to follow and (2) extend that advantage still further."[26]

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CHAPTER

13

Corporate Level Generic Strategies

As pointed out earlier, strategic management is establishing a proper firm environment fit. Therefore, as the environment (i.e., the treats and opportunities) changes or the characteristics of the firm (i.e., the organisational strengths and weaknesses and factors like vision/mission) changes an evaluation of the firm-environment fit may become necessary. It would be appropriate to recall here the observation of Peter Drucker quoted in Chapter 1. The ultimate objective of strategic planning "is to identify the new and different businesses, technologies, and markets which the company should try to create long range. But the work starts with the question what *is* our present business? Indeed, it starts with the questions which of our *present* businesses should we abandon? Which should we play down? Which should we push and supply new resources to?" This summarises the essence of corporate level generic strategies.

The corporate level generic strategies pertain to the question which business(es) the company shall be in and what should be the development strategy in respect of each of these businesses? The generic strategies are concerned with, thus, the portfolio strategy. (These generic strategies are also applicable to SBUs when they confront the question of the business(es) they shall be in).

There are four alternative strategies, viz., stability, expansion, defence and a combination. Several examples of the various strategies are given in several places in this book, particularly in the chapters on *Portfolio Strategy*, *Mergers and Acquisitions* and *Globalisation.*

STABILITY STRATEGY

If the answer to the question whether the company should continue in the existing business is affirmative and if the company is doing reasonably well in that business but no scope for significant growth, the strategy to be adopted is stability. (The stability strategy is sometimes referred to as *neutral* strategy).

As Jauch and Glueck observe,[1] a stability strategy is a strategy that a firm pursues when:

1. It continues to serve the customers in the same product or service, market, and functional sectors as defined in its business definition, or in very similar sectors.
2. Its main strategic decisions focus on incremental improvement of functional performance.

The stability strategy is not a "do nothing" strategy. As indicated above, it may involve incremental improvements. It also requires adoption of appropriate competitive strategies to remain successful in the business. It may also have to make offensive and defensive moves *vis-à-vis* the competitors.

Long-term stability strategy also requires reinvestment, R&D and innovation. However, the business definition remains the same.

In short, this "do-the-same thing" strategy endeavors to "do-the-same thing better."

This strategy is common with large and dominant companies in mature industries where the important challenge is to maintain the current position. Another category of industries this strategy is common with is the regulated industries such as alcoholic beverages, tobacco products etc. Many family dominated small and medium companies also prefer this strategy.

Reasons for Stability Strategy

The important reasons for pursuing stability strategy are the following:

1. The company is doing fairly well and it is hopeful of the same in future.
2. A family dominated or private company may not like to expand its business if it amounts to diluting the control or if effective supervision is not possible by the family members.
3. The feeling that sticking to the known business is always better and safe.
4. The company may not have the resources and capabilities for expansion.
5. The company may not want to take the risks of growth and expansion.
6. The company which has core competence in the existing business does not want to take the risk of losing sufficient attention to the current business by going for diversification.
7. The management does not have the mind-set of a strategist to analyse the environmental opportunities and seize the opportunities.

GROWTH STRATEGY

If the answer to the question 'Should the company increase the level of activities in the current business and/or enter new business(es)?' is affirmative, a growth (expansion) strategy is called for.

The growth strategy amounts to redefining the business by adding new products/services or new markets or by substantially increasing the current business. In other words, a company pursues a growth strategy when:

1. It enters new business (including functions) or market.
2. Effects major increase in its current business.

A company may pursue either or both internal or external growth strategies. Growth strategies are discussed in detail in the next chapter.

Reasons for Growth Strategy

Important factors, which encourage companies to adopt growth strategy, are the following.

1. The current business is perceived as having no future.
2. The current business is unstable or volatile in nature.

3. The current business does not fully utilise the available resources and capabilities.
4. There is a feeling of the need for spreading business risks.
5. In some cases, expansion is a retaliatory move. When a company in another business enters the firm's business, the firm retaliates by entering the other company's business.
6. Some firms have a tendency to imitate the growth strategies of competitors.
7. In many cases, growth strategy is the result of the urge to grow.
8. In several cases, the motive for growth is the objective to increase market share or gain dominance.
9. In many cases, growth strategy results from the decision to exploit the environmental opportunities.

RETRENCHMENT STRATEGIES

Retrenchment strategy, also known as *defensive* strategy, involves contraction of the scope or level of business or function. In some cases, it amounts to a redefinition of the business.

A firm pursues a retrenchment strategy when:

1. It drops product line(s), market(s), market segment(s) or function(s).
2. Focuses on functional improvements or reversing certain deteriorating trends.

Reasons for Retrenchment Strategy

There are a number of situations that necessitate a retrenchment strategy.

1. Certain divisions/product lines/products/market segments/functions are not profitable.
2. The profit from a business is less than the target rate.
3. The company's new strategy is to focus on its core business.
4. The company is too diversified/scattered that effective management is not possible.
5. The company has serious financial problem so that the funds obtained by divestiture can be used for strengthening other businesses.
6. Certain current business does to confirm to the company philosophy/ethics.
7. The company is confronted with deteriorating performance indicators (see the chapter on *Turnaround Management and Restructuring* for details).

DEFENSIVE STRATEGIES

Defensive strategies include divestiture, liquidation, becoming a captive and turnaround.

Divestiture

A divestiture strategy is pursued when a company sells or divests itself of a business or part of a business. It may be because of loss, less than target rate of return, urgency to mobilise funds, managerial problems, or redefinition of the business of the company.

Liquidation

Liquidation occurs when an entire company is sold or dissolved. The reasons for divestiture mentioned above could also be reasons for liquidation.

When there are no buyers for a company that wants to be sold, its assets may be sold and company may be wound up.

Becoming a Captive

A firm becomes a captive of another firm when it subjects itself to the decision of the other firm in return for a guarantee that a certain amount of the captive's product will be purchased by the other firm.

Turnaround Strategy

A turnaround strategy involves management measures designed to reverse certain negative trends and to bring the firm back to normal health and profitability. For details, see the chapter on *Restructuring and Turnaround.*

COMBINATION STRATEGY

A company pursues a combination strategy when it adopts more than one grand strategy (i.e., stability, growth, and retrenchment) simultaneously or sequentially.

The reason for pursuing a combination strategy is the existence of a combination of reasons for any two or more of the other three generic strategies.

Under the combination strategy, a company adopts any one of the following:

1. Stability and growth strategies.
2. Stability and retrenchment strategies.
3. Growth and retrenchment strategies.
4. Growth, retrenchment and stability strategies.

A combination strategy results from environmental changes and redefinition of the business portfolio of the company.

Box 13.1

ITC's Combination Strategies

ITC was established in 1910 under the name Imperial Tobacco Company of India Ltd. As the company's ownership progressively Indianised, the name of the company was changed from Imperial Tobacco Company of India Ltd. to Indian Tobacco Company Ltd. in 1970 and then to I.T.C. Ltd. in 1974. In recognition of the company's multi-business portfolio encompassing a wide range of businesses, the full stops in the company's name were removed effective from September 18, 2001. The company now stands rechristened ITC Ltd. where 'ITC' is today no longer an acronym or an initialised form.

In the first six decades, the company concentrated on the growth and consolidation of the cigarettes and leaf tobacco businesses. The packaging and printing business which the company set up in 1925 was a strategic backward integration for ITC's cigarettes business.

ITC started a strategic diversification move in the mid-1970s by entering the hospitality business, which eventually led to the development of the second largest Hotel Chain in India. The company steadily added new businesses to its business portfolio like, financing, agribusiness, paperboards and speciality papers and infotech.

ITC's foray into the packaged foods business in 2001 is an outstanding example of successfully blending multiple internal competencies to create a new driver of business growth. In 2000, it entered lifestyle retailing with premium men's apparel. In 2002, ITC launched the education and stationery products business. The company entered the Personal Care Business in 2005.

ITC also supports small and cottage sector through its agarbattis and safety matches business.

ITC has been following a combination of strategies for its development. In the tobacco industry, ITC, the largest Indian firm, is globally reputed. However, in the context of the social campaign against tobacco consumption and the growing awareness of the consequences of tobacco usage, the limitations of the tobacco business in spuring the growth of a company became very obvious. It is no wonder that ITC, therefore, adopted a stability strategy for the tobacco business and pursued an aggressive diversification strategy for a rapid growth trajectory. As indicated above under the section *Stability Strategy*, the stability strategy is not a 'do nothing' strategy; it may require reinvestment, R&D and innovation. It has been very much true of ITC's tobacco business which continues to grow, athough at a lower rate than the overall growth of ITC.

ITC's diversification into financial sector (ITC Classic) ended in a failure, judged by the huge loss it accumulated *vis-à-vis* the size of its business. ITC, therefore, exited this business (i.e., retrenchment/ divestiture strategy).

ITC has been following an impressive growth strategy in respect of its first major diversification – hospitality business. Its hotel business has grown to occupy a position of leadership, with over 100 owned and managed properties spread across India under four brands namely, *ITC Hotels – Luxury Collection, Welcom Hotels, Fortune Hotels and Welcom Heritage.* Internationalisation of the hospitalty business has also set in.

In 2000, ITC spun off its information technology business into a wholly owned subsidiary, **ITC Infotech India Ltd.** to more aggressively pursue emerging opportunities in this area. Today, ITC Infotech is one of India's fastest growing global IT and IT-enabled services companies and has established itself as a key player in offshore outsourcing, providing outsourced IT solutions and services to leading global customers across key focus verticals – Banking Financial Services and Insurance (BFSI), Consumer Packaged Goods (CPG), Retail, Manufacturing, Engineering Services, Media and Entertainment, Travel, Hospitality, Life Sciences and Transportation and Logistics.

ITC's smart diversification into non-tobacco FMCG sectors has become a major driver of the company's impressive growth. According to the company source, it "is today proud to have created over 50 energetic and popular brands across categories that delight nearly 140 million households. Within a relatively short span of time, ITC has established vital brands with significant salience among consumers like *Aashirvaad, Sunfeast, Bingo!, Yippee!, Candyman, mint-o and Kitchens of India* in the **Branded Foods** space and *Essenza Di Wills, Fiama Di Wills, Vivel* and *Superia* in the **Personal Care products** segment. In addition, brands like *Classmate* and *Paperkraft* in **Education and Stationery products**; *Wills Lifestyle* and *John Players* in the **Lifestyle Apparel business**; *Mangaldeep* in **Agarbattis** as well as *Aim* in **Matches** have established significant market standing and continue to delight consumers with superior offerings."

As a result of ITC's chosen strategy of creating multiple drivers of growth, it is "today, the leading FMCG marketer in India, a trailblazer in 'green hoteliering' and the second largest Hotel chain in India, the clear market leader in the Indian Paperboard and Packaging industry and the country's foremost Agribusiness player. The company's wholly-owned subsidiary, ITC Infotech India Limited,

is one of India's fast growing Information Technology companies in the mid-tier segment." The company with a market capitalisation of over ₹ 2,60,000 crores in the beginning of 2013 has consistently featured amongst the top 10 private sector companies in terms of market capitalisation and profits.

The non-cigarette segment net revenue has grown 14-fold from about ₹ 1,360 crores in 1996 to nearly ₹ 19,500 crores in FY 2013. As a result, 58 per cent of net segment revenue of ITC in FY 2013 was from businesses other than cigarettes. This shows the great role diversification has played in the growth of ITC, even as its traditional business, cigarettes, has been growing.

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CHAPTER

14

Business Growth

WHY AND HOW BUSINESS GROW?

A business may grow by:

- Increasing its existing line(s) of business in the existing market(s).
- Adding new line(s) of business, including entirely different businesses.
- Entering new market(s).

In fact, many companies pursue growth by all these means. For example, the Cochin-based V-Guard group, which started its business with voltage stabilisers, initially expanded its business by adding new lines of electrical goods, but later entered entirely different businesses – tourism (*Wonderla* theme parks), real estate and readymade garments (*V-Star*). While its electrical goods business continues to grow, the tourism business has been developed by adding new parks and restaurants. The readymade garments business has been expanded by introducing new lines.

Business expansion means adding new line(s) or entering new markets. Business expansion is an important strategy of business growth. When the potential of the existing markets or products is fully tapped, further growth can come only from expansion.

Even when the current market for the current business line is not fully exploited, a company may resort to expansion due to various reasons like better growth or profit opportunities provided by expansion, minimisation of risk by diversification, improving competitive strength etc.

When a firm does not have sufficient resources to grow by itself, it may resort to foreign collaboration, including joint ventures. Such collaborations may also enable a company to grow by expanding to foreign markets.

In many cases, the domestic market limits the growth prospects. The size of the domestic market may be too small that it is not possible to achieve economies of scale. Further, the markets of several countries have reached a saturation level and some are even declining. For example, in the advanced countries where the birth rate is falling, the market for several baby products is declining. Such factors may prompt a company to become multinational. Even when domestic market is growing well, companies may seek to expand globally for rapid growth or other reasons, as has been the case of many Indian companies. (Examples are cited in many places in this book, particularly in the next chapter.)

REASONS FOR GROWTH

There are a number of reasons or motives for growth (including expansion of business). Important reasons for growth are given below.

1. **Natural Urge:** A healthy firm normally has a natural urge for growth. Opportunities provide great stimulus to such urge. For example, if the demand for a company's products were steadily increasing, there would be a natural urge to make best use of the opportunity. Further, in a dynamic world characterised by the growth of many firms around it, a firm would have a natural urge for growth.
2. **Survival:** Sometimes, growth is essential for survival. In some cases, a firm may not be able to survive unless it has the critical minimum level of business. So, growth to achieve that critical minimum level is necessary. When operations are below the optimal level, the incidence of fixed costs are high and business may not be able to break-even. Further, if a firm does not grow when competitors are growing, it might undermine its competitiveness.
3. **Market Share:** A company may grow to increase its market share. Growth is necessary even to maintain the market share in a growing market.
4. **Leadership:** Market leadership is an objective of growth for several companies.
5. **Competition:** In several cases, growth may be a competitive strategy. By foreclosing the supply gap, a company may be able to preempt competition. Further, when a competitor enters the company's market, the company may enter the competitor's markets as a countercompetitive strategy. There is also a tendency on the part of several companies to grow in the same ways as the competitors grow.
6. **Diversification of Risk:** A company may diversify its business to minimise the risks.
7. **Resources:** Full utilisation of the existing resources or potentials of the company is an objective of growth in many cases.
8. **Opportunities:** Exploitation of the business opportunities is often a motivation for growth. For example, the economic liberalisation in India has enormously increased the business opportunities.
9. **Motivation:** People working in the organisation will be motivated only if there are challenges, opportunities and growth. A firm, which does not grow, will find it very difficult to keep efficient people with it.
10. **Personal Reason:** Sometimes, personal reasons could also be behind the policy to grow. For example, head of a family group business in India stated that the group was diversifying its business because there was not enough business for all the members of the family.
11. **Profit:** To increase profits is often an objective of growth.
12. **Miscellaneous:** There could also be other motives for growth like special objectives (like production of essential goods, exports, import substitution, protection of interests of farmers by processing agricultural products, providing work to employees displaced by modernisation etc.

INDICATORS OF GROWTH

There are a number of indicators of growth. The important indicators are:

1. Increase in net worth
2. Increase in total assets
3. Increase in the number of employees
4. Increase in the total volume of business
5. Increase in the market share
6. Increase in the number of products and markets
7. Increase in profits.

It is not necessary that all the above indicators should be positive simultaneously. Business growth could take place even with negative trend in some of the indicators. For example, if labour-saving technology is substituted, business could grow even with lower number of employees. Similarly, when the total market is growing faster than the growth in the sale of the company, growth takes place with declining market share.

RISKS OF GROWTH

There is a general feeling that business growth is good. However, it is important to note that there are several risks associated with growth and growth may land some companies in trouble. Common risks associated with growth are the following:

1. An increase in the productive capacity would have very adverse effect if the demand falls.
2. If new business fails, that could sometimes even affect the old business.
3. There is a tendency to concentrate more on the new business at the expense of old business.
4. A rapid and substantial growth of business may sometimes lead to ineffective management.
5. When a firm becomes large, it may lose several advantages like tax concessions, subsidies, exemption from several laws causing an increase in costs and other problems.
6. As a firm grows significantly, it is likely to receive more attention by competitors and the public.

GROWTH STRATEGIES

There are a number of strategies for growth. Kotler has grouped these strategies under three heads, viz.,

1. Intensive growth strategy.
2. Integrative growth strategy.
3. Diversification growth strategy.

Intensive Growth Strategies

Intensive growth strategies aim at achieving further growth for existing products and/or in existing markets. There are three important intensive growth strategies, viz., market penetration, market development and product development.

Market Penetration Strategy

Market penetration strategy strives to increase the sale of the current products in the current markets. There are the following three major strategies to achieve this.

1. **Increase sales to the current customers:** For example, if customers of toothpaste, who brush teeth once a day now, habituate to brush twice a day, the sale of the product to the current consumers would almost double.
2. **Pull customers from the competitors' products:** If the company succeeds in making the customers to switch from the competitors' brands to the company's brands while maintaining its existing customers intact, there will be an increase in the company's sales. This is growth at the expense of the competitors. The competitors would naturally fight back. This strategy will, therefore, succeed only if the company has some distinctive edge over the competitors.
3. **Convert non-users into users:** If there is a significant number of non-users of a product who could be made users of the product, that provides a potential opportunity for increasing the sales. For example, in India, there is a very large number of people, particularly in the rural areas, who do not have the habit of using toothpaste who could be encouraged to start using the product. It was reported that *Balsara* introduced the *Babool* toothpaste mainly targeting the first time users.

Market Development Strategy

The market development strategy involves broadening the market for a product. This may be achieved by the following strategies.

1. By adding new channels of distribution and thereby expanding the consumer reach of the product.
2. By entering new market segments. For example, the Hindustan Lever (now Hindustan Unilever) entered the low price detergent market by introducing the *Wheel*. The company increased its share of the toothpaste market from less than 7 per cent in 1989 to 17 per cent 1992 by opening up new segments through innovative products and packaging.
3. By entering new geographical markets. A company, which has been confined to some part of a nation, may expand to other parts and foreign markets. The Nirma which in the beginning had been confined to the local market later expanded to the regional market and then to the national market.

Product Development Strategy

A company may be able to increase its current business by product improvement or introducing products with new features. *Colgate-Palmolive* has been trying to maintain its share of the toothpaste

market by introducing new brands. (Maintaining the market share in a growing market means, obviously, increasing sales).

Many companies endeavour to maintain/increase sales through continuous feature improvements/introduction of new products. This is very obvious in certain industries like electronics, white goods, passenger vehicles (including two-wheelers) etc.

Often, market development and product development strategies facilitate better market penetration.

INTEGRATIVE GROWTH STRATEGIES

One of the common growth strategies is the integrative growth strategy. A major contributor to the growth of Reliance Industries in the early stages was backward and forward integration. It is today the most fully integrated company in the world (from petroleum exploration to textiles retailing).

There are broadly two types of integrative growth:

1. Integration at the same level or stage of business in the same industry (horizontal integration), or
2. Integration of different levels/stages of business in the same industry (vertical integration).

Horizontal Integration

Integration at the same level of business, popularly known as horizontal integration, involves the acquisition of one or more competitors. For example, a tyre company may grow by acquiring another tyre company. Examples of horizontal integration includes acquisition of Universal Luggages (Aristocrat) by Bloplast (V.I.P.) and Tata Oil Mills Company (TOMCO) by Hindustan Lever. The Indian cement industry has witnessed considerable horizontal integration. The FMCG sector has recently undergone several acquisitions resulting in horizontal integration (Table 14.2 gives some examples).

Perhaps the most important advantage of horizontal integration is that it eliminates or reduces competition.

Vertical Integration

Integration of the different levels/stages of the same industry is known as vertical integration.

Vertical integration may be:

1. Backward integration, or
2. Forward integration.

Vertical integration may be brought about by greenfield investment (i.e., investment in entirely new project) or by acquisition of existing enterprise.

Backward Integration

Backward integration involves starting the preceding stage of the current business. For example, manufacturer of a finished product may start the manufacture of the raw material required for the finished product. For instance, a detergent manufacturer may take up the manufacture of LAB that is a

raw material for detergents (as has been done by Nirma). By establishing a packaging and printing business, ITC resorted to backward integration for its cigarettes business.

A company which currently only markets a products, taking up the manufacturing of it is another example of backward integration. For example, the erstwile Brook Bond Ltd. (which was merged with Hindustan Lever) resorted to backward integration by acquiring tea plantations.

Backward vertical integration has been the cornerstone of the evolution and growth of Reliance. Starting with yarn trading and then textiles manufacturing in the late seventies, Reliance pursued a strategy of backward vertical integration – in polyester, fibre intermediates, plastics, petrochemicals, petroleum refining and oil and gas exploration and production – and forward integration to textiles retailing to be fully integrated along the materials and energy value chain. Reliance has well leveraged its strengths with opportunities unfolded by the economic liberalisation and its activities now span exploration and production of oil and gas, petroleum refining and marketing, petrochemicals (polyester, fibre intermediates, plastics and chemicals), textiles, retail, infotel and special economic zones. It enjoys global leadership in its businesses, being the largest polyester yarn and fibre producer in the world and among the top five to ten producers in the world in major petrochemical products.

Backward integration has certain advantages. It ensures smooth supply of materials for production or goods for marketing. This is particularly important when there are supply bottlenecks. Secondly, it may enable the company to obtain the goods cheaply or to make some profits out of the manufacturing. Thirdly, it may also help the company to ensure quality of the goods. Further, it may also facilitate tax savings.

Backward integration, however, is not an unmixed blessing. In some cases, it may have the following problems:

1. The cost of making may be higher than the cost of buying.
2. Integration may make exit from a business more difficult.

Forward Integration

Forward integration means entering the subsequent stage of the industry. For example:

1. The manufacturer of a product who does not do the marketing of it currently, may start the marketing of it.
2. The manufacturer of the raw material may take up the manufacture of the finished product. For instance, a LAB manufacturer may start the manufacture of detergents.

Some tea plantations like AVT, Mahavir Plantations, Harrisons Malayalam etc. started consumer packing and marketing of tea. Textile firms like Bombay Dyeing, Maftalal, J & K (Raymonds) resorted to forward integration by entering the readymade garments business.

The advantages of forward integration are:

1. It creates captive demand for the product.
2. It may generate additional profit.

The major risk of forward integration is that there is no guarantee that the new business will be a success.

DIVERSIFICATION

Diversification means adding new lines of business. The new lines of business may be related to the current business or may be quite unrelated. If the new lines added make use of the firm's existing technology, production facilities or distribution channels or it amounts to backward or forward integration it may be regarded as related diversification. (Example: the diversification of Videocon). Some companies expand the business into unrelated industries (Example: Wipro which is in the business of several FMCG, electical and lighting, furniture and IT. Other examples include the V-Guard cited in the beginning of this chapter, Reliance (see Table 5.3 in Chapter 5), LG, Samsung, Hyundai, General Electric etc. Also see Box 14.2. Expanding the market to geographical areas where the company has not had business is also regarded as diversification.

Diversification is also described as portfolio change. See the chapter on Portfolio Strategy for details.

Large conglomerate (diversified) business houses dominate the industrial sector of many countries. While most of the top industrial houses of the US are focused, of the West European and Asian countries like Japan, South Korea and India are diversified.

Reasons for Diversification

The important reasons for companies diversifying their business are the following.

1. **Saturation or decline of the current business:** If the market for the current business is not growing or is declining, it may become necessary to enter new business to achieve growth.
2. **Additional opportunities:** Even when current business provides scope for further growth, diversification provides additional opportunities for growth.
3. **Better opportunities:** There may be better opportunities in new lines of business. They may look more attractive because of faster growth of the market, limited competition, higher profit margins, stability of demand etc. A firm in a sunset industry may be tempted to enter sunrise industries.
4. **Risk minimisation:** Some companies diversify their business to eliminate or reduce the risks associated with confining the business to one or very few products.
5. **Better utilisation of resources and strengths:** Diversification enables companies to make better utilisation of its resources and strengths. It may enable better utilisation of production facilities, technological capabilities, managerial expertise, marketing infrastructure like distribution channels and sales personnel, financial resources etc. Synergetic advantages could become a reason for diversification.
6. **Benefits of integration:** Diversification may also be encouraged by the benefits of backward and/or forward integration mentioned earlier.
7. **Competitive strategy:** Diversification may also be a competitive strategy. For example, when Indana Industries entered the instant coffee market with the Gold Cafe, the Nestle and Food Specialties (the Indian fanchisee of Nestle) retaliated by entering the market for ghee that was Indana's major business. A company may enter new lines of business to preempt potential competitors or to gain an edge over competitors by entering the market before the

competitors. Sometimes, some companies follow the same course followed by competitors in business expansion.

8. **Need-related diversifications:** A company may introduce new products to serve its current customers better or to cater to all the related needs of the current customers. Example: Camlin, Kores etc.
9. **Consolidation:** Diversification may also be aimed at consolidating the company's market position, image etc.
10. **Inspiration:** Diversification may charge people at various levels, particularly the managerial and technical personnel, with vigour, inspiration and enthusiasm so that competent people would be encouraged to stay with the organisation.

Risks of Diversification

Diversification entails several risks, like the following:

1. There is no guarantee that the firm will succeed in the new business. In fact, many diversifications of a number of companies have been failures.
2. If the new lines of business result in huge losses, that may adversely affect the old business.
3. Diversification may sometimes result in the neglect of the old business or the management not being able to pay sufficient attention and resources to the old business.
4. Diversification may invite retaliatory moves by competitors that may adversely affect even the old business.

Types of Diversification

Broadly, there are two types of diversification, namely, synergistic diversification and conglomerate diversification.

Synergistic Diversification

Synergistic diversification is diversification that results in the realisation of synergistic effects. In business literature, synergy is often described as '2 + 2 = 5' effect which implies that the result of the combined performances will be greater than if they were done separately and independently. In other words, synergy offers a firm the advantage of higher consolidated return on investment than can maximally be obtained from a conglomerate (i.e., separate) firm. For example, if a firm which is currently selling product 'A', introduces a new product 'B' which can be sold by the same salesmen selling product 'A', the average selling cost of these products will be lower than if they were handled by separate salesmen for each product. Similarly, if a company publishing a newspaper introduces several periodicals such as a general weekly, a women's magazine, a literary journal, a children's magazine, a business periodical etc., it would enable it to share the production, administrative and selling overheads.

Following are important possible synergies.

1. **Marketing Synergy:** Marketing synergy can occur when products use common distribution channels, sales promotion (including sales personnel) and sales administration.

2. **Operating Synergy:** Operating synergy is realised by better utilisation of facilities and personnel, economies in purchasing etc.
3. **Investment Synergy:** This can result from the use of same production facilities, technology, materials etc.
4. **Management Synergy:** Management synergy exists if the existing managerial expertise of the company will be an advantage for the new business.

Videocon is an example of a company that followed synergistic diversification. It has taken advantage of all the synergies mentioned above.

If a company adds new products that have technological and/or marketing synergies with existing product lines, even though they are meant for new class of customers, that is described as *Concentric Diversification.* For example, an audiocassette tape manufacturer may start computer-tape manufacturing using the know-how it possesses.

If a company introduces a new product which is technologically unrelated to the current product line but which has appeal to its current customers, it is described as *horizontal diversification.* For example, Camlin has introduced several products that are not technologically related with each other but are meant for same customer class.

Although synergistic diversification has the advantages of synergy, overemphasis on synergy could lead to neglect of several good business opportunities, which have no synergy with the current business. Thus, the overemphasis on synergy could confine an enterprise to a particular field of business with all its disadvantages.

Further, synergy by itself does not guarantee success.

Box 14.1

Synergistic Diversifications at Manorama

The Malayala Manorama Company Ltd., established in 1888, whose flagship product is the Malayala Manorama daily (the second largest circulated daily in India) is an example of smart diversification deploying the enormous operational, marketing, administrative and investment synergies. While most of its products represent concentric diversification, there is horizontal diversification too (TV channels, audiocassettes, FM radio).

Most of its products are printed publications with different periodicity, ranging from daily to annual.

Some its products are multilingual. For example, the well-known *Manorama Yearbook* is a concise encyclopedia of current affairs and general knowledge, is published annually in English, Hindi, Tamil and Bengali languages, besides Malayalam. The fortnightly women's magazine *Vanitha* is published in Malayalam and Hindi. As Table 14.1 shows, there are several English periodicals, including the popular weekly, *The Week.*

The company's product lines also include TV channels. It has two Malayalam channels – Manorama News (a news and features channel) and Mazhavil Manorama (an entertainment channel – 'mazhavil' means rainbow).

Table 14.1
Manorama Publications

Name	Frequency	Language	Type
Arogyam	Monthly	Malayalam	Health
Balarama	Weekly	Malayalam	Comic magazine
Balarama Amar Chitra Katha	Fortnightly	Malayalam	Comics
Balarama Digest	Weekly	Malayalam	Children
Bhashaposhini	Monthly	Malayalam	Arts and literature
Kalikkudukka	Weekly	Malayalam	Children
Karshakasree	Monthly	Malayalam	Agriculture
FastTrack	Monthly	Malayalam	Automobile
Magic Pot	Weekly	English	Children
The Man	Monthly	English	Men's lifestyle
Manorama Weekly	Weekly	Malayalam	General interest
Smart Life	Monthly	English	Society
Tell Me Why	Monthly	English	Children
Thozhil Veedhi	Weekly	Malayalam	Career
Vanita	Fortnightly	Hindi	Women
Vanitha	Fortnightly	Malayalam	Women
Vanitha Veedu	Monthly	Malayalam	Property
Watch Time India	Monthly	English	Technology
The Week	Weekly	English	News and general interest

Conglomerate Diversification

Conglomerate diversification is quite unrelated diversification, i.e., the new business will have no relationship to the company's current technology, products or markets. For example, the ITC's diversification described in Box 13.1, Reliance's diversification given in Table 5.3 (Chapter 5), the diversifications of V-Guard and Wipro mentioned earlier in this chapter etc.

Many companies achieve conglomerate diversification by mergers and acquisitions (M&As), like Nirma's entry into the pharmaceutical business.

While some companies go in for conglomerate diversification with the same firm, some corporates establish separate companies for managing different types of business. A company belonging to a conglomerate (group of companies) itself may resort to conglomerate diversification.

While conglomerate diversification provides enormous scope for business expansion and growth and diversification of risks, diversification into quite unrelated and inexperienced fields may sometimes create their own problems.

Box 14.2

Conglomerate Business Houses

The business sector (industrial, trading, financial sectors) of many countries are characterised by large conglomerate business houses playing a very important (often a dominant or influential) role. A conglomerate business house is a business house with a diversified business portfolio (i.e., having a significant presence in several businesses). It is true of India too.

In Japan and South Korea, most of the top corporates are conglomerates. In Western Europe too, many are conglomerates. But in the US, only the General Electric among the top ten is a conglomerate.

Large industrial houses of India include Tatas, Birlas, Reliance, ITC, Avantha (the erstwhile Thapur Group), Mahindra and Mahindra, Godrej, Murugappa, Goenka etc. Many of the large industrial houses consist of a group of companies. For example, the Tata Group has more than 100 companies. Some of the companies of this group are giants in terms of size. Tata Steel is a *Global Fortune 500* company. Tata Global Beverages (former Tata Tea) is the second largest tea marketing firm in the world and Tata Motors is globally one of the largest. TCS is the largest Indian IT firm. Some of the companies coming under the business groups are also conglomerates.

EXTERNAL GROWTH STRATEGY

External growth strategy refers to growth by mergers and acquisitions and joint ventures/foreign collaborations.

Mergers and Acquisitions

Mergers and acquisitions (M&As) were a strategy employed by several industrialists like R.P. Goenka, Vijay Mallya and Manu Chhabria for growth. Companies taken over by R.P.G. included Dunlop, Ceat, Philips Carbon Black, Gramaphone India and Harrisons Malayalam. Two of these – Philips Carbon Black and Harrisons Malayalam (plantation) have linkages with the tyre (Ceat and Dunlop). Mallya's U.B. Group was straddled mostly by takeovers. Companies under the U.B. conglomerate included Best and Crompton (engineering), Mangalore Chemicals and Fertilizers, Kissan (foods) and Unitel (telecom) besides the four liquor firms (United Breweries, Carew Phipson, Herbertson and McDowell). M&As are an important growth strategy employed by the giant Hindustan Lever. The Ajay Piramal Group has almost entirely been built up by M&As. It may be noted that several companies had to give up some of the acquired companies later due to various reasons.

A number of examples of recent M&As are given in many places in this book, particularly in the next chapter. Motives/advantages of M&As are described in the chapter on *Mergers and Acquisitions*.

Foreign Collaborations/Joint Ventures

Foreign collaborations/joint ventures have become very popular world over for various reasons. It has been reported that in the 1990s joint ventures as a development vehicle for corporations has fast replaced mergers and acquisitions, the rage of the 1980s.[1]

Advantages

The main advantages of foreign collaboration/joint ventures from the point of view of Indian firms are the following:

1. It enables the Indian firm to upgrade the existing technology or to obtain new technology.
2. Acquisition of new technology enables the firm to enter new business.
3. Foreign equity participation enables the Indian company to take up projects with larger outlay than would be possible without such collaboration.
4. Foreign collaboration may make it easier for the Indian company to raise capital through public issue because the public, generally, has a more favourable attitude towards companies with foreign collaboration.
5. Foreign collaboration may help the Indian company to gain managerial expertise.
6. In some cases, collaboration with the foreign firm would help to pre-empt competition.
7. Foreign collaborations in many cases help the Indian company in its exports. The technological upgradation would improve the company's competitiveness not only in the domestic market but also in the foreign market. Similarly, the new technology may also help the company in exports. When the collaboration involves foreign equity participation, the foreign collaboration may take an active interest in the exports of the joint venture. A number of Indian companies have been able to increase/start exports because of foreign collaborations.
8. Foreign collaboration may help improve quality, reduce wastage, improve productivity and reduce cost.

Disadvantages

The foreign technology supplied may not be the latest. Particularly when the foreign collaboration does not have equity participation, the collaborator may be reluctant to transfer the latest technology.

There are chances of the foreign collaborator overcharging. For example, if the foreign company's contribution to the capital takes the form of supply of machinery, the chances of overcharging cannot be ruled out.

When there is a tie-up of foreign capital with technology, the Indian party cannot opt for technology of other firms even if that is better.

In some cases, the foreign technology may not be appropriate one for the local conditions.

When there is foreign equity participation, there would also be participation in the management by the foreign company. If the foreign company has majority shareholding, control of management would be mostly in the hands of the foreign collaborator and the foreign company's interests would influence the company's policies and future development. It is to gain control over the management that several foreign companies have raised their equity holding in their joint ventures in India to 51 per cent taking advantage of the policy liberalisations. It may be noted that Mafatlal's refusal to permit the Royal

Dutch Shell to raise its equity holding in their joint venture, National Organic Chemical Industries Ltd. (Nocil), resulted in Shell pulling out of Nocil. Mafatlal turned down Shell's proposal for raising the equity holding to 51 per cent because Mafatlal wanted "Nocil to be a proper Indian company".

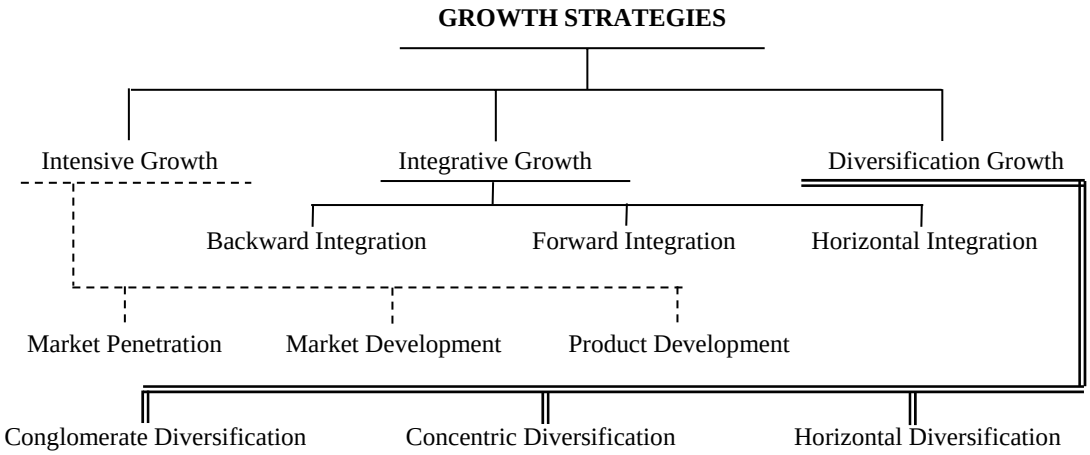

Fig. 14.1: Growth Strategies

Box 14.3

Organic and Inorganic Growth

Broadly, there are two routes to growth, whether growth in an existing business or by adding a new business. These two routes or growth strategies are organic growth and inorganic growth.

Organic growth is increasing the business using the existing facilities or by enlarging the facilities by virgin investments (*greenfield* investment), i.e., putting up entirely new facility like a new plant. Inorganic growth is growth by mergers and acquisitions, i.e., by adding an existing external facility (i.e., a facility which was owned by some other firm) to the company. Investment for acquisition is known as *brownfield* investment.

Many companies pursue growth by both organic and inorganic routes. The role of acquisition in driving the growth of companies has increased recently. The inorganic route has been dominant in the recent rapid growth of a number of Indian companies. Acquisitions have enabled several of them to make foreign forays in a range of industries such as metals, automobiles and FMCGs, as described in a number of other places in this book, particularly in the next chapter.

Table 14.2 gives some indications of the role of organic and inorganic routes in the growth of Wipro Consumer Care and Lighting Ltd. It may be noted that between 2006 and 2013, the company made six acquisitions (four of these were foreign acquisitions); after 2004 it had no greenfield project.

Table 14.2

Wipro Consumer Care and Lighting Ltd. – Organic and Inorganic Routes to Growth

Year	Organic Path	Inorganic Path	Nationality of Acquired Firm
1947	Establishment of an oil crushing unit at Amalner in Maharashtra		

1970	Manufacture of Hydrogenated cooking medium (Vanaspati) at Amalner		
1982	Introduced Flexi packs for Hydrogenated cooking medium – a first in India		
1986	Launch of Santoor soap		
1991	Launch of Baby Soft products		
1991	Establishment of Wipro lighting		
2003	Launch of Wipro Safewash		
2003		Acquisition of Glucovita	India
2003		Acquisition of marketing rights of Chandrika	India
2004	Starting of Furniture business		
2004	Launch of Santoor Facewash and Cream		
2006		Acquisition of North-west Switches	India
2007		Acquisition of Unza, one of the leading companies of South East Asia, in personal care business	Malaysia
2010		Acquisition of rights of brand Yardley for India and MENA	UK
2011		Acquired Aramusk	India
2012		Acquisition of right of brand Yardley, UK	UK
2013		Acquisition of South East Asian Skin care company LD Waxson	Singapore

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CHAPTER

15

Mergers and Acquisitions

Mergers and acquisitions (M&As) are used many a time as a critical means of the corporate strategy. It may be employed as a growth strategy, restructuring strategy or competitive strategy. Indeed, M&As have been instrumental in the restructuring of a number of industries globally and domestically and they continue to shape the market structure of industries through corporate strategies.

M&As have played a great role in the transformation of the industrial structure of the advanced economies. The United States, for instance, experienced several waves of M&As. Terms such as *merger mania*, *merger frenzy* and *merger fever* have been used by business magazines and dailies to refer to the surging M&A activities (including those in India following the liberalisation). It is pointed out that about two-thirds of the large public corporations in the USA have had at least one case of merger in their history and that the acquisition oriented conglomerates experienced superfast growth in sales, profits and assets (for example, Litton Industries grew from $ 3 million in sales in 1953 to an amazing size of $ 1800 million in 1960).[1]

MERGERS AND ACQUISITIONS – MEANING AND TYPES

Mergers or amalgamation refers to the merging of one company into another or two companies getting merged into one another to form a new corporate entity. In this method, there is a change in the ownership.

Acquisition or takeover denotes a company acquiring controlling stake in another so that the acquirer can have management control over the other firm. In this case, both the companies continue as separate legal entities.

On the basis of the nature of relationship between the businesses of the companies involved in the M&A, broadly there are three types of M&As.

Horizontal M&As

This refers to M&As involving firms in the same type of business. (Example: the takeover of Raasi Cements by India Cements, acquisition of Natsteel, Millennium Steel and Corus by Tata Steel)).

The trend toward focus and consolidation of business set in motion by the liberalisation has made horizontal M&As a very significant element of the corporate strategy of many companies in India and abroad.

Horizontal M&As enable companies expand and consolidate in the same business by acquiring competitors.

Vertical M&As

These are M&As involving firms at different levels in the value chain in the same industry. In other words, this refers to M&As resulting in *backward integration* or *forward integration.*

Backward integration refers to adding the earlier phase of the value chain to the company's business (for example, a finished goods manufacturer adding raw materials manufacturing to its business). Forward integration refers to adding the successive phase of the value chain to the company's business (for example, a raw materials manufacturer moving to finished goods production also or a manufacturing firm moving forward to marketing its products).

Forward or backward integration can be achieved either by establishing greenfield enterprise (i.e., an entirely new enterprise, or by acquiring existing enterprise.)

The takeover of some tea plantations by erstwhile Brook Bond (which merged into HLL, the present HULL) which was a tea processing and marketing company and the takeover of Polyolefins Rubber Chemicals from the Mafatlal Group by Onkar S. Kanwar Group, which controls Apollo Tyres, are examples of vertical M&As resulting in backward integration.

The acquisition by the Calcutta-based Delta Industries, a jute yarn producing firm, of the Netherlands Jute Industries, a company processing yarn into finished products and marketing jute products in Europe, is an example of vertical M&A leading to forward integration.

Conglomerate M&As

These are M&As involving companies whose businesses are different. In other words, this is a part of the diversification strategy of certain companies (Example: takeover of Transelectra – Goodknight brands by Godrej; Core Healthcare Ltd. (a pharmaceuticals firm) by Nirma Ltd.).

Conglomerate M&As is a commonly preferred route to diversification because of certain advantages associated with it like instant access to the market with certain share of the market and a set of customers, possession of an enterprise with resources and expertise in an unfamiliar business etc.

M&A WAVES

As mentioned above, there have been several waves of M&A. Analysing the M&A waves in the US, Weston *et al.* point out that all the merger movements occurred when the economy experienced sustained high rates of growth and coincided with particular developments in business environments. According to their hypothesis, it is not a coincidence. Mergers represent resource allocation and reallocation processes in the economy with firms responding to new investment and profit opportunities arising out of changes in economic conditions and technological innovations impacting industries.[2] Most of the waves occurred during economic booms.

The period of the first wave of M&As in the US (1895-1904), which accompanied major developments in economic infrastructure and production technologies, was one of rapid economic expansion. The advent of electricity and increased use of coal fueled economic growth. The completion of the transcontinental rail road system which facilitated the development of a national

market encouraged mergers and transformation of regional firms into national ones. The combination movement of this period consisted mainly of horizontal mergers (i.e., merger of firms in the same business) so that many monopolies were created. The US was the dominant arena.

The second wave of M&As, covering the period 1922-1929, occurred mostly outside the previously consolidated heavy manufacturing industries. Major industries affected by this wave were public utilities, banking, food processing, chemicals and mining. A large portion of mergers of this period represented product extension mergers as in the case of IBM, General Motors and Allied Chemicals; market extension mergers in food retailing, depart stores, motion picture theatres and vertical mergers in the mining and metal industries.[3] These mergers, however, did not create monopolies.[4] The important motivational factors of these mergers were major developments in transportation (motor vehicles in particular) which facilitated national distribution system, communication (like the rise of home radio which facilitated product differentiation through national brand advertising) and merchandising.[5] *While the first wave of M&As represented mostly horizontal mergers, the second wave was predominated by vertical (both forward and backward) integration.*

The third wave of M&As occurred during 1940-47. Government policies such as tax policies and controls on price and allocations during the war and post war periods might have encouraged the M&A wave of this period. However, lacking any significant changes in technological and business environments, this merger movement was much smaller than earlier ones.[6]

The next wave of M&As was in the 1960s, peaking during 1967-69 reaching its then historically highest level. *They were mostly conglomerate mergers*, characterised by acquisition of companies in different industries. While the economic boom provided a favourable environment, several other important developments contributed to the merger movement of the sixties. According to Weston *et al.*, they appeared to reflect changes in management technology that had developed in the 1950s. These were associated with improved methods of financial planning and control, long-range planning, and the emergence of the methodology of strategic analysis.[7]

The M&A activities were comparatively at a low ebb for nearly one decade that followed the fourth wave. These, however, began to surge in the last years of the 1970s and were brisk during the eighties ushering in the fifth wave (1981-1989). One important factor related to the M&A wave of the eighties was that corporate raiders relied heavily on borrowed funds, particularly on junk bonds.

M&A activities have been hectic during the nineties. The sixth wave (1992-2000) was characterised by a number of mega mergers.

The seventh wave which started in 2003 and which still continues is the longest of all the M&A waves. The recent trend has been towards related mergers and acquisitions mostly designed to serve the corporate strategic objectives. Post-merger integration also received significant attention.

The trend of divestiture of non-core businesses and of focusing on the core business have lent support to M&As. That is while some companies wanted to get out of some businesses, there were companies which wanted to acquire them as they happened to be the businesses they were focusing on. Industries/sectors such as telecommunications, broadcasting, utilities, IT, banking and finance, automobiles, pharmaceuticals, metals etc. have witnessed heavy M&A activities.

REASONS FOR M&A

There are a number of motives for or advantages of M&A. Besides those mentioned in this section, several examples cited in the subsequent sections of this chapter (like *Strategic Considerations in M&A*) are illustrative of the advantages of M&A. The section *Theories of Mergers* also highlight the reasons for/advantages of M&A.

Mergers and acquisitions may be driven by one or, often, more of the many advantages/motives described below.

1. M&A and Growth Gap Filling

One important objective of M&A is to fill the growth-gap, i.e., the gap between the company's sales potential and its current actual performance. The four important components of growth gap are the following.

Product Line Gap: A gap in the product line, either in width (i.e., number of product lines) or depth (i.e., number of items in a product line) may be filled by merger or acquisition of a firm having products which can fill this gap. Several examples are given under the sub-heading *Product Mix Optimisation* in this section.

Distribution Gap: In many cases, an important roadblock to increasing sales is inadequacy of distribution gap. This is particularly so in international marketing, Takeover of firms with strong distribution infrastructure would solve these problems. The takeover of Wiltshire Breweries, UK, by the U.B. Group, for example, has provided it with immediate access to the UK market. It was mostly the distribution problem that prompted the Procter and Gamble to forge an alliance with Godrej Soaps. When the alliance ended, P&G got possession of the distribution infrastructure – in effect the same effect of a takeover.

Usage Gap: The Usage Gap may be filled by converting non-users of the product into users and encouraging current users to increase the rate of usage. M&A would not have an immediate impact on the usage gap. However, the consolidation of company's strength by M&A may enable the company to improve the product promotion and other marketing efforts which may help narrow down the usage gap.

Competitive Gap: Competitive gap is the difference between the company's market share and the total market size. M&A helps the narrowing of this gap in two ways. Merger or takeover has the immediate effect of increasing the market share by the share the merged or taken over company had. Secondly, the strengthening of the market power by M&A and the strengthening of its marketing may help the company to make inroads into the market share of competitors.

2. Achieving Economies of Scale

This is one of the important reasons of horizontal M&As. For example, one of the important objectives of the proposed merger of Cochin Refiner is, Madras Refineries and with IBP (which involves horizontal and vertical integrations) is to achieve economies of scale so as to be in a stronger position to face the emerging global competition.

The increase in the size of the operations resulting from the M&As has enabled many companies to reap several economies of scale and synergies. A survey of Indian corporate managers in 2006 by

Grant Thornton[8] found that 28 per cent of the acquisitions were motivated by faster growth in scale and quicker time to market. Desire to enhance the size and thereby attaining higher economies of scale has been one of the key motivations for M&A in pharmaceutical sector. The highly fragmented Indian cement industry has been witnessing consolidation by M&As. A large cement company enjoys the benefits of economies of scale and M&As bring about consolidation of capacities which adds up the benefits of scale. The economies of scale may enable a company to reduce the production costs and other operational expences. The A.V. Birla Group's acquisition in 2003 of two companies possessing copper mines in Australia helped it to consolidate its raw material position for its copper smelter, enabling it to reach the global size of 2,50,000 tonnes from its earlier size of 1,50,000 tonnes. It also gave a lot of freight advantage as the cost of shipping from Western Australia is substantially lower than from North America.

3. Increasing the Market Power

Increasing the market share and consolidating the competitive strength is an important motive of many horizontal M&As. According to the Grant Thornton survey cited above, more than one-tenth of the M&As aimed at eliminating competition and increasing market share.

For example, the takeover of L&T's cement business by Grasim Industries in June 2003 catapulted Grasim (later its cement division merged into UltraTech Cement) from the third position to the numerouno position in India. The acquisition of the domestic firm Premier Tyres and several foreign acquisitions have enabled Apollo Tyres to increase the market power enormously. Such examples are plenty. Essel Propack, Bharat Forge, Tata Steel, Tata Global Beverages (erstwhile Tata Tea) etc. have become major global players mainly by acquisitions.

4. Diversification

M&A is sometimes the preferred strategy to enter new businesses. This was true of the RPG Group, The Murugappa Group, the Mallyas, the Chhabrias, the Piramal Group, the Nirma etc.

As pointed out elsewhere in this chapter, conglomerate M&As is a commonly preferred route to diversification because of certain advantages associated with it.

Several examples of product mix diversification is provided under the sub-heading *Product Mix Expansion.*

Diversification denotes not only the diversification of product portfolio but also the market geography. Look at this case: Indian companies such as Wipro, Dabur, Marico, Godrej Consumer and Emami were interested to acquire the Malaysian FMCG firm Unza which is a leading personal care manufacturer and marketer in South East Asia with 48 brands across soaps, shampoos, deos and talcs; presence in about 58,000 retail outlets and five manufacturing locations including one in China. This was because such a buyout would give the acquirer a strong foothold in several foreign markets and provide be strong driver of their globalisation strategy. Further, it can also act as a derisking strategy against a downturn in the domestic business. Indian FMCG company Marico's international business has acquired soap brands in Bangladesh — Camelia and Aromatic — which have a 1.5 per cent market share in the country. It has helped Marico to enter a category through existing brands and allows it to learn about a new segment. The company which bought post-wash hair care brands Fiancee and Haircode in Egypt has been looking for more such acquisitions in Africa. A number of

examples of substantial global market diversification gained by cross-border acquisitions are given in several other places in this chapter.

5. Acquisition of Technology

Access to technology or R&D facilities is a major benefit of some of the M&As. For example, the acquisition of the Italian steel major Ilva Laminati Piani by the Essar Gujarat gave it access to downstream steel technology, *inter alia*. Tata Motor's acquisitions helped it to enhance its tecnological competence. Crompton Greaves' acquisition Pauwel provided it with technologies to expand its transformer range beyond 400 KV and enabled the leveraging of the technical and marketing strengths of both the companies.

The Grant Thornton survey found that acquisition of new technology or competence was an objective of more than one-fifth of the acquisitions.

The acquisition of Trao enables Sun Pharmaceuticals to build on Taro's expertise in dermatology and cardiovascular, along with speciality and generic pharmaceuticals, and over-the-counter products, besides providing a basket of new products for the US market. Gaining access to technology has been an important motive of a number of acquisitions in the IT sector as well as in several industries. For example, Wipro Technologies' acquisition, in 2007, of Nasdaq-listed Infocrossing, has enabled it to diversify into promising newer areas, enabling Wipro to plug the strategic gaps in data centre, mainframe and managed services. Infocrossing was expected to enhance Wipro's hit rate of winning large outsourcing deals.

6. Market Entry/Market Seeking

M&A is a common strategy employed to enter new, particularly foreign, markets, as exemplified by several examples given in the preceeding and following parts of this chapter.

Instant market access is often a great advantage of M&As. While greenfield project involves a gestation period, often several years, acquisition has the great advantage of giving instant presence in the market with a certain share of the market, which normally takes a long period to build up from scratch.

Many Indian acquisitions are in the industrial economies mainly because it is a much easier means than the organic route to enter these highly competitive and difficult markets. As has already been mentioned, several Indian FMCG firms have entered developing and emerging markets in Asia, particularly South East Asia, and Latin America through the inorganic route (i.e. acquisitions).

The list of Indian companies which gained foreign market entry by acquisitions is large and includes the likes of Asian Paints, Tata Motors, Tata Steel, Tata Global Beverages, Godrej Consumer Products, Apollo Tyres, Bharat Forge, Essel Propack etc. On the other hand, many foreign firms entered India through the inorganic route. Holcim, a Switzerland-based global cement major, entered India and became the second largest cement player in the Indian market by acquisition of Ambuja Cement and through it the ACC. Lafarge, the French cement major, too entered India by takeovers.

Examples of the market entry and expansion advantages of M&As are plenty. For example, Reliance Communication (RCom)'s acquisition of data communications company Yipes, which has a 40 per cent share of the US data communication market, helps the Indian telecom services provider to penetrate the $ 100-billion global enterprise and institutional data market. By synergising operations

RCom aims to become a global leader in the ethernet-based data communications market. The acquisition of the Singapore-based Berger International gave Asian Paints access to 11 markets including China, South East Asia, the Middle East and Caribbean Islands with paint manufacturing facilities in all these regions. It had earlier taken over paint firms in Australia, Sri Lanka and Egypt. The acquisition by Subhash Chandra family controlled Essel Packaging Ltd., the number two laminated tube producer worldwide with manufacturing facilities in China, Germany, Egypt and Nepal, of the Propack Ltd., the fourth largest laminated tube producer, gave Essel access to Propack's operating entities in China, Indonesia, the Philippines, Venezuela and Colombia, and made it the largest laminated tube producer in the world. It (renamed as Essel Propack Ltd.) now has substantial operations in the US. The acquisition of Daewoo Commercial Vehicles in 2004, the second largest manufacturer of heavy-duty trucks in Korea, with a modern manufacturing facility at Gunsan in South Korea, gave Tata Motors a market for a mix of products in around 50 countries across five continents and made it the world's fifth largest medium and heavy commercial vehicle manufacturer, compared to the sixth position earlier. The acquisition of the Singapore-based NatSteel, which owns mills in China, Thailand, Vietnam, the Philippines and Australia, in August 2004 provided Tata Steel with ready access to customers in South East and East Asia, a region that consumes a third of the world's steel. Its Corus acquisition in 2007 made it one of the world's most geographically diversified steel producers, with operations in 26 countries and a commercial presence in over 50 countries. Tata Steel, with over 81,000 employees across five continents is a *Fortune 500* company today.

The market reach that the acquisition of Tetley, the second largest tea marketing firm in the world, gave Tata Tea has been enormous. It has been further consolidated by subsequent acquisitions. In 2005, Indian company Crompton Greaves acquired the Pauwels Group of Belgium and its transformer manufacturing facilities in 5 countries – Belgium, Ireland, Canada, USA and Indonesia. This acquisition had the effect of increasing the international business of Crompton Greaves from 15 per cent to 50 per cent of its turnover and giving it a prestigious position amongst the top 10 transformer manufacturers in the world, making it a force to reckon with in the international market.

Market seeking overseas M&As have been very popular with Indian pharma industry. Several firms in this industry have made enormous use of M&A for foreign market entry and gaining market share.

In telecommunications, through the acquisition of Zain's mobile operations in Africa, Bharti Airtel has expanded to mobile markets in 15 African countries and has become the world's fifth largest mobile telecom operator by number of subscribers.

In information technology (IT)-enabled services, Infosys and Wipro have expanded into new markets and areas of business through both international greenfield investments and M&As.

7. Possession of Marketing Infrastructure

Getting possession of marketing infrastructure, like distribution network, is an important motive of a number of M&As. The acquisition of Lauffenmuehle, for example, a major name in the premium end of the European textiles market, has given Arvind Mills the company's denim brand *Big Mill* and access to customers across the world — not to mention the 10 million metre plant. Marketing infrastructure is a major benefit of a number of acquisitions. The acquisition of Nippon Universal Pharmaceutical by Zydus Cadila has provided it critical access to a ready manufacturing and marketing base as well as strong distribution network in Japan, penetration of which market is

regarded as very difficult. The possession of Nippon, which reaches out countrywide to more than 4,000 hospitals and clinics, is expected to give a fillip to the group's operation in a highly complex market dominated by the local pharma companies and provides an opportunity for the group to establish itself in Japan's rapidly evolving generics space. These are but two illustrative examples of many.

8. Product Mix Expansion

Some M&As help to fill the product mix gap. This has been true of several acquisitions in industries such as pharmaceuticals, steel, automobile, FMCG etc. as described earlier in this chapter. Majority of the respondents of the AT Kearney-Wharton survey (jointly done by the global consultant AT Kearney and the online news and business analysis journal of the Wharton School, University of Pennsylvania)[9] identified product line extension as a key factor behind M&As.

Some 52 per cent of the respondents of the AT Kearney-Wharton survey cited above identified product line extension as the key factor behind M&As. Some examples have been provided in the preceding section.

Filling critical gaps in the product mix and gaining a foothold in new markets have been a major motives of many Indian acquisitions in industries such as, in particular, pharmaceutical, automobile, IT and FMCG. For instance, the acquisition of Ethimed, ranked 10th among generic companies in Belgium with over 20 product registrations, gave Ranbaxy a foothold in the Benelux territories, which include Belguim, The Netherlands and Luxembourg. Wockhardt's acquisition of French pharma major Negma has given it access to Negma's portfolio of patented products. Examples of product mix expansion by M&As are plenty in the pharma industry. Adding new product lines or line enlargement, along with critical market entries/expansions, have been the major driver of many acquisitions in several other industries such as automobiles, IT, FMCG, paint etc. too. Recall the acquisitions of Tata Motors, Tata Tea, etc. referred to earlier. The acquisition of luxury brands Jaguar and Land Rover enabled Tata Motors to move to the luxury segment of the car market globally.

9. Acquisition of Brands

Speaking at a session on consumer goods at the Indian Economic Summit, Mr. Adi B. Godrej said: "Building brands in India for a new company would be extremely difficult as has been obvious in many cases already. In such a situation, a lot of international corporates would find that the best entry strategy would be acquisition of Indian brands." The same logic is equally applicable for corporate India's foreign acquisitions. For example, acquisitions gave Godrej the possession of several well-known brands in different forein markets.

Several Tata group companies got in their possession a number of well-known foreign brands by acquisition. In 2008, Tata Motors bought luxury brands Jaguar and Land Rover from Ford Motors. By acquisition, Tata Tea got several well-established brands, including Tetley which commanded the second largest share of the global market for packaged tea. Acquisition gave Tata Motors the Daewoo name and Crompton Greaves the internationally reputed Pauwels brand.

10. Geographical and Logistical Factors

Improving the logistical efficiency is another important motive of M&As. For example, a fairly even geographical distribution of production facilities would help to smoothen supply and to reduce

distribution costs. When a company takes over the production and distribution facilities of another company in a different location, it immediately extends its geographical reach and increases its market share on account of expansion of the market for its product.

A number of M&As help improve the supply chain by vertical or horizontal integration or improved logistics. For example, acquisitions have enabled Tata Steel to improve the operational efficiency and overall competitiveness by breaking up the value chain (which may be very broadly divided into steel making and finishing) and putting each part where it is the most cost-effective through an appropriate global supply chain management.

As has already been pointed out, M&As expanded the geographical spread of Grasim Cement (now UltraTech Cement), an Aditya Birla Group company. The most important acquisition was that of the cement business of L&T which has given it a pan India presence. UltraTech has 22 cement plants in India (in September 2013). The enhanced geographical reach may also result in substantial reduction in transportation costs which are quite high as cement is a bulk commodity.

About two-thirds of the 178 Indian executives covered by an AT Kearney-Wharton Survey have revealed that geographic expansion was an important consideration while selecting an acquisition target.

The acquisition of 32 per cent stake in the Ilva Laminati Piani, an Italian state-owned steel major, for example, by the Essar Gujarat gave it a global steel presence and access to downstream steel technology. Besides, there is access to Ilva's marketing network worldwide. According to Ravi Ruia, Vice-Chairman, Essar Group, "these are major pulses for us. On our own, it could take us decades to do these things.[10] The acquisitions of the Federal Forge Inc., USA, by Bharat Forge (which has become a major global player by acquisitions) have given it some logistical advantages, among other things.

11. Efficiency-seeking

An UNCTAD survey has revealed that efficiency-seeking is the second most important motive of FDI. FDI with this motive mostly targets developing countries and tends to be concentrated in a few industries (such as electrical and electronics and garments and textiles). In the electrical/electronics industry, FDI is strongly regionally focused, while in the garments industry it is geographically more widely dispersed. This motive is common with firms from the relatively more advanced developing countries.[11]

Efficiency-seeking was indicated as a strategic motive of FDI by more than one-fifth of the responses in the UNCTAD global survey. Its prevalence, however, varies considerably among developing-country TNCs, especially in terms of their country or region of origin and industry. According to the survey, most of the companies for which efficiency-seeking FDI is important are Asian and in three main industries, electrical and electronic products, garments and IT services.

It is interesting to note that, according to the survey results, for Indian TNCs, which consider this also as a relatively important motive, efficiency means primarily the synergies to be gained through the international integration of production and service activities, rather than "low-cost" inputs.

Efficiency-seeking FDI was found to be relatively unimportant for Chinese and South African TNCs, possibly because of continuing relatively low costs in their respective home economies.

12. Resource-seeking

According to an UNCTAD global survey, overall resource-seeking FDI is rated to be of moderate significance. It is observed that FDI by companies in the primary sector can be divided into that by TNCs from China, India or other resource-poor countries, and that by TNCs from resource-rich developing countries. FDI to access natural resources is very important for Chinese and Indian TNCs, as well as those from a number of other developing countries, because the security of supply of raw materials is deemed essential for their rapidly growing economies.[12]

One of the missions of the Indian public sector Oil and Natural Gas Corporation (ONGC), a *Fortune 500* company, for instance, is to explicitly secure foreign oil for Indian development as a prime goal. To achieve this goal, it has established a series of oil and gas exploration, production and distribution projects overseas, many in cooperation with other developed- and developing-country firms. Because of the scale of resources it aims to secure, ONGC's operations are widely dispersed, including in Algeria, Brazil, Côte d'Ivoire, Cuba, the Islamic Republic of Iran, Kazakhstan, Nepal, Nigeria, Qatar, the Russian Federation, Syrian Arab Republic, Sudan and Venezuela. Hindalco, an A.V. Birla Group company, is a typical example of resource-seeking investors in natural-resource-based industries. It operates a number of aluminium and copper smelting plants in Australia, the output from which is sold to Indian companies as well as exported to economies such as China, Saudi Arabia and Taiwan Province of China.

TNCs from other natural-resource-rich countries are less active in resource-seeking FDI.

Many manufacturing companies that depend heavily on raw materials for their products (e.g., furniture, metal and pulp and paper manufacturers) might also pursue resource-seeking FDI strategies directly, either by moving production to a foreign site where a crucial raw material is located or by extracting and importing the material to their home country plants.

As international prices of raw materials and other commodities have been rising – increasingly driven by rapid economic growth in some developing countries – the competition for resources has intensified, especially in regions such as Africa, where Asian, North American, European and South African companies are vying for oil reserves, mines and other assets.[13]

13. Created-Asset-seeking

Created-asset-seeking is regarded as relatively unimportant, overall, by Indian TNCs according to an UNCTAD survey, compared to Chinese TNCs which regard created-asset-seeking as the second most important motive after market-seeking. Its importance is highest in a relatively small number of industries including electrical and electronics, chemicals and infrastructural services. In the case of Indian TNCs created-asset-seeking is closely correlated with market-seeking FDI, especially in North America, Western Europe and East and South East Asia. In the case of Indian TNCs, created-asset-seeking is closely correlated with market-seeking.[14]

14. Use of Surplus Funds

Some of the M&As are prompted by the desire to make productive use of surplus resources [reserves], as in the case the merger of Brooke Bond India – Lipton with Hindustan Lever, referred to earlier.

15. Optimum Utilisation of Resources and Facilities

Sometimes, M&As are resorted with the objective of achieving optimum utilisation of the company's underutilised resources, including managerial expertise and facilities. The merger of Brook Bond and Lipton, both of which were in the same lines of business, facilitated elimination of duplication, unhealthy competition, and optimisation of resource use.

16. Pre-emptive Strategy

M&A is also used as a strategy to pre-empt the competitor from acquisition that would give the competitor an entry to a business or market or increase the competitive strength. There have been several cases of competitors bidding for the same firm.

17. Vertical Integration

Backward or forward integration that will benefit the current business of the company is another important motive of M&A. For example, the merger of the stand-alone refineries, CRL, MRL and BRPL, with the IBP, a marketing company, referred to earlier.

18. Tax Benefits

Sometimes M&As are encouraged by the tax benefits. More information is given under the sub-section *Determination of Strategic Purpose* in the section Management of M&As.

19. Increasing the Share of Promoters' Stake

Some mergers had the effect of increasing the promoters' stake in the company, as pointed out earlier.

20. Regulatory Approvals

Getting regulatory approvals for products or manufacturing facilities from foreign authorities are often complex procedures and very difficult. This problem is overcome when firms with such approvals are taken over. Several acquisitions in the pharma industries had this advantage, including possession of patented products. The Sun Pharmaceutical Industries Ltd.'s acquisition of Caraco Pharmaceuticals in the late 1990s gave it strong position in the US market, contributing over 20 per cent of Sun's consolidated revenue in 2006. In 2007, Sun moved to acquire Israelian generic drug firm Taro Pharmaceutical Industries which has manufacturing facilities with regulatory approvals in Canada and Israel that manufactures topical creams and ointments, liquids and tablets dosage forms which complement Sun's manufacturing and development capabilities in the US. The firm has over 100 abbreviated new drug applications (ANDA) approvals in the US alone.

Box 15.1
Motives/Advantages of M&As

- Achieving economies of scale
- Increasing the market power
- Diversification
- Acquisition of technology
- Market entry

- Possession of marketing infrastructure
- Use of surplus funds
- Optimum utilisation of resources and facilities
- Product mix optimisation
- Pre-emptive strategy
- Vertical integration
- Tax benefits
- Logistical benefits
- Increasing the share of promoters' stake
- Acquisition of brands
- Moving up the value chain
- Improving global competitiveness

DISADVANTAGES/PITFALLS IN M&A

Many M&As have failed to produce the expected results; several of them have been disastrous. A number of companies have later sold off businesses they acquired. Disappointing results of acquisitions are plenty across the world. Al Ries in the well-known book '*Focus: The Future of Your Company Depends on it*' gives a list of American companies which exited – in most cases after a six year itch – the unrelated businesses they had acquired.

There are a variety of reasons for the diappointing results of M&As. Majority of the companies report that their M&A deal failures may be attributed to "people and organisation issues" such as lack of shared vision, leadership clash, cultural mismatch, loss of key talent, misaligned structures, lack of management commitment, lack of employee motivation, poor communication and poor change management.[15]

The Indian scenario, including that of the recent period, is no better than the global.

An examination of 750 deals (out of the total of 1,100 deals) conducted by listed companies in India between 2005 and 2011, by consultancy firm KPMG, presents a picture that is not encouraging as far as their success in creating value post-merger. Three-fourths of the acquisitions made by local firms have failed to create substantial value from the deals and 59 per cent of the acquirers have actually destroyed value within a year of closing a deal.[16]

There are many downside risks or pitfalls in M&A. The common ones are the following.

Overpricing

A problem in many cases has been the unrealistically high price paid for the acquisition. It may be due to the deficiencies of the valuation. Further, the valuation is often based on certain assumptions, which may not hold true. Bidding high to win over competitive bidders also sometimes causes unrealistic price. P. Rajarathinam, who took over 19 companies within a span of three years, reportedly paid high prices for some of the acquisitions to edge out deep-pocketed rival bidders. His businesses had to face an avalanche of financial problems. There is also a view that the price paid for the Corus acquisition by Tata Steel was high.

Means of Financing

Financing takeovers by debt may create problems. What landed many companies in trouble is the acquisition leveraged by high cost junk bonds. The financing strategy was a major inherent flaw of the M&A strategy of Rajarathinam.

Hidden Liabilities and Improper Due Deligence

Another problem is hidden liability like product injury liability for hazardous products, expenses for pollution abatement etc. that were not obvious at the time of evaluation. Further, companies which are deliberately prepared and 'window-dressed' for sale might have avoided such normal operating expenditures on preventive maintenance, maintenance of buildings and premises, R&D, human resource development, etc. Both Chhabria and Rajarathinam have deplored that their acquisitions had hidden liabilities.

Because of the possibility of such mistakes or misjudgments, it is important to ask the seller to give a written warranty of certain facts, conditions etc. which protect the buyer. Some buyers also take care to structure the payment over a period of time so that in case misrepresentations or negative eventualities become evident, payment may be withheld correspondingly.

Due diligence for an M&A transaction is a time-consuming process and is often based on assumptions which may not hold true. If adequate homework was not done and the evaluation was not right, the acquisition decision could be wrong.

Problems of Acquired Company

When a company is taken over, its problems are also often taken over. Some of the units acquired would have problems such as old plant, obsolete technology, surplus or demoralised labour, heavy debt etc.

Managerial Problems

In some cases, the company may not have the experience and expertise to manage the unit taken over if it is in an entirely new field. If the acquired company does not have a good management team and culture which can be retained, the situation could be difficult.

Varun Gupta, director, integration and separation advisory for KPMG in India, has obsrved that post-transaction, most people lose interest in the acquired asset and do nothing new, often letting it let it run the way it was running. This affects the value of the acquirer.[17]

Post-merger Integration Problems

Post-merger/acquisition integration of the firms is a crucial task to be accomplished for effective performance. There are several aspects of the integration. The organisational culture of the companies may be different. Sometimes, there may be differences in the policies, procedures and styles. Functional facilities and activities will have to be aligned and coordinated.

Emotional integration of personnel of the organisations is another aspect. Some of the important areas of post-merger/acquisition integration are the following.

While cultural disparity and post-integration hurdles are the most cited reasons for acquisition failure,[18] there are several other factors as well, as described above.

Dissipation of Managerial Attention

Another risk associated with acquisition is that it may lead to all businesses not getting the required managerial attention.

It is pointed out that post-transaction, most people lose interest in the acquired asset and do nothing new, often letting it let it run the way it was running.[19]

Look at the observation of a FMCG veteran regarding the possible post acquisition risk in respect of Unza: "The product portfolio is unwieldy and likely to make a ₹ 1,000-2,000 crore Indian acquirer defocussed. One cannot scale up at such a speed".

THEORIES OF MERGERS

There are a number of theories of mergers and other forms of asset redeployment. They seek to explain the reasons for/benefits of mergers and other forms of asset redeployment.

Weston *et al*. have categorised these theories as shown in the following table.[20]

Table 15.1

Theories of Mergers and Tender Offers

1. Efficiency Theories
   - Differential managerial efficiency
   - Inefficient management
   - Operating synergy
   - Pure diversification
   - Strategic realignment to changing environment
   - Undervaluation
2. Information and signaling
3. Agency problems and managerialism
4. Free cash flow hypothesis
5. Market power
6. Taxes
7. Redistribution

According to the efficiency theories, M&As result in social gains, besides the gains for the firms involved.

The *Differential Managerial Efficiency* theory says that if a firm is merged with or taken over by another firm with better managerial efficiency, the overall managerial efficiency will be improved to the level of the efficient firm. This theory suggests that M&A occurs mostly in respect of firms in similar kinds of business.

According to the *Inefficient Management Theory*, the rationale for M&A is that some firms are managed so inefficiently that some one else can do it better. It is obvious that while the differential efficiency theory is more likely to be a basis for horizontal M&As, the inefficient management theory is applicable to all types of M&As.

The *Operating Synergy Theory* postulates that the reason for M&A is the resultant operating synergy or operating economies of scale. This theory can be applied to vertical, horizontal and conglomerate M&As.

The *Pure Diversification Theory* purports that the main reason for diversification-oriented M&A is the desire to protect the interests of the managers and employees who are at greater risk if the single industry in which their firm operates should fail. "Therefore, firms may diversify to encourage firm-specific human capital investments which make their employees more valuable and productive, and to increase the probability that the organisation and reputation capital of the firm will be preserved by transfer to another line of business owned by the firm in the event its initial industry declines."[21]

According to the theory of *Strategic Alignment to Changing Environments*, M&A is an attempt to adapt to the changing environment. The M&A route is preferred because it makes the response quick and is believed to be less risky than developing capabilities internally.

According to the *Undervaluation Theory*, the provocation for M&As is the undervaluation of the target companies.

According to the *Information or Signaling Theory*, the shares of the target company tends to be permanently revalued even if a tender offer does not result in acquisition because it sends signal to the market that the target shares are undervalued or alternatively it signals information to the target management which inspires them to implement a more efficient strategy on their own. According to some, the revaluation of the share due to an unsuccessful offer is because of the expectation that another company will subsequently acquire the target firm.

According to the theory of *Agency Problem*, an agency problem arises when managers who own only a fraction of the ownership shares of a firm are not fully committed to the efficient management of the firm and/or involve in extravagance at the expense of the firm and this state of affairs may ultimately lead to a takeover. *The Theory of Managerialism* suggests quite a different relationship between the agency problem and acquisitions, according to which the self-serving managers make ill-conceived combinations solely to increase firm size to enhance their own positions and compensation.

The *Free Cash Flow* hypothesis suggests that the reason for takeovers is the conflicts between managers and shareholders over the pay out of free cash flows (defined as the cash flow in excess of the amount required to fund all projects that have net positive present values when discounted at the applicable cost of capital).

Another theory is that M&As are for gaining *Market Power*. *Tax Effects* are also advocated as an important reason for mergers. According to the *Redistribution* hypothesis, M&A increases value to shareholders at the expense of other stakeholders in the firm, like bondholders, government (in the case of tax savings) and organised labour.

MANAGEMENT OF M&A

Management of M&A involves the following important phases:

1. Determination of the strategic purpose of M&A.
2. Screening, evaluation and choice of candidates for M&A.

3. Determination of acquisition strategy.
4. Post-acquisition integration.

Determination of Strategic Purpose

The first important step in the management of M&A is the determination of the strategic purpose of merger/acquisition. Is the objective to gain an entry into the market? Is it to strengthen the competitive position or to gain market leadership? Is it to acquire technology? Is it for achieving economies of scale or advantages of synergy? Is it to deepen/or widen product mix? Is it to strengthen the distribution? Is it to improve the inbound or outbound logistics?

Consider the M&A activities of the Hindustan Lever, for example. Brook Bond and Lipton, two Lever group companies whose businesses had overlapping, merged in 1993 to benefit by operational economies and synergies. HLL, like its parent Unilever, identified the food business as its major business. While markets in several advanced countries tend to saturate and margins are under pressure, the food business in India is expected to experience an explosive growth in future. The company went on an acquisition spree to fuel the growth of its business. Within 18 months (1995-96), Unilever, with a strategy to grow the businesses in ice cream, margarine, and other processed foods, took over 18 ice cream businesses and eight- margarine businesses world over. During this period, in India, Brooke Bond Lipton India (BBLIL) took over three key players in the ice cream market – Kwality, Milk Foods and Dollops – which together with its own brand Walls gave it almost half the share of the market. BBLIL also took over some other food businesses like Kissan.

The merger of BBLIL with HLL in 1996 was a crucial strategic move to fuel and propel the company's growth in the food business that is identified as the thrust area. This has brought in enormous financial synergy, besides other benefits. The *cash cows* of HLL (like soaps and detergents) can now fund the *stars* in the food business. The merger has also substantially enhanced the external funding potential for the growth of the food business. While the BBLIL could borrow ₹ 200 crore or so on its own, the merged company with ₹ 200 crore in share capital and nearly ₹ 800 crore in reserves could have a borrowing potential of over ₹ 700 crore. The merger can, thus, help fund the enormous investment needs to make a major thrust into the food business. The merger has also enabled the HLL to use its funds more productively than just keeping it in blue chip stocks. The merger was expected to result in considerable tax savings. While HLL was paying 30 per cent tax, BLLIL had a lower (17.5 per cent) tax incidence because of its large capital depreciation charges. The higher investment following the merger could reduce the incidence of tax on the combined entity.

The TOMCO merger had enabled HLL to consolidate its market power in soaps and detergents.

The strategic purposes are further elaborated in the following sub-section.

Strategic Considerations in M&A

The important strategic considerations in M&A are the following:

Fit with Mission and Strategy: The most important consideration in M&A is how well the firm considered for merger/acquisition fits with the mission and strategy. In fact, all other considerations or evaluation criteria must subserve this critical strategic issue.

Fit with Portfolio Strategy: This, obviously, is a corollary of the point mentioned above. A basic consideration is 'what will be the contribution of merger or acquisition to the Portfolio strategy?'

Does it provide a strategic leverage to expand the portfolio as the strategy envisages? Or, how will it help the growth of the current portfolio? The acquisition of Tomco by Hindustan Lever, for instance, helped HLL to fill the line gap and to improve the geographical distribution of production facilities. The takeover of some tea gardens by Brooke Bond facilitated backward integration that was very significant from the point of view of raw material supply. As pointed out earlier, the takeover of food businesses and the merger of BBLIL have gone a long way in implementing HLL's portfolio strategy.

Competitive Impact: A very important consideration in M&A is its impact on the competition. Sometimes, one of the motives of hostile takeover is to reduce competition and to increase the competitive strength of the acquiring firm. Even in the case of many takeovers, which are not hostile, the competitive impact is an important consideration. Consider an example of three companies in the same industry – A, B and C. If C is taken over by B, that may enhance the relative competitive position of B and reduce that of A. That is one reason why several companies attempt to takeover the same company. The takeover of Premier Tyres and Stallion Tyres by Apollo helped it to increase its market share from 18 per cent in 1995 to 23 per cent in 1996. Similarly, HLL's market share increased with the takeover of Tata Oil Mills Company (Tomco). If these firms were taken over by Apollo's/HLL's competitors, the competitive situations would have been different. The takeover of some other mosquito repellent products firms by Transelectra helped to further increase its market dominance.

When market shares of the major players are not significantly different, takeover can be a factor determining market leadership or position.

Ranbaxy which traditionally opted the capacity expansion route turned to M&A because of the possible competitive fallout of the M&A move that began in the Indian pharmaceutical industry (in 1996 there were eight M&As). During December 1996-January 1997, Ranbaxy acquired three firms and these have made Ranbaxy the market leader, relegating GlaxoIndia to the second and Cipla to the third positions respectively by increasing its market share from 3.9 per cent to 5.3 per cent. The Glaxo India-BurroughWellcome merger that followed increased Glaxo's market share from 5.2 per cent to 7 per cent making it again the market leader.

According to R.B. Putatunda, Director (Lamps and Luminaries), Philips India, one certainly has "to explore takeovers as a competitive strategy. Either for buying up market shares or to create stronger entry barriers for new competitors."[22]

Scale Economies and Synergy: Whether the merger/acquisition would bring any economies of scale is another consideration. "Merger can improve profitability through reduction in overheads, effective utilisation of facilities, the ability to raise funds at a lower cost and deployment of surplus cash for expanding business with higher returns."[23]

Similarly, whether, it will have the advantage of synergy is also a very important issue. That is, whether the combining of the resources of the two firms generate more value than the individual constituent firms could have generated with them separately. If the bringing together of complementary resources or capabilities create additional value, there is *complementary* synergy. A combination may generate *supplementary synergy* when it creates value by strengthening or supplementing existing resources or capabilities to new and higher levels of productivity.

Several examples cited in this book, like the Brook Bond-Lipton merger, HLL-BBLIL merger, Tomco-HLL merger, takeovers by Ranbaxy etc. illustrate these benefits. In early 1997, four group

companies were merged into Nirma Ltd., because it was felt that as all these firms were doing similar business, the combining of operations would result in business synergy and would enable it to achieve economies of scale and reduction in overheads. The acquisition by Tata Tea of Consolidated Coffee, which grows beans, and Asian Coffee, which processes beans into coffee, provided considerable synergy. The Essar Group took over the Tamil Nadu Mercantile Bank as it was a good fit to their financial services business and also because banking would be a future growth business.

Pre-emptive Motive: Sometimes acquisition can be a pre-emptive move. If it is understood that a potential competitor plans to make a quick and easy entry to the market by acquiring a firm, such a move may be pre-empted by acquiring that firm and depriving the competitor of that chance. Acquisitions may also be encouraged by the intention to prevent competitors' gaining the advantage of M&A. Examples include some of the acquisitions by Ranbaxy and acquisition of Premier Tyres by Apollo.

Comparison with Establishment of New Unit: A comparison of the strategic advantages of M&A and putting up a new unit is a must so as to determine which of the two alternatives is better. Both have their own advantages and disadvantages. The advantages and disadvantages of M&A are listed elsewhere in this chapter. In some industries or places, establishment of new units may be impossible or very difficult due to environmental problems or government policy. In mature industries, acquisition is often preferable to establishment of new capacity because in such industries capacity expansion will cause problems of excess capacity. In many cases, the capital cost of setting up a greenfield unit is higher than the price at which an existing unit may be taken over. For example, the acquisition of Narmada Cement enabled L&T to expand its capacity by 1.4 million tonnes (making it the No. 1 with a total capacity of 12 million tonnes) at a cost of ₹ 2,020 a tonne compared to ₹ 4,000 to –4,500 in the case of greenfield plants.

Long-term Financial Considerations: The long-term financial implications of the M&A is a very important factor to be considered. For example, acquisitions, which are highly leveraged by junk bonds, impose large financial risks in the future. It may be noted that the acquisition spree has landed many firms, Indian as well as foreign, in severe financial problems and many of them were compelled to sell off many of the acquisitions. The financial problems so created can even affect the whole business. Acquisitions have landed 'takeover tycoons' like Chhabria and Rajarathinam in severe crisis.

M&A can have positive financial implications as well, as in the case of the synergy between cash cows and stars. The HLL-BBLIL merger described earlier illustrates favourable financial impact of merger. Similarly, the strengthening of the capital base of Nirma Ltd. as a result of the merger of four group companies into it enhanced its potential to tap domestic and international financial markets.

It may be noted that the Companies Act, 1956, imposed restrictions on the inter-company flow of funds according to which the loan to or investment in another company by any company could not exceed the specified limit of its net worth. Merger solves this problem. The flexibility in the use of cash flow is an important motivator of many mergers. Referring to the merger of Mafatlal Fine Spinning and Manufacturing into Mafatlal Industries (MIL), Hrishikesh A. Mafatlal, Vice-Chairman and MD, MIL, remarked: "Before merger, optimising the funds utilisation of both the companies was impossible due to legal constraints and administrative impediments. Post-merger, all operations get access to the same pool of funds."[24] Cash-rich firms are often coveted targets of raiders. Ceat Tyres had nearly ₹ 20 crore in cash when the RPG Group took it over in 1981.

Tax Shields: The tax benefits of merger are a very important consideration in many mergers. Mergers result in substantial tax saving in a number of cases. There are mainly three avenues of tax savings.

1. Merger of a profitable company into a loss-making group company. For example, the merger of Godrej Soaps in 1994 with Gujarat Innovative Chemicals and the resultant restructuring of the gross profits and tax liability helped Godrej Soaps to increase the net profits by nearly ₹ 13 crore.
2. Tax Savings by higher capital expenditure and depreciation made possible by merger, as in the case of, for example, HLL-BBLIL merger referred to earlier in this chapter. Jayant Thakur, Chartered Accountant, points out that "despite the MAT, the possibility of large tax savings will continue to be a major incentive for mergers."[25]
3. Savings in Sales Tax and Excise Duty. These benefits accrue when two companies in successive points in the value chain merge together. That is just what improved Polyolefins Industries' balance sheet in 1993, after its merger with NOCIL, from which Polyolefins used to buy 40,000 tonnes of ethylene per annum. As a result, the merged company's sales tax as well as excise duty payments came down substantially.[26]

Strengthening Ownership Control and Guarding against Acquisition: Companies with low promoters' share, *inter alia*, are often takeover targets. Merger may alleviate this risk. Merger may help this in two ways. The market capitalisation of the merged entity will be much higher than the pre-merger separate firms, thus making the amount required for acquisition very high. Secondly, merger may help increase the promoters holding, provided an appropriate swap ratio is used. For example, the 1995 merger of Reliance Polyethylene and Reliance Polypropylene into the Reliance Industries (RIL) is believed to have helped the Ambanis leverage their high stakes in the two smaller companies for increasing their holding in the RIL from about 23 per cent to about 33 per cent even though warding off a takeover bid was not the objective. Similarly, merger enabled the Nanda family (Escorts Ltd.) and Piramal to increase their stakes in their companies.[27]

Screening, Evaluation and Choice

Having considered the strategic issues and determined the strategic purpose of acquisition, a company can move on to the next stage, that is choice of the eligible candidate for acquisition. This involves a screening and evaluation of the possible firms.

The purpose of screening is to eliminate firms, which do not satisfy certain set criteria. For example, firms above a certain size in value, or firms who are too small, may not suit the resources or purpose of the company. Other criteria used at the screening stage may involve market share, product mix, market coverage, international business etc. Screening facilitates shortlisting of companies for detailed analysis.

Under the *strategic considerations* described above, firms were evaluated very broadly, mostly with reference to their business *vis-à-vis* the company's mission and strategy. Firms, which at the outset do not fit into the acquisition strategy, are eliminated by screening. A thorough evaluation of the shortlisted firms, or by some other chance considered, has to be undertaken for the final decision on acquisition. This requires a lot of information. Several companies have a good stock of such valuable information, collected as a part of the marketing intelligence.

Important criteria used for evaluation include the following.

Earnings Potential: The earnings potential is a very important criterion for evaluating the suitability for acquisition. Earnings may be measured by net income, return on assets or return on investments. Although the past and current earnings are good, the situation in future could be different, particularly in case of highly leveraged acquisitions. In such cases, it must be ensured that the future earnings will be sufficient at least to cover interest and principal payments over the entire period of the proposed debt package.

Value of Company: The valuation of the company is a very critical factor. There are several methods of valuation. The choice of the method is very important. The choice of the method may be influenced by the benefits the acquirer is looking for.

The commonly used methods of valuation include:

1. Valuation based primarily on assets and liabilities.
2. Valuation based on the projected earnings of a company.
3. Gut feeling.

There are several problems in the valuation. For example, the book value may not reflect the real value of the assets. There may be risk in respect of some of the receivables. A company, which plans to sell, may even try to influence the price-earning ratio. The 'gut feeling' sometimes will be very unrealistic.

Here are some Indian examples of the amount paid for acquisition. Udayan Bose's (Chairman, Lazard Credit Capital) "thumb rule for buying a consumer product company is to offer 1 to 1.5 times the turnover, Coca Cola's offer to Parle was equal to the Indian company's turnover. The Khaitans paid 1.7 times the turnover – ₹ 290 crore – for Union Carbide (UCIL), and Heinz paid ₹ 210 crore for Glaxo's food business, 2.1 times the turnover. Another method is to project the future earnings potential for 10 years and then discount everything down to today's value from the value projected for the 10th year. Lazard uses a 30 per cent discounting factor for its Chinese M&A deals. Here, it is usually 18 per cent. To fix its bid figure of ₹ 290 crore, Williamson Magor capitalised UCIL's profit before tax – ₹ 30 crore – to arrive at ₹ 150 crore, added on another ₹ 100 crore – a guesstimate – for the Eveready brand equity and ₹ 40 crore for getting control of the company. Whirlpool Corporation paid ₹ 300 crore for 51 per cent stake in Kelvinator India. That's 1.52 crore shares at ₹ 197.16 per share, the average share price over the previous six months."[28]

Market Position: Market position, including brand equity, market share, product mix characteristics, strength of distribution network, complementarity with the company's products and marketing, is a very important factor to be considered.

Capital Requirement: Many firms need substantial infusion of capital for their revival or realisation of full potential. When the future of the firm is uncertain or it has been decided to sell off, certain types of expenditures like expenses on maintenance, replacements, renovation etc. may be avoided and this would become an additional burden on the acquirer.

Condition of Plant and Machinery, Technology etc.: The condition of plant and machinery, the quality of the technology, facilities for expansion etc. also need to be carefully evaluated.

Quality of Management Team: The importance of the quality of the management team needs no emphasis. If the management team is not efficient, how feasible will a change of it be? Further, will the efficient managers remain with the company after the merger/takeover?

When the future of a company is uncertain or when there is news about the possible sale, many managers and technicians leaving the company is common.

Human Resources: In respect of human resources, it is not enough to consider the management cadre. The quality of the workers and the industrial relations are equally, sometimes, more important (because changes at the lower levels may sometimes be more important than at the top).

In many companies, workers are demoralised or undisciplined. Excess manpower is common. The implications of these are obvious. The evaluation of the human resources is, therefore, very essential.

ACQUISITION STRATEGY

Once a firm is identified for acquisition, the company has to determine the acquisition strategy.

The strategy will depend, *inter alia*, on the particular case and situation. For example, if the management of the target company is unwilling for the company to be taken over, it cannot be a friendly one. In several cases, a company may be on the lookout for buyers and the seller may have certain specific considerations, besides the price. In a number of cases, there are several prospective buyers. Both strategy and tactics are required to deal with takeover cases.

Several companies – such as Hindustan Unilever and Ajay Piramal Group, for example – have strategic teams scouting for possible acquisition targets in their industry sectors. Once a target is identified, a small working group is set up. Its job is to investigate the target from all angles, stalk it relentlessly, figure out a bid and carry the takeover process to its conclusion. The team typically includes the CEO, a senior finance executive, and a legal expert. It should also have an investment or merchant banker with takeover experience. And increasingly, media experts are becoming key members of such teams, to make sure that public and minority shareholder opinion does not turn against the takeover try, and also to use the media to discourage other bidders.[29]

The preparatory work for takeovers are normally done highly confidentially. In several cases, one also has to be very quick to seize an opportunity. Ajay Piramal attributes, for example, his successful takeover of Rote to the fact that he initiated meetings with the seller faster than other bidders. Says he: "The Rote team was supposed to come back to India for a second round of discussions with the bidders, but rather than wait for them, I flew down to their headquarters and quickly finalised everything." [30]

Sometimes, a company enters into a lease agreement with potential takeover firms – as HLL did in the case of Stepan Chemicals, Sunrise Industries and Union Home Products – which enables the company to more closely assess the viability of the units.

There are also cases of companies entering into *Management Contracts*, managing the firm for some period and then taking over as done by companies like Tata Tea in the cases of some tea plantations in Sri Lanka.

Completion of the legal and other procedural aspects of the deal need very careful handling.

PROCEDURAL FORMALITIES

The process effecting a merger is quite complex and elaborate in nature that can be summed up as follows:[31]

1. Preparation of draft scheme of merger.
2. Approval of the same by the board of directors of the companies intending to merge.
3. Application to the concerned High Court to convene general meetings of the respective companies for obtaining approvals of the shareholders to the proposed scheme of merger.
4. Obtaining approval of the High Court for convening such meeting including fixation of time, place quorum and appointment of Chairman.
5. Giving notice of the petition to the Central Government.
6. Holding the general body meetings and obtaining approvals of the shareholders.
7. Submission of the particulars of the general body meetings to the High Court where the following resolutions need to be passed.
8. Resolution approving the scheme of mergers to be passed by three-fourths majority in value of shareholders and authorising the directors to implement the scheme.
9. Resolution for increasing the authorised capital of the company, if necessary.
10. Submitting petition to the High Court by the respective companies for obtaining the Court's final order, which may be given on the basis of the report of the Official Liquidation.
11. Filing the certified true copy of the court's order with the concerned Registrar of Companies.
12. Annexing a copy of the order of the High Court to every copy of the memorandum of association after filing the certified copy of the order as aforesaid.
13. Allotment of shares of other instruments as per the approved scheme of merger.

POST-MERGER INTEGRATION

As pointed out in the section, *Disadvantages/Pitfalls in M&A*, post-merger/acquisition integration of the firms is a crucial task to be accomplished for effective performance.

There are several aspects of the integration. The organisational culture of the companies may be different. Sometimes, there may be differences in the policies, procedures and styles. Functional facilities and activities will have to be aligned and coordinated.

Emotional integration of personnel of the organisations is another aspect. Some of the important areas of post-merger/acquisition integration are the following.

Procedural Integration

Procedural integration encompasses a very broad area. "It involves combining systems and procedures of the merged companies at the operating, management control, and strategic planning levels. The objective of integration is to homogenise and standardise work procedures and administrative systems. Standardisation of procedures simplifies communications between acquiring

and acquired companies. It also improves productivity and reduces the cost of processing information. It involves integrating the legal entities, accounting systems, functional areas, and strategic business units."[32]

Physical Integration

Physical integration involves consolidation and integration of facilities for and activities of production, R&D, logistics etc. for optimum results.

Managerial and Socio-cultural Integration

Cultural disparity and post-integration hurdles seem to be the most cited reasons for acquisition failure.

Managerial and socio-cultural integration is one of the most difficult ones. It involves "a complex combination of issues related to selection or transfer of managers and changes in organisational structure and development of a consistent corporate culture including a frame of reference to guide strategic decision-making. Commitment and motivation of personnel and the establishment of new leadership are also important issues."[33]

The cultural difference is a very important problem to be tackled in many of the M&A cases. This problem was there, for example, in respect of the merger of Brook Bond and Lipton, TOMCO with HLL and BBLIL with HLL. A human resource development expert has observed, for instance, that TOMCO managers were not used to dealing with tough targets, or discussing product profitability. It was not part of their culture. But it is the only language Lever's managers understand. Some 100 managers from Ponds, Brook Bond, Lipton and even from Levers itself quit their respective companies, unable to deal with the Leverisation process. The dilemma expressed by one senior TOMCO manager that having fought the Lever in the marketplace for 20 years he could not mentally accept the situation working for the Lever exposes one important aspect of the cultural problem when competitors merge.[34]

Referring to the HLL-BBLIL merger, S.M. Data, the then chairman who was the chief architect of the merger, was asked: "Will the merger create cultural msimatches? The new HLL is after going to be an amalgam of three different companies...three different cultures." Datta answered: "The culture factor is indeed an issue and we have taken that into consideration. We have got an outline strategy already in place on how we shall deal with such problems. The first task is to communicate the immediate plan clearly. Then, only slightly less important, is to ensure that no insecurity creeps in. No needless insecurity should be there because we have failed to communicate. Then counselling, to remove any scope for misunderstanding. The important thing is that the success or failure of any new entity will depend upon the people who are important and the people who run it'll. If there is any unhappiness, insecurity or uncertainty, obviously, we cannot get the best out of them. So that will require a very high degree of attention."[35]

People Issues

People issues are an aspect of the *Managerial and Socio-cultural Integration* described above.

As the KPMG, *White Paper on Post Merger People Integration* observes, people issues in a merger can begin at the earliest stages of the deal if not properly accounted and planned for. It is essential that HR be involved and kept abreast of the CEO's agenda with regard to the proposed

merger. It is imperative that HR asks critical questions in the initial meetings as well as across the merger process. The function must be aware of the key stages and milestones in the process This would also enable HR to effectively assess the key pitfalls that needed to be overcome to support the CEO's agenda and manage human capital risks.[36]

As Kumar Mangalam Birla, Chairman of the Aditya Birla Group, comments, "M&As are not about stronger balance sheets or enhanced market shares, rather, they are about the coming together of people, their hearts, minds, cultures and values."[37]

DEFENCE STRATEGIES

There are several defence strategies which companies may employ against hostile takeover attempts. Important strategies are the following.

Pacman Defence

Named after the computer game, under this strategy the target company attempts to raid the predator. This would be more effective if the target company is larger in size than the predator.

Swallowing Poison Pill

This strategy attempts to make the takeover target less attractive by measures such as issue of convertible debentures. As this strategy can prove to be very dangerous to the target company itself, it is also known as *Scorched Earth Policy*.

Disposing off Crown Jewels

This strategy, by disposing off the most valuable assets, also aims at making the target less attractive to the predator in a bid to discourage any takeover move. Such a strategy may find favour with the target company if it is possible to sell the crown jewel to an associate company.

Management Buyout

The Management Buyout (MBO), also known as *Leveraged Recap*, is another strategy to make the target company unattractive. Under this strategy, the target company raises funds from the market by issue of bonds, may be junk bonds, and uses this fund to declare massive dividends or spin-off price for shares to the existing shareholders (While repurchase of shares is allowed in USA, it is under the consideration of the Government of India). The high gearing also makes the company less attractive.

Operation Gray or White Knight

The Gray Knight, a friend of the takeover target, will seek to help the Target Company by launching a counter-takeover attack on the predator. The White Knight helps the target company by offering a higher bid to the target company than the other raider. The White Knight may later restore the status quo for the target company, may be for a consideration.

Golden Parachutes

This strategy involves providing protection to the company directors through such measures as extravagant termination packages which would make it unattractive for raiders to replace them.

CROSS-BORDER ACQUISITIONS AND FDI

For a long time now, the trends in FDI have been led by cross-border mergers and acquisitions (M&As), the level of FDI flow often fluctuating with the trends in M&A. The changes in the global business environment, caused mostly by the intertwined liberalisation-privatisation-globalisation, have led to an avalanche of cross-border mergers and acquisitions with its concomitant cross-border flow of investments.

The surge in cross-border M&As, *albeit* characterised by ups and downs, has been causing substantial restructuring and transformation of the competitive environment of industries globally. M&As have been found to be particularly important in the FDI flows to the developed countries. A notable trend has been the increasing participation of developing country firms in the global M&A activities. They have shown great interest in the acquisition of firms in the advanced economies. Corporate India has significantly resorted to overseas acquisitions as part of the globalisation and competitive strategies.

The liberalisation and deregulation of several vital industries in many countries across the world have given an impetus to cross-border M&As in both developed and developing countries. Privatisation has been a very important stimulant to M&As. Banking, finance, insurance and telecommunication and several other industries have witnessed a spate of M&As.

Features of the recent M&A activities include the large size and number of M&As; growing interest of collective funds, particularly private equity funds and sovereign wealth funds, in acquisition; increasing participation of the developing country firms in M&A activities and changes in the industry destinations of M&As.

The value of cross-border M&As, however, cannot be calculated as a percentage of FDI, because they are financed by FDI as well as borrowing from capital markets, both domestic and foreign, and the financial transactions related to mergers and acquisitions can be phased over several years. M&As do not necessarily require cash or new fund but can be based on stock swaps (mutual exchange of stocks).

The mega M&A deals (i.e., deals worth over $ 1 billion, particularly over $ 3 billion), have been often setting the trend of the total M&A activities and the FDI flows, with the total number and value of mega deals and the level of FDI flows moving in tandem. FDI flows often rise when the number of mega deals and their value, and often their share of the total value of the cross-border M&As, increase, and *vice versa*.

As an UN Report points out, one recent feature is that M&As among large or dominant TNCs, resulting in even larger TNCs, seem to impel other major TNCs to move towards restructuring or making similar deals with other TNCs. The pharmaceutical, automobile, telecommunications and financial industries are typical example of industries in which such concentration can be observed.[38]

M&As have been encouraged by the trend to sell non-core operations or affiliates by firms and the acquisition of similar operations from other firms (of divisions or affiliates, or firms that have similar businesses). This indicates a strategic shift by TNCs to focus on their core activities. In addition to strategic considerations of firms, liberalisation and deregulation are the other main factors behind the dramatic increases in M&As in both developed and developing countries.

Developed countries accounted for the lion's share of the mega mergers. However, in the recent period, acquisitions have become a very important growth and globalization strategy of firms of developing countries.

The growing dynamism of the developing countries and the increasing competitiveness and global orientation of developing country firms have their reflection in the global M&A trends. Like MNCs based in developed countries, firms from developing countries, particularly from developing Asia, resort to M&As as an important mode of foreign market entry and product mix expansion. A very notable trend is that since 2000 South-North transactions have shown particularly fast growth, indicating a strong desire among developing country firms to acquire strategic assets in developed economies and/or speed up their expansion in these markets. (South refers to the developing countries and North to the developed).

Although M&As have been playing an important role in driving the FDI flow to the developing countries, greenfield investments have been more important, whereas M&As have been playing a greater role in respect of the developed economies. As the *WIR 2012* points out, greenfield investment and M&A differ in their impacts on host economies, especially in the initial stages of investment. In the short run, M&As clearly do not bring the same development benefits as greenfield investment projects, in terms of the creation of new productive capacity, additional value added, employment and so forth. The effect of M&As on, for example, host country employment can even be negative, in cases of restructuring to achieve synergies. In special circumstances, M&As can bring short-term benefits not dissimilar to greenfield investments; for example, where the alternative for acquired assets would be closure. Privatisations are another special case, where openness of the bidding process to foreign acquirers will enlarge the pool of bidders and increase the value of privatised assets to the State. In any case, over a longer period, M&As are often followed by sequential investments yielding benefits similar to greenfield investments. Also, in other investment impact areas, such as employment and technology dissemination, the differentiated impact of the two modes fades away over time.

M&As by Special Funds

Collective investment funds like private equity (PE) funds, sovereign wealth funds (SWF) and hedge funds are important part of the FDI dynamics. The rapid rise of the cross-border M&As by PE funds and SWF was stumbled by the global economic crisis that set in 2008.

PE funds are funds controlled and managed by private equity firms (i.e., firms that collect funds from private investors (asset holders that are not publicly listed) and buy majority or entire ownership stakes in companies and/or business units with a view to restructuring the management and organisation, and thereby raising the stock value of the latter for resale. Acquired firms are usually delisted (unless already unlisted) held privately and restructured over a certain period of years, and then resold to other parties or again listed through an initial public offering (IPO). Unlike other kinds of FDI, private equity firms tend not to undertake long-term investment, and exit their positions with a time horizon of 5 to 10 years (or an average of 5-6 years), long enough not to be regarded as typical portfolio investors. Thus, host countries and developing ones in particular, need to be aware of this difference in time horizon. At the same time, foreign ownership can bring market access and new technologies, and private equity investment can help host-country enterprises at a critical juncture to move to a new phase of development.

Net value of the cross-border M&As by PE funds reached peaked at $ 288 billion in 2007 accounting for 28 per cent of the total cross-border M&As. However, the share was only 17 per cent in 2011.

Sovereign Wealth Funds (SWFs), which are investment funds owned by the governments, with very large amounts of money at their disposal, have emerged as well-established institutional investors and important participants in the international monetary and financial system, buying large stakes in companies and giving governments' exposure to sectors they may otherwise be unable to achieve.

The term sovereign wealth fund was introduced in 2005, but the first SEF was introduced in 1953 by the government of Kuwait (Kuwait Investment Authority).

Sovereign wealth funds, as defined by the US Treasury, are government investment funds, funded by foreign currency reserves but managed separately from official currency reserves. Basically, they are pools of money governments invest for profit. The International Working Group on Sovereign Wealth Funds defines SWF as special purpose investment funds or arrangements, owned by the general government. Created by the general government for macroeconomic purposes, SWFs hold, manage, or administer assets to achieve financial objectives, and employ a set of investment strategies which include investing in foreign financial assets. The SWFs are commonly established out of balance of payments surpluses, official foreign currency operations, the proceeds of privatisations, fiscal surpluses, and/or receipts resulting from commodity exports.

The growth of SWFs has been impressive: even during 2007-2011, a period spanning the global financial crisis, and despite losses on individual holdings, the total cumulative value of SWF assets rose at an annual rate of 10 per cent, compared with a 4 per cent decline in the value of international banking assets. That growth is likely to continue as the emerging-market owners of most funds keep outperforming the world economy, and as high commodity prices further inflate the revenue surpluses of countries with some of the largest SWFs.

The combined assets of the major SWFs (owned by 20 governments) have reached nearly 4 trillion dollars, and are expected to reach over 10 trillion dollars by 2012. Over half of the SWF assets are owned by oil and gas exporting nations, and about one-third by Australia, China, and Singapore.

The size of some of the SWFs is mammoth, far exceeding the value of the GDP of the respective countries. For example, the fund value of Abu Dhabi Investment Authority ($ 625 billion), the largest SWF, was more than 500 per cent of the GDP of UAE.

Although the current total amount makes up only some 3 per cent of the world's traded securities, the SWFs already have tremendous concentrated financial power. SWFs are aggressive investors and have bought into firms as diverse as Morgan Stanley, General Electric, and Sony. As their influence on the worldwide economy continues to grow, SWFs represent a vitally important source of capital, especially in terms of the alternative asset classes as they continue to increase their activity in this area.

SWFs are for the most part portfolio investors, with the bulk of their funds held in relatively liquid financial assets in mature market economies. Only a small proportion of their value (less than 5 per cent of SWF assets under management and less than one per cent of global FDI stock in 2011).

FDI by SWFs is concentrated on specific projects in a limited number of industries, finance, real estate and construction, and natural resources.

In part, this reflects the strategic aims of the relatively few SWFs active in FDI, such as Temasek (Singapore), China Investment Corporation, the Qatar Investment Authority and Mubadala (United Arab Emirates). Even these four SWFs have devoted only a fraction of their total holdings to FDI.

There is concern that these funds would be able to buy stakes in another country's strategic industries. SWFs are aggressive investors and have bought into firms as diverse as Morgan Stanley, General Electric, Sony, Citigroup, Merrill Lynch, London Stock Exchange, London's Herron Tower skyscraper, Hotel Washington, budget hotel chain Travelodge etc. and Sony.

Despite SWFs' current focus on developed countries, and the concentration of their activities with their long-term and strategically oriented investment outlook, SWFs may be ideally well placed to invest in productive activities abroad, especially in developing countries, including in particular the LDCs that attract only modest FDI flows from other sources. The scale of their holdings enables SWFs to invest in large-scale projects such as infrastructure development and agricultural production – key to economic development in many LDCs – as well as industrial development, including the build up of green growth industries.

For both developing and developed countries, investment by foreign State-owned entities in strategic assets such as agricultural land, natural resources or key infrastructure assets can lead to legitimate policy concerns. Nonetheless, given the huge gap across the developing world in development financing for the improvement of agricultural output, construction of infrastructure, provision of industry goods as well as jobs, and generation of sustainable growth, FDI by SWFs presents a significant opportunity.

M&As IN INDIA

Mergers and acquisitions have played an important role in the transformation of the industrial sector of India since the Second World War period.

World War II and Post-war Period

The economic and political conditions during the Second World War and post-war periods (including several years after independence) gave rise to a spate of acquisitions and mergers. The inflationary situation during the wartime enabled many Indian businessmen to amass income by way of high profits and dividends and black money. This led to "wholesale infiltration of businessmen in industry during war period, giving rise to hectic activity in stock exchanges. There was a craze to acquire control over industrial units, in spite of swollen prices of shares. The practice of cornering shares in the open market and trafficking of managing agency rights with a view to acquiring control over the management of established and reputed companies had come prominently to light. The net effect of these two practices, viz., of acquiring control over ownership of companies and of acquiring control over managing agencies, was that large number of concerns passed into the hands of prominent industrial houses of the country."[39] As it became clear that India would be gaining Independence, British managing agency houses gradually liquidated their holdings at fabulous prices offered by Indian business community. Besides the transfer of managing agencies, there were a large number of cases of transfer of interests in individual industrial units from British to Indian hands. Further, "at that time, it used to be the fashion to obtain control of insurance companies for the purpose of utilising their funds to acquire substantial holdings in other companies. The big industrialists also floated banks

and investment companies for furtherance of the objectives of acquiring control over established concerns."[40]

The post-war period is regarded as an era of takeovers and amalgamations. Large number of M&As occurred in industries like jute, cotton textiles, sugar, insurance, banking and tea plantations.

Pre-liberalisation Period

Although there were a large number of M&As in the early post-Independence period, the 'anti-big' government policies and regulations of the 1960s and 70s seriously deterred M&As. This does not, of course, mean that M&As were uncommon during the controlled regime. The deterrent was mostly to horizontal combinations. There were many conglomerate combinations. The law was against horizontal mergers that would result in concentration of economic power to the common detriment. Horizontal mergers, which would not have such effects, could take place. Government encouraged M&A of sick units. Government also played a direct role in M&As in some industries. The formation of the Life Insurance Corporation and nationalisation of the life insurance business in 1956 resulted in the takeover of 243 insurance companies. There was a similar development in the general insurance business. The public sector National Textiles Corporation (NTC) took over a large number of sick textile units.

Post-liberalisation Period

The liberalisation ushered in 1991 very significantly changed the scene. Following the liberalisation of the regulations on growth and M&A (delicensing, dereservation, MRTPA relaxations, liberalisation of policy towards foreign capital and technology), the M&A mania has bitten corporate India making the 1990s a decade of structural transformation of the industrial sector.

The total number of mergers and acquisitions which India witnessed during the entire decade of 1980s was only 84 (32 mergers and 52 takeovers), but in 1993 alone there were 114 and there were much higher levels of M&A activities in the following period. According to estimates by Grant Thornton, a consulting and audit firm, between 2005 and 2011, Indian companies did about 1,100 deals with a total deal value of about $ 75 billion.[41] According to the Report of the Takeover Regulations Advisory Committee (see the section on Regulation of Takeovers for more about the report of the Committee), the number of takeovers of listed companies increased from an average of 69 a year during the period between 1997 and 2005 to an average of 99 a year during the period between 2006 and 2010.

In the decade ended 2010, the pharmaceutical industry had the highest share in M&A in the Indian manufacturing sector. 264 M&A deals were undertaken in this industry during 2001-2010. 37.5 per cent of them were mergers and 62.5 per cent were acquisitions. Indeed, the global trend of M&A in pharmaceutical industry has been very much visible in India too as would be clear from the reference to it elsewhere in this chapter.

The SEBI Takeover Code 2011 goes a long in encouraging takeovers in India.

The M&As during the 1990s cut across small, medium and large companies and groups and veteran industrialists to new entrepreneurs. There were new and very young entrepreneurs like Ajay Piramal who was regarded as a role model of a skillful and successful M&As and P. Rajarathinam who (having taken over 19 firms within a period of three years) was regarded as an indiscriminate corporate raider. On the other extreme was the giant Hindustan Lever (HLL). Corporate India's 'take

over kings' or 'tycoons' included R.P. Goenka (R.P.G. Enterprises) Vijay Mallya (U.B. Group), Manu Chhabria (Shaw Wallace) and S.M. Datta (HLL). While Datta's role was that of a CEO, that of the others was primarily that of an industrialist. The takeover frenzy has landed some of them like Rajarathinam, Mallya and Chhabria in financial problems.

Companies taken over by R.P.G. included Dunlop, Ceat, Philips Carbon Black, Gramaphone India and Harrisons Malayalam. Two of these – Philips Carbon Black and Harrisons Malayalam (plantation) have linkages with the tyre (Ceat and Dunlop). Mallya's U.B. Group was straddled mostly by takeovers. Companies under the U.B. conglomerate included Best and Crompton (engineering), Mangalore Chemicals and Fertilizers, Kissan (foods) and Unitel (telecom) besides the four liquor firms (United Breweries, Carew Phipson, Herbertson and McDowell). M&A are an important growth strategy employed by the giant Hindustan Lever. The Ajay Piramal Group has almost entirely been built up by M&As. It may be noted that several companies had to give up some of the acquired companies later due to various reasons.

There are a number of companies/business groups whose growth was been propelled by M&As. Built entirely by M&A, starting with the acquisition of Nicholas Laboratories in 1988, the Piramal Enterprise's pharmaceutical business jumped from Top Twenty in 1994 to Top Ten in 1995 and Top Five in 1996; its position in 2012 was also the same. Since the late 1980s, the Piramal Group evolved from a textile-centric business to a diversified pharmaceutical-based global organisation. It made 28 acquisitions between 1989 and 2012, majority of them global, mostly in the pharmaceutical and other healthcare related sectors. The group operates across sectors such as healthcare, life sciences, drug discovery, healthcare information management, specialty glass packaging and real estate. Today, this diversified conglomerate has operations in over 30 countries and brand presence across 100 markets around the world.

M&As have significantly contributed to the growth of a number of companies/business groups. For example, M&A was an important contributor to the fast growth of the Murugappa Group. In 1996, about half of its turnover of over ₹ 2,500 crore came from companies acquired over the past decade and a half. According to M.V. Subbaiah, the Group CEO, the group's penchant for acquisition was that in the past capacities could not be expanded because of the MRTP constraints and hence the group had to take the route of buying a company through the BIFR route.[42] In less than 15 years, the group took over a dozen companies which include EID Parry, Coromandel Fertilizers, Bharat Pulverising Mills, Sterling Abrasives, Cutfast Abrasives etc. Other companies/groups whose growth has been significantly contributed by M&As include Hindustan Lever, RPG Enterprises, Shaw Wallace, U.B. Group, Ajay Piramal Group, Ranbaxy, Glaxo India etc.

There were also many mergers. This applies to greenfield enterprises and acquired firms. Brooke Bond and Lipton were merged in 1993 and the merged entity, Brooke Bond Lipton India Ltd. (BBLIL) merged into Hindustan Lever in 1996. The Pharmaceutical firms of the Ajay Piramal Group (Nicholas Piramal India Ltd., Piramal Healthcare Ltd. – into which the group company Sumitra Pharma was merged earlier – and Boehringer Mannheim India Ltd.) merged. Similarly, the four bulk drug and formulation companies of the Natco Group have merged. The Nirma Group companies have merged into Nirma Ltd. Consumer durables groups like BPL, Videocon and Onida have also undertaken merger of various group companies. These are but just some examples of the merger trend that enveloped the Indian corporate sector.

The liberalisation of forein investment paved the way for many acquisitions of Indian firms by foreign firms, as mentioned in several places in this chapter.

Foreign Acquisitions by Indian Firms

As pointed out in a previous section, a powerful trend has been the increasing foreign acquisitions by developing country firms, including Indian.

Table 15.2

Largest Cross-border M&As by Indian TNCs, 2005-2012

Year	Acquiring Company	Target Company	Target Industry	Target Nation	Value ($ Million)	Shares (%)
2007	Tata Steel UK Ltd.	Corus Group Plc	Steel	United Kingdom	11791	100
2010	Bharti Airtel Ltd.	Zain Africa BV	Telecommunications	Kuwait	10700	100
2007	AV Aluminum Inc.	Novelis Inc	Metal	United States	5789	100
2010	Investor Group	Republic of Venezuela-Carabobo Block	Oil and gas	Venezuela (Bolivarian Republic of)	4848	40
2010	Adani Mining Pty Ltd.	Linc Energy Ltd.	Mining	Australia	2740	100
2008	Investor Group	Sabiha Gokcen International Airport	Transport	Turkey	2656	100
2008	Jarpeno Ltd.	Imperial Energy Corp Plc	Oil and gas	United Kingdom	2608	100
2008	Tata Motors Ltd.	Jaguar Cars Ltd.	Automotives	United States	2300	100
2011	Mundra Port & Special Economic Zone	Abbot Point Coal Terminal	Transport	Australia	1951	100
2005	Ratnagiri Gas & Power Pvt. Ltd.	Dabhol Power Co.	Power	United States	1939	100
2010	Chennai Network Infrastructure Ltd.	Aircel Ltd. Mobile Towers	Telecommunications	Malaysia	1704	100
2007	Essar Steel Holdings Ltd.	Algoma Steel Inc.	Steel	Canada	1603	100
2007	Tata Power Co. Ltd.	Kaltim Prima Coal PT	Mining	Indonesia	1300	30

2011	GVK Power & Infrastructure Ltd.	Hancock Coal Pty Ltd.	Mining	Australia	1260	100
2007	United Spirits Ltd.	Whyte & Mackay Ltd.	Food and beverages	United Kingdom	1176	100
2010	Reliance Eagleford Upstream LP	Pioneer Natural Resources Co.	Oil and gas	United States	1145	38
2008	GMR Infrastructure Ltd.	InterGen NV	Power	United States	1107	50
2008	Tata Chemicals Ltd.	General Chemical Industrial Products Inc.	Chemicals	United States	1005	100

Source: UNCTAD, *World Investment Report, 2013*.

The global orientation of Indian corporates has led to large outbound M&As, particularly since the beginning of the present century. This trend has been so conspicuous that it has been described as India Inc. on an "overseas shopping spree", "acquisition spree" etc. India is indeed reckoned as an important player in the global acquisition game, particularly in industries such as metals, IT, pharmaceutical, automobile, packaging, paint, tyre, FMCG etc. In fact, in some years, the value of foreign acquisitions by Indian firms was larger than that of the Indian acquisitions by foreign firms.

The following observation by Kumar Mangalam Birla gives some candid indication of the role of M&As: "Our global acquisitions are dictated by our business ambitions. We have made 26 acquisitions globally and in India, which have helped us leapfrog growth. The rationale for acquiring assets globally has been the sourcing of raw materials, investing in downstream operations and access to innovative technologies."[43]

Some of the recent Indian acquisitions have been spectacular. For instance, the value of a single overseas acquisition by an Indian company (Corus by Tata Steel) – more than $ 12 billion – in early 2007 was twice the total FDI in India in 2005 and more than the aggregate value of both the inbound and outbound deals in 2006. Other big acquisitions include Hindalco's $ 6 billion buyout of Novelis, Bharti Airtel's acqusition of Keniyan firm Zain Africa for $ 10.7 billion, Suzlon's $ 1.6 billion acquisition of RE-Power and Essar Steel's $ 1.5 billion acquisition of Algoma.

M&As have made a number of Indian companies the leading or major players globally. For example, acquisitions have made Tata Tea and Bharat Forge second largest, Essel Propack the largest, Tata Steel the sixth (from 56th prior to the Corus buy), and Tata Motors fifth (with Daewoo acquisition from sixth) in their industries. Acquired firms now contribute the substantial or a significant share of the turnover of a number of companies in several industries.

Box 15.2

The Direction and Motives/Benefits of Indian Acquisitions

The most important destination of Indian acquisitions is industrial economies, particularly North America and Western Europe. For example, of the 18 cross-border Indian M&A deals with investment values over $ 1 billion between 2005 and 2012, more than two-thirds were in developed countries, most notably in the United States (6 deals).

While a number of acquisitions in the developed economies have been big ticket deals, in other countries they have been largely of relatively smaller size, mostly in the FMCG space.

According to an AT Kearney-Wharton survey of 178 Indian executives, referred to earlier in this chapter, besides North America and Western Europe, preferred destinations for acquisitions are South East Asia, South Asia, Eastern Europe, South America, West Asia Australia, New Zealand, and Africa.

M&As are done for a variety of reasons. Firms derive one or, often, more benefits from M&As.

The *World Investment Report 2013*, points out that the mega deals referred to in the opening paragraph of this Box were mainly in extractive industries (oil and gas, and metal mining), infrastructure industries (telecom and transport) and heavy industries (automotive, chemicals and metal production).

Acquisition is often seen as an important foreign market entry mode and market expansion strategy. A number of examples of market-seeking acquisitions by Indian companies are given in several places in this chapter.

Product mix expansion has been an important benefit gained by a number of Indian acquisitions, both foreign and domestic.

A great advantage of a number of acquisitions is the possession of well-known brands, such as Jaguar and Land Rover, and Daewoo by Tata Motors, Tetley by Tata Tea, Big Mill by Aravind Mills, Pauwel by Crompton Greeves, a large number of brand by Wipro Consumer Care and Lighting Ltd., both domestic and foreign including nearly 50 brands of the Malaysian FMCG firm Unza across a variety of products, several foreign FMCG brands by Godrej Consumer Products Ltd. and so on.

Distribution is often regarded as one of the most difficult areas in international marketing. One of the critical advantages of many acquisitions is the marketing infrastructure, particularly the logistics, of the acquired firm.

Access to technology or R&D facilities is a major benefit of some of the M&As. A major handicap of many Indian firms is the uneconomic size of their operations which seriously affect their competitiveness in the domestic and global market. M&A helps them to overcome this problem.

Getting regulatory approvals for products or manufacturing facilities from foreign authorities are often complex procedures and very difficult. This problem is overcome when firms with such approvals are taken over.

A number of M&As have helped to improve the supply chain by vertical or horizontal integration or improved logistics.

There were also several acquisitions which were assest-seeking, as in the cae of some of the acquisitions in the energy sector and metal mining cited in this Box. Indian companies have been able to secure access to significant mineral resources worldwide, including through mega deals in countries such as USA, Australia, Indonesia, the Sudan and the Bolivarian Republic of Venezuela.

REGULATION OF TAKEOVERS

The Significance

With the liberalisation, particularly globalisation, takeovers have become a common feature of the corporate sector of all countries with a dynamic industrial economy.

As the Takeover Regulations Advisory Committee (TRAC), appointed by the Securities and Exchange Board of India (SEBI), observes, it is a widely recognised fact that one of the key elements of a robust corporate governance regime in any country is the existence of an efficient and well-administered set of Takeover Regulations. Regulations on takeovers seek to ensure that the takeover markets operate in a fair, equitable and transparent manner. The objectives of takeover regulation are elaborated in a following sub-section.

Evolution of Takeover Regulations in India

The need for regulation of takeovers have been well recognised in India and the last nearly two-and-a-half decades have seen a steady evolution of a set of capital market regulations in respect of substantial acquisition of shares and takeovers. Initially, some such regulatory measures were incorporated in the late 1980s through Listing Agreement of companies with the Stock Exchanges.

The establishment of SEBI was an important milestone in the progress of Takeover Regulations. The Securities and Exchange Board of India Act, 1992, provided for formulating a legal framework for regulating substantial acquisition of shares and takeovers by suitable measures. Consequently, SEBI notified a Takeove Code [(Substantial Acquisition of Shares and Takeovers) Regulations, 1994] which came into force on November 4, 1994. On February 20, 1997, SEBI notified a new Takeover Regulations, repealing the Takeover Regulations of 1994, based on the recommendations of Justice P.N. Bhagwati Committee appointed by SEBI to review the Takeover Regulations. The 1997 regulations were amended from time to time – 23 times before a new set of Regulations were notified in 2011.

On September 4, 2009, SEBI constituted a Takeover Regulations Advisory Committee (TRAC) to examine and review the Takeover Regulations of 1997 and to suggest suitable amendments to the same, under the Chairmanship of C. Achuthan, Former Presiding Officer of the Securities Appellate Tribunal. Incorporating most of the recommendations of the TRAC, the Takeover Code was revamped and the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011, replaced the old Regulations with effect from October 22, 2011. Some amendments to the 2011 Regulations were effected by the SEBI (Substantial Acquisition of Shares and Takeovers) (Amendment) Regulations, 2013.

Box 15.3

Takeover Code: A Balancing Act

Substantial acquisition of shares in, or takeover of, a listed company impacts a host of stakeholders, such as, the acquirer, the target company, the management and the public shareholders. It is critical that the legal framework regulating such substantial acquisition of shares and takeovers is precise, unambiguous and predictable, and balances multiple, and at times, conflicting interests of such stakeholders. For instance, the public shareholder of the target company would be keen to get the highest possible price for his shares, while the acquirer would want to shoulder the least possible financial and regulatory burden. The target company may wish to support, oppose or remain neutral to, a transaction, often depending on who the acquirer is. It then falls upon the regulator to balance the interests of various stakeholders and to provide for a fair, equitable and transparent regime that addresses the concerns of all stakeholders.

In drafting the Proposed Takeover Regulations, the *TRAC* adopted an approach of balancing and calibrating such conflicting objectives. While the Committee believed that the Proposed Takeover Regulations, by and large, strike such a balance, the Regulations do recognise and accord primacy to the goal of protection of the interests of the public shareholders in takeover situations.

The Committee also recognised that no regulation would be able to provide for every situation that may arise in the domain of economic activity. However, if the regulatory intent, purpose and underlying philosophy are clearly understood and articulated, these can provide guidance even in ambiguous situations.

Courtesy: Report of the Takeover Regulations Advisory Committee.

Objectives of Takeover Code

The TRAC stated the following as the fundamental objectives of the Takeover Regulations:

1. To provide a transparent legal framework for facilitating takeover activities;
2. To protect the interests of investors in securities and the securities market, taking into account that both the acquirer and the other shareholders or investors and need a fair, equitable and transparent framework to protect their interests;
3. To balance the various, and, at times, conflicting objectives and interests of various stakeholders in the context of substantial acquisition of shares in, and takeovers of, listed companies;
4. To provide each shareholder an opportunity to exit his investment in the target company when a substantial acquisition of shares in, or takeover of a target company takes place, on terms that are not inferior to the terms on which substantial shareholders exit their investments;
5. To provide acquirers with a transparent legal framework to acquire shares in or control of the target company and to make an open offer;
6. To ensure that the affairs of the target company are conducted in the ordinary course when a target company is subject matter of an open offer;
7. To ensure that fair and accurate disclosure of all material information is made by persons responsible for making them to various stakeholders to enable them to take informed decisions;
8. To regulate and provide for fair and effective competition among acquirers desirous of taking over the same target company; and
9. To ensure that only those acquirers who are capable of actually fulfilling their obligations under the Takeover Regulations make open offers and provide a transparent legal framework for facilitating takeover activities.

Important Features of the Takeover Code

The present Takeover Code is more comprehensive, clear, simple and transparent than the earlier regulations. This section briefly describes some of the salient features of the Regulations.

Initial Trigger: The Takeover Regulations will be triggered when the shareholding or voting rights in a target company by an acquirer reaches an aggregate of 25 per cent of the total. That is, at this point, the Takeover Regulations will become applicable. The initial threshold that mandated application of regulatory provisions under the previous Code was 15 per cent. In other words, while in the past, substantial acquisition of shares/voting rights meant a minimum aggregate of 15 per cent, it is 25 per cent now.

Creeping Acquisition Trigger: The acquirer holding 25 per cent or more voting rights in the target company can acquire additional shares or voting rights to the extent of 5 per cent of the total voting rights in any financial year, up to the maximum permissible non-public shareholding limit (generally 75 per cent). Acquisition of more than 5 per cent shares or voting rights requires an open offer for acquiring shares from the public as per the Takeover Code.

Mandatory Open Offer: A mandatory open offer becomes applicable when:

- The aggregate acquisition/holding of shares/voting rights of the acquirer is 25 per cent or more in the target company.
- Creeping acquisition of more than 5 per cent voting rights in a financial year by the acquirer who already holds 25 per cent or more voting rights in the target company.
- Acquisition of control over the target company, irrespective of shares or voting rights held by the acquirer.

In a mandatory open offer, the acquirer has to offer to acquire minimum 26 per cent of the total shares of the target company from public shareholders, in accordance with the Takeover Code. (Under the previous Code, the stipulation was 20 per cent.)

Voluntary Offer: A concept of voluntary offer has been introduced in the Takeover Code of 2011, by which an acquirer who holds more than 25 per cent but less than the maximum permissible limit, shall be entitled to voluntarily make a public announcement of an open offer for acquiring additional shares subject to their aggregate shareholding after completion of the open offer not exceeding the maximum permissible non-public shareholding. Such voluntary offer would be for acquisition of at least such number of shares as would entitle the acquirer to exercise an additional 10 per cent of the total shares of the target company.

This would facilitate the substantial shareholders and promoters to consolidate their shareholding in a company.

Indirect Acquisition: The new Takeover Code clearly lays down a structure to deal with indirect acquisition, an issue which was not adequately dealt with in the earlier version of the Takeover Code. Simplistically put, it states that any acquisition of share or control over a company that would enable a person and persons acting in concert with him to exercise such percentage of voting rights or control over the company which would have otherwise necessitated a public announcement for open offer, shall be considered an indirect acquisition of voting rights or control of the company.

Evaluation of the Takeover Code

The new Takeover Code, which is based on a thorough review and evaluation of the existing regulation in India and other countries by an expert committee appointed by the SEBI, marks a very significant improvement over the previous Regulations. In other words, although the Takeover Code of 2011 adheres to the framework and principles of the Takeover Code of 1997, the changes it has brought about are far-reaching.

Implications of the increase in the threshold from 15 to 25 per cent and open offer size from 20 to 26 per cent. This will help the listed companies to get more investments without triggering the open offer requirement as early as 15 per cent, therefore making the takeover process more attractive, speedier and cost-effective.

Now, the strategic investors, including private equity funds and minority foreign investors, can increase their shareholding in listed companies up to 24.99 per cent and will have greater say in the management of the company. An acquirer holding 24.99 per cent shares will have a better chance to block any decision of the company which requires a special resolution to be passed.

The increase in the threshold and open offer size make the present takeover scenario very different from the previous one. Under the Takeover Code of 1997, an acquirer with 15 per cent shareholding and increasing it by another 20 per cent through an open offer would have got only 35 per cent shareholding in the target company. However, the present scenario is that an acquirer with a 25 per cent shareholding and increasing it by another 26 per cent through the open offer can get 51 per cent shareholding and thereby attain simple majority in the target company. This matters a lot for strategic investors. The new Code, thus, roles out a red carpet for big strategic investors.

However, the new Code has substantially increased the amount required for sustantial acquisition because of the increase in the threshold and offer size (resulting in the increase in the aggregate holding from 35 to 51 per cent) even under the current norms the cost of acquisitions goes up substantially.

In fact, the Achuthan Committee had recommended an open offer for buying upto 100 per cent in the target company. The idea was to give an exit opportunity to all the public shareholders in case of promoters of target company selling out their stake to acquirers or the acquirers mopping up large volumes of shares from the market. However, the open offer size was limited to 26 per cent. It is said that this decision was influenced by intense opposition from industry and other market participants.

The promoters of listed companies with low shareholding will undoubtedly be concerned about any acquirer misutilising it. There are many companies where promoter holding is thin. At the time when the new Code came into effect, it was reported that there were 24 companies in the BSE 500 index where promoter holding was below 26 per cent, and the number of companies where promoter holding is 51 per cent or below was 210. The new Code can become handy to wrest control from the promoters who have toiled to bring up the companies to a position, in many a case suffering lots of hardships and risks.

Improved openness, transparency and governance: An important feature of the new Code is measures for improving the transparency and governance, as reflected in the more clarity in the definitions; Inclusion of various judicial decisions in the regulations itself to impart more transparency by removing the ambiguity in certain areas; insertion of SEBI administrative views in the regulations; simplification in the provisions of certain regulations of the old Code etc.

Protection of interests of small investors: The removal of non-compete fees (which could be as high as 25 per cent of deal value) by the new Code in line with the Achuthan Committee recommendations has been hailed as a measure protecting the interests of minority shareholders.

Conclusion

The Takeover Code of 2011 is a timely and progressive regulation that would facilitate investments and attract investors. Even though SEBI has not implemented all the suggestions of the Achuthan Committee, it has still taken into consideration some of the major issues that had been plaguing the industry till now. It has tried to maintain a balance between the concerns of the investors as well as that of the promoters.

The new Takeover Code seeks to align the India Code with global best practices pertaining regulations of takeovers.

In sum, the ‘new’ Code is characterised by:

- More clarity in the definitions
- Inclusion of various judicial decisions in the regulations itself to more transparency by removing the ambiguity in certain areas
- Insertion of SEBI administrative views in the regulations
- Simplification in the provisions of certain regulations of the old Code
- Better protection for the small shareholders
- More openness and transparency
- More opportunity for PE investors
- Attempt to align the India Code with global best practices pertaining regulations of takeovers.

The new Code will, undoubtedly, change the dynamics of mergers and acquisitions in India. It should, however, be noted that it is a mixed bag of positives and flip sides.

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CHAPTER 16

Turnaround Management and Corporate Restructuring

Measures of turnaround management and restructuring are designed to improve the performance and soundness of the organisation.

This chapter takes a look at first the common symptoms of decline and then the important measures for improving the health and performance.

DANGER SIGNALS

Pradip N. Khandwalla, who has made a very substantial study of turnarounds, observes that turnarounds are organisational recoveries from recoveries. However, there has yet been no agreement on what constitutes decline.[1]

There are a number of general indications of business decline or the deterioration of business health. John M. Harris has listed[2] a dozen danger signals of impeding trouble trend. Companies which are turnaround situations will probably exhibit one or more of these characteristics. We may broadly classify them as follows:

1. Performance Indicators

Deterioration of certain performance indicators are very serious danger signals of the ensuing crisis. These indicators are the following:

(i) **Decreasing Market Share:** A falling trend in the market share is often a reflection of a company's declining competitiveness.

(ii) **Decreasing Constant Rupees Sales:** Another important danger signal is the falling sales at constant prices (i.e., the sales figure after adjusting for the inflation).

(iii) **Decreasing Profitability:** Falling profits and profitability measured by such ratios as profits to sales, return on investment etc. could be dangerous situations.

2. Deteriorating Financing Problems

This may be reflected in the adverse trends in the capital structure and dividend policies.

(i) Increasing Reliance on Debt: A substantial rise in the amount of debt, a lopsided debt-equity ratio, and a lowered credit rating may cause banks and other lenders to apply restrictions which would further compound the financial problems.

(ii) Restrictive Dividend Policy: Restriction of dividends to conserve cash or satisfy debt convenants is a danger signal.

3. Investment Policies

Inadequate reinvestment or lopsided investment could land companies in serious trouble.

(i) Inadequate Reinvestment in Business: Adequate reinvestment in plant, equipment and maintenance is necessary for a company to stay competitive. A company which fails to do so would be preparing the groundwork for failure.

(ii) Proliferation of New Ventures at the Expense of the Priority Business: Harris observes that a common policy in troubled companies is to ignore the basic business and rely on new, "easier" tasks like new ventures.

4. Lack of Planning

Lack of proper planning, particularly when the environment is very competitive and dynamic, could result in the company landing itself in trouble.

5. Problems at the Top Management Levels

In many companies, there are several problems at the top management levels which adversely affect the effective functioning or proper development of the company's business or lead the company in wrong direction. Following are the important such problems.

(i) Lack of Receptiveness of CEO: Some chief executive officers resist new ideas other than their own. They may also have a tendency to aggressively carry through their own ideas without a really critical evaluation. Both these tendencies could do harm to the company.

(ii) Management Succession Problem: Some companies face the problems of flight of young managers out of frustration due to lack of enough opportunities to move up the organisational ladder. Such a situation deprives the company of efficient managers.

Further, in several companies, particularly in family dominated companies, the succession becomes a serious problems. Several family dominated business groups have split up because of differences of opinion between the family members.

(iii) Ineffective Directors: There are many cases of the members of the Board of Directors not playing their role (for example, criticising wrong policies or measures) due to various reasons like personnel or other relations with the Chairman or CEO, fear of one sort or other etc. The Board members' taking such a 'friendly' or 'comfortable' stand often injures the interests of the company. Some references to the ineffectiveness of the Boards of many Indian companies have already been made in Chapter 1. It may be noted here that a Company Law Board – appointed director in Shaw Wallace stated (May 1997) that the

company's whole-time directors seemed to be terribly afraid of the non-executive chairman who held the controlling interest in the company, implying that there could be no frank discussion of the problems of the company. According to him, the roots of the company's problems were traceable to certain transactions entered into several years ago, especially its huge borrowings through ICDs and its equally huge, but unrealisable loans and investments to subsidiaries and associates for which there seemed to be no proper board approval. The problem went accumulating for quite some time and it was doubtful whether the board knew all that was happening. Pointing out that the company was not being governed properly by its board for several years to such an extent that its financial credibility was gone, he suggested that Shaw Wallace needed a board which can be independent of the promoter's control as this was essential for restoring the company's crediability and for preventing irregularities from taking place.

(iv) Ineffective Management Team: For success in the changing environment, particularly when the environment is very competitive, a company should constantly monitor the environment and formulate suitable strategies. This also involves analysing the competitors, learning from their strategies and other strengths etc. The management team should be both willing and competent to do these.

TURNAROUND MANAGEMENT

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

Turnaround Management Factors

The exact nature of turnaround management and the relative importance of different factors may vary from company to company. The important factors commonly employed in turnaround management are the following. This account is based on this author's examination of several successful cases of turnaround management.

1. Management Factor: Managerial inefficiency is the root cause of the problems in a number of cases. Therefore, improvement of the management becomes a prerequisite. For carrying out the turnaround management, a new efficient chief executive officer is usually appointed. The new CEO should streamline things and in many cases will have to change the organisational culture. This was true of several successful cases of turnaround management such as E.I.D. Parry and Travancore Cochin Chemicals (TCC).

2. Human Resource Factor: In many of the companies which are in very bad shape, the human resource is redundant, demoralised and surplus. The surplus manpower should be got rid of, morale should be restored and the quality of the manpower should be improved through training and recruitment of competent people for the key positions, if needed.

3. Production Facilities: Modernisation and other improvements of plant, equipments etc. are also often an important part of the turnaround management. Such measures help to achieve uninterrupted production flow and better capacity utilisation, quality improvement, reduction in wastage, increase in productivity and cost reduction. Proper management of the plant and equipments like preventive maintenance etc. have also been found to be absent in several sick units.

4. Finance Management: Arranging additional finance, financial discipline, financial restructuring (described under Business Reorganisation) etc. are usually an inevitable part of the turnaround management.

5. Product Mix Modification: A number of turnaround management cases involve modification of the product mix. Unprofitable products may have to be dropped and new products may have to be introduced. Sometimes, current products require quality improvement or some other modifications. In some cases, new models may have to be introduced.

6. Marketing Strategy: Absence of a proper marketing strategy is a major reason for the problems of several companies. An appropriate marketing strategy could help improve such cases. Even product mix modification may form a part of such strategy. Marketing strategy may also involve market modification like entering new markets or market segments, withdrawing from certain markets/segments, developing new customers etc.

7. Miscellaneous: Turnaround management may also involve several measures like liquidation of assets which are not in use, closing down of some divisions or lines of business, restraints on emoluments of employees, better management of procurement of raw materials, etc.

Box 16.1

Types of Turnaround

A number of researchers have tried to identify different types of turnarounds. Pradip N. Khandwalla, in his book *Innovative Corporate Turnarounds*[3] has cited the following types:

Strategic versus Operating Turnarounds. This categorisation was postulated by Charles Hofer. Strategic turnarounds are those achieved through a change in the organisation's strategy for competing in its existing business, or through altering the emphasis on a key management function like marketing, finance, or production, or through diversification. Operating turnarounds are those achieved through increasing revenue, cost-cutting, and/or asset-reduction strategies.

Management Process Turnarounds and Turnarounds Achieved through Favourable External Changes. This classification was suggested by Donald Bibeault. The management process turnarounds are achieved through vigorous management action aimed at correcting the weakness of the previous management and achieving a change in company culture. Sometimes, turnarounds are achieved through favourable external changes such as a business upswing, reduced competitive pressures, and favourable change in government policies.

Turnarounds by Asset and Cost Surgery, Selective Product and/or Market Pruning, and Piecemeal Productivity. These three types of turnaround were identified by Hambrick and Schecter. In asset and cost surgery turnaround, increased productivity and capacity utilisation are strongly emphasised, as are liquidation of receivables and inventories and pruning of R&D and marketing expenditure. In selective product and/or market pruning turnaround also, the raising of productivity and liquidation of receivables and inventories are emphasised; in addition, prices are raised and product quality is emphasised. In peacemeal productivity turnarounds, capacity utilisation and productivity are emphasised.

Turnaround Management Elements

Pradip N. Khandwalla, in his study of *Innovative Corporate Turnarounds*[4] has identified, for the sample of 42 complete turnarounds, 27 turnaround elements engineering in different turnaround action. These actions have been classified by him into three classes.

The first group consists of action that may be necessary for most successful turnarounds (observed in 60 per cent or more cases), such as diversification, product-line rationalisation and such related activity, changes in top management, marketing related actions, restructuring, cost reduction measures other than retrenchment, plant modernisation and similar measures. There surely is a great verity of action available within each of these six turnaround elements, but it would appear that a management trying to turn around a corporation must try to shuffle its product around, bring in fresh blood at the top, try and strengthen the marketing of its products or services, pat attention to cost reduction measures, decentralise with enhanced accountability, and improve operations through modernisation, and so on. All the 42 cases reported action related to diversification, product-line rationalisation, expansion and such related activity.

The second group consist of elements which were true of 40 to 60 per cent of the sample turnaround cases. It implies that it is not necessary that action that can be subsumed under these elements be taken; however, it may often be expedient to do so. Much would depend on the particular context of the corporation and the orientation of top management as to whether these elements are activated. That is, operating condition of top management ideology may determine whether these elements will be part of the corporation's turnaround strategy or not. These elements range from management control enhancing actions, innovation and retrenchment, attempts to motivate staff, participative management, disciplining, diagnostic efforts and raising capital.

The third group consists of turnaround elements that are apparently infrequently used (observed in less than 40 per cent of the cases). These range across management communications, the public articulation of corporate mission and goals by management, and credibility-building action by management, to increased professionalisation of management systems, increased training, example-setting by top managers and such like. The infrequency of their use need not mean low usefulness. These rarely used elements, compatible with 'transformational leadership', management professionalism and a human resource development emphasis, may be precisely the ones that could be sources of major innovations in turnaround management.

Table 16.1: Percentage of Cases Engineering in Different Turnaround Action

Sample: 42 Complete Turnarounds

	Percentage Engineering in Action
1. Diversification, product-line rationalisation, expansion etc.	100
2. Change in top management	93
3. Marketing related actions	81
4. Restructuring (decentralisation, fixing accountability, structural changes etc.)	69
5. Cost-reduction measures other than retrenchment	64
6. Plant moderation etc. for greater efficiency, quality, productivity	60
7. Management control-enhancing actions	57
8. Innovation, new product development etc.	57
9. Significant retrenchment	52
10. Divestiture and liquidation of fixed assets and long-term liabilities	45
11. Garnering stakeholders' support	45
12. Incentives, motivation, grievance redressal	45
13. Better organisational integration, participative management, emphasis on core values	45
14. Disciplining	43
15. Borrowing, raising equity finance etc.	40
16. Formal diagnostic activities	40
17. Fresh induction of managers, technical staff etc.	38
18. Management communicating with staff, lower managers etc.	38
19. Attempts to increase efficiency, quality, productivity other than through plant modernisation etc. and training	35
20. Public articulation by management of mission, goals etc.	33
21. Professionalisation of manufacturing management, personnel management planning etc.	29
22. Credibility-building actions of management	28
23. Liquidation of current assets and liabilities	26
24. Initiation of managerial meetings, problem-solving task forces	26
25. Increased training of managers and staff	26
26. Example-setting by top managers	21
27. Miscellaneous	14

Source: Pradip N. Khandwalla, in his study of *Innovative Corporate Turnarounds*, pp. 55-6.

Foundational and Strategic Turnaround Variables

Khandwalla has classified the turnaround elements into Foundational and Strategic as detailed below:[5]

A. Foundational Elements

1. Diversification, product-line rationalisation, expansion etc.
2. Change in top management
3. Marketing related actions
4. Restructuring (decentralisation, fixing accountability, structural changes etc.)
5. Cost-reduction measures other than retrenchment
6. Plant modernisation etc. for greater efficiency, quality and productivity.

B. Strategic Decision Variables

1. Incentives, motivation, grievance redressal
2. Garnering stakeholders' support
3. Initiation of managerial meetings, problem-solving task forces
4. Increased training of managers and staff
5. Formal diagnostic activities
6. Better organisational integration, participative management, and emphasis on core values.

CORPORATE RESTRUCTURING

Companies restructure for various reasons mentioned under *Portfolio Strategy, Mergers and Acquisitions and Turnaround Management*. The restructuring may involve expansion or contraction of the portfolio, or changes in the ownership pattern and control.

Changes in the nature and volume of business, changes in the business conditions etc., may necessitate restructuring of the business.

Different types of restructuring are usually a part of the turnaround strategy. This does not, however, mean that restructuring is required only when a business is sick. Indeed, many a times, restructuring is required to improve the performance or to increase the vitality or health of the units. Growth and expansion programmes may also call for restructuring. Restructuring may also be necessary to prevent a unit from becoming sick. In other words, restructuring may be resorted in the following cases:

(*i*) To turnaround a sick unit

(*ii*) To prevent a unit from becoming sick

(*iii*) To further improve the vitality and performance of units which are doing well

(*iv*) To facilitate growth and expansion

(*v*) To improve the organisational efficiency

(*vi*) To influence management control.

FORMS OF CORPORATE RESTRUCTURING

The important forms of restructuring as classified by Weston *et al.*[6] is given in Table 16.2.

Table 16.2: Forms of Corporate Restructuring

1. Expansion
Mergers and Acquisitions
Tender Offers
Joint Ventures
2. Sell-offs
Spin-offs
Split-offs
Split-ups
Divestitures
Equity Carve-outs
3. Corporate Control
Premium Buybacks
Standstill Agreements
Anti-takeover Amendments
Proxy Contests
4. Changes in Ownership Structure
Exchange Offers
Share Repurchases
Leveraged Buyouts

Expansion

Mergers and Acquisitions: An acquisition may be friendly or hostile. Conglomerates wanting to sell some of their businesses as part of portfolio restructuring is common as referred to under the *Portfolio Strategy*. Promoters of companies seeking out buyers are also common. There are also many cases of major shareholders agreeing to sell when approached with a good offer. In all these cases, the takeover is friendly.

Hostile takeovers, however, are not uncommon. If the target company for takeover is not willing to be sold, the predator may pick up controlling amount of shares from the market. Such a move may be done secretly to the extent possible. Alternatively, a public *Tender Offer* may be made to the shareholders for purchase of shares. These are easy only when the shareholding by the management and directors is comparatively very low. In many Indian companies, such shareholding is comparatively very low and, therefore, they are easily vulnerable to hostile takeovers.

Joint Venture: All joint ventures do not represent restructuring. If the joint venture is the result of another firm, having taken a stake in an existing firm, that is a case of restructuring. Sometimes,

companies spin-off certain divisions as separate company for the purpose of formation of joint venture. Such joint ventures are formed to facilitate infusion of technology and capital by another firm (often a foreign firm).

Sell-offs: There are two major types of sell-offs, namely spin-offs and divestiture.

While synergy which says 2 + 2 = 5 is a motive behind many mergers, a motive behind sell-offs often is anergy which says 5 – 3 = 3. Sell-offs help sharpen business focus and better utilisation of resources, elimination of cross subsidies and better management.

Divestitures: Divestiture involves the sale of a division unit or part of the asset of a company to another. In case of conglomerates or business groups, it may also involve sale of a company. For the seller, the divestiture amounts to business contraction and for the buyer it is business expansion.

A number of cases of divestiture are cited in the chapter *Portfolio Strategy*.

The main objectives of divestitures are the following:

- **Better Focus:** As suggested by several examples cited in the chapter Portfolio Strategy, the most important reason of many divestitures is the need to concentrate on the core business. Such divestitures result from the corporate Portfolio Strategy.
- **Raising Funds:** An important benefit of divestiture is the money it brings in. This is particularly important for companies facing financial cruch. Indeed, divestiture which generates funds is a part of the revival strategy of many companies/business groups. The amount realised by divestiture may be made use of for developing other businesses. Several examples are given in the chapter on Portfolio Strategy.
- **Loss Reduction:** The sale of loss making unit would enable the company to reduce the loss and/or increase profits.
- **Anergy:** Devestiture may also result in anergy which will help the overall improvement of the business.

Spin-offs: Spin-off refers to creation of new legal entity by the parent company. The existing shareholders of the parent company will be allocated shares in the new entity on a *pro rata* basis. Unlike in a divestiture, the parent company does not receive any payment in case of a spin-off.

Spin-offs are resorted mostly for the purpose of better focus on different businesses. The new entity can develop its own strategies for the development of its business. The original parent, on the other hand, can now concentrate more on its core businesses.

There are two variations of Spin-off, viz., split-off and split-up. In the case of a Split-off, a portion of existing shareholders receives stocks in a subsidiary in exchange for parent company stock. In the case of a Split-up, the entire firm is broken up in a series of spin-offs, so that the parent ceases to exist.

The main advantages of spin-offs are the following.

- **Better Focus:** Spin-offs facilitate sharper focus and thereby better development of different businesses.
- **Result Orientation:** The separation and independence would help the new entity to become more result-oriented because of its accountability for its performance. People may become more responsible and committed.

- **Corporate Control:** There are several means of consolidating and enhancing corporate control.

"Premium buybacks represent the repurchase of a substantial stockholder's ownership interest at a premium above the market price (called *greenmail*). Often in connection with such buyback, a standstill agreement is written. This represents a voluntary contract in which the stockholder who is bought out agrees not to make further attempts to take over the company in the future. When a standstill agreement is made without a buyback, the substantial stockholder simply agrees not to increase his or her ownership which presumably would put him or her in an effective control position."[7]

Anti-takeover amendments seek to make an acquisition of the company more difficult or expensive. These include: (1) supermajority voting provisions requiring a high percentage (for example, 80 per cent) of stockholders to approve a merger, (2) staggered terms for directors which can delay change of control for a number of years, and (3) golden parachutes which award large termination payments to existing management if control of the firm is changed and management is terminated.[8]

The proxy contest is a dubious way by which the management of a company seeks to undermine the control position of the 'incumbents' or existing board of directors. This is sought to be achieved by an outside group, referred to as *dissidents* or *insurgents* obtaining representation on the board of directors of the company.

Changes in Ownership Structure

The ownership structure of a firm may be changed due to various reasons.

As a firm grows, the ownership structure may undergo change. For example, a sole proprietorship may be converted into a partnership, when a partnership firm grows and when more ownership capital needs to be brought in, a private limited company may be formed.

Private companies become public for several reasons.

A firm may derive the following advantages by becoming a public company.

Increase in Capital Base: A public company can raise capital by public issue. Further, it may be more easy to raise loans as compared to a private company.

Foreign Collaboration: Foreign firms normally prefer to have collaborations with public companies than private companies.

Respectability: Public companies have, generally, more respectability than private companies. Therefore, they will be in a better position to attract efficient human resources. Further, public companies have more visibility.

There are, however, some disadvantages associated with a private company becoming public.

The wide ownership will result in the dilution of control of the promoters.

Secondly, the flexibility in decision making and functioning will be reduced as a public company is subject to fairly comprehensive regulations.

Thirdly, a public company is bound by law to disclose many things and the approval of the shareholders is required on several important matters.

Further, the management is accountable to the shareholders and the performance of the company is subject to their scrutiny.

Firms which have gone public in the early 1990s include Godrej Soaps, Nirma and Dabur. Godrej Soaps entered into an alliance with Procter & Gamble after it became public. Dabur has entered into several foreign collaborations. The public issue helped Nirma to fund massive investments in backward integration.

Exchange Offers: Exchange offer may involve exchange of debt or preferred stock for common stock, or, conversely, of common stock for more senior claims.

Several cases of turnaround involve exchange of debt for equity. For example, the government loan to a public or joint sector unit may be converted into equity. Such a measure helps to reduce the interest burden and reduces cash outflow by loan repayment also.

Share Repurchase: Buyback of shares by a company may help tilt the management control. If the company buys back shares from those who hold substantial shares, it could tilt the control in favour of the promoters, although the percentage of shares they hold does not increase.

Buyback of shares can also guard against takeovers to some extent. It can also help stabilise the share prices.

A major objection to the buyback of shares is that it provides scope for manipulation of share prices by the management.

Management Buyouts: Management buyout may involve the purchase of a division of a company or even a whole company by a new entity formed specifically for this purpose. When such a purchase is financed by large debt (i.e., highly liveraged), it is referred to as Leveraged Buyout.

It is claimed that because of the high debt repayment obligation, the management will make all possible efforts to get the best operating results.

LBOs are very risky because of the high interest burden and loan repayment obligation. A default in repayment would aggravate the interest burden and cash flow problem. LBOs have landed many companies in serious crisis.

Financial Restructuring

Many units, particularly sick units, need financial restructuring to mitigate their financial problems.

Financial reorganisation may involve any one or more of the following.

(i) Rescheduling of loans and debts: This may involve altering the repayment period and interest structure. For example, short-term loans may be converted into long-term loans. The grace period may be extended and in the case of the existing long-term loans, the repayment schedule may be softened. In some cases, the interest rates may also be altered to the advantage of the firm.

(ii) Conversion of loans and debts: Loans and debts may be converted into other forms of borrowing or debt like debentures, or into equity. Debentures may be converted into equity. Conversion of debt into equity reduces the financial difficulties of the firm since no interest is to be paid on equity capital.

The aim of financial restructuring in the above cases is to reduce the financial difficulties of the firm and improve its financial health. In many cases, a firm will not be able to survive without such financial restructuring.

CORPORATE RESTRUCTURING IN INDIA

Corporate restructuring is not a new phenomenon in India. It has, however, become very profound after 1991. The restructuring of the economic policy has made corporate restructuring essential, in many a case, for survival or exploiting the new growth opportunities. The drastic changes in the business environment have compelled many public sector enterprises also to join the bandwagon of restructuring. The scope and intensity of restructuring in the liberalised era have been much larger than in the past.

Reasons for Restructuring

According to a survey of corporate restructuring in India (1994), sponsored by the All-India Management Association (AMA),[9] covering 92 companies (60 in the private sector and 32 in the public sector), economic liberalisation has been the major reason for restructuring. The survey has revealed that, although restructuring was a continuous process with many companies, a number of companies has discovered this tool only after 1991.

The reasons for restructuring in the case of public enterprises, in the order of importance, as revealed by the survey were the following.

1. Overseas market opportunities.
2. Decline of markets for existing products.
3. Domestic market opportunity.
4. Abolition of the concept of monopoly.
5. The inability to update technology.
6. Lack of resources to stay in the market.

In the private sector, the reasons for restructuring, in the order of priority, were as follows:

1. Domestic and overseas market opportunities.
2. Entry of MNCs into India.
3. Decline of markets for existing products.
4. Import liberalisation and the resultant increases in competition from foreign companies.

Need for Restructuring

According to the AMA survey, the most important need in restructuring a company was to gain customer focus. This was a result of increasing competition and the emergence of a buyer's market.

Second came in importance the need to simplify the organisational structure to enable faster responses. This was a response to growing competition and the perception of the revolution brought about by the new information technology.

Simplification of internal communications was the third important factor necessitating corporate restructuring "Companies must have recognised that it is essential to draw upon the knowledge and experience of all their employees, instead of handing over decisions from top down. If the organisation was to mobilise all its available human resources, it was essential that everybody be informed about what was happening in the company."

New technology absorption, aggressive competition and expansion of capacities were the other important factors calling for restructuring.

Restructuring Process

According to the AMA survey, the common process adopted by a majority of the responding units was decentralisation of decision-making.

Retraining and redeployment of staff was the second most important process of corporate restructuring in the private sector. "This suggests that there was a genuine attempt at decentralisation and it was not just lip service to the ideas. At the same time, retraining and redeployment must have called for considerable reorganisation of personnel, records and procedures, to identify training needs and the potentials of different employees."

Flattening of organisational hierarchies was found to be the next important restructuring process adopted by companies. This was of greater importance in the private than in the public sector. The public sector has, because of rigidities due to its ownership, far less flexibility in this action.

Along with these were measures to improve quality, creating strategic business units, and creating representation in more market segments. These processes were considered to be of even less importance in the public sector.

Other factors revealed by the survey include going for joint ventures, overseas expansion, acquisition of synergistic businesses etc.

Types of Corporate Restructuring in India

Broadly, there are three important types of corporate restructuring.

1. Portfolio restructuring.
2. Organisational restructuring.
3. Functional restructuring.

Portfolio Restructuring

Portfolio restructuring refers to change in the portfolio of businesses of the company. This has become widespread since the liberalisation ushered in 1991, as pointed out in the chapter *Portfolio Strategy*. The increase in competition has provoked many companies to divest businesses in which they are not competitive and to concentrate on their core businesses in which they tend to grow by setting up new capacity and/or by acquisition. The dismantling of the entry barriers (delicensing, dereservation, liberalisation of policy towards foreign technology and capital participation, MRTPA relaxations etc.) has opened up enormous new opportunities for expanding the business. Many examples of portfolio restructuring have been given in the chapter on Portfolio Strategy. Another aspect of portfolio strategy is the realignment of portfolios of the group companies. For example, the

A.V. Birla group has merged Indian Rayon's cement business with that of Grasim. Similarly, some companies do organisational restructuring to redistribute the portfolio. For example, certain businesses are spun off as separate divisions or companies.

Organisational Restructuring

As has already been mentioned earlier in this section, organisational restructuring has been very common. Decentralisation, delayering or flattening and regrouping of activities are important organisational restructuring measures.

Changes in corporate strategy, such as portfolio strategy, sometimes call for organisational restructuring. Often, structure follows strategy.

Increase or decrease in activity levels, expansion or contraction of portfolio or functions etc. may cause modification of organisational structure.

Functional Restructuring

The AMA survey reveals that restructuring of corporate functions (marketing operations, personnel and finance) has been very significant both in the public and private sectors.

1. Marketing Function. The survey results show that the revamping of the marketing function meant the creating of a product management team, building up salesforce, restructuring distribution system, and creating marketing research cell.

2. Financial Function. As far as the modifying of the financial function was concerned, the emphasis was on improving the financial reporting system.

A number of companies have also resorted to financial restructuring.

3. Operations. Restructuring of operations has been very significant. Re-engineering has become very popular. Technological upgradation has been an important concern. The acceptance of total quality management and the requirements for ISO 9000 certification etc. have had significant influence on operational restructuring.

4. Personnel Function. Personnel function was found to receive high priority in restructuring. The emphasis in both public and private sectors was on training and succession planning. The private sector also gave the creation of appropriate rewards and punishments for performance high priority. This was, however, not so in the case of the public sector.

Barriers to Restructuring

According to the AMA survey, the major barrier to restructuring was perceived to be the cost of doing so. In the private sector, this was followed by the lack of accountability for key performance indicators laid down. Top managements themselves lacked entrepreneurial skills and this was a barrier. Salary structures based on seniority were another important barrier in the private sector. This was a legacy of the era of a closed economy, and needed to be replaced soon by performance-related structures, says the survey report.

An interesting finding of this survey is that contrary to the general impression, in many cases labour is not a serious barrier and that companies do not face much problem in convincing their employees that restructuring is for the good of all.

Conclusion

In the emerging business environment, which is vastly different from the past, restructuring is inevitable in respect of many companies. As Prahalad observes, "the future will not be an extrapolation of the past. Like a space rocket on the way to moon, a company has to be willing to jettison the parts of its past which no longer contain fuel for the journey and which are becoming, in effect, excess baggage."[10] There will also be many cases where it will be desirable or inevitable to add new ones.

BUSINESS PROCESS REENGINEERING

The concept of Business Process Reengineering (BPR), conceived as a means to radically improve the performance efficiency and enhance the competitiveness of a firm, shot into such prominence in the 1990s that it even came to be regarded as a fad. The publication entitled *Reengineering the Corporation* by consultants Michael Hammer and James Champy (1993) significantly contributed to popularising BPR.

According to Hammer and Champy, "reengineering is the fundamental rethinking and redesign of business processes to achieve dramatic improvements in critical, contemporary measures of performance, such as cost, quality, service and speed."

BPR starts with questioning the very process, as it exists, itself in performing an activity. Processes "normally consist of one or more inputs into one or more value-adding activities that lead to one or more outputs. The boundary of a process defines its limits. Within a process, there may be a number of sub-processes, and each activity may be made up of a number of tasks. Business processes are sequences and combinations of activities that deliver value to a customer. Management processes control and coordinate these activities and ensure that business objectives are delivered. Support processes, as the name implies, provide infrastructural and other assistance to business processes."[11] Typical examples of process include executing a customer order, issuing a new insurance policy, developing a new product etc.

BPR involves fundamental rethinking and redesigning of a business process for better value creation and customer satisfaction by eliminating delays and inefficiencies in the process and radically improving the whole process. BPR may encompass the application of latest, relevant, technologies and also process innovations.

Process reengineering, which contemplates radical change, is different from process simplification, which may yield significant but incremental improvements. Table 16.3 highlights the differences.

Table 16.3: Simplification vs. Reengineering

Process Simplification	Process Reengineering
Incremental change	Radical transformation
Process-led	Vision-led
Within existing framework	Review framework
Improve application of technology	Introduce new technology
Assume attitudes and behaviour	Change attitudes and behaviour
Management-led	Director-led
Various simultaneous projects	Limited number of corporate initiatives

Source: Colin Coulson-Thomas, *Transforming the Company*.

Phases of BPR

BPR involves three main phases, viz., initiation, implementation and exploitation.

Initiation

The initiation phase involves creating awareness about BPR, making the people concerned fully understand and appreciate it and thereby arising interest and enthusiasm to carry out BPR.

Implementation

This is the core phase. This involves several steps. Firstly, the current processes are thoroughly analysed, critically evaluated and the strengths and weaknesses are clearly identified. The next step is to formulate, based on the critical assessment of the current processes, alternative redesigns – typically using different configurations of process roles, work tasks and technology supports. The alternatives are then evaluated and the best one is chosen and further improved upon, if needed. The reengineered process is put to test and further modified, if needed. The 'perfected' reengineered process is then implemented. Further, modifications may also be required on the basis of the operational feedback.

The implementation phase also involves bringing about the required mindset of the people (which should have been initiated in the initiation phase) and motivating and training people for the reengineered process. Also very important is an effective organisational structure.

Exploitation

Exploitation of the reengineered business involves providing ongoing support for the successful advances of the reengineered operations. This calls for a conducive organisational environment and efficient system in place for proper monitoring of the performance and taking required corrective measures.

Steps

Companies that have successfully reengineered their operations around strategically critical business processes have pursued the following steps:[12]

1. Develop a flow chart of the total business process, including its interfaces with other value chain activities.

2. Try to simplify the process first, eliminating tasks and steps where possible and analysing how to streamline the performance of what remains.
3. Determine which parts of the process can be automated (usually those that are repetitive, time-consuming, and require little thought or decision): consider introducing advanced technologies that can be upgraded to achieve next-generation capability and provide a basis for further productivity gains down the road.
4. Evaluate each activity in the process to determine whether it is strategy-critical or not. Strategy-critical activities are candidates for benchmarking to achieve best-in-industry or best-in-world performance status.
5. Weigh the pros and cons of outsourcing activities that are non-critical or that contribute little to organisational capabilities and core competencies.
6. Design a structure for performing the activities that remain: reorganise the personnel and groups who perform these activities into the new structure.

Conclusion

The scope of reengineering is very broad. It may be applied to individual processes, organisations, markets, and even whole communities.

"Processes frequently cut horizontally across the vertical functional boundaries of the marketing, production, accounts and other departments found in traditional organisations. Various obstacles, barriers and sources of delay are encountered *en route*....BPR takes a horizontal and process view. It is having the greatest impact where functional forms of organisation exist. The purpose of BPR is to radically improve the outputs or benefits of processes. Especially in relation to the resources they consume and the value they generate for the various stakeholders in an organisation."[13]

There are critics of BPR who argue there is nothing new in it and it is just another management fad.

It is pointed out that "reengineering can do untold and lasting damage to the organisation when used rashly and indiscriminately as a blunt cost-cutting tool. The climate of fear and the obsession with measurement that accompanies many so-called reengineering projects can act to destroy the very lifeline to the future which we should actually be seeking to strengthen. This is because fear, accompanied by confusion over the organisation's goals, can act as powerful inhibitors on the key levers of progress – empowerment, team working, risk taking, innovation, learning and knowledge creation."[14]

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CHAPTER

17

Globalisation

Globalisation is a very powerful driving force that makes strategic management immensely significant. It is also a very important factor that influences the shaping of the corporate strategy.

Companies are becoming more globalised in their operations, financing, marketing and other functions. Indeed, globalisation means a borderless business world. That is, for a firm, both the opportunities and challenges are global. Companies even in developing countries like India are becoming more and more global in their strategic orientation and operations.

MEANING AND DIMENSIONS

Globalisation, in its true sense, is a way of corporate life necessitated, facilitated and nourished by the transnationalisation of the world economy and developed by corporate strategies. Globalisation is an attitude of mind — it is a mind-set, which views the entire world as a single market so that the corporate strategy is based on the dynamics of the global business environment. International marketing or international investment does not amount to globalisation unless it is the result of such a global orientation.

Companies, which have adopted a global outlook, stop "thinking of themselves as national marketers who venture abroad and start thinking of themselves as global marketers. The top management and staff are involved in the planning of worldwide manufacturing facilities, marketing policies, financial flows and logistical systems. The global operating units report directly to the chief executive or executive committee, not to the head of an international division. Executives are trained in worldwide operations, not just domestic or international. Management is recruited from many countries, components and supplies are purchased where they can be obtained at the least cost, and investments are made where the anticipated returns are the greatest."[1]

A truly global corporation views the entire world as a single market - it does not differentiate between domestic market and foreign markets. In other words, there is nothing like a home market and foreign market – there is only one market, the global market.

As Kenichi Ohmae observes in his well-known book *The Borderless World*, a global corporation develops a genuine equidistance of perspective. That is, managers with a truly global orientation consciously try to set plans and build organisations as if they view all key customers equidistant from

the corporate centre. For example, the managers of Honda, which has operations in several parts of the world, do not think or act as if the company were divided between Japanese and overseas operations. Indeed, the every word "overseas" has no place in Honda's vocabulary because the corporation sees itself as equidistant from all its key customers. At Casio, the top managers gather information directly from each of their primary markets and then sit down together once a month to lay out revised plans for global product development.[2]

In short, globalisation encompasses the following:

1. Doing, or planning to expand, business globally.
2. Giving up the distinction between the domestic market and foreign market and developing a global outlook of the business.
3. Locating the production and other physical facilities on a consideration of the global business dynamics, irrespective of national considerations.
4. Basing product development and production planning on the global market considerations.
5. Global sourcing of factors of production, i.e., raw materials, components, machinery/technology, finance etc. are obtained from the best source anywhere in the world.
6. Global orientation of organisational structure and management culture.

More and more companies are adopting such a global strategic orientation. The renovation of Arvind Mills given in Box 17.1 is an example.

Box 17.1

Arvind Mills: Renovision on the Art of Global Dominance

- Source raw materials wherever they are cheapest.
- Manufacture wherever in the world is most cost-effective.
- Sell in those global markets where prices are highest.
- Raise finances globally.
- Forge international strategic alliances.
- To manage all these, take on the best talent from all over the world.

And you will have achieved the stature of a true multinational.

STAGES OF GLOBALISATION

Normally, a firm passes through different stages of development before it becomes a truly global corporation. Typically, a domestic firm starts its international business by exporting. Later, it may establish joint ventures or subsidiaries abroad. From an international firm, it may then develop into a multinational firm and finally into a global one.

Ohmae identifies[3] five different stages in the development of a firm into a global corporation. The first stage is the arm's length service activity of essentially domestic company, which moves into new markets overseas by linking up with local dealers and distributors. In stage two, the company takes over these activities on its own. In the next stage, the domestic-based company begins to carry

out its own manufacturing, marketing and sales in the key foreign markets. In stage four, the company moves to a full insider position in these markets, supported by a complete business system including R&D and engineering. This stage calls on the managers to replicate in a new environment the hardware, systems and operational approaches that have worked so well at home. It forces them to extend the reach of domestic headquarters, which now has to provide support functions such as personnel and finance, to all overseas activities. Although stage four, the headquarters mentality continues to dominate. Different local operations are linked, their relation to each other established by their relation to the centre.

In the fifth stage, the company moves toward a genuinely global mode of operation. In this context, Ohmae points out that a company's ability to serve local customers in markets around the globe in ways that are truly responsive to their needs as well as to the global character of its industry depends on its ability to strike a new organisational balance. What is called for is what Akio Morita of Sony has termed global localisation, a new orientation that simultaneously looks in both directions.

Getting to stage five, however, means venturing onto new ground altogether. Ohmae argues that to make this organisational transition, a company must denationalise their operations and create a system of values shared by corporate managers around the globe to replace the glue a nation-based orientation once provided.

Ohmae further observes[4] that today's global corporations are nationalityless because consumers have become less nationalistic. True global corporations serve the interests of customers, not Governments. They do not exploit local situations and then repatriate all the profits back home, leaving each local area poorer for their having been there. They invest, they train, they pay taxes, they build up infrastructure and they provide good value to customers in all the countries where they do business. IBM Japan, for instance, has provided employment to about 20,000 Japanese and over the past decade has provided three times more tax revenue to the Japanese Government than has the Japanese company Fujitsu.[5]

GLOBALISATION OF SUPPLY CHAIN

Optimisation of cost and efficiency is the prime concern in business management. As a result, the business process, i.e. operations management., has been increasingly becoming global. Efficient global operations management necessitates the disintegration of the value chain and integration of the disintegrated system for optimisation of cost and operational efficiency.

Large firms, particularly, tend to spread their operations globally, either locating their own operations in different places or linking up with suppliers globally or both. Developing country firms, small to large, have a lot of scope to benefit from this trend. Many products available in the market with the label made in a specific country are global products in the sense that various phases of its business process from R&D to marketing are carried out in different countries. The R&D and product development may be done in one or more countries, the production may be carried out in some other country/countries using technology and other inputs sourced globally, employing global financing, and marketed globally. A major challenge of today's business system, thus, is the integration and management of diverse activities. The business system, thus, involves the integration and management of diverse activities.

Realising the great role of globalization of supply chain management in enhancing cost and operational efficiencies, there has been a powerful trend towards globalisation of markets and business process by companies across the world. This has been done by greenfield investments or acquisitions. Many Indian companies too have gone global in a big way. For example, Tata Steel, one of the largest steel producers in the world and the second largest geographically spread steel firm has broken up its value chain (which may be broadly divided into steel making and steel finishing) putting each part where it is the most cost-effective through an appropriate global supply chain management. Primary steel may be produced in India, South Africa or some other developing country where primary steel making is cost-effective and take the semi-finished steel to its plants in different parts of the world near the customers for doing the finishing.

A product's value chain starts with R&D and product development, passes through various value-adding activities associated with production, marketing and ends with customer relations management.

In an intensely competitive market, only those firms which win the race in satisfying the consumers *vis-à-vis* product features and performance, price, delivery, services etc. can survive. It is, therefore, necessary to take a holistic view of the business system that encompasses the key determinants of the success of a firm. Figure 17.1 presents a schematic outline of the production and logistical factors making up the business system.

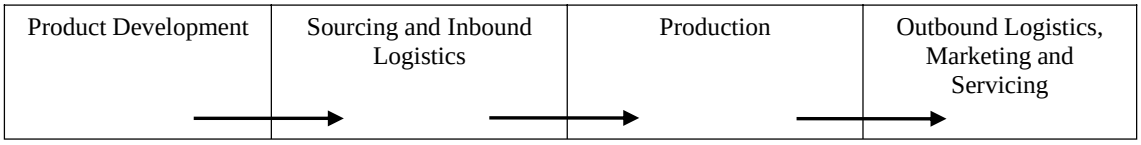

Fig. 17.1: Major Components of Business Process

Each of the stages represented in Figure 17.1 involves a number of activities. A firm may carry out all these activities by itself or do one or some of them and the rest may be outsourced. For example, *Mazda's* sports car *MX-Miata* was designed in California, prototype created in England, assembled in Michigan and Mexico using advanced electronics components invented in New Jersy and fabricated in Tokyo, financed from Tokyo and New York, and marketed globally. Many firms now concentrate on its core competence/business and outsource the rest. The multinational Nike, for example, concentrates itself on the two critical ends of the business – R&D and marketing – and gets the product manufactured by independent subcontractors located in different countries as per the design and other specifications given by the company, with the result that Nike indirectly employs several times the number of people it directly employs. Multinational automobile firms, which have established production facilities in India with FDI, manufacture cars using imported machinery and parts and components sourced from India and abroad. Some of these companies use India as a hub for production and export of small cars to other countries.

This indicates that the essence of supply chain management is deciding how, where, when and who is to do each value-adding activity of the business process or value chain so as to optimise cost and operational efficiency. In other words, efficient supply chain management involves disintegration of the supply chain and management of integration of the disintegrated system for optimum results.

Operations management/supply chain management is becoming increasingly global. Even a firm which markets the products only within the domestic market may be conducting its business

operations internationally like sourcing the inputs or finished products internationally or manufacturing the product abroad. A dynamic company will take advantage of the favourable conditions that exist anywhere in the world. There are a number of American companies which ship the parts/components to overseas assembly facilities where the labour is cheap and bring the finished product back home or send to other foreign markets. A number of developed country firms have established facilities in developing countries like China and India for manufacturing products for the world market.

Supply chain management is indeed one of the most important determinants of business success. As stated above, there has been an increasing globalisation of operations management. The common streams of international business operations are depicted in Figure 17.2.

Each of the major phases of the operations shown in Figure 17.2 involves different operations and operations management encompasses all of them. Each of these activities may be subdivided into several activities. For example, marketing and sales include activities such as advertising, sales promotion, sales force management, marketing research, customer relationship management etc. Operations management involves a number of strategic decisions such as make or buy?; if buy, from where to buy?, to go for partnering or not?; in which country and place to locate the manufacturing or other facilities; logistical factors and so on.

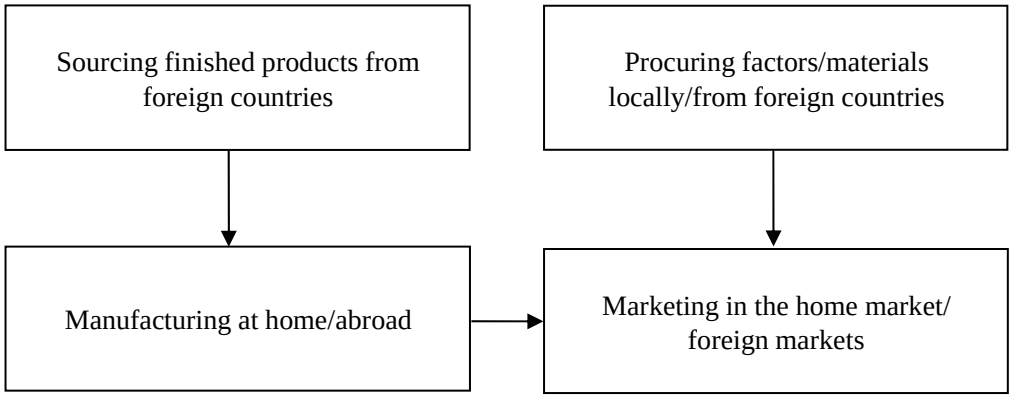

Fig. 17.2: Phases of Business Operations

The business system, thus, involves the integration and management of diverse activities. On the one extreme, a firm may undertake all of these different activities, carrying on the whole production process and doing all the other operations encompassing the business system. On the other extreme, a firm can outsource most of these.

To be a successful participant in a globally competitive environment, in many cases, a company has to be global in the organisation of production and marketing.

Operations management, in fact, is, to a very large extent, supply chain management. As Schary and Larsen observe, “managing the supply chain is vital for international business. The ultimate objective is to deliver products to market with variety, responsiveness, timeliness and efficiency. Corporate strategy must include organising, coordinating and executing the process of product flow as a competitive necessity and as a source of potential competitive advantage. The strategic requirements of international business determine the extent, characteristics and strategic direction of the supply chain. Some businesses are only involved with international operations to secure a supply of materials

and components; marketing is domestic. Other businesses manufacture and export from a home base and procure materials overseas. Some corporations serving global markets rationalise production using international factory networks for supply."[6]

According to Houlihan, the underlying concept of the supply chain embraces the following points:[7]

- The supply chain identifies the complete process of providing goods and services to the final user.
- It includes all parties and logistics operations from supplier to customer within a single system.
- The scope of the supply chain includes procurement, production and distribution operations.
- The supply chain extends across organisational boundaries.
- It is coordinated through an information system accessible to all members.
- The primary objective of the supply chain is service to customers. This must be balanced against costs and assets.
- Objectives of individual supply chain members are achieved through the performance of the chain as a whole.

The above exposition of the scope of the supply chain connotes that operations management is, by and large, supply chain management (note, particularly, the third point). As the supply chain becomes more complex, there is an increasing need to integrate each stage as part of a larger system. Intel, for example, focuses on the design and manufacture of microprocessors and a few related products rather than combining captive in-house chip production with the production of computer systems, as was long the strategy of IBM, NEC and Samsung. In many industries, TNCs have recently tended to focus more on the knowledge-intensive, less tangible functions of the value chain such as product definition, R&D, managerial services, marketing and brand management.

The increasing globalisation is enhancing the scope for global networking of the operations for optimising the operations and increasing the competitiveness. The increased freedom for factors and functions to move within the international production systems of TNCs facilitated by the liberalisations has been the major facilitator of this. Linkages can now be more easily established with suppliers, buyers and even competitors, and they can reach across the world. They may also involve other foreign affiliates or local (i.e. domestically owned) firms.

A large number of components are outsourced in respect of products like automobiles. The maneuverability of the outsourcing and the efficiency of the management of the materials flow are very critical in imparting competitive edge.

As an UNCTAD Report[9] points out that there are three core elements critical to the international production systems: governance, global value chains and geographic configuration.

The first element is *governance*, or the structure of control that determines the geographic and functional distribution of business activities and ensures their coordination. International production system governance occurs in forms ranging from ownership (or equity) linkages that provide direct managerial supervision, to various non-equity linkages in which formally independent intermediaries - suppliers, producers and marketers – are linked through a variety of relationships such as franchising,

licensing, subcontracting, marketing contracts, common technical standards or stable, trust-based business relationships.[10]

The second element of an international production system is the organisation and distribution of production activities and other functions in what is commonly known as the *global value chain*. It extends from technology sourcing and development through production to distribution and marketing. The core competitive advantages of TNCs can reside anywhere along the value chain, although, in practice, they tend to cluster in one component. Value chains are becoming fragmented, as business functions are differentiated into ever more specialized activities. Functional specificity allows TNCs to distinguish activities with widely varying inputs, capacity requirements and financial returns, even within the same industry or production process. As a result, there is a general trend towards functional specialisation, which contrasts with the type of vertically integrated structures that characterised many TNCs until quite recently.[11]

The third element of international production systems, which holds particular interest for developing countries, is their *geographic configuration* in an effort to acquire a portfolio of locational assets that maximises the competitiveness of the corporate system as a whole. The past two decades or so have seen great changes in the determinants of the optimal location of TNC activities, and hence in the geographic distribution of technology, production and marketing activities within international production systems. Production has been internationally dispersed for decades, but the trend towards integration over ever larger geographic scales is relatively new. Perhaps a more striking trend has been the geographic dispersal of other global value chain functions. The internationalisation of business service and support functions has progressed rapidly in recent years. Even innovation, presumably the function most firmly anchored in home countries by specialised skills and strategic motivations, is increasingly being carried out on a global stage.[12]

The trend towards greater networking can have important implications for firms in developing countries. It can open up new avenues for competent developing country firms to link up with global production systems as TNCs scan the globe for efficient and reliable suppliers and subcontractors. Backward linkages from foreign affiliates to local firms, in particular, can become important channels through which intangible and tangible assets can be passed on from the former to the latter, contributing to an upgrading of the local enterprise population and “embedding” and “grounding” foreign affiliates more in their host economies. Given the role that backward linkages can play in these respects, their linkages with TNCs to become global suppliers and sometimes competitors.[13]

The liberalisation of FDI regimes and the strengthening of international standards for the treatment of foreign investors allow firms greater freedom in making international location decisions and in choosing the mode for serving each market and meeting functional needs. TNCs can increasingly fine-tune and differentiate their combinations of internationalisation modes (trade, majority- or wholly owned subsidiaries, joint ventures, non-equity alliances, licensing and so on) to suit each activity and location. In conjunction with privatisation, this opens up new areas of international production, allowing new activities to “go transnational” in ways inconceivable a few years ago: the emergence of previously home-bound infrastructure providers as international investors is a recent example. The spread of FDI in services, in turn, encourages manufacturing firms to cluster in locations in which service TNCs have set up facilities.[14]

STANDARDISATION VERSUS GLOCALISATION

An important issue debated pertaining to globalisation strategy is *globalisation versus localisation.* It is also referred to as *standardisation versus customisation.*

Globalisation or standardisation means, in this context, a globally standardised business strategy. It is indeed the *one size fits all* approach. In other words, the entire global market is regarded as a single homogeneous market that can be successfully tapped with a globally standardised business strategy.

Localisation or customisation, on the other hand, means appreciating the idiosyncrasies of the different markets and having a tailor-made business strategy for each of these distinct markets.

The term glocalisation, to describe localisation/customisation, is in very popular use now. The message of glocalisation is *think global, act local*. The word glocalisation, obviously, is a portmanteau of globalisation and localisation and implies a global strategy with due attention to the distinctive characteristics of different markets or specific customer groups.

According to Ronald Robertson, a sociologist who is credited with popularising the term glocalisation described it as an outcome of local conditions toward global pressures. At a 1997 conference on "Globalization and Indigenous Culture," Robertson described glocalisation as "the simultaneity – the co-presence – of both universalising and particularising tendencies."[15]

Let us now have a look at some of the arguments for and against globalisation and standardisation.

As Sands remarks,[16] in literal sense, multinational standardisation would mean the offering of identical product lines at identical prices through identical distribution systems, supported by identical promotional programmes, in several different countries. At the other extreme, completely "localised" marketing strategies would contain no common elements whatsoever. Obviously neither of these extremes is feasible or desirable and in practical marketing these terms are not used in the literal sense. In many cases, the issue boils down to what extent localisation or standardisation is appropriate. In a number of cases, what is appropriate is neither localisation nor globalisation but regionalisation.

Arguments for Globalisation

There have been many supporters of globalisation. In the late 1960s, R. Bartels in a *Journal of Marketing* paper claimed that for US firms, "emphasis on the inherent similarities rather than differences will enable a better understanding of the nature of foreign marketing"[17] and developed a framework studying standardisation concerning market characteristics, industry conditions, and legal restrictions. One of the most staunch advocates of globalisation is Theodore Levitt who has indeed been described as the guru of global marketing and the champion of world brands. In his 1983 *HBR* paper entitled "The Globalisation of Markets", Levitt argued that, "the world is becoming a common marketplace in which people—no matter where they live—desire the same products and lifestyles. Global companies must forget the idiosyncratic differences between countries and cultures and instead concentrate on satisfying universal drives.[18]

Citing the examples of many high-tech and high-touch standardised products being sold in the same way everywhere, Levitt argued that "World's needs and desires have been irrevocably

homogenised and that this makes the multinational corporation obsolete and the global corporation absolute."[19]

While "the multinational corporation operates in a number of countries and adjusts its products and practices in each – at a high relative cost, the global corporation operates with resolute constancy – at a low relative cost – as if the entire world (or major regions of it) were a single entity; it sells the same thing the same way everywhere."[20]

Levitt further argued that the modern global corporation contrasts powerfully with the aging multinational corporation. Instead of adapting to superficial and even entrenched differences within and between nations, it will seek sensibly to force suitably standardised products and practices on the entire globe. They are exactly what the world will take, if they come also with low prices, high quality, and blessed reliability. The global company will operate, in this regard, precisely as Henry Kissinger wrote in *Year of Upheava*l about the continuing Japanese success – "voracious in its collection of information, impervious to pressure, and implacable in execution."[21]

According to the proponents of standardisation, thanks to technological innovation, mass communication, and consumer mobility, consumer needs around the globe are converging, allowing marketers to pursue uniform marketing approaches across the globe. Besides the homogenised customer needs, there are also other reasons supporting globalisation like the economies of scale and cost savings. It has also been argued that global brands would have more bargaining power than local ones, the worldwide brand better enabling them to penetrate new markets.

In short, the following developments too tend to favour globalisation.

1. Technological Advance: It is argued that the proletarianisation of communication and travel by the technological revolution drives the world toward a converging commonality.

The very fast changes in technology also makes products obsolete very soon, i.e., the product life cycle is very short in many cases. Customisation involves time and the resultant delay in introducing the product in different markets may make the product life cycle even more shorter in an environment of fast changes and come in the way of fast recouping the cost of products with short life cycles due to technological obsolescence or other reasons like changes in fashion.

2. Travel and Communication: Transnational travel encourages globalisation in two ways. First, it helps diffusion of product information. Second, transactional travellers become customers for a product in different countries. International migration also has similar effects.

Developments in the field of education and communication have a tremendous impact on product promotion. The spread of English education has increased the international circulation of English publications. Media from one country – newspapers, magazines, radio, TV etc. – may reach audience in many other countries. The cable and world wide web have really brought in a borderless world.

In short, "worldwide, communications carry everywhere the constant trumbeat of modern possibilities to lighten and enhance work, raise living standards, divert and entertain. The same countries that ask the world to recognise and respect the individuality of their cultures insist on the wholesale transfer to them of modern goods, services and technologies.[22] As far as comforts of life are concerned, peoples' attitudes are becoming more and more secular.

3. Product Image: Consumers are becoming more price and quality conscious. Competitors are not marketing magicians. They will rely on two rather universal needs of their customers – reliable

products and low prices.[23] Standardisation makes production more cost efficient, leading to low prices. Standardisation reduces costs because of the economies of scale in production and marketing and because of the savings on R&D and product development. Levitt concedes that by translating benefits of enormous economies of scale in production, distribution, marketing and management into reduced world prices, the corporations geared to standardisation can decimate competitors that still live in the disabling grip of old assumptions about how the world works.[24]

4. International Standard: The laying down of international standards for many products also encourage standardisation. Many such industrial products which perform the same function every where lend themselves for standardisation.

There are, thus, several factors which tend to encourage globalisation. Levitt feels that standardisation can help expand the market. "When the global producer offers his lower costs internationally, his patronage expands exponentially. He not only reaches into distant markets, but also attracts customers who previously held to local preferences and now capitulate to the attractions of lesser prices. The strategy of standardisation not only responds to worldwide homogenised markets but also expands those markets with aggressive low pricing.[25]

Arguments for Glocalisation

Many academicians and marketers disagree with the strategy of globalisation and argue for customisation.

Philip Kotler holds that Levitt's theory that the world is becoming one marketplace is a lot of bunk.[26] According to Kotler, setting up marketing in each country is like an organ transplant – the question is will it take. What works in one country may not work in another. Kotler also points out that Levitt blundered in his assessment of the overseas success of certain products cited by him as examples of successful globalisation. The success of these products is based on variation, not offering the same product everywhere. McDonald's, for example, sells differently in different countries.[27] Thus, we find that the product that is available under the global brand name may not be same everywhere. The Lux marketed in India is different from the product in other markets. The Liril in India is different from that in Japan. Similarly, Procter & Gamble markets worldwide products like Camay soap, Crest toothpaste, Head and Shoulders shampoo and Pampers diapers; but the smell of Camay, the flavour of Crest and the formula of Head and Shoulders differ from region to region and so do the advertising.

In short, as McCann-Erickson Worldwide says, "our experience suggests that, even though the world is busily defining new similarities, the nuances of differences are still critical. A global theme is often fine, but fine-tuning is even finer. Otherwise all you finish up with is a very low common denominator indeed – all things to few people."[28]

It may also be noted that there are also differences in the perception of what constitutes product modification. What is regarded as product modification by certain people is not considered so by others. Levitt observes, for instance, that to say that Japanese companies are not global because they export cars with left side drive to the US and the European continent, while those in Japan have right side drivers, or because they sell office machines through distributors in the US but directly at home or speak Portuguese in Brazil is to mistake a difference for a distinction.[29]

There is general agreement that "the key to successful international business is adaptation to the differences in the environment that usually exist from one market to another. Adaptation is not a

passive process but a conscious effort on the part of the international marketer to anticipate the influences of both the foreign and domestic uncontrollable environments on a marketing mix and then to adjust the marketing mix to minimise their effects."[30] For example, an analysis of the experience of leading American firms in the major markets of the world has identified that "the outstanding marketer is keenly aware of the variations from one market to another …He knows that countries, and even sections of countries, differ enormously in almost every factor critical to his market planning."[31]

Lee suggests[32] that the root cause of most international business problems is the ***self-reference criterion (SRC)*** in making decisions, that is, an unconscious reference to one's own cultural values, experiences and knowledge as the basis for decisions. The SRC is one of the most difficult to break. Lee proposes a systematic four-step framework for eliminating this form of myopia.

- Define the problem or goal in terms of home-country cultural traits, habits, and norms.
- Define the problem or goal in terms of the foreign cultural traits, habits, and norms.
- Isolate the SRC influence in the problem and examine it carefully to see how it complicates the problem.
- Redefine the problem without the SRC influence and solve for the foreign market situation.

There are a number of examples of even mighty multinationals seriously burning their finger because of the failure to adapt to the idiosyncrasies of the foreign markets. In may cases, it was the SRC which doomed them to failure. For example, Procter & Gamble (P&G) stormed into the Japanese market with American products, American managers, American sales methods and promotion strategies. The result was disastrous until the company learnt how to adapt products and marketing style to Japanese culture. P & G which entered Japan in 1973 lost money until 1987 but by 1991 Japan became its second largest foreign market. American company Texas Instruments too had similar experience. Apple Computers and the Colgate-Palmolive products are also among those which failed in Japan as they did not adapt to the Japanese market. A study of 300 major American companies doing business in Japan has revealed that most of the successful companies entered the market with the strength of a resource-driven product, a technological lead, a new to Japan concept, a differentiated marketing strategy or most likely, a combination of these.[33]

Numerous examples illustrate that, to be successful in a foreign market, a company should establish a strong insider position based on the marketing environment. In his famous *The Borderless World*, Kenichi Ohmae, renowned management expert and author, observes that *insiderisation* is the key to success in a foreign market. "When global success rests on market-by-market functional strength, you have to play a series of domestic games against well-defined competitors. You have to become a true *insider* in that market. If the market requires a first class sales force, you have to have one. If competition turns on dealer support programs, that's where you have to excel. Some occasions do exist when doing more better is the right, the necessary course, to follow. Still there are usually opportunities to redefine these domestic games to your own advantage."[34]

Global fast food chains like McDonald's, KFC and Starbucks and global beverages firms like Coca-Cola provide examples of weaving success across the world by thinking global, acting local, by adaptation and innovation, coming up with innovative products and services and tailor-made promotion strategies to address the needs of diverse consumer markets—as shaped by demographic, economic and local factors. Burger King — arguably McDonald's largest competitor in the world —

on the other hand, presents a picture of characteristic failure in the fast expanding French fast food market by its arrogant standardisation strategy.

Burger King entered the French market in 1981 but closed its 39 stores in 1997. McDonald's and Quick, which entered the French market around the same time as Burger King, increased the number of restaurants to 542 and 258 respectively. From 1983 to 1996, the French fast food market grew by nearly 1,450 restaurants, and total market value increased fivefold. Why did, then, Burger King had to wind up in France? It is mostly due to its arrogant standardisation strategy – strategy of directly transplanting the American restaurants, with no local adaptation. McDonald's success in France is largely attributed to the age-old American adage: The customer (in France, of course, the French customer) is the king – it has been very responsive to the preferences of French consumers, both inside the restaurants and in their daily lives.[35]

Quick, the leading European fast food hamburger restaurant brand, claims that their "history is a tale of taste and the successful adaptation of the American fast food model to the habits and tastes of Europeans."

The extent of localisation may vary between markets. Take the case of Starbuks, for example. The customer experience you get in a Starbucks in London or New York is pretty similar which reflects the similar coffee house cultures in both countries. However, step inside a Starbucks in China and the overall feel is different. A larger outlet; busier at different times of the day (they are most popular in the late afternoon) and some local Chinese favourites on the menu. But, the brand experience you get is still Starbucks and in many respects that is what the increasingly affluent Chinese consumer is looking for. Indeed, the price of a coffee at a Starbucks in China is relatively higher than comparable drinks in the USA.[36]

While McDonald's is the market leader in the US and globally, in China KFC is far ahead of McDonald's. It is attributed mostly to the aggressive localisation strategy pursued by the Kentucky firm. In the beginning, McDonald's claimed that they would not change the menu in China, and always stick to their American style but years later it began to adapt but remained much behind KFC in localisation. While worldwide the proportion of KFC's localised products reportedly account for 20 per cent among its entire product line, nearly half of its products for Greater China region are specially designed for the Chinese market.[37] KFC has been growing fast in the Chinese market by launching more and more new products to suit the local palates.

There is a growing recognition of the importance of the local/cultural touch in touching the hearts of the customers. For instance, to continue to grow globally, SABMiller marketing executives were challenged to base their advertising upon the varying "attitudes, traditions and customs" of their desired market. (SABMiller, headquartered in London, is one of world's largest brewers with more than 200 beer brands in over 75 countries. It is also a major bottler of Coca-Cola.) According to a company source, it has "become a global leader by excelling locally – nurturing strong, local brands and building brand portfolios that meet the needs of consumers in each of our markets."

Promotion is an area where many marketers do blunders, paying a heavy price for not appropriately localising. Foreign countries have their own customs, traditions and practices regarding trade promotion, gift-giving etc. Ignoring them could be disastrous. For example, the Japanese rebate, entertainment and gift-giving practices differ significantly from Western practices and it is particularly important that these be recognised and understood. Some of the rebate or kick-back practices unique to

Japan, such as those for purchasing agents, have evolved from the traditional custom of giving special monetary gifts on occasions of celebration or mourning in order to strengthen ties of fellowship. A foreign affiliated company, a joint venture formed with a Japanese partner, received clear instructions from the head office to advertise heavily at the initial stage. The Japanese partner accepted this proposal but at the same time proposed that allocations be made for promotional rebates to wholesalers and retailers. The foreign partner, however, did not accept this. In spite of heavy advertising, in TV and other media, there was not enough of the product out on the retailers' shelves because neither the wholesalers nor the retailers had been given any incentive to push the company's products. Not surprisingly, the company was burdened with a colossal loss.[38] Similarly, the Procter and Gamble also blundered in the Japanese market. In the beginning, P&G tried to work with virtually every wholesaler and used its tried and true US style price off promotions. As a result, the company failed to establish close relationship with wholesalers and sparked devastating price wars among wholesalers. The company found itself with poor distribution and little in-store display support. P&G, however, became successful later after it has revamped its marketing strategy. The company then worked closely with 100 wholesalers, down from the original score of 400 and no longer offers discount promotions.

A number of MNCs, including Kelloggs, and Reebok, Lacoste, Philips, Procter & Gamble, Hindustan Lever, Nestle, Pepsi, Amway and so on, have realised that it makes business sense to adapt to the Indian tastes and preferences and business conditions. They have modified products/launched new product forms or got into new categories relevant to Indian market. McDonald's, Pizza Hut and KFC have added new products – vegetarian and non-vegetarian including biriyani and chicken tikka – to satisfy the Indian palate. Considering the low income of Indian consumers, some of the fast food chains have added products in low price range. Tropicana of Pepsi Foods introduced a modified product, brand named *Season's Best*, in India. Pepsi has modified the flavour of *7Up* in India. *Lacoste* has introduced several typical Indian dresses to generate business volume. Reebok introduced shoes without frills suitable for just walking or jogging. It also introduced shoes in dark colours, including black, as buyers in India do not generally prefer white shoes as they easily get discoloured with dirt. There are many examples of motor cars to cell phones having modified to better fit the local conditions. In short, cases of glocalisation galore, from high-touch to high-tech products.

Box 17.2

Glocalisation by Acquisition

Glocalisation implies a company with a global business orientation adopting tailor-made product (good/service) offerings and associated business strategies which fit well specific markets. In other words, a global company adapts its strategies to suit the local conditions. The term local would mean a defined geographical area – small or big – within a country or a whole country or group of countries with very conspicous common customer characteristics. A company can achieve such localisation or customisation by modifying (lightly to substantially) its existing markeing mix or other strategies to suit the new market chosen. It often requires substantial R&D to understand the market dynamics and to develop appropriate strategies. An alternative to this, often easier for companies which are not very resourceful and not well experienced in global business, is acquisition of companies in foreign markets which are well meshed with the local markets.

Several Indian companies, particularly in the FMCG sector, have made their foreign forays by glocalisation through acquisition of such local companies with established products in these markets. Few examples: The Godrej Consumer Products Ltd. (GCPL), a major player in the Indian

home care, personal care and hygiene products spaces, has made a series of acquisitions in these industries in South East Asia, Africa, Latin America and elsewhere. Indian FMCG company Marico has acquired soap brands in Bangladesh and post-wash hair care brands in Egypt. The Wipro Consumer Care and Lighting Ltd. acquired Malaysian FMCG firm Unza which is a leading personal care manufacturer and marketer in South East Asia with 48 brands across soaps, shampoos, deos and talcs; presence in about 58,000 retail outlets and five manufacturing locations including one in China.

ESSENTIAL CONDITIONS FOR GLOBALISATION

There are, however, some essential conditions to be satisfied on the part of the domestic economy as well as the firm for successful globalisation (in this section, the term globalisation means globalisation of busines, i.e. growing the business globally). They are:

1. Business freedom: There should not be unnecessary government restrictions which come in the way of globalisation, like import restriction, restrictions on sourcing finance or other factors from abroad, foreign investments etc. That is why the economic liberalisation is regarded as a first step towards facilitating globalisation.

2. Facilities: The extent to which an enterprise can develop globally from home country base depends on the facilities available like the infrastructural facilities.

3. Government support: Although unnecessary government interference is a hindrance to globalisation, government support can encourage globalisation. Government support may take the form of policy and procedural reforms, development of common facilities like infrastructural facilities, R&D support, financial market reforms and so on.

4. Resources: Resources is one of the important factors, which often decides the ability of a firm to globalise. Resourceful companies may find it easier to thrust ahead in the global market. Resources include finance, technology, R&D capabilities, managerial expertise, company and brand image, human resource etc. It should, however, be noted that many small firms have been very successful in international business because of one or other advantage they possess.

5. Competitiveness: The competitive advantage of the company is a very important determinant of success in global business. A firm may derive competitive advantage from any one or more of the factors such as low costs and price, product quality, product differentiation, technological superiority, after-sales service, marketing strength etc. Sometimes, small firms may have an edge over others in certain aspects or times of business.

COMPETITIVE ADVANTAGE OF NATIONS

Why does a nation achieve international success in a particular industry? Michael Porter in his renowned *Competitive Advantage of Nations*[39] points out that the answer lies in four broad attributes of a nation that shape the environment in which local firms compete that promote or impede the creation of competitive advantage. These factors are factor conditions; demand conditions; related and supporting industries; and firm strategy, structure and rivalry.

Nations are most likely to succeed in industries or industry segments where the national *diamond* (a term used by Porter to refer to these four determinants as a system, forming four corners of a

diamond when represented schematically) is the most favourable. The diamond is a mutually reinforcing system. The effect of one determinant is contingent on the state of others. While competitive advantage based on one or two determinants is possible, *albeit* usually unsustainable, in natural resource-dependent industries or industries involving little sophisticated technology or skills, advantages throughout the diamond are necessary for achieving and sustaining competitive success in the knowledge-intensive industries that form the backbone of advanced economies.

Factor Conditions

Competitive advantage from factors depend on how efficiently and effectively they are employed.

Advanced factors (such as modern digital data communication infrastructure, highly educated personnel and research institutes in sophisticated disciplines) and *specialised factors* (such as narrowly skilled personnel, infrastructure with specific properties, knowledge base in particular fields, and other factors with relevance to a limited range or even to a single industry) are more critical in determining competitive advantage than *basic factors* (such as natural resources, climate, location, unskilled and semi-skilled labour and debt capital) and *generalised factors* (such as the highway system, a supply of debt capital or a pool of well motivated educated employees).

Development of advanced and specialised factors demands concerted effort and large and often sustained investments in both human and physical capital. Nations succeed in industries where they are particularly good at factor creation.

It is also important to note that selective disadvantages in the more basic factors can prod a company to innovate and upgrade. For example, the very poor position in natural resources have only served to spur Japan's competitive innovation.

Demand Conditions

There are three attributes of home demand which influence the competitive advantage, viz., the composition (or nature of buyer needs) of home demand, the size and pattern of growth of home demand, and the mechanism by which a nation's domestic demands are transmitted to foreign markets.

Nations gain competitive advantage in industries where the home demand gives their companies a clearer or earlier picture of emerging buyer needs, and where demanding buyers pressure companies to innovate faster and achieve more sophisticated competitive advantages than their foreign rivals.

The size and pattern of growth of home demand can reinforce the national advantage in an industry. Large home market size can lead to competitive advantage in industries where there are economies of scale or learning, by encouraging a nation's firms to invest aggressively in large-scale facilities, technology development and productivity improvements. Large home demand, however, will be an advantage only if it is for segments that are demanded in other nations.

A nation may also gain advantage when its domestic demand internationalises and pulls its products and services abroad. This may happen when a nation's buyers for a product or service are mobile (like those who extensively travel abroad) or are MNCs or when domestic needs and desires get transmitted to or inculcated in foreign buyers (for example, US medical equipment firms find a receptive audience abroad in the doctors trained in the US).

Related and Supporting Industries

The presence in the nation of related and supporting industries that are internationally competitive creates advantages in downstream industries in several ways such as the supply of the most cost-effective inputs in an efficient and sometimes preferential way. More important, however, is the advantage they provide in innovation and upgrading, based on close working relationships.

Firm Strategy, Structure and Rivalry

National circumstances and context create strong tendencies in how companies are created, organised and managed as well as what the nature of domestic rivalry will be.

Among all the points on the diamond, domestic rivalry (i.e., competition) is arguably the most important because of the powerfully stimulating effect it has on all others. Domestic rivalry not only creates pressures to innovate but to innovate in ways that *upgrade* the competitive advantages of a nation's firms.

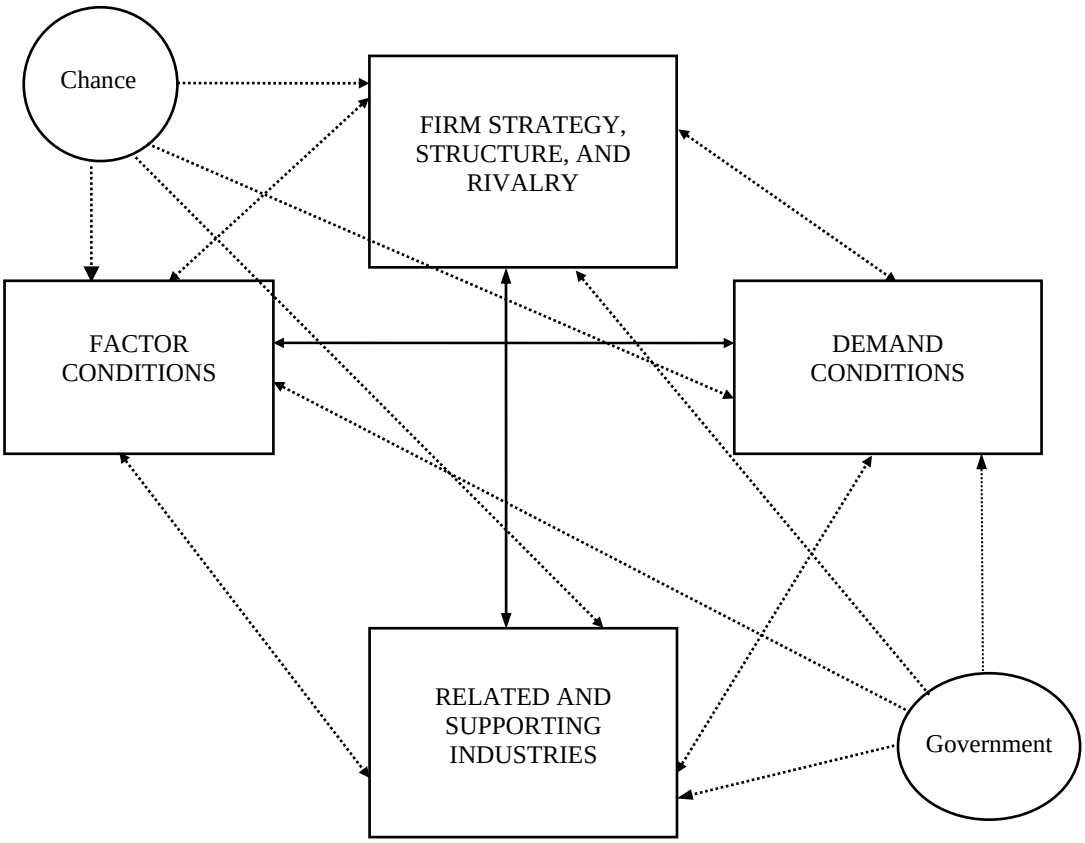

Fig. 17.3: Factors Determining Competitive Advantage of Nations

Role of Government and Chance

In addition to the above four determinants, which shape the competitive advantage of nations, two variables, viz., government and chance, also play important roles.

Government can influence each of the four determinants by industrial, fiscal and monetary policies, promotional and regulatory measures in respect of industry and trade etc.

Chance events can affect competitive position because of developments such as major technological breakthroughs or new inventions, political decisions by foreign governments, wars, significant shifts in world financial markets or exchange rates, discontinuities in input costs such as oil shocks, surges in world or regional demand etc.

The complete system determining the competitive advantage of nations, as presented by Porter, is portrayed in Figure 17.3. The system consisting of the four determinants excluding government and chance represents the diamond.

GLOBALISATION OF INDIAN BUSINESS

India's economic integration with the rest of the world was very limited because of the restrictive economic policies followed until 1991. Indian firms confined themselves, by and large, to the home market. Foreign investment by Indian firms was very insignificant.

With the new economic policy ushered in 1991, there has, however, been a change. Globalisation has, in fact, become a buzzword with Indian firms now and many are expanding their overseas business by different strategies.

The following sub-section takes a look at the hurdles to and prospects for globalisation of Indian business and the different globalisation strategies.

Obstacles to Globalisation

The Indian business suffers from a number of disadvantages in respect of globalisation of business. The important problems are the following:

1. Government policy and procedures: Government policy and procedures in India are among the most complex, confusing and cumbersome in the world. Even after the much-publicised liberalisation, they do not present a very conducive situation. One prerequisite for success in globalisation is swift and efficient action. Government policy and the bureaucratic culture in India in this respect are not that encouraging.

2. High cost: High cost of many vital inputs and other factors like raw materials and intermediates, power, finance infrastructural facilities like port etc. tend to reduce the international competitiveness of the Indian business.

3. Poor infrastructure: Infrastructure in India is generally inadequate and inefficient and therefore very costly. This is a serious problem affecting the growth as well as competitiveness.

4. Obsolescence: The technology employed, mode and style of operations etc. are, in general, obsolete and these seriously affect the competitiveness.

5. Resistance to change: There are several socio-political factors, which resist change, and this comes in the way of modernisation, rationalisation and efficiency improvement. Technological modernisation is resisted due to fear of unemployment. The extent of excess labour employed by the Indian industry is alarming. Because of this, labour productivity is very low and this in some cases more than offsets the advantages of cheap labour.

6. Poor quality image: Due to various reasons, the quality of many Indian products is poor. Even when the quality is good, the poor quality image in India has become a handicap.

7. Supply problems: Due to various reasons like low production capacity, shortages of raw materials and infrastructures like power and port facilities, Indian companies in many instances are not able to accept large orders or to keep up delivery schedules.

8. Small size: Because of the small size and the low level of resources, in many cases Indian firms are not able to compete with the giants of other countries. Even the largest of the Indian companies are small compared to the multinational giants.

9. Lack of experience: The general lack of experience in managing international business is another important problem.

10. Limited R&D and marketing Research: Marketing Research and R&D in other areas are vital inputs for development of international business. However, these are poor in Indian business. Expenditure on R&D in India as a percentage of GDP (R&D intensity) is less than one per cent and it has not shown any significant increase over time whereas it has increased from 2.47 per cent in 2001 to 4.03 in 2011 in respect of South Korea and nearly doubled from 0.95 per cent to 1.84 per cent for China.

11. Growing competition: The competition is growing not only from the firms in the developed countries but also from the developing country firms. Indeed, the growing competition from the developing country firms is a serious challenge to India's international business.

12. Trade barriers: Although the tariff barriers to trade have been progressively reduced thanks to the GATT/WTO, the non-tariff barriers have been increasing, particularly in the developed countries. Further, the trading blocs like the NAFTA, EC etc. could also adversely affect India's business.

Factors Favouring Globalisation

Although India has several handicaps, there are also a number of favourable factors for globalisation of Indian business.

1. Human resources: Apart from the low cost of labour, there are several other aspects of human resources to India's favour. India has one of the largest pools of scientific and technical manpower. The number of management graduates is also surging. It is widely recognised that given the right environment, Indian scientists and technical personnel can do excellently. Similarly, although the labour productivity in India is generally low, given the right environment it will be good. While several countries are facing labour shortage and may face diminishing labour supply, India presents the opposite picture. Cheap labour has particular attraction for several industries.

2. Wide base: India has a very broad resource and industrial base, which can support a variety of businesses.

3. Growing entrepreneurship: Many of the established industries are planning to go international in a big way. Added to this is the considerable growth of new and dynamic entrepreneurs who could make a significant contribution to the globalisation of Indian business.

4. Growing domestic market: The growing domestic market enables the Indian companies to consolidate their position and to gain more strength to make foray into the foreign market or to expand their foreign business.

5. Niche markets: There are many marketing opportunities abroad present in the form of market niches, as pointed out in Chapters 9 and 10. Such niches are particularly attractive for small companies. Several Indian companies have become very successful by niche marking.

6. Expanding markets: The growing population and disposable income and the resultant expanding internal market provides enormous business opportunities.

7. Transnationalisation of world economy: Transnationalisation of the world economy, i.e., the integration of the national economies into a single world economy as evinced by the growing interdependence and globalisation of markets is an external factor encouraging globalisation of Indian business.

8. NRIs: The large number of non-resident Indians who are resourceful — in terms of capital, skill, experience, exposure, ideas etc. is an asset which can contribute to the globalisation of Indian business. The contribution of the overseas Chinese to the recent impressive industrial development of China may be noted here.

9. Economic Liberalisation: The economic liberalisation in India is an encouraging factor of globalisation. The delicensing of industries, removal of restrictions on growth, opening up of industries earlier reserved for the public sector, import liberalisations, liberalisation of policy towards foreign capital and technology etc. could encourage globalisation of Indian business. Further, liberalisation in other country increases the foreign business opportunities for Indian business.

10. Competition: The growing competition, both from within the country and abroad, provokes many Indian companies to look to foreign markets seriously to improve their competitive position and to increase the business. Sometimes, companies enter foreign market as a counter-competitive strategy, i.e., to fight the foreign company in its own home market to weaken its competitive strength.

GLOBALISATION STRATEGIES

Indian industry can move towards globalisation by different strategies such as developing exports foreign investments including joint ventures and acquisitions, strategic alliance, licensing and franchising, etc.

Exporting

Exporting, of course, is one of the important ways of globalisation. With the economic liberalisation, an environment for globalisation of Indian exports, however, is slowly emerging. In a truly globalised environment, the exports will also be very much global: the sourcing of finance, materials and managerial inputs will be global, based on purely business considerations.

India has potential for significantly increasing the exports of many products if appropriate measures are taken. Although there are a number of products with large export potential, India failed to exploit the potential satisfactorily. Because of the advance made by other developing countries in the export of such products, although the situation has now become more difficult for India, there still exists a lot of scope for substantially increasing the exports of many of these products.

With the right policy and procedural reforms and institutional support, with technological upgradation and modernisation and enlargement of production facilities, with thrust on quality and value-added products, with improvements in infrastructural facilities and with right marketing strategy, great strides could be made in the export of a number of products.

Broadly, there are three strategies to increase the export earnings, viz.,

1. Increase the average unit value realisation,
2. Increase the quantity of exports, and
3. Export new products.

One of the most important considerations in exports should be to achieve maximum unit value realisation. Value-added exports is a much-needed graduation for India to enhance the foreign exchange earnings. Value-added exports assume greater significance particularly in view of the stagnation or fall in the exportable surplus of several commodities – like pepper, cardamom, tea, coffee etc.

The major part of India's manufactured exports end up in the low-price segments of the foreign markets. Quality upgradation and marketing efforts are needed to reach the upper segments and to achieve enhanced value realisation. Technology imports or foreign collaborations are required for this in many cases.

In many cases, what comes in the way of increasing exports is the supply constraints. This is true of a number of manufactured products as well as agricultural commodities. Given the constraints for area expansion, increase in agricultural production should come mostly from increase in productivity that is very low in India. In respect of many industrial products, the production capacity is very low and highly fragmented so that there are a large number of cases of Indian firms not being able to accept offers from abroad for purchase of large quantities of the products which are far beyond the capacity of these firms to supply.

One of the important ways to increase exports is to expand the export basket by adding new products and achieving substantial sales of them abroad. The share of non-traditional items in India's exports has increased very significantly. However, a lot of potential still remains untapped.

For identifying new products for exports, there are two important courses: (i) Explore the export opportunities for products currently produced in India, (ii) Identify products with good demand abroad which can be competitively produced and supplied by India.

An important export opportunity for India and other developing countries is provided by the vacation of certain industries or market segments by the developed country firms due to various reasons like environmental consideration, lack of competitiveness, declining industry attractiveness etc. For example, the developed countries are phasing out production of a wide range of chemicals due to increased expenditure on overheads and high labour costs.

Given the capabilities and limitations of the Indian companies and the international environment, appropriate strategies should be formulated to market different products abroad.

Market niching is the right strategy for many Indian companies. Several Indian companies have indeed successfully used this strategy in the foreign markets.

In some cases, a company can adopt the strategy of *straight extension*, i.e., extending the same product as marketed in the home country to the foreign markets. It is particularly relevant in respect of other developing countries with similar market characteristics as that of India. A large number of the cases, however, demand quality upgradation, product modification or product development.

Foreign Investment

As pointed out in Chapter 3, it is simply not possible to maintain substantial market standing in an important area unless one has a physical presence as a producer. Otherwise, one will soon lose the 'feel' of the market.

Besides the advantage of getting a feel of the market, offshore investments are encouraged by such factors as cost advantage, trade barriers etc. The demand for 'local content' is also satisfied by production in the respective countries.

Foreign investment by Indian companies in the past was very limited. The attractiveness of the domestic market, lack of global orientation, government regulations etc. have been responsible for this.

With the economic liberalisation and growing global orientation, many Indian companies are setting up manufacturing/assembling/trading bases abroad, either wholly or in partnership with foreign firms. These would help these companies to increase their international business. Indian companies have also been making investments abroad on acquisitions, as pointed out in the chapter on *Mergers and Acquisitions*. Several of these overseas investments aim not only at expansion of production base and business abroad but also at consolidation of the domestic business.

Mergers and Acquisitions

Mergers and Acquisitions (M&As) are very important market entry as well as growth strategy. As explained in the chapter on *Mergers and Acquisitions*, Indian companies have become very active in M&As in the recent period.

Joint Ventures

The reasons for and advantages of joint ventures have been described in Chapter 7.

Joint venturing is a very important foreign market entry and growth strategy employed by Indian firms. It is an important route taken by pharmaceutical firms like Ranbaxy, Core, Lupin, Reddy's etc.

In several cases, joint ventures, as in the case of foreign subsidiaries, help Indian firms to stabilise and consolidate their domestic business, besides the expansion of the foreign business. Essar Gujarat's joint ventures in countries like Indonesia and Bangladesh to manufacture cold rolled (CR) steel have resulted from a strategy to create an assured market for its hot rolled (HR) coil mother plant at Hazaria (HR coils are inputs for manufacturing CR steel products).

The Essel Packaging has taken the joint venture route to expand its business abroad. The joint ventures abroad convert the laminate into tubes to be marketed in foreign markets. The centralisation of the laminate production in India enables the company to reap enormous economies of scale. The high cost of transportation of tubes over laminates makes the conversion of laminates into tubes in the foreign markets more profitable. Further, the establishment of tube production facilities in foreign markets helps to pre-empt competition.

Strategic Alliance

Strategic alliance provides enormous scope for the Indian business to enter/expand the international business. This is particularly important for technology acquisition and overseas marketing. Alliance is indeed an important international marketing strategy employed by several Indian firms.

Licensing and Franchising

Licensing and franchising, which involve minimal commitment of resource and effort on the part of the international marketer, are easy ways of entering the international market.

Many Indian firms can use licensing or franchising for the overseas market; particularly the developing countries. For example, Ranbaxy has licensing arrangement in countries like Indonesia and Jordan.

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CHAPTER

18

Functional Strategies

Functional strategies are an important component of strategic management. Functional-level strategies are strategies for different functional areas like Operations, Finance, HR, and Marketing.

As explained in Chapter 1 and depicted in Figure 1.3, functional strategies are the third level in the strategic management hierarchy in a multi-SBU company (second level in single SBU firm). Figure 8.3 (Chapter 8) indicates the role of functional strategies in implementing the corporate strategy to achieve the corporate objectives. Figure 1.4 (Chapter 1) indicates the differences and relationships between Corporate, Business and Functional Strategies.

OPERATIONS MANAGEMENT STRATEGIES

Production management, rather the broader operations management, involves a number of strategic decisions such as make or buy?; if buy, from where to buy?; to go for partnering or not?; in which country and place to locate the manufacturing or other facilities; logistical factors and so on. The business system involves the integration and management of diverse activities. On the one extreme, a firm may undertake all of these different activities, carrying on the whole production process and doing all the other operations encompassing the business system. On the other extreme, a firm can outsource most of these.

4 Cs of Manufacturing

The success of a manufacturing strategy depends on four key factors: compatibility, configuration, coordination, and control.[1]

Compatibility: Compatibility with reference to manufacturing strategy refers to the degree of consistency between a host of strategic variables *vis-à-vis* the company's competitive strategy. Important factors that must be considered include:[2]

1. Efficiency/cost — reduction of manufacturing costs.
2. Dependability — degree of trust in a company's products and its delivery and price promises.
3. Quality — performance reliability, service quality, speed of delivery, and maintenance quality of the product(s).

4. Flexibility — ability of the production process to make different kinds of products and to adjust the volume of output.
5. Innovation — ability to develop new products and ideas.

Cost minimisation strategies often prompt companies to opt for offshore manufacturing locations like developing countries and for outsourcing. Factors like characteristics of supplier firms in respect of dependability, flexibility, quality and innovation influence the make or buy decision, choice of vendors etc. In case of the make situations, the choice of production location will be based on evaluation of the location with its environment *vis-à-vis* the above critical factors.

Configuration: Manufacturing configuration refers to the strategy of centralisation or dispersion of manufacturing facilities. There are broadly three broad categories of manufacturing configuration, viz., centralised facility, regional facilities, and multi-domestic facilities.

The choice of the configuration strategy is influenced by several factors such as scale economies, nature of technology and skill requirements, firm strategies such as internalisation or externalisation, international orientation and the organisational mode of the company, foreign market prospects and other characteristics etc.

Coordination and Control: Coordination and Control which are two sides of the same coin refer to the integration, monitoring and taking of required actions to ensure that the implementation of the plans progress as envisaged.

Location Strategy

The location of production facilities may be influenced by a number of factors, such as the following:

Nature of Organisation: The organisational model is a major determinant of the location. For example, in a *Multinational Company*, the subsidiaries do most of the production for their respective markets. In an *International Company* and *Global Company*, there is tendency to centralise core production activities in the home country.

The transnational corporation is characterised by globally integrated networks of production facilities and other factors.

Cost: Given other factors (like political factors, organisational model and strategic orientation etc.), the overall cost of operations is often the most important consideration in the location decision-making. Important factors, which determine the cost, include the following:

1. Scale Economies: Where there is large-scale economies in production, production tends to concentrate in one or very limited number of locations. Such concentration may be in the home country or foreign countries.

2. Nature of Assembly Operations: If there is large economies of scale in production of components and if the assembly operations are labour-intensive, the locations of components manufacture and assembly operations could be different. The assembly operations may be carried out in countries where the labour is very cheap.

3. Taxes and Transport Costs: The import duty structure also influences the location of production phases. If the import duty is very high on finished product and comparatively low on components, it would encourage assembling of the product in the foreign market, *ceteris paribus*. If

the cost of transporting the finished product is significantly higher than for the components, export in the CKD form would be preferred and the assembling of the product would be done in the foreign market. This will be particularly attractive if the labour is cheap in the foreign market. Sometimes, the import duty and transport cost will favour the complete or most of the manufacturing activity in the foreign market.

Exchange Rate Variation: Exchange rate fluctuations may also influence the import vs. manufacturing decision. A depreciation of the foreign currency *vis-à-vis* the home currency will make imports into the foreign country costly and this may encourage production within the foreign market.

Availability and Cost of Inputs: Availability and cost of inputs (including land and infrastructure), obviously, are critical factors influencing the location decision. The infrastructure and other facilities and incentives are the attraction of export processing/special economic zones.

Logistical Factors: Certain locations are preferred because of logistical reasons — the cost and ease of moving products to various markets. Some locations (Singapore, for example) are indeed regarded as the *hub* of international operations.

Product Life Cycle and Pattern of Demand: The stage in the product life cycle may influence the location of production base. As explained in the International Product Life Cycle Theory, when the product is in the declining stage of the life cycle or when the technology/product becomes standardised, the production base tends to shift to the developing countries.

Nature of Product: Nature of the product, like perishability, weight-losing or weight-adding characteristic during production process etc. also influence the location decision.

Government Policies and Regulations: Government regulations like foreign investment policy, environmental regulations, local content stipulations, labour laws, taxation, assistances and incentives, dividend policies etc. influence the location.

Social and Political Factors: Social and political factors such as attitude towards foreign business, domestic harmony and peace etc. also influence the location decision. Production management, better the broader operations management strategy, determines the policy of own operations versus outsourcing, where and how the operations are carried out, level of operations, deployment of operations facilities etc.

Make or Buy

As indicated above, one of the strategic decisions in operations management is make or buy. There are a number of factors which influence this decision, which are referred to in several places in this chapter. Table 18.1 gives a summary view of the advantages and disadvantages of both the make and buy options.

The make or buy decision is influenced by a number of factors. The organisational technological environment may affect the buying decision. Some of the firms which outsource components, design or redesign the component parts in-house and select suppliers who can offer the best combination of quality, price, service and delivery. In other words, in such cases, called *make to print*, the buying company provides the *product technology* to the supplier who has the required *process technology*. Some firms want the product technology also to be developed by the supplier. In some cases, both the supplier and buyer work in collaboration to develop proper solution to the problem. In short, a buying

decision may be influenced by the technological environment in the buying organisation and technological capabilities and manufacturing skills of the supplier.

Table 18.1

Advantages and Disadvantages of Make and Buy

	Make	Buy
Advantages	Control over cost	Wide choice
	Control over supply	Release of capital, managerial and other resources
	Control over quality	Benefit of concentration on core activities
	Control over technology	Flexibility and scope of switching suppliers
	R&D initiatives	Scope for bargaining and gaining price advantage
		Benefits of technological and product developments outside the firm
		Lower labour force and less industrial relations problems
		Lower impact of recession
		Ease of exit
Disadvantages	Higher investment	Bargaining power of suppliers
	Many a time, high cost	Uncertainty of supply
	Out-suppliers may be more innovative and efficient	Control over cost and quality sometimes difficult
	Dissipation of managerial expertise and other resources	Labour or other problems of the suppliers may affect the buyer
	Problems associated with large labour force	If the vendor base is not well developed, it may cause several problems
	Greater impact of recession	
	Difficulty of exit	

MARKETING MANAGEMENT STRATEGIES

As any commercial enterprise is essentially market-oriented, marketing strategy has a pivotal role in the corporate strategy.

The marketing strategy, however, is constrained by or influenced by the SBU strategy which, in turn, is formulated within the broad framework of corporate mission, objectives and strategy. Table 4.3 (Chapter 4) highlights the important characteristics of Corporate, SBU and Marketing strategies.

The crux of the marketing strategy is the marketing mix strategy, i.e., the strategic decisions in respect of product, price, promotion and place. It also encompasses decisions such as the market coverage strategy.

The important steps involved in the Strategic Marketing Management are outlined below and schematically presented in Figure 18.1.

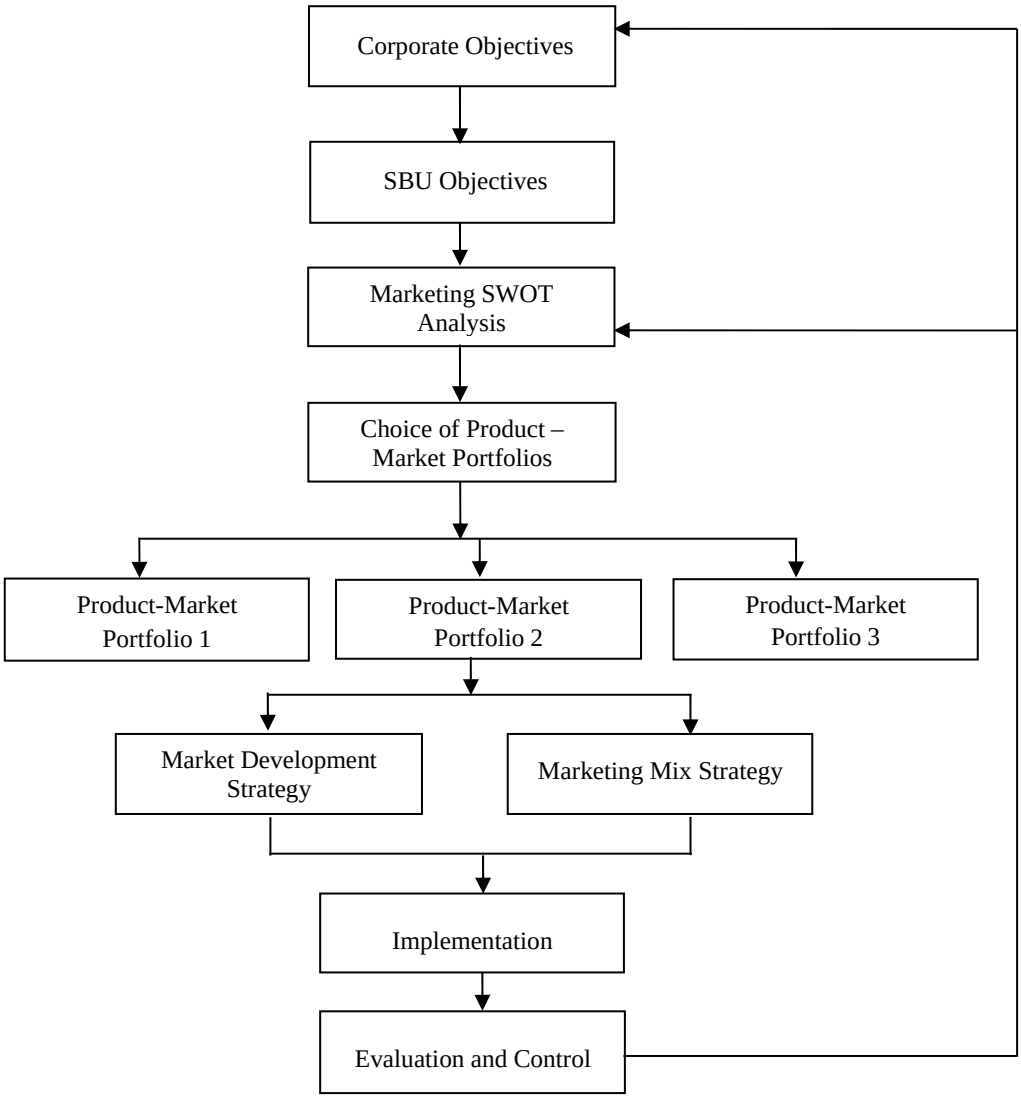

Fig. 18.1: Strategic Marketing Management Process

Marketing SWOT Analysis and Choice of Product-Market Set

Within the broad definition/scope of the business of the SBU, a SWOT analysis with a marketing perspective is to be done to determine the product-market portfolio of the SBU. Such a SWOT analysis will help determine whether the SBU should continue with all its existing product – market portfolios or to drop any of it, and whether it should add any new product – market portfolio. Business

portfolio analysis (described chapter on *Portfolio Strategy*) will be helpful in deciding the policy towards the current portfolio.

Market Development and Marketing Mix Strategies

The next step is the formulation of market development strategy and marketing mix strategy for each of the chosen product-market set.

Market development strategy is the strategy to develop existing and new markets for the product. Obviously, both market development strategy and marketing mix strategy go hand in hand; they cannot be considered in isolation.

Implementation and Evaluation and Control

The next steps in the process are implementation and evaluation and control. The important aspects of implementation and evaluation have been described in earlier chapters of this book.

Table 18.2

Characteristics of Corporate, Business and Marketing Strategies

Factors	Corporate Strategy	Business Strategy	Marketing Strategy
Scope	Entire organisation	SBU or single business company	Product-market definition
Objectives	Overall corporate objectives aggregated across business	Derived from corporate objectives, aggregated across product market configuration in business unit	Derived from corporate and SBU objectives – objectives for each product-market set
Responsibility	Top level corporate managers	Top level SBU managers or top level single business company managers	Marketing managers
Time horizon	Long-term	Medium- to long-term	Short- to long-term
Specificity	General statements of overall direction and intent	Concrete and operation-oriented	Action- and implementation-oriented
Resource allocation	Allocation among corporate portfolios and across functions shared by SBUs	Allocation among product-market sets and across functional departments in the SBU	Allocation among marketing mix elements for specific product-market set
Sources of competitive advantage	Superior corporate resources (finance, human resources, R&D, brand equity, core competencies etc.)	Superior SBU resources (in relation to competitors) and corporate strengths	Marketing mix, brand equity and product positioning
Sources of Synergy	Shared resources and functional competencies across businesses within the firm	Shared resources or functional competencies across product market sets within an industry	Shared marketing resources, competencies or activities across product-market sets

The strategy often employed in respect of weak cash cows (i.e., those that do not have long-term prospects) is to *harvest*, i.e., to increase the short-term cash flow regardless of the long-term effects. In

case of strong cash cows (i.e., those with long-term prospects), some reinvestment may be required to keep them in good stead for harvesting for long.

There are a number of strategies for growth, which also form part of the marketing management strategy. They have been described in Chapter 12.

HRM STRATEGIES

The human resource management (HRM) involves ascertaining the corporate strategy of the company and assessing the corresponding human resource needs; determining the recruitment, staffing and organisational strategy; recruiting, inducting, training and developing and motivating the personnel; putting in place the performance appraisal and compensation plans and industrial relations strategy and the effective management of all these. "The strategic role of HRM is complex enough in a purely domestic firm, but it is more complex in an international business, where staffing, management development, performance evaluation, and compensation activities are complicated by profound differences between countries in labour markets, culture, legal systems, economic systems, and the like."[3]

It is not enough that the people recruited fit the skill requirement, but it is equally important that they fit in to the organisational culture and the demand of the diverse environments in which the organisation functions.

The strategic HRM components and requirements will depend on, *inter-alia*, the organisational modes.

Factors Affecting HRM

The following are some of the important factors which affect HRM.

Labour Market Characteristic: The skill levels, the demand and supply conditions and the behaviour characteristics of labour vary widely between and within countries. While some countries/regions experience human resource shortage in certain sectors, many countries/regions have abundance.

In the past, developing countries were regarded, generally, as pools of unskilled labour. Today, however, many developing countries have abundance of skilled and scientific manpower as well as unskilled and semi-skilled labour. This changing trend is causing significant shift of location of business activities. Hard disk drive manufacturers are reported to be shifting their production base from Singapore to cheaper locations like Malaysia, Thailand and China. While in the past unskilled and semi-skilled labour-intensive activities tended to be located in the developing countries, today sophisticated activities also find favour with developing countries. The changing quality attributes of human resources in the developing countries and wage differentials are causing a locational shift in business activities, resulting in new trends in the global supply chain management. India is reported to be emerging as a global R&D hub. India and several other developing countries are large sources of IT personnel. In short, the labour changing labour market characteristics have been causing global restructuring of business processes and industries. And this causes a great challenge for strategic HRM.

Cultural Factors: Cultural differences cause a great challenge to HRM. The behavioural attitude of workers, the social environment, values, beliefs, outlooks etc. are important factors which affect

industrial relations, loyalty, productivity etc. There are also significant differences in aspects related to labour mobility. Cultural factors are very relevant in interpersonal behaviour also. In some countries, it is common to address the boss Mr. so and so but in countries like India addressing the boss by name would not be welcome. In countries like India, people attach great value to designations and hierarchical levels. This makes delayering and organisational restructuring difficult.

Regulatory Environment: A firm operating in different countries is confronted with different environments with respect to government policies and regulations regarding labour.

Attitude towards Employment: The attitude of employers and employees towards employment of people show great variations among different nations. In some countries, *hire and fire* is the common thing whereas in a number of countries the ideal norm has been lifetime employment. In countries like India, workers generally felt that while they have the right to change organisations as they preferred, they had a right to lifetime employment in the organisation they were employed with. In such situations, it is very difficult to get rid of inefficient or surplus manpower. The situation, however, is changing in many countries, including India.

Conditions of Employment: Besides the tenancy of employment, there are several conditions of employment the differences of which cause significant challenge to international HRM. The system of rewards, promotion, incentives and motivation, system of labour welfare and social security etc. vary significantly between countries.

Staffing Policy: With reference to the choice of the nationality of the people recruited for key management positions, there are three types of staffing policies in international business, viz., the ethnocentric approach, the polycentric approach and the geocentric approach.

Ethnocentric Approach: Under the ethnocentric staffing policy, all key management positions in the company are filled by parent (home) country nationals. This approach is regarded appropriate where the organisational mode of the company is *international.*

This practice was very widespread among American and European corporations (such as Procter & Gamble and Philips) at one time. In many Japanese and South Korean firms today, such as Toyota, Matsushita, and Samsung, key positions in international operations are still often held by home-country nationals.[4] According to the Japanese Overseas Enterprise Association in 1996, only 29 per cent of foreign subsidiaries of Japanese companies had presidents who were not Japanese. In contrast, 66 per cent of the Japanese subsidiaries of foreign companies had Japanese presidents.[5]

Polycentric Approach: A company with a polycentric staffing policy recruits host country nationals to manage subsidiaries while the key positions at the corporate headquarters are occupied by parent country nationals. This approach is regarded appropriate for *multinational* corporations.

Geocentric Approach: Geocentric staffing policy connotes seeking the best people from anywhere in the world for managing the organisation. This strategy is regarded appropriate for *global* and *transnational* corporations.

Table 18.3

Salient Features of Ethnocentric, Polycentric and Geocentric Approaches

Policy	Key Positions Occupied by	Organisational Mode for Which the Policy is Appropriate	Merits	Demerits
Ethnocentric	Parent-country nationals	International	1. Appropriate when competent people are not available in the host country 2. Helps maintain unified corporate culture throughout the organisation. 3. Preferred where internalisation of exclusive resources or close control over core competencies required.	1. Ignores local capabilities. 2. Limits career advancement opportunities for nationals and this may affect the morale and motivation. 3. A company manned completely by parent-country nationals may be looked at as an alien by nationals. 4. May lead to cultural myopia. 5. HRM cost tends to be high.
Polycentric	Host-country nationals	Multinational	1. As the local people know the local conditions better, they could manage better. 2. The growth opportunities for the nationals contributes to morale, motivation and committed work. 3. Helps reduce HRM cost. 4. Helps to get local support for the company. 5. Alleviates cultural myopia.	1. Lack of availability of nationals with skill and communication capabilities could be a problem in some cases. 2. Cultural integration may be challenging. 3. Limited career advancement opportunities for nationals when compared to the geocentric policy. 4. Informal controls and relationships and emotional bondages sometimes are not effective as in the ethnocentric cases.
Geocentric	People recruited globally	Global/ Transnational	1. Globally best talents. 2. Global mind-set of managers. 3. Advantages of multi-cultural background, wider vision and perspective.	1. Problems of cultural integration. 2. HRM cost tends to be high.

			4. Career opportunities. 5. Helps easy to transfer competencies across the organisation..	

The important features of the three approaches are presented in Table 18.3.

Staffing Policy Determinants

As Taggart and M.C. McDermott point out,[6] the important factors influencing the staffing policy are the following:

1. The Cultural Dimension: It should be pointed out that given the need to coordinate activities world-wide, and therefore the necessary ability of foreign subsidiary top executives to communicate directly with corporate headquarters, MNCs from some countries (e.g., Japan, South Korea, Taiwan) may need to depend more heavily upon home-country nationals because relatively few foreigners are fluent in the mother tongue of the home country. In contrast, language is less likely to prove a major restricting influence on the staffing policies of MNCs where English is the mother tongue. Japanese MNCs have been accused of adopting very ethnocentric staffing policies, and limiting job opportunities for non-Japanese nationals.[7]

2. Subsidiary Characteristics: When the MNC establishes a new subsidiary or plant, it is likely to ensure that someone already very familiar with corporate culture heads the operation. Thus, initially the staffing policy is likely to be ethnocentric but become less so as host-country nationals are 'socialized' into corporate culture.[8]

3. Parent Company Characteristics: As indicated under the sub-section Staffing Policy, the strategic predisposition of the MNC, in terms of its EPRG (ethnocentric, the polycentric, regiocentric, geocentric) profile, will influence staffing policy.

4. Host Country Characteristics: Host country characteristics like the social environment, government policies, host country human resource characteristics, government policies etc., also may influence the staffing policy.

5. Costs: The cost is also an important consideration in formulating the staffing policy when there are significant variations between nations the salary revels.

FINANCIAL MANAGEMENT STRATEGIES

The corporate and business level strategies, often, have very important and far-reaching financial implications. The financial strategy examines such implications of the corporate and business level strategic options and identifies the best financial course of action.

The objective financial strategy is to provide the firm competitive advantage through a lower cost of funds and a flexible ability to raise capital to support a business strategy and to maximise the financial value of the firm.

The financial strategy encompasses such areas as capital structure, sources and cost of funds, fund flow and cash flow management etc.

Financing strategy can even affect business strategy. For example, overemphasis on internal financing can affect growth strategy. Family controlled businesses may try to avoid all external sources of funds in order to avoid outside entanglements and to keep control of the company within the family.

Financing through long-term debt can help a corporation to use financial leverage to boost earnings per share, thus raising stock price and the overall value of the company. Higher debt levels may not only deter takeover by other firms (by making the company less attractive), but also may lead to improved productivity and improved cash flows by forcing management to focus on core businesses. It should also be noted that high debt burden is a common reason for the ills of a company. Leveraged buyouts have landed many companies in deep trouble.

The major decisions pertaining to financial strategy include the following:

Capital Structure

The capital structure policy is concerned with the optimum debt-equity ratio, i.e., the optimum mix of equity capital and debt capital. This decision is influenced by factors such as the interest payment burden, risk of excessive borrowing and the company's objective of maximisation of owners' wealth. The factors like the overall weighted cost of capital, the debt capacity of the firm in terms of adequacy of cash flows to meet the fixed interest rate burden and principal amount, and the need for flexibility in the capital structure are also required in deciding the capital structure.

Sources of Finance

Very closely related to the capital structure decisions is the sources of finance. Broadly, there are two sources of funds, viz., external sources and internal sources. The external sources include equity capital, preference capital, debenture capital, public deposits, and loans from development banks and commercial banks.

The internal sources of finance include reserves of the company for long-term purposes and bank balances and cash on hand with the company for short-term purposes.

Sometimes, inter-corporate investments also play an important role.

Dividend Policy

The management of dividends to shareholders is an important part of a company's financial strategy. Companies in fast growing industries such as computers and computer software often do not declare dividends in the initial stages. They use a major part of the profits to finance rapid growth. If the company is successful, its growth in sales and profits is reflected in a higher stock price—eventually resulting in a hefty capital gain when shareholders sell their common stock.

The dividend policy is influenced by factors such as the shareholders' preference to current dividend income against capital gains, the reinvestment opportunities and financial needs of the company, need for stability of dividend distribution, advantages and disadvantages of cash dividend and stock dividend, financing policies etc.

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CHAPTER

19 Knowledge Management

Knowledge is one of the cutting edges of competitiveness for an organisation, particularly in the knowledge economy. Indeed, "in today's economy, knowledge is people, money, leverage, learning, flexibility, power, and competitive advantage….Knowledge is the basis for, and the driver of, our post-industrial economy. Knowledge is the result of learning which provides the only sustainable competitive advantage".[1] It is, therefore, no wonder that Knowledge Management is considered by many organisations as an essential input for strategic management.

The above statements imply that an organisation shall have an efficient system for generation/acquisition of knowledge, systematic processing and storing, and making it available as and when required. Many firms strive to expand the frontiers of knowledge by generating new knowledge through research and practical experiences and experiments so as to improve their competitiveness and expand the business horizon. In other words, there shall be efficient knowledge management. Knowledge management requires qualified and committed human resource, adequate facilities and systems, and above all, a knowledge management strategy.

Box 19.1

Knowledge Society and Knowledge Workers

Peter Drucker, who coined the term Knowledge society in his book The Age of Discontinuity: Guidelines to Our Changing Society (1969), has made the following observations in an article "The Next Society" published in 2001 in *The Economist.*

The present society is a knowledge society and it is quite different from the society of the late 20th century. Knowledge is its key resource, and knowledge workers are the dominant group in its workforce. Its three main characteristics are:

- Borderlessness, because knowledge travels even more effortlessly than money.
- Upward mobility, available to everyone through easily acquired formal education.
- The potential for failure as well as success. Anyone can acquire the "means of production", i.e. the knowledge required for the job, but not everyone can win.

Together, these three characteristics make the knowledge society a highly competitive one, for organisations and individuals alike. Information technology, although only one of many new features of the next society, is already having one hugely important effect: it is allowing knowledge to spread near-instantly, and making it accessible to everyone. Given the ease and speed at which

information travels, every institution in the knowledge society—not only businesses, but also schools, universities, hospitals and increasingly government agencies too—has to be globally competitive, even though most organisations will continue to be local in their activities and in their markets. This is because the Internet will keep customers everywhere informed on what is available anywhere in the world, and at what price.

Knowledge technologists are likely to become the dominant social—and perhaps also political—force over the next decades.

This new knowledge economy relies heavily on knowledge workers. At present, this term is widely used to describe people with considerable theoretical knowledge and learning: doctors, lawyers, teachers, accountants and chemical engineers. But the most striking growth will be in "knowledge technologists": computer technicians, software designers, analysts in clinical labs, manufacturing technologists paralegals. These people are as much manual workers as they are knowledge workers; in fact, they usually spend far more time working with their hands than with their brains. But their manual work is based on a substantial amount of theoretical knowledge which can be acquired only through formal education, not through an apprenticeship…..

They are not, as a rule, much better paid than traditional skilled workers, but they see themselves as "professionals". Just as unskilled manual workers in manufacturing were the dominant social and political force in the 20th century, knowledge technologists are likely to become the dominant social—and perhaps also political—force over the next decades.

MEANING, NATURE AND CHARACTERISTICS OF KNOWLEDGE

Before we go into the details of knowledge management, let us have a look at the meaning, nature and characteristics of knowledge.

According to Webster's dictionary, knowledge applies to facts or ideas acquired by study, investigation, observation, or experience. This implies that knowledge extends beyond information. It has some thing to do with facts and ideas that have been acquired mostly through experience and includes formal and informal learning.

Roget's Thesaurus provides a set of synonyms for knowledge: cognizance, cognition, cognoscente; acquaintance, experience, ken, privity, insight, familiarity, comprehension, apprehension, recognition, appreciation, judgment; intuition, conscience, consciousness, perception and precognition. The inclusion of all these words depict knowledge in a more complete manner than the definition given above.

According to a holistic view, knowledge is present in ideas, judgments, talents, root causes, relationships, perspectives and concepts. Knowledge is stored in the individual brain or encoded in organisational processes, documents, products, services, facilities and systems… Knowledge is action, focused innovation, pooled expertise, special relationships and alliances. Knowledge is value-added behaviour and activities. For knowledge to be of value it must be focused, current, tested and shared.[2]

According to Karl M. Wiig, knowledge – the insights, understandings, and practical know-how that we all possess – is the fundamental resource that allows us to function intelligently. Over time, considerable knowledge is also transformed to other manifestations – such as books, technology, practices, and traditions – within organisations of all kinds and in society in general. These transformations result in cumulated expertise and, when used appropriately, increased effectiveness.

Knowledge is one, if not the principal, factor that makes personal, organisational, and societal intelligent behaviour possible.[3]

Wiig observes that, given the importance of knowledge in virtually all areas of daily and commercial life, two knowledge-related aspects are vital for viability and success at any level:[4]

1. Knowledge assets – to be applied or exploited – must be nurtured, preserved, and used to the largest extent possible by both individuals and organisations.
2. Knowledge-related processes – to create, build, compile, organise, transform, transfer, pool, apply, and safeguard knowledge – must be carefully and explicitly managed in all affected areas.

Davenport and Prusak's definition of knowledge, which best captures both its valuable and almost impossible-to-manage characteristics, provides a very comprehensive description of knowledge: "Knowledge is a fluid mix of framed experience, values, contextual information, expert insight and grounded intuition that provides an environment and framework for evaluating and incorporating new experiences and information. It originates and is applied in the minds of knowers. In organizations, it often becomes embedded not only in documents or repositories but also in organisational routines, processes, practices and norms."

Arthur J. Murray defines corporate knowledge as the collective body of experience and understanding of an organisation's processes for managing both planned and unplanned situations; and, corporate knowledge management as the process whereby knowledge seekers are linked with knowledge sources, and knowledge is transferred.[5]

Data, Information and Knowledge

Many people use the terms *data*, *information* and *knowledge* as synonims. They, however, mean different things.

Knowledge comprises of data and information sensibly presented.

Information is meaningfully put together data. Isolated data which do not provide a meaningful sense cannot be regarded as information. Knowledge is useful or actionable information.

The qualification *actionable* connotes that the information should lend itself for useful application for specific purpose This implies that the required information should be available to the user at the right time, context and place. Knowledge is deeper, richer, more expansive, more sensible, more informative and therefore more useful than information.

According to *Darwin Magazine* (July 2001), "knowledge is the **right information** put into use in the **right way** at the **right time**, whereas information is merely the amalgamation of various data sets within a specific context."

Box 19.2

Comparing Information and Knowledge

Information	**Knowledge**
Processed data	Actionable information
Simply gives us the facts	Allows making predictions, casual associations, or predictive decisions
Clear, crisp, structured and simplistic	Muddy, fuzy, partly unstructured
Easily expressed in written form	Intuitive, hard to communicate, and difficult to express in words and illustrations
Obtained by condensing, correcting, contextualing, and calculating data	Lies in connections, conversations between people, experience based
	Intuition, and people's ability to compare situations, problems, and solutions
Devoid of owner dependencies	Depends on the owner
Handled well by information systems	Also needs informal channels
Key resource in making sense of large volumes of data	Key resource in intelligent decision making, forecasting, design, planning, diagnosis, and intuitively judging
Evolves from data; formalised in databases, books, manuals and documents	Formed in and shared among collective minds; evolves with experience, successes, failures, and learning over time
Formalised, captured, and explicated; can easily be packaged into a reusable form	Often emerges in minds of people through their experiences

Source: Amrit Tiwana, *The Knowledge Management Toolkit*, 2005, Pearson Education, p.66

Dimensions of Knowledge

A common framework for categorising the dimensions of knowledge discriminates between ***embedded knowledge*** as knowledge which has been incorporated into an artifact of some type (for example an information system may have knowledge embedded into its design); and ***embodied knowledge*** as representing knowledge as a learned capability of the body's nervous, chemical, and sensory systems. These two dimensions, while frequently used, are not universally accepted.

It is also common to distinguish between the creation of "new knowledge" (i.e., innovation) versus the transfer of "established knowledge" within a group, organisation, or community. Collaborative environments such as communities of practice or the use of social computing tools can be used for both creation and transfer.

Michael Polayni's distinction between tacit and explicit knowledge, reformulated by Nonaka, is useful to understand some important aspects of the process of knowledge generation and management. ***Tacit knowledge*** is personal, context- specific and is stored in the heads of people. It is knowledge that is difficult to formalise, record, or articulate; it is stored in the heads of people. Tacit knowledge consists of various components, such as intuition, experience, ground truth, judgment, values,

assumptions, beliefs, and intelligence. ***Tacit knowledge*** is subjective and experimental and is difficult to formalise, record, or articulate.

Belief, perspective, mental models, ideas and ideals are examples of tacit knowledge.

Explicit knowledge is objective, rational knowledge that can be expressed, modified and transmitted in a systematic and formal language, documents, databases, webs, e-mails, charts, etc.

Nonaka and Takeuchi argued that a successful knowledge management (KM) programme needs, on the one hand, to convert internalised tacit knowledge into explicit codified knowledge in order to share it, but, on the other hand, it also must permit individuals and groups to internalise and make personally meaningful codified knowledge they have retrieved from the KM system.

KNOWLEDGE MANAGEMENT

Retrospect

Knowledge management is ageless – it has been in existence in one form or other since time immemorial, although it is only in the modern times it became systemic. It gained profound importance in the recent decades.

Although Knowledge Management as a discipline is relatively young, KM has always existed in one form or another, like workshops, discussion forums, peer discussions, formal training, libraries, data records, professional mentoring programmes etc. However, with recent developments in the field of information and communication technologies, specific adaptations of technology such as knowledge bases, expert systems, and knowledge repositories have been introduced to further enhance the process.

The great Management guru Peter Drucker was one of the first to emphasise the far-reaching importance of knowledge as an organisational resource. As early as 1966, Drucker predicted that the major changes in society would be brought about by information and argued that knowledge has become the central, key resource that knows no geography. According to him, the largest working group would be what he termed "*knowledge workers*."

In 1993, Drucker published a short book entitled Post-c*apitalist Society*. Despite the fact that the internet was still in its pre-browser infancy, he identified that developed-world economies were entering a new *knowledge-based era* – as opposed to the preceding industrial-based era, which represented just as big a leap from the agrarian-based one it had superseded.

The concept of the 'learning organisation' introduced by Peter Senge in the book *The Fifth Discipline: The Art and Practice of the Learning Organisation* (1990) became immensely popular and, in 1997, *Harvard Business Review* identified it as one of the seminal management books of the past 75 years. Senge's vision of a learning organisation as a group of people who are continually enhancing their capabilities to create what they want to create has been deeply influential. Peter Senge has also co-authored several other books linked to the themes first developed in *The Fifth Discipline*. These include: *The Fifth Discipline Fieldbook: Strategies and Tools for Building a Learning Organisation* (1994)*; The Dance of Change: The Challenges to Sustaining Momentum in Learning Organisations* (1999) and *Schools that Learn* (2000). Leonard-Barton's well-known case study of the *Chaparral Steel*, a company having effective knowledge management strategy in place since the mid- 1970s was another development that highlighted the significance of KM. It was pointed out that every worker in

Chaparral Steel was considered a knowledge worker and there was no division of knowledge labour designating some people as thinkers and relegating others to doers. Ideas come from everybody in the organisation.

Another very popular work was *The Knowledge-Creating Company: How Japanese Companies Create the Dynamics of Innovation* (1995) by Ikujiro Nonaka and Hirotaka Takeuchi who sought to address the question why the Japanese were so successful in business. The authors argued that Japanese firms were successful because they were innovative – that is, because they created new knowledge and used it to produce successful products and technology. Japan's enduring competitive advantage is its talent for innovation: its willingness to break with the past, dissolve fond attachments and invent the next great thing.

KM emerged as an established discipline in the 1990s with a body of university courses and both professional and academic journals dedicated to it. The International Knowledge Management Network (IKMN) went online in 1994.

Now, the National Knowledge Network (NKN) of the Government of India which is a high-speed multi-gigagibit network is not only connecting educational and research institutes in the country, but is getting connected to global research networks to enable real-time collaboration and research. The NKN is allowing students and researchers to move towards a new paradigm of education and research based on a virtual platform that breaks silos of geography and boundaries.

Knowledge management has become big business for such major international consulting firms as Ernst & Young, Arthur Andersen, and Booz-Allen & Hamilton.

Many large companies have resources dedicated to Knowledge Management.

Box 19.3

Knowledge Creation: The Key to Sustaining Competitive Advantage

Ikujiro Nonaka and Hirotaka Takeuchi in their well-known book ***The Knowledge-creating Company: How Japanese Companies Create the Dynamics of Innovation*** point out that the American and Japanese executives tend to hold fundamentally different attitudes about information and knowledge.

Americans tend to put their faith in "explicit knowledge," or knowledge that is formal, unambiguous, systematic, falsifiable and scientific. The Japanese are more inclined to value "tacit knowledge," or knowledge that is intuitive, bodily, interpretive, ambiguous, non-linear and difficult to reduce to a scientific equation.

The authors also highlight the deficiencies of benchmarking, a widespread American practice. In benchmarking, companies keep a scorecard on their competitors' business practices to stay a step or two ahead of them. The Japanese think that this leads to incremental improvement, not to true creativity or knowledge creation. In a Japanese company, knowledge is thought to be internally generated from basic principles laid out by top management, then improved on by brainstorming from within the ranks and finally some amount of feedback from external sources. Knowledge acquired by individuals becomes "organisational knowledge" shared among colleagues.

According to Nonaka and Takeuchi, Japan's enduring competitive advantage is its talent for innovation: its willingness to break with the past, dissolve fond attachments and invent the next great thing. Knowledge will become the key to sustaining a competitive advantage in the future.

Because the competitive environment and customer preferences changes constantly, knowledge perishes quickly. It is, therefore, necessary to commit to create knowledge continuously, and to use it to make

successful new products, services, and systems. In this knowledge-intensive environment, knowledge begets knowledge, new competencies develop, and the result is innovation.

The claim enduring competitive advantage of Japanese companies would perhaps have been convincing in the past when Japanese companies tend to excel globally. However, today, several of them present a different picture, raising doubts as to whether the observations of Nonaka and Takeuchi enduring. Or is it that now companies in other countries (South Korea, for example) more ardently follow the path shown by the Japanese?

Meaning of KM

As indicated earlier, the term knowledge management is very comprehensive and encompasses different components from identification of knowledge to making available the right knowledge at right time to the right users. However, KM as a discipline is of recent origin, with new concepts emerging constantly. Often, it is portrayed simplistically; discussions typically revolve around blanket principles that are intended to work across the organisation.

Knowledge management may be defined as the system that identifies the knowledge requirements and their sources; generates the required information; processes, analyses and suitably presents the information; stores and makes available the knowledge to the right people at right time in the right format.

Knowledge management is the name of a concept in which an enterprise consciously and comprehensively gathers, organises, shares, and analyses its knowledge in terms of resources, documents, and people skills. In early 1998, it was believed that few enterprises actually had a comprehensive knowledge management practice (by any name) in operation. Advances in technology and the way we access and share information have changed that; many enterprises now have some kind of knowledge management framework in place.[6]

As *Wikipedia* observes, Knowledge Management programmes are typically tied to organisational objectives such as improved performance, competitive advantage, innovation, developmental processes, lessons learnt transfer (for example, between projects) and the general development of collaborative practices. KM is frequently linked and related to what has come to be known as the learning organisation, life-long learning and continuous improvement. KM may be distinguished from Organisational Learning by a greater focus on the management of knowledge as an asset and the development and cultivation of the channels through which knowledge, information and signal flow.

KM comprises a range of practices used by organisations to identify, create, represent, and distribute knowledge. It has been an established discipline since 1995 with a body of university courses and both professional and academic journals dedicated to it.

There is a broad range of thought on KM with no unanimous definition. The approaches vary by author and school. KM may be viewed from each of the following perspectives:

Techno-centric: A focus on technology, ideally those that enhance knowledge sharing/growth.

Organisational: How does the organisation need to be designed to facilitate knowledge processes? Which organisations work best with what processes?

Ecological: Seeing the interaction of people, identity, knowledge and environmental factors as a complex adaptive system.

KNOWLEDGE MANAGEMENT FRAMEWORK

The definitions of Knowledge Management given above indicate the components/stages/process of KM.

Knowledge is supported by both formal and informal processes and structures for its acquisition, sharing, and utilisation. Knowledge workers or employees broadly communicate and assimilate values, norms, procedures, and data, beginning with early socialisation.

In an *Information Week* article, Jeff Angus and Jeetu Patel describe a four-process view of knowledge management as depicted in the following table.

Table 19.1

Four-process View of Knowledge Management

Processes	Activities Involved
Gathering	• Data entry • OCR and scanning • Voice input • Pulling information from various sources • Searching for information to include
Organising	• Cataloging • Indexing • Filtering • Linking
Refining	• Contextualising • Collaborating • Compacting • Projecting • Mining
Disseminating	• Flow • Sharing • Alert • Push

IMPORTANCE OF KNOWLEDGE MANAGEMENT

Knowledge is the most dynamic force driving the development of any society. The world, in fact, is experiencing an information/knowledge revolution.

The importance of knowledge to today's world is highlighted by such usages as knowledge society, knowledge worker, learning organisation, knowledge explosion etc.

Knowledge is a core competence that can provide competitive edge to individuals, organisations and nations. Knowledge generation, managing knowledge and imparting and disseminating knowledge are, therefore, of critical importance.

Knowledge is the key resource in intelligent decision-making, forecasting, design, planning, diagnosis, analysis, evaluation, and intuitive judgment. It is formed in and shared between individual and collective minds. It does not grow out of database but evolves with experience, successes, failures, and learning over time.

Knowledge allows for making predictions, casual associations, or predictive decisions about what to do – unlike information, which simply gives us the facts.

In short, knowledge allows the creation of capability which determines the ability to do things.

STEPS IN KNOWLEDGE MANAGEMENT PROCESS

The knowledge management system of an organisation typically has the following components/stages/processes.

Identification of knowledge needs: The important first step in knowledge management is the identification of the knowledge requirements of the organisation. The knowledge requirements may vary from organisation to organisation, depending on factors like the nature and scope of its business, competitive and other businesss environments, future plans etc.

Identification of data sources: Once the data needs are identified, the next step is identification of sources of data for generating the required knowledge. Data/knowledge may be readily available somewhere. If they are not readily available, primary data will have to be gathered and the sources of such primary data have to be identified.

Acquisition/generation of knowledge: The next stage is acquisition/generation of knowledge. It may include acquisition of books and other publications or other available materials, sourcing from internet etc. Collection of primary data or generation of entirely new knowledge may be done in-house or may be outsourced. Outsourcing even R&D is common today.

Processing, analysing, presenting and codifying: The data/information/knowledge acquired/generated need to be properly processed, analysed, interpreted and presented meaningfully and usefully. They should also be systematically classified for easy identification for accessing any time.

Storing: There must be a proper system for storing the knowledge so that they are available at the right time to the right people.

Policy and system: As indicated in the definition of knowledge management, knowledge management is a system. That is the organisation shall establish the appropriate system integrating the various components and suitable technologies and methods.

The organisation shall also have an appropriate policy regarding knowledge management, including a policy in respect of accessing information, sharing/disseminating knowledge, protecting its knowledge base etc.

KNOWLEDGE GENERATION

Knowledge generation is, in fact, a part of knowledge management, considered in a broad perspective.

Knowledge generation is a pre-requisite for widening and deepening the knowledge horizon. There cannot sustainable knowledge expansion without more or less constant generation of new knowledge.

Meaning of Knowledge Generation

Knowledge generation is the process of obtaining the required knowledge by an individual/organisation or community. Knowledge may be acquired/sourced externally or created internally. Knowledge generation process also encompasses establishing facilities/systems for accessing knowledge, like that for accessing internet, EBSCO etc.

Process of Knowledge Generation

According to Professor Ikujiro Nonaka, knowledge creation is a spiraling process of interactions between explicit and tacit knowledge. The interactions between the explicit and tacit knowledge lead to the creation of new knowledge.

As referred to earlier, Nonaka and Takeuchi developed the model of the various ways in which organisations create knowledge. Organisational knowledge creation is seen as a capability of the organisation. They postulate that the organisation creates new knowledge through interactions between tacit and explicit knowledge, and through the dynamic conversion of knowledge between these two dimensions. Through this 'social conversion' process, tacit and explicit knowledge expands in terms of both quality and quantity. Knowledge is transferred from individuals to the larger group in a spiraling process. This follows from the proposition that although tacit knowledge is initially locked up in the heads of the individuals, shared experiences allows individuals to project themselves into each other's thinking processes. This 'SECI' (socialisation, externalisation, combination, internalisation) perspective suggests that organisational knowledge creation takes place between three levels: individual, team and organisation. The spiral represents the dynamic process, starting at the individual level and expanding as it moves through communities of interaction that transcend sectional, departmental, divisional and even organisational boundaries.

Cook and Brown have presented a different model for organisational knowledge creation *albeit* based on a different view of the types of knowledge. They argue that tacit and explicit knowledge are two different forms of knowledge which complement each other but cannot convert into each other. They propose that individuals and groups can each possess explicit knowledge and tacit knowledge, giving four different categories of knowledge. However, all four knowledge types can be mutually

enabling in the pursuit of purposeful activity or 'active process of knowing'. New knowledge is generated as different knowledge types 'dance' together in course of doing something.

Continuing with different types of knowledge and ways of knowing, Spender has sketched a theory of the firm as a system processing different kinds of knowledge and generating common knowledge. He has suggested that knowledge, learning and memory form the interdependent parts of organisational systems which are influenced by particular types of knowledge. Firms comprise four distinct types of knowledge: conscious (explicit knowledge held by the individual), objectified (explicit knowledge held by the organisation), automatic (pre-conscious individual knowledge) and collective (highly context-dependent knowledge which is manifested in the practice of an organisation). Each implies different learning and memory processes. These different types of knowledge interact dialectically to form an organic system with knowledge both at the level of system and at the level of the individuals it embraces.

These perspectives all propose that organisations have different types of knowledge and that identifying and examining these will lead to more effective means of generating, sharing and managing knowledge in organisations. However, Tsouskas has characterised such perspectives as 'taxonomic' and argues that typologies of knowledge are marked by 'formistic' type of thinking as typologies are based on the assumption that observable systematic similarities and differences exist between objects of study. He has further explained that as tacit and explicit knowledge are mutually constituted – they should not be viewed as separate types of knowledge. Tacit knowledge is a necessary component of all knowledge.

Modes of Knowledge Generation

Knowledge generation may be autonomous or conscious and intentional.

A lot of knowledge emerges or gets generated autonomously, i.e., without deliberate effort such as out of experience, thinking process, intuition, unplanned listening, casual conversation etc.

The substantial part of the knowledge generated today, however, is the result of planned or conscious effort.

There are five important modes of strategic or intentional knowledge generation, viz., Acquisition, Dedicated Resources, Adaptation, Data Mining and Knowledge Networking.

TRENDS AND CHALLENGES IN KNOWLEDGE MANAGEMENT

The five modes of knowledge generation mentioned above also represent some dimensions of the trends in KM. They also indicate, implicitly, the challenges to knowledge management.

Acquisition

Acquisition means acquisition of organisations engaged in knowledge generation and management (this has become common in the business sector) and acquisition of knowledge from other organisations, individuals etc. (like purchase of know-how from research institutions and other organisations, including patented knowledge). The attractiveness of acquisition of other organisations is possession of the knowledge source and established system for knowledge generation and management. It frees the organisation from the need to establish such a system from scratch which, in many cases, is time-consuming and fraught with several difficulties.

Acquisition, however, may have problems/challenges. Proper valuation of the organisation is important. There could also be the risk of hidden costs. The organisational culture is also, sometimes, a problem. In short, while taking over an organisation, all its problems are also being taken over.

Dedicated Resources

Dedicated resource means investing resources and establishing systems for generating knowledge internally, like investing in and building up R&D facilities. Many business enterprises, research institutes and educational institutions of higher learning have such dedicated resources. Besides the physical infrastructure, the resources include, very importantly, the human resources.

Besides or instead of its own exclusive dedicated resources, an organisation may also dedicate resources for consortium generation of knowledge. Such alliance between organisations for R&D etc. both at national and international levels, is a growing trend.

Dedicated resources also include resource earmarking for specific, though not very elaborate, knowledge gathering. This includes field studies and explorations.

Quite a lot of important but widely scattered and unorganised/undocumented knowledge, like traditional knowledge in many areas, can also be gathered so.

Outsourcing

Outsourcing knowledge is becoming increasingly popular. This includes giving on contract or on some other arrangement research or other knowledge generation to other organisations (also to individuals). The main reasons for this are the expertise of the external source and cost advantages. Knowledge Processing Outsourcing (popularly known as KPO), typically involves a component of Business Processing Outsourcing (BPO), Research Process Outsourcing (RPO) and Analysis Process Outsourcing (APO). KPO business entities provide typical domain-based processes, advanced analytical skills and business expertise, rather than just process expertise.

Data Mining

The data mining technique can play an important role in knowledge generation and knowledge management in many complex data- knowledge environments.

Data mining is sorting through data to identify patterns and establish relationships. Data mining parameters include:[7]

- Association – looking for patterns where one event is connected to another event.
- Sequence or path analysis – looking for patterns where one event leads to another later event.
- Classification – looking for new patterns (may result in a change in the way the data is organised but that's ok).
- Clustering – finding and visually documenting groups of facts not previously known.
- Forecasting – discovering patterns in data that can lead to reasonable predictions about the future (This area of data mining is known as predictive analytics).

Data mining techniques are used in many research areas, including mathematics, cybernetics, and genetics. Web mining, a type of data mining used in customer relationship management (CRM), takes advantage of the huge amount of information gathered by a website to look for patterns in user behaviour. A data miner is a program that collects such information, often without the user's knowledge, as spyware.

Networking

Networking has become an important and common source of knowledge sharing and development. There are both formal and informal networkings. The advent of the internet has given a big boost to networking.

KM Technologies

The technological developments are fast changing the knowledge management scenario. The early K M technologies were expertise locators, like online organisational yellow pages, and document management systems. Combined with the early development of collaborative technologies (in particular Lotus Notes), KM technologies expanded in the mid- 1990s. Subsequently, it followed developments in technology in use in Information Management. In particular, the use of semantic technologies for search and retrieval and the development of KM specific tools such as those for communities of practice.

More recently social computing tools (such as blogs and wikis) have developed to provide a more unstructured, self-governing approach to the transfer, capture and creation of knowledge through the development of new forms of community, network or matrix. However, such tools for the most part are still based on text and code, and thus represent explicit knowledge transfer. These tools face challenges in distilling meaningful reusable knowledge and intelligible information and ensuring that their content is transmissible through diverse channels, platforms and forums.

Knowledge Mapping is commonly used to cover functions such as a knowledge audit (discovering what knowledge exists at the start of a knowledge management project), a network survey (mapping the relationships between communities involved in knowledge creation and sharing) and creating a map of the relationship of knowledge assets to core business process. Although frequently carried out at the start of a KM programme, it is not a necessary pre-condition or confined to start up.

Knowledge management involves *data mining* and some methods of operation to push information to users. Some vendors are offering products to help an enterprise inventory and access knowledge resources. IBM's Lotus Discovery Server and K-Station, for example, are products advertised as providing the ability to organise and locate relevant content and expertise required to address specific business tasks and projects. They are said to be able to analyse the relationships between content, people, topics, and activity, and produce a knowledge map report.

ROLE OF R&D/INNOVATION AND TECHNOLOGY IN STRATEGIC MANAGEMENT

Technology is one of the important determinants of success of a firm in a competitive environment. We shall, therefore, consider the relevant aspects of technology *vis-à-vis*-strategic management.

What is Technology?

According to the UNCTAD's Draft TOT Code, Technology should be described as "systematic knowledge for the manufacture of a product, for the application of a process or for the rendering of a service and does not extend transactions involving mere sale or lease of goods".

"Technology includes not only knowledge or methods that are necessary to carry on or to improve the existing production and distribution of goods and services, but also entrepreneurial expertise and professional know-how."[8] The latter two elements may often prove to be the essential competitive advantage possessed by the technology owner.[9] The MNCs are often in a particularly advantageous position in this regard.

The term technology encompasses both hard and soft technologies. "Technology includes the tools – both machines (hard technology) and ways of thinking (soft technology) – available to solve problems and promote progress between, among and between societies."[10]

IMPORTANCE OF INNOVATION/TECHNOLOGY TO FIRMS

The World Economic Forum brings out every year a *Global Competitiveness Report* (*GCR*) ranking countries globally on competitiveness. The *Global Competitiveness Report 2013-14* observes that in today's globalised world, technology is increasingly essential for firms to compete and prosper. According to this Report, there are 12 pillars of global competitiveness. One of these is the technological readiness of the country and another is innovation.

The swift and sweeping technological changes in the industry and the swings in the market shares of firms in several industries, like in the smartphone industry, are a clear examples of the role technology plays in determining the fortunes of companies. Many industries are characterised by incremental to revolutionary changes in technology. While revolutionary technological changes may substantially change the way a customer need is met, often making existing products obsolete and significantly changing the industry characteristics, incremental changes may get reflected in improving product features and performance or creation of new market segments. Technological advances have significantly enhanced the efficiency of inventory management and logistics, delivery mode/system, customer relationship management etc. These factors clearly indicate the role of R&D and innovation in Strategic Management.

Technological capabilities are an important determinant of the scope of the business of an enterprise. The technological strength and maneuverability of a company *vis-à-vis* the technological changes in the industry and related spheres may call for a restructuring of the scope of the business of a company (i.e., portfolio restructuring) whether the company should exit some of the existing businesses (or business segments or functions) or enter new businesses (or segments or functions).

For example, with the popular advent of cable TV and popularity of internet and smartphone, many newspaper publishing companies entered TV channels and the content of the newspapers are made available in the websites and can be accessed by smartphones. Several of them have multiple channels designed to meet different desires of the diverse set of customers.

It is very relevant here to recall the definition of the scope and mission of the business given by Derek F. Abell, mentioned in Chapter 2 of this book. According to this, technology is one of the three determinants of the scope and mission of the business. In his framework of the business model, Abell has suggested defining business along three dimensions, viz., customer groups (i.e., who is being satisfied) customer functions (i.e., what need of the customer is being satisfied) and alternative technologies (i.e., how the need is being satisfied). Such a three-dimensional definition of the business would clearly delineate the boundaries and nature of the business and gives a very critical message that the technological dimension is very relevant in determining the scope of the business. The

newspaper publishing companies have been serving knowledge gathering and entertainment needs of customers. These companies have taken advantage of the new technologies to serve these needs of the customers differently and better.

In other words, the technological readiness has enabled these firms to move new contours of business. Although the term technological readiness is used in the *GCR* in the national context, the readiness of firms too is equally important.

The technological readiness pillar in the *GCR* measures the agility with which an economy adopts existing technologies to enhance the productivity of its industries, with specific emphasis on its capacity to fully leverage information and communication technologies (ICTs) in daily activities and production processes for increased efficiency and enabling innovation for competitiveness.

As the *GCR 2013-14* observes, whether the technology used has or has not been developed within national borders is irrelevant for its ability to enhance productivity. The central point is that the firms operating in the country need to have access to advanced products and blueprints and the ability to absorb and use them. Among the main sources of foreign technology, FDI often plays a key role, especially for countries at a less advanced stage of technological development. It is important to note that, in this context, the level of technology available to firms in a country needs to be distinguished from the country's ability to conduct blue-sky research and develop new technologies for innovation that expand the frontiers of knowledge.[11] That is, outsourcing technology from outside the country too is an important strategy to improve its competitiveness or expand its business horizon.

Technology and Competitive Advantage

As Michael Porter points out in his well-known book *Competitive Advantage*, technological change is "one of the principal drivers of competition. It plays a major role in industry structural change as well as in creating new industries. It is also a great equalizer, eroding the competitive advantage of even well-entrenched firms and propelling others to the forefront. Many of today's great firms grew out of technological changes that they were able to exploit. Of all the things that can change the rules of competition, technological change is among the most prominent."[12]

Porter who observes that the relationship between technological change and competition is widely misunderstood, points out that "technological change is not important for its own sake, but is important if it affects competitive advantage and industry structure. Not all technological change is strategically beneficial; it may worsen a firm's competitive position and industry attractiveness. High technology does not guarantee profitability. Indeed, many high-technology industries are much less profitable than some "low-technology" industries due to their unfavourable structures."[13] It is very important to understand that technology "pervades a firm's value chain and extends beyond those technologies associated directly with the product. There is, in fact, no such thing as a low technology industry if one takes this broader view. Viewing any industry as technologically mature often leads to strategic disaster. Moreover, many important innovations for competitive advantage are mundane and involve no scientific breakthroughs. Innovation can have important strategic implications for low-tech as well as hi tech companies."[14]

As Porter points out, technology can alter the nature and basis of rivalry among existing competitors in several ways. Technology affects competitive advantage if it has a significant role in determining relative cost position or differentiation. It can also alter the bargaining power of the

suppliers and buyers. Technology, in several instances, is an entry barrier. Thus, technology can influence all the five competitive forces.

If the technology employed in a value activity becomes widespread, it would be an important determinant of overall industry structure. "Technological change that is diffused can potentially affect each of the five competitive forces, and improve or erode industry attractiveness. Thus, even if technology does not yield competitive advantage to any one firm, it may affect the profit potential of all firms. Conversely, technological change that improves a firm's competitive advantage may worsen structure as it is imitated. The potential effect of technological change on industry structure means that a firm cannot set technology strategy without considering the structural impacts."[15]

According to Porter, technological change by a firm will lead to sustainable competitive advantage under the following circumstances, which he calls the tests of a desirable technological change.[16]

- The technological change itself lowers cost or enhances differentiation and the firm's technological lead is sustainable.
- The technological change shifts costs or uniqueness drivers in favour of a firm.
- Pioneering the technological change translates into first mover advantages besides those inherent in the technology itself.
- The technological change improves overall industry structure.

Porter cautions that technological change will destroy competitive advantage if it not only fails the tests but has the opposite effect contemplated in the tests, such as skewing cost or uniqueness drivers in favour of competitors. A firm may also find itself in the situation where a technological change may meet one test but worsen a firm's position via another.

Technological Leadership and Followership

An important broad issue a firm must address in technology strategy is whether to seek technological leadership. According to the notion of technological leadership "a firm seeks to be the first to introduce technological changes that support its generic strategy. Leadership can be established in technologies employed in any value activity." Technological followership refers to a conscious and active strategy in which a firm explicitly chooses not to be first on innovations."[17]

The decision to become a technological leader or follower can be a way of achieving either low cost or differentiation. Porter points out that the choice of whether to be a technological leader or follower in an important technology is based on the following three factors:[18]

Sustainability of the Technological Lead, i.e., the degree to which it can sustain its lead over competitors in a technology.

First Mover Advantages, i.e., the advantages a firm reaps from being the first, such as reputation, preempting a positioning, switching costs, unique access for a new product, proprietory learning curve, favourable access to facilities, inputs or other scarce raw materials, definition of standards, institutional barriers against imitations; and early profits.

First Mover Disadvantages, i.e., the disadvantages a firm faces by being first rather than waiting for others, such as pioneering costs (like costs of gaining regulatory approvals, achieving code compliance, educating buyers, high costs of early inputs because of scarcity of supply or small-scale

needs), demand uncertainty, changes in buyer needs, specificity of investments to early generations or factor costs, technological discontinuities and low cost imitation.

Technological leadership can be sustained only if the competitors cannot duplicate the technology, or the firm innovates as fast or faster than competitors can catch up.

IT AND STRATEGIC MANAGEMENT

The computer, considered "the machine that changed the world," and the rapid changes in the related technologies have been making the business environment immensely dynamic.

The global competitiveness reports have been increasingly highlighting the role of information technology in determining competitiveness. Technology is one of the eight factors considered by the World Economic Forum to evaluate the global competitiveness of nations. One of the earlier Reports which observed that information technology has emerged as a new source of competitiveness, has pointed out that there are at least three aspects to it. First, e-mail has greatly expanded the possibilities for interpersonal, inter-firm, and international communication. Second, the Internet has allowed for much more extensive and rapid dissemination of information. Third, the emerging area of e-commerce offers a potentially huge increase in the customer base for companies and huge savings in marketing costs and search costs in finding low-cost suppliers. Competitiveness in all of these areas is closely linked with the competitiveness of the local telephone infrastructure and with the penetration of the computer culture in the local economy. The Report also observes that for a successful internet culture, the population needs to have computers, telephones need to work, and the country's telecommunications hardware needs to support high bandwidth for Internet traffic.[19]

The *GCR 2013-14* has emphasised on the capacity to fully leverage information and communication technologies (ICTs) in daily activities and production processes for increased efficiency and enabling innovation for competitiveness. ICTs have evolved into the "general purpose technology" of our time, given their critical spillovers to other economic sectors and their role as industry-wide enabling infrastructure. Therefore, ICT access and usage are key enablers of countries' overall technological readiness.

As Lucas observes,[20] IT:

- Provides new ways to design organisations that can lead to structure like the T-Form organisation.
- Creates new relationships between customers and suppliers who electronically link themselves together.
- Enables tremendous efficiencies in production and service industries through electronic data interchange to facilitate just-in-time production.
- Changes the basis of competition and industry structure, *for example*, in the airline and securities industries.
- Provides mechanisms through groupware for coordinating work creating a knowledge base of organisational intelligence.
- Contributes to the productivity and flexibility of knowledge workers.
- Provides the manager with electronic alternatives to face-to-face communications and supervision.

As Lucas points out, there are a number of recent trends that have drastically altered the way organisations use technology. These trends make it imperative that a manager becomes familiar with both the use of technology and how to control it in the organisation. He pinpoints the following five major trends.[21]

1. The use of technology to transform the organisation: The cumulative effect of what all the technology firms are installing is to transform the organisation and allow new types of organisational structures. This ability of information technology to transform organisations, to create the T-Form firm, is one of the most powerful tools available to a manager today.

2. The use of information processing technology as a part of corporate strategy: Firms that prosper in the coming years will be managed by individuals who are able to develop creative, strategic applications of the technology.

3. Technology as a pervasive part of the work environment: From the largest corporations to the smallest business, technology is used to reduce labour, improve quality, provide better customer service, or change the way the firm operates. Factories use technology to design parts and control production.

4. The use of personal computers as managerial workstations: The personal computer, when connected to a network within the organization and to external networks like the Internet, it provides a tremendous tool for knowledge workers.

5. The evolution of the computer from a computational device to a medium for communications: For many people, today, the communication aspects of computers are more important than their computational capabilities.

The Planning Commission of India observes in the *Approach to 12th Five Year Plan of India* that India is uniquely poised to reap the advantages provided by a nation of a billion connected people, with over 800 million mobile phones, and global leadership in Information and Communication Technology (ICT) and software. This connectivity as well as ICT talent is changing the nature of processes, business, industry, governance, education and delivery systems and our innovation thinking also has to leverage the unprecedented advantages provided by this changing landscape of connectivity and collaboration.

ICT and Marketing

As an illustrative case of impact of ICT on business, we take the field of Marketing Management. Indeed, every other functional area dimension of the business are similarly substantially impacted by ICT.

Advances in information and communications technology are revolutionalising the *modus operandi* of marketing and the business system. The business horizon is humming with buzzwords like *internet, world wide web (www), cyberspace, information superhighways* etc. which are changing the way of contacting customers; order receiving and processing; and networking and integrating business system. The revolutionary changes being ushered in by the internet are indeed exciting.

Technology experts are anticipating that the internet and the www would become the centre of commercial universe. Electronic markets will eliminate the need for intermediaries and that direct contact between manufacturer and customer will bring down the cost of transaction and the cost of the final product. The internet has the potential to evolve into an interconnected electronic marketplace

(cyberspace) bringing buyers and sellers together to facilitate commercial exchanges. The internet is fast becoming an important new channel for commerce in a range of business – much faster than anyone who would have predicted in the past. The opportunities presented by this new channel seem to be readily apparent; by allowing for direct ubiquitous links to anyone anywhere, the internet allows companies build interactive relationships with consumers and suppliers and deliver new products and services at low cost.[22]

Revolutionary changes in information technology have been sweeping across the global business. Developments in telecommunications and information technologies have reduced the barriers to time and place in doing business. It is now possible for customers and suppliers to transact business at any time any part of the globe, without having to come together physically, thanks to the developments in optical fiber technology, videophone and teleconferencing facilities. The net has changed face and pace of business-to-business marketing and retailing.

Effective use of information technology helps a company to identify and profile customers, reach out to customers quickly and more effectively, and make inventory management and distribution system more efficient.

If Indian firms do not keep pace with such contemporary developments, global business, and even domestic business in due course, will be largely out of their reach.

ICT has been significantly transforming the distribution system. Xavier points out that effective use of ICT in distribution can help companies:[23]

- Reduce inventories
- Reduce delivery time/unproductive waiting time
- Reduce stock-outs/lost sales
- Respond faster to market changes
- Reduce rush orders
- Cut down overproduction
- Reduce unnecessary movement (forwarding and back-tracking)
- Reduce paperwork and wasteful processing
- Plan production better

All the above benefits result in improved service at a lesser cost. In the West, IT is drastically changing the distribution systems. Electronic networking has become all-pervasive. The boundary of the organization is blurring, as it becomes more of a network, with electronic links forward into customers, backwards to suppliers and sideways to business partners. Looking at the enormous benefits, one may wonder as to why Indian companies have not computerised their distribution as yet.[24]

As Xavier points out, IT has also greatly contributed to the retail revolution, which is sweeping the entire world. What used to be a fragmented industry has got consolidated due to the sophisticated use of IT systems. Large retail chains are gobbling up small-town retailers. Retailing has now become a global business, thanks to the sophisticated IT systems being used by them. Typically, the retail stores were all along operated by owners, but currently the shift is towards systems-driven stores.[25] The major shifts that are taking place in the retail industry are summarised in Table 19.2.

Table 19.2: Retail Revolution

From	To
Fragmented	Consolidated
Local	Global
Low technology use	High technology use
Owner-operated	Systems-driven
Traders	Retail brand managers
Mass marketing	Individualised relationship customisation
Marketplace	Market space

Source: M.J. Xavier, *Marketing in the New Millennium*, p. 142.

INNOVATION

Innovation is a very important factor that provides competitive advantage and, consequently, determines business success. As Gorden Pearson observes, "innovation is the key weapon in achieving a sustaining competitive advantage. To compete successfully, it is vital to use the most appropriate technology to produce and distribute your product or service. Generally, this means using the latest technology, which will mean using the latest technology, which will incorporate more features, higher performance, greater quality or lower costs. In some cases, this may involve invention as well as innovation. Innovations may be based on inventions or discoveries, but their importance rests on their commercial exploitation."[26]

One of the important determinants of the market share and success of companies across industries is innovation. In the global pharmaceutical industry, for example, firms which were very innovative have achieved enormous growth. Block buster drugs powered the rapid growth of several of them (a block buster drug is one which generates an annual sale of $ 1 billion. It was in the 1980s that the first block buster drugs emerged. Because of inflation, $ 1 billion of the 1980s is only about one-seventh of it today.

As indicated earlier, innovation is one of the 12 pillars of competitiveness mapped by the *Global Competitiveness Report*. According to the *GCR,* Innovation can emerge from new technological and non-technological knowledge. Non-technological innovations are closely related to the know-how, skills, and working conditions that are embedded in organisations and are therefore largely covered by another pillar of the GCI, viz., *Business Sophistication* which concerns two elements that are intricately linked: the quality of a country's overall business networks and the quality of individual firms' operations and strategies.

Joseph Schumpeter, a well-known economist, has given a lot of importance to innovation in economic development. According to him, significant advances in the economy occur by disharmonious leaps and spurts as entirely new investment horizons are exploited. The entrepreneur who is the innovator is the central figure in the Schumpeterian analysis. Innovation may take any of the following forms: the introduction of a new product; the use of a new method of production; the opening of a new market; the conquest of a new source of raw material supply and the reorientation of

an industry. Our concern here is technological innovation; some of the above, obviously, do not represent technological innovation.

Box 19.4

India's Decade of Innovation and New Paradigm of Innovation

Innovation can play a key role in not only driving growth and competitive advantage, but also ensuring that this development includes a larger cross-section of people and is socially, economically and environmentally sustainable. Realising that innovation is the engine for national and global growth, employment, competitiveness and sharing of opportunities in the 21st century, the **Government of India has declared 2010-20 as the 'Decade of Innovation'**. In this context, there is a need for an Indian Model of Innovation that focuses on affordability and inclusive growth which can be a model for emulation for countries across the globe facing similar challenges of sustainable development. Indian entrepreneurs and policymakers are already moving towards this inclusive model of innovation, and three distinctions of this emerging Indian approach to innovation are worth noting. First, it focuses on finding affordable solutions for the needs of people—for health, water, transport, so on—without compromising quality. For instance, extremely low-cost eye surgeries which do not compromise on surgical standards at US$ 50 compared to US$ 1,650 in the US. Other examples of affordable innovation are: a vaccine for Hepatitis B at a fraction of the cost of earlier products, a peoples car for less than US$ 2,500; an innovative refrigerator using thermo electric cooling at a price less than US$ 75, a water purifier combining nano-technology and rice husks to provide safe drinking water for a family of 5 at US$ 0.02 per day; a solar lighting system for rural houses at US$ 200 and a solar powered ATM machine that has just 4.0 per cent of the total energy requirement of conventional ATMs.

Second, in this Indian approach to innovation, desired outcomes are produced by innovations in organisational and process models that deliver to people the benefits of technologies that may be developed in scientific laboratories. An example is the delivery models of mobile telephony services that have expanded the reach of telephony with the cheapest call services in the world. Third, there are innovations in the process of innovation itself to reduce the cost of developing the innovations. An example is the Open Source Drug Discovery (OSDD) process being applied by the Council of Scientific and Industrial Research (CSIR) to develop drugs for treatment of tuberculosis, based on a semantic-search, web-based platform for collaboration developed by Infosys, an innovative approach that has cut down the costs and reduced the time for drug development.

This new paradigm of innovation, focused on producing 'frugal' cost solutions with 'frugal' costs of innovation, in which India may be emerging as a global leader, contrasts sharply with the conventional approach, mostly focused on increasing inputs of Science and Technology and R&D and measurement of the numbers of papers and patents produced. Frugal innovation is focused on the efficiency of innovation and on outcomes that benefit people, especially the poor.

The resource needs for creating a strong R&D system are substantial. At present, R&D expenditure in the country is only about 0.9 per cent of GDP, of which about three-fourth is in the public sector and only one-fourth is in the private sector. This is simply not adequate to develop strong R&D. We must take steps to ensure that total expenditure in R&D increases to 2.0 per cent of GDP by the end of the Twelfth Plan. This could consist of about 1.0 per cent in the public sector and 1.0 per cent in the corporate sector, including PSUs. At present, the resources devoted to R&D by our large public sector organisations are far too small. They should be incentivised to make larger provisions. This should not just be for in-house R&D, but also they should fund R&D in research institutions and universities, both public and private. The need for such deployment of resources is critical particularly for our energy PSUs.

Adopted from, Planning Commission of India, *Approach to 12th Five Year Plan of India (2012-17).*

In the business context, innovation may be defined as "the technical, industrial and commercial steps which lead to the marketing of new manufactured products and to commercial use of new technical processes and equipment."

Betz classifies innovations into the following types or what is called scales.[27] This is based on how big an impact does a technology change make on the applications.

1. *Radical Innovation*—a basic technological innovation that establishes a new functionality (e.g., steam engine or steamboat).
2. *Incremental Innovation*—a change in an existing technology system that does not alter functionality but incrementally improves performance, features, safety, or quality or lowers cost (e.g., governor on a steam engine).
3. *Next-generation Technology Innovation*—a change in an existing technology system that does not alter functionality but dramatically improves performance, features, safety, or quality or lowers cost and opens up new applications (e.g., substitution of jet propulsion for propellers on airplanes).

All innovations need not be commercially successful. For example, many new products fail commercially due to a variety of reasons. From a study of a wide variety of industrial product winners and losers, Calantone and Cooper have identified six major reasons for the new product failures.[28] They are as follows:

1. The better mousetrap no one wanted: These are products which have some uniqueness or some superiority but which failed to generate enough demand. It is not because of any technical problem with the product or inadequacy of marketing effort. These products often represent technical R&D efforts not guided by proper marketing research or identification of customer requirements and preferences. Industrial customers, particularly, want products that can serve their purpose to their full satisfaction and they are not prepared to pay a higher price for a product, however superior the product may be, if it does not bring in additional income larger than the additional cost.

2. The me-too product meeting a competitive brick wall: Products which are mere imitations of competitors' products may find it difficult to succeed in the market because of intense competition from entrenched firms with established market shares and customer loyalty. The established firms often fight heavily the new entrants, sometimes even sacrificing their profits, so that the new entrant will find it very difficult to penetrate the market and establish a foothold.

3. Competitive one-upmanship: New product failures of this type result from factors such as deficiencies of the marketing management. Even if a product is good it may not succeed in the market if not marketed effectively. The promotion, including the launch, positioning, distribution, and pricing play their role in the marketing of the product. Competitors would initiate the product. Often they try to come out with better products and steal the march away from the pioneer firm. Even if the product is not superior, more efficient marketing may make a difference. The company which introduces the new product should, therefore, constantly try to improve the product and marketing.

4. Environmental ignorance: Product failures may also emanate from the ignorance of marketing environment leading to wrong decisions. Ignorance, neglect of environmental factors such as regulatory factors (encompassing, for example, performance standards, materials permitted to be used, safety norms, environmental aspects, technology etc.), technological factors, customer

preferences and demands, competitive environment etc. Such factors should be considered since conception of the product idea to its launch.

5. Technological dog products: These are products which fail to increase up to the expectations of the customers. In most of these cases, it is not that the companies have not understood what the market wants but they fail to deliver the product of the required quality or other attribute.

6. The price crunch: New products also fail because of mismatch between price of the product and value of the product as perceived by the customers. This may arise because of the eagerness of the companies to recoup all the investment at the earliest by charging a high price. Overestimation of the value of the product to the customer often results in pricing the product high.

Product and Process Innovations

William Abernathy and James Utterback have pointed out that usually the pattern of early innovations in a new-technology-based industry will be, first, product innovations (improving the performance and safety of the product); later, innovations shift to improving the production process to make the product cheaper and with better production quality.[29] This is depicted in Figure 19.1. The rate of product innovations peaks about the time of introduction of a design standard for the new technology product. Thereafter, the rate of innovations to improve the product declines, and the rate of innovations to improve production increases. This occurs because until the product design has been standardised manufacturer cannot focus on improving the production processes that produce such a design.

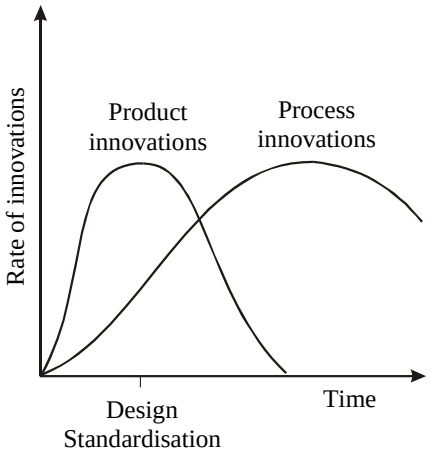

Fig. 19.1: Rates of Product and Process Innovations

After the key technologies of the industry mature, the market for the industry will eventually saturate. This level of market for the industry will continue, unless the key technologies for the industry become obsolete by technology substitution. Then, the market volume of the industry based on the older key technology product will decline to zero or to a market niche.

Technology S-Curve

According to the commonly observed pattern in the development of technologies, the rate of progress in a new technology follows an S- shaped curve, with an initial exponential rate, slowing to a linear rate, and turning off toward a natural limit.

As Betz points out[30] at first, all new basic inventions for a new technology show poor performance, are awkward and dangerous to use, and are costly to produce. Yet the opportunities for technical improvement begin as inventors and engineers seek ways of overcoming the limitations of the original invention. There is usually a rapid flush of new ideas that provides exponential increase in performance. Eventually, and rather soon, all the obvious ideas get tried. Further progress in the new technology gets harder. Thus begins the linear phase of technology progress on the S-curve. As Pearson observes[31], in due course, the rate of improvement slows down as it approaches its limit, which may be technological (e.g., some physical limit on performance), economic (e.g., diminishing returns from further research and development) or social (e.g., production of undesirable by-products). At this point, there will be considerable economic and competitive benefit in changing to an alternative technology to which the limit does not apply, and consequently in due course a new technology will emerge and be adopted.

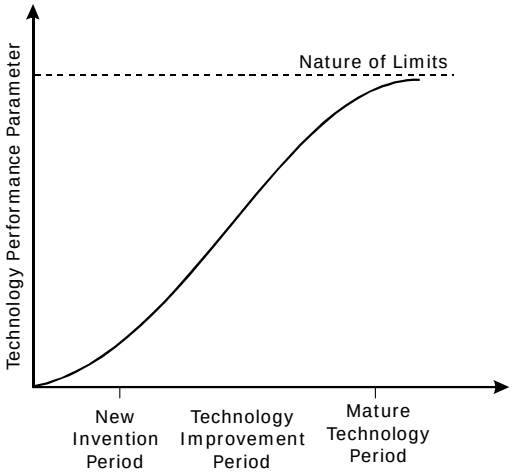

Fig. 19.2: Technology S-curve

SOURCES OF TECHNOLOGICAL DYNAMICS

There are a number of factors which determine the technological dynamics of a company. The source of technological change may be internal or external. As Porter suggests, technological leaders in industries with key external sources of technology must capture the best of those sources through coalitions or exclusive arrangements in order to sustain their lead, or have a superior ability to adapt externally developed technology to the industry.[32]

The important factors which determine the technological dynamics of a company include the following:

Innovative drive of the company: Many companies view technology as a driving force of competitiveness and development and give great importance to R&D. Recognising the critical role of

R&D in the pharmaceutical industry, Ranbaxy, for instance, has positioned itself as a research-based international company. Several other firms, such as Dr. Reddy's Laboratories, have also been investing considerably on R&D and they have been significantly benefiting out of it. It is a policy of some companies that a certain percentage of their sales every year shall come from new products.

Customer needs/expectations: Technological orientation and R&D efforts of a company may also be influenced by the customer needs and expectations. In several cases, the customer and the supplier have a collaborative relationship to develop products or solutions. If the consumers are highly demanding, companies would be compelled to be innovative.

Demand conditions: Besides customer needs/expectations, there are certain demand-related factors which influence the technology choice. For example, the size of the demand influences the choice of the technological scale. Expected future trend could also be important. For example, a fast growing trend of demand would encourage adoption/development of technology of large scale. It would also encourage R&D efforts. The situation may be different in a declining industry.

Suppliers' offerings: Many a time, technological changes are encouraged by the suppliers of a company, like capital goods suppliers and other technology suppliers etc. In many process industries, for example, the key source of technology is construction engineering firms that design production processes and build plants. The competitiveness of the Italian tile industry, for example, owes a lot to the dynamic and innovative technology suppliers.

Competitive dynamics: Competition compels the adoption of the best technology and constant endeavour to innovate. Japanese companies have, generally, a high degree of technological orientation. According to Akio Morita, the glory and the nemesis of Japanese business, the life's blood of the industrial engine, is good old-fashioned competition. And this makes the consumer in Japan a king. In Japan, there are more makers of civilian industrial products than in any other country, including the United States.[33]

Absence of/lack of competition was a major reason for the technological backwardness of corporate India. The impact of competition on technological improvement is very evident in many industries in India after the liberalization.

Substitutes

Emergence of new substitutes or technological improvements of substitutes which alter a firm's/industry's competitive advantage vis-à-vis the substitutes is a compelling reason for technological change. Porter points out that perhaps the most commonly recognised effect of technology on industry structure is its impact on substitution. Substitution is a function of the relative value to price of competing products and the switching costs associated with changing between them. Technological change creates entirely new products or product uses that substitute for others, such as fiber glass for plastic or wood, word processors for typewriters, and microwave ovens for conventional ovens. It influences both the relative value/price and switching costs of substitutes. The technological battle over relative value/price between industries producing close substitutes is at the heart of the substitution process.[34]

Social Forces

Certain social forces like protest against environmental pollution or other ecological problems, demand/preference for eco-friendly products, the need to tackle certain social problems etc. may prompt efforts to technological developments in certain direction.

The technological environment has some other social/cultural dimension too. For instance, Morita points out that the Japanese have always been eager to develop their own technology from abroad, and blend them to make suitable objects or systems.

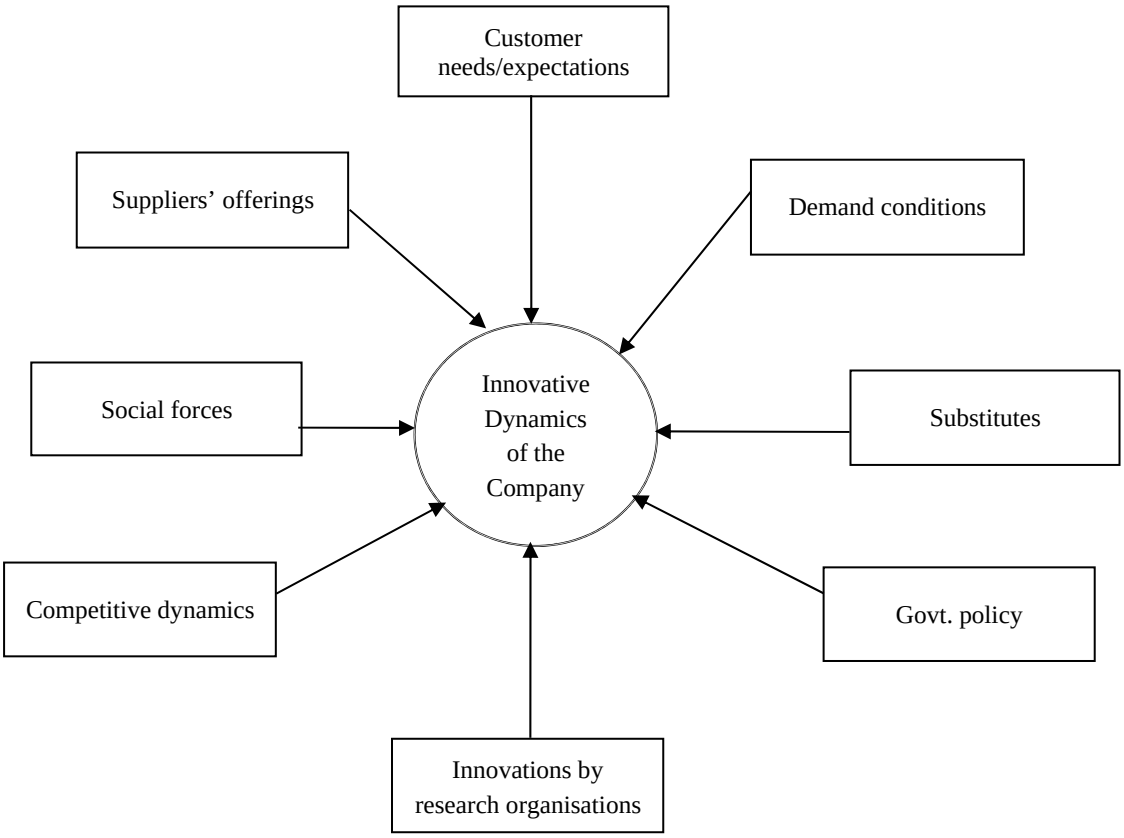

Fig. 19.3: Innovative Drivers

Research Organisations/Technical Facilities

The technological environment of the business is enriched by research organisations, including research departments of universities, which develop new technologies and provide other technical inputs. Research establishments like Indian Council for Scientific Research (ICSR), Central Food Technological Research Institute (CFTRI), Defence Food Research Laboratory etc. are well known in India. The technology developed by the CFTRI for making baby food from buffalo milk and its commercialisation by Amul, *for example*, was a milestone development.

Another supportive technological environment is the availability of common technical facilities like testing facilities or facilities to do certain jobs.

Government Policy

Technology policy of the government is a very important element of the technological environment. *For example*, a government may favour or disfavour certain types of technologies. Government's policy towards foreign technology is also a critical factor.

Government has a great role to play in promoting R&D by investment and by providing a favourable environment and strong support for encouraging the private sector involvement.

Box 19.5

Government of India's Role in R&D and Technological Development

Planning Commission, of India has made the following observations in the Ninth Five Year Plan (1997-2000) document:

Indeed, in the emerging competitive environment, cooperation and coordination between Indian enterprises and R&D institutions is not a matter of choice but rather of compulsion derived by competitive pressures.

The increasing complexity of technology makes it difficult for the individual enterprises, especially the small and medium enterprises (SMEs), to engage themselves in the competitive R&D and technological development efforts due to high financial risks. In the emerging competitive environment, cooperation and coordination between Indian enterprises and R&D institutions is not a matter of choice but rather of compulsion derived from competitive pressures. The initial emphasis and endeavour should be on developing synergies and alliances to enhance Indian industry's competitive advantage and on gaining greater share of global markets.

The need for cooperation is to bring about value addition to the products through endogenous resources/skills; environmentally clean and economically viable processes; closely held technologies that are commercially denied to Indian industry; strategic/dual-use technologies; technology packages as available from commercially operating units; process/product upgradation and incremental productive improvements; and strategic alliances with partners abroad for gaining market/technology advantage/dominance.

The initial emphasis and endeavour should be on developing synergies and alliance to enhance Indian industry's competitive advantage and on gaining a greater share of global markets in identified areas.

The *Approach to the Twelfth Five Year Plan* (2012-17) lays down that a principal objective of must be to increase 'depth' in manufacturing, to increase domestic value addition, and meet national strategic requirements. The technological depth of the country's manufacturing sector goes up when it becomes an active player in more parts of the manufacturing value chain (research, development and production).

Depth defined in these terms increases synergies across the value chain and also strengthens the overall trade position. It may be noted that depth is not necessarily required in all sectors. There is merit in being part of a global value chain but substantial part of industry must have technological depth.

Depth in technology is extremely important for a country to sustain its competitive advantage in a global economy. It is not only important from the point of view of greater value addition, but it is also required to attract new industries and maintain competitive advantage of current industries.

The key requirements for improving technology and depth are to:

- Provide an enabling environment for domestic enterprises to invest in technology creation, technology absorption and achieve higher value addition.
- Ensure availability of demand for products developed and/or manufactured indigenously.
- Provide enabling environment for foreign enterprises to invest in manufacturing and research activities in the country, in the areas in which the country needs foreign technology.
- Mitigate the risks of MSMEs investing in technology development and technology upgradation.

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CHAPTER

20

Management of Change

As the well-known saying goes, the only thing permanent in the world is change. True, organisations need to undergo change to survive or grow.

Changes may be gradual or drastic, minor or substantial, partial or whole. Peter Drucker observes: "Very few businesses can prosper even five or seven years without substantial change and massive rethinking of the very concepts on which they are based. There are exceptions, to be sure, but they are rare. It is by no means sure that it is a blessing for business to enjoy long decades of continuity without challenge to its fundamental concepts and assumptions."[1] And the fundamental questions confronting an organisation include, points out Drucker, 'how can we anticipate change?', 'how can we make organisations create the future?', and 'how can we manage change?'[2]

Companies which fail to change suitably would disappear or decline to insignificance. The *Fortune* has for the last six decades been publishing each year a list of the top 500 top manufacturing companies in the US. During these years, one-third of the companies in the original list have disappeared from it altogether — either because they have been liquidated or merged or because they have become insignificant. Another third has lost position in the list, that is, has dropped from being a major to become a relatively minor business. Only one-third have maintained themselves in the list, that is, in their position.[3]

Changes may be needed in portfolio strategy, competitive strategy, functional strategies, organisational structure or organisational culture.

TYPES OF CHANGE

Henry Mintzberg's historical studies of organisations have thrown some light on the nature of change. He found that there were periods of continuity in which established strategies remained unchanged and there were periods of change. There are four types of change, viz., *incremental, piecemeal, transformational* and *flux*.[4]

The most frequent types of change are incremental which are gradual changes and piecemeal changes when some strategies change and others remain unchanged. When strategies change without any clear direction, it is regarded as a period of flux. Transformational change, which is infrequent, marks a major, discontinuous, change.

An incremental change is a logical and relatively small departure from the past, like expansion of a firm's market to a region within a new country or an improvement in a historical technology. It is also known by other terms such as *logical incrementalism and evolutionary change process.*

A change is discontinuous, or novel whenever it does not directly follow the historical logic of the firm's development. For example, adoption of an entirely new technology, conglomerate diversification etc. In other words, "a discontinuous change is a significant departure from the historical growth vector."[5]

One test of the degree of discontinuity, with reference to portfolio strategy, is the extent to which the firm makes a departure from the market needs which it knows how to serve, from the technology on which the firm's products are based or from the geographical, economic, cultural, social or political settings in which it knows how to do business."[6] Another, and related, test of discontinuity is the extent to which the change will require revisions in the culture, power structure, systems, organisational structure and reward/incentives within the firm.

It is pointed out that "in many respects ... gradual change makes a lot of sense, and arguably managers should seek to manage strategy so that it is achieved. No organisation could function efficiently if it were to undergo frequent major revisions of strategy and in any case, it is unlikely that the environment will change so rapidly that this would be necessary. Incremental change might therefore be seen as an adaptive process in a continually changing environment; indeed, this is the view held by some writers on the management of strategy and by many managers themselves. There are, however, dangers here. Environmental change may not always be gradual enough for incremental change to keep pace."[7]

When environmental changes are drastic and substantial as the economic liberalisation ushered in India in 1991, discontinuous/transformational changes may be needed. In this context, it is appropriate to reproduce here a part of the TISCO Chairman's statement at the AGM, 1997:

"Large integrated steel plants like Tata Steel will need to compete domestically with newer more cost-effective plants which are being commissioned in India, as also against imported steel products.

To meet these challenges, the company has undergone a significant transformation in recent years. It has closed down some of its older mills and steel melting shops, replacing them with state-of-the-art steel-making and continuous casting plants. Rather than a proliferation of products, the company has set its sights on being a major producer of flat products to meet the growing needs of the automobile and consumer product segments in India and overseas. The company is transitioning from a producer in a seller's market to a more aggressive, customer oriented steel manufacturer in a more competitive buyer's market. Its growth plans will be market-driven. Customer-orientation has been one of the special focuses of Tata Steel in the current year and with the establishment of customer service centres, the company will be able to better meet special customer needs and provide prompt and effective deliveries.

The performance of Tata Steel is no longer measured against its own past history. The company now benchmarks itself against world-class steel producers with a view to match or betters the "best of breed" and adopt global best practices. Benchmarking has contributed significantly towards the company's goals in cost reduction and improved manufacturing efficiencies."

The transformation of the Tata Steel, emerging as one of the best steel companies and an important global player, has been very impressive indeed.

BARRIERS TO CHANGE

There are many obstacles to change.

Non-recognition/Non-acknowledgement of the Problem

One common barrier is the lag in recognising the problem or need for change. The major reason for this is the failure to understand the environmental changes. Many organisations do not have any system for proper analysis of the environmental dynamics and for strategic management based on that. One tragic consequence of this is that an organisation may feel that its performance is good and remain complacent even when its position in the market is being seriously eroded. For example, firms whose sales are increasing say by 10 per cent, may feel happy about its performance; but the fact is that it is losing market share if the market is growing at a higher rate. Again, such a complacent firm may also fail to understand the market segment developments. A firm may feel complacent if its products are selling well even when the market segment it occupies has been graded down and down — often due to the dual phenomena of the shift of the consumer classes of its product and development of higher grade and premium segments by competitors, including new firms. Nirma, Wheel, Ariel Supersoaker, Rin, Ariel Microsystem, Surf, Surf Ultra, Surf Excel etc. are all, and some of them well, sold in the market but what are their images, prices and segments? A Management or Technical Institute may feel that its products have enough takers and, therefore, has no problem as far as the placement is concerned. However, an analysis with vertical and horizontal comparisons, of the institutional and product images, pay packs and market segments may make shuddering revelations in case of several institutions.

Behavioural Resistance

One of the important barriers to change is the behavioural resistance. Some reference to it has already been made above. Fry and Killing classify behavioural resistance into two categories, viz., *inertial resistance* and *conscious resistance*. "Inertial resistance to change arises from the existing perceptions, beliefs, and habits of work in the organisation. Inertial obstacles are critical factors whenever the strategic requirements call for changes of culture, management style, and management preferences. The impact of inertial forces is to delay or distort awareness, understanding and response to strategic requirements."[8]

"Conscious resistance on the part of individuals or groups consists of deliberate actions or inaction that is intended to delay or deny change. Conscious resistance may be covert or overt, it may range from foot dragging to outright organised challenge, and it may spring from a variety of motives."[9]

One source of conscious resistance is the belief that change is not good. Or it may be that the need for change is not realised.

Conscious resistance also arises from the unwillingness to accept/acknowledge the existence/emergence of a problem or need for change even when the existence/emergence of the problem or need for change is really recognised. This unwillingness may be due to the lack of self-confidence to solve the problem. Unwillingness to acknowledge the problem often leads to attempts to cover up problems instead of taking measures to solve them.

One of the major reasons for conscious resistance is that circumstances of strategic change are typically marked by uncertainty — about causes, priorities, appropriate action and even about the existence of a problem. This is particularly true when the concerns are of a long-term nature.

Resistance may spring up from many vested interests also. For example, a restructuring may cause some retrenchment or transfers or redeployment. Delayering may affect the hierarchical positions of some. In some cases, change will also mean new responsibilities, tasks, challenges or more effort.

Resource Constraints

In many instances, an important barrier to change is resource constraints. For example, change strategy may involve large investment, which the organisation finds very difficult to mobilise. Sometimes there may even be human resource constraint. For example, an organisation in a bad shape may experience the flight of able personnel and it may be difficult to make up the deficiency by new appointments, as people may be hesitant to join such organisation.

Environmental Barriers

Environmental factors may also come in the way of change. Examples of many government policies affecting strategic change are mentioned elsewhere in this book. Sometimes, a company also has to face opposition from the public on account of the technology adopted, ecological issues, product mix, labour policy etc.

CHANGE REQUIREMENTS

There are several pre-requisites for change. They include the following:

1. Urgency: An essential requirement for change is recognition of the inevitable need for change. A firm may resort to strategic change in anticipation of environmental changes or as a reaction to the emerging changes or on account of a crisis it is in.

2. Crisis Change: In many instances, a significant change in the strategy is caused by a crisis. Often, new strategies and drastic measures are required to overcome the crisis. Crisis may compel people to shed the inertia. When a situation is too bad that something drastic or substantial needs to be done, a strong urgency for action is felt. Even if the change entails risks, the inevitability of change is appreciated.

It may be noted that a transformational change in India's economic policy resulted from an economic crisis in 1991. Hitherto only *incremental changes* were attempted. It is true of several other countries too.

Many firms fail to adopt anticipatory change or even reactive change. However, when a crisis situation is reached, strategic changes may be effected for survival. Many firms resort to measures of turnaround management only when the unit has become sick.

As Fry and Killing point out, "in crisis situations the initiating circumstances have reached an acute state. The symptoms of trouble are clear-cut — an opportunity may be disappearing, sales may be in collapse, a cash crunch may be imminent, banks may be on the brink of calling their loans and so forth. Fast decisive action is required."[10]

3. Reactive Change: In reactive situations, there are clear symptoms of need for change. In the chapter on *Turnaround Management and Restructuring*, mention has been made of a number of deteriorating performance indicators, which are danger signals. The deteriorating performance indicators suggest need for effective measures to reverse the trends lest they should lead to a crisis situation.

The initiating forces of reactive change may also be positive (as opposed to the problematic forces mentioned above), like the emergence of a new opportunity.

The liberalisation (in the 1980s) in the two-wheeler industry and the increase in competition have posed some serious problems for the Bajaj Auto. The company took some reactive measures to combat the emerging situation. One market trend was the fall in the share of scooter and rise in the share of motor cycle in the two-wheeler market. Although the sale of Bajaj Scooter was still rising, the company responded to the developments by introducing its own brand of motor cycle, promoting the superiority of scooter, emphasising the superiority of Bajaj Scooter over competing brands and product improvements and new launches.

4. Anticipatory Change: "The hallmark of anticipatory change is that the requirements are uncertain. Opportunities and problems are forecast but there are no clear and compelling conditions. It is difficult to guide both the timing and the impact of the forces that are at work."[11]

The Godrej and ICICI entered into MoUs with foreign firms to enter the insurance business well before the insurance sector in India was opened up.

5. Resources: As has already been indicated, one of the important requirements for change is resources. Many firms are not able to carry out turnaround measures or other strategic changes for want of funds. Sometimes, there may also be problems of non-financial resources.

6. Favourable Environment: A favourable business environment like conducive government policy etc., is also a very important requirement for strategic change.

7. Leadership: An able and committed leadership is an essential requirement to initiate and carry forward the change.

8. Internal Factors: Besides the right leadership, there are several other internal factors relevant to change, like the quality and support of people at different levels, organisational culture, support of shareholders etc.

IMPLEMENTATION OF STRATEGIC CHANGE

Important steps in the implementation of strategic change involve the following:

1. Determination of Change Strategy: Finalisation of change strategy involves evaluation of alternatives and choice of the best. Evaluation should also include the scope of change, possible barriers to changes and strategies to overcome them, the consequences of change, capability for change, the feasibility and desirability of change etc.

The pace (i.e., the speed with which change will be attempted); change targets (i.e., individuals and groups who will be central to the change programme) and focus (i.e., the specific change targets to be addressed at different times) should also be clearly determined.

2. Leadership Implementation: Leadership implementation refers to appointing right people at the top positions for carrying out the strategy. Successful implementation of the strategy depends to a large extent on the commitment and capability of the people responsible for implementation of the strategy. Leadership implementation may involve redeployment of managers within the organisation and/or recruitment from outside the organisation.

In many cases, formulation or implementation of major strategic changes is preceded by the appointment of a new CEO because implementing strategic change in any organisation is ultimately the responsibility of the CEO.

3. Communication: It is important to communicate the change strategy to all within the organisation and to those linked with the organisation. The objective is to convince them of the need for change, the objectives of change and the nature of change and to take them into confidence. Proper communication may help remove/reduce the resistance to change. Proper communication is necessary to create a feeling of belongingness and to enlist the support of all sections.

This, however, does not mean that every thing should be communicated to all. Advance information regarding certain matters may do more harms than good. It may give scope for organising mounting opposition in certain cases. Some types of information may help the competitors to the detriment of the company. Therefore, there should be proper judgment and selectivity in respect of the communication.

"In implementing strategic change, the CEO uses communication processes to shape a coherent productive culture, which in turn helps to marshal the commitments of the management and staff to the goals and objectives of the enterprise. Some conflict in the organisation is inevitable — and actually desirable. By airing and then dissolving issues and critical concerns, the CEO can secure not only this commitment but often dedication as well."[12]

Here are two examples of successful communication for change.[13] The first case is of the divestments by Glaxo India (referred to in the chapter on Portfolio Strategy). The CEO, V. Thyagarajan, drew up a communication plan to convince Glaxo employees that these divestments just had to be made. The strategic planning process had revealed that the company could grow to market leadership if fresh resources could be pumped in. By contrast, the foods division would need much higher investments for Glaxo to compete effectively in those markets. Moreover, parent Glaxo no longer possessed cutting edge technology in the foods business, having exited from it long ago. To get the message across divisions, Thyagarajan personally met employees to explain the strategic reason for smartsising and to clear all doubts. The idea was to involve the entire family of employees in the company, and remove any hint of it being a clandestine operation.

It became imperative for the Indian Oxygen (IOL) to sell some of the businesses for its successful survival. Instead of steamrollering the strategy down which might have made the managers antagonistic, the CEO, S.S. Prasad, let the decision emerge from the managers by putting them to strategy sessions to plot survival tactics. The solution they evolved was the sale of the welding and explosives businesses, which used obsolete technology. The sale of the loss-making division brought in ₹ 35 crore as cashes and caused the profit to jump by 85 per cent.

4. Organisation: Another important requirement for implementing the strategy is the right organisation. This may even involve restructuring of the existing organisation or creation of an

entirely new organisation. It is not uncommon that companies spun-off certain business as new divisions or companies.

5. Resource Allocation: Many strategic changes require resource commitment. Timely availability of sufficient resources is an essential requirement for implementation of strategic change. Many strategies necessitate mobilisation of additional resources. Besides reserves, additional equity and loans, sources of finance include sale of assets or divestiture in many cases.

6. Tactics: Tactics here refer to the specific measures or way of action/management style to implement the change strategy. The common basic tactics for change are the following:

Direction: Direction "encompasses top-down methods in which giving orders and instructions is the dominant theme. Power is sometimes bluntly used to overcome resistance and at all times are at least a background factor. Change targets are minimally involved in shaping the nature and pace of change."[14]

This method lacks participation and therefore lower levels may not have a sense of involvement. People may even become indifferent about the success of the change. If this method involves coercive use of power that can cause resentment, overt or covert.

"The evidence is that coercion and edict is the least successful style of managing business unless time is short, or perhaps, there is such a crisis or state of confusion in the organisation that people welcome it as a way of clarifying and soothing the situation."[15]

A very able, powerful and committed leadership is a pre-requisite for this method.

Participation: This is a very democratic way. The change targets actively involve in the process and the use of direction by the change agent is minimal. The change targets are treated as genuine participants in the determination of what is to be done. Whether this codetermination is largely a result of basic management preference, or simply a pragmatic appreciation of the power of the change target (based, for example, on closeness to the action and information, or on a capacity to delay or divert the desired change), it forms the basis for face-to-face management of the change."[16] The participation in the decision or change process helps to increase the commitment of the change targets.

This method requires for its success that the change targets are knowledgeable, capable and committed. Further, this method is not suitable where very quick action is needed. Again, when it is not desirable to make the strategy public, this method has its own limitation.

Intervention: Delegation is an important aspect of this method. The "change agent retains the coordination of and authority for such process, but delegates aspects of the change process.... the sponsor of the change maintains overall control and ensures that progress is monitored and improvement demonstrated."[17] An essential requirement for this method is that the subordinates are able and committed.

Accommodation: The change targets play a very important role in this bottom-up method and, therefore, "result will usually be one to which the change targets are committed. After all, they played a large part in designing it."[18]

This method, however, has some limitations. The capability, vision, commitment and experience of the change targets are important. Similarly, "change determined locally may not fit with the overall change requirements of the business."[19] Further, this method is not suitable in certain situations and for certain types of change strategies.

Networks Action: This is an indirect action method which uses an intermediate change agent in the change process. "It requires that the general manager has influence over individuals and groups that have the capacity, in their turn, to influence."[20]

This method requires considerable monitoring. The success depends to a large extent on the capability, commitment and sincerity of the intermediate agents.

Kotter's Model of Change Management

John P. Kotter, a Harvard Business School professor and leading thinker on organisational change management, through his books *Leading Change* (1995) and the follow-up, co-authored with Dan Cohe, *The Heart of Change* (2002) has proposed an 8-step change model for helping managers deal with change. This is summarised in Table 20.1. The first three of these overlapping steps are about *creating a climate for change*. The next three are about *engaging and enabling the organisation* and the last two pertain to implementing and sustaining change.

Table 20.1
Kotter's Change Management Model

	Steps	Action Plan
	Creating a climate for change	
1	**Increase urgency**	Inspire people to move, make objectives real and relevant
2	**Build the guiding team**	Get the right people in place with the right emotional commitment, and the right mix of skills and levels
3	**Get the vision right**	Get the team to establish a simple vision and strategy, focus on emotional and creative aspects necessary to drive service and efficiency
	Engaging and enabling the organisation	
4	**Communicate for buy-in**	Involve as many people as possible, communicate the essentials, simply, and to appeal and respond to people's needs. De-clutter communications – make technology work for you rather than against
5	**Empower action**	Remove obstacles, enable constructive feedback and lots of support from leaders - reward and recognise progress and achievements
6	**Create short-term wins**	Set aims that are easy to achieve – in bite-size chunks. Manageable numbers of initiatives. Finish current stages before starting new ones
	Implementing and sustaining change	
7	**Don't let up**	Foster and encourage determination and persistence – ongoing change – encourage ongoing progress reporting – highlight achieved and future milestones
8	**Make it stick**	Reinforce the value of successful change via recruitment, promotion, new change leaders. Weave change into culture.

CONCLUSION

There are only two options: Change or sink. Change is inevitable for survival. However, as Drucker observes, to be able to take advantage of change, enterprises have to welcome change. They have to consider change as normal rather than as an exception to be feared and to be avoided if at all

possible. They have to be innovative, in other words. This require that the enterprise is organised systematically to abandon the outworn and obsolete; to get rid of things that do not work, no matter how attractive they looked when the enterprise first went into them; to concentrate resources, especially of competent people, on opportunities, rather than waste them on yesterday's problems; and to work together on developing tomorrow rather than on defending yesterday."[21]

As Gibson who points out that future will not be a continuation of the past, observes, "in the 21st century, the winners will be those who stay ahead of the change curve constantly redefining their industries, creating new markets, blazing new tails, reinventing the competitive rules, challenging the status quo."[22]

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Cases

Case 1

STRATEGIC BREAKTHROUGH AT HLL LIFECARE

This case illustrates how right vision and mission and pragmatic strategies can drive fast the growth of a company.

Hindustan Latex Ltd. (HLL), a central public sector undertaking, was established in 1966 to produce contraceptives to support government's family planning programme. HLL had done well in its core business. However, a breakthrough strategic thinking invaded the company more than three-and-a-half decades after its establishment. In 2003, HLL formulated a Vision-2010 which envisaged a substantial development of business — increasing its turnover from ₹ 163 crore in 2003 to ₹ 1,000 crore by 2010 — by further developing its core business and diversification. Reflecting the expansion of its business domain, the name of the company was changed to HLL Lifecare Ltd. Including the value of transactions handled by the Procurement and Consultancy Division and Infrastructure Division, the turnover of the company in 2010-11 was ₹ 1,131 crore.

HLL Lifecare's vision, mission and objectives are presented below.

Vision

To be a globally respected organisation, focusing on inclusiveness by providing affordable and quality healthcare solutions through continuous innovation.

Mission

To accomplish the Corporate Vision, HLL Lifecare Ltd. has outlined following mission which focus on six key areas:

- Provide quality products and services meeting international standards.
- Excellence through continued improvement by adoption of appropriate technologies and best practices.

- Customer satisfaction and value creation through innovation, R&D, cost management and customer care.
- Focusing on human resource development to meet the needs of challenging business environment.
- Be socially committed maintaining highest standards of corporate governance and corporate social responsibility.
- Committed to environmental protection, conservation and green initiatives for the promotion of sustainable development.

Objectives

The company will strive to fulfill its vision/mission by:

- Attaining rapid growth and global levels of operation with high quality and cost competitiveness to attain leadership in main product categories.
- Create a culture of continuous innovation in R&D and customer care.
- Being an employer of choice in India with employee satisfaction level of over 90 per cent.
- Being a leading social sector organisation in the field of Reproductive and Women's Healthcare with commitment to the society — a partner of choice for implementing all government and multilateral initiatives in the segments.
- Focusing on capacity building, skill development and infrastructural development for the benefit of the marginalised and underprivileged sections for their empowerment and inclusion in the economic mainstream.
- To place emphasis on environmental friendly activities that bring out conservation of resources and waste management leading to sustainable development.

The Corporate Plan and Vision-2020 of the company envisage a ten-fold jump of the turnover (i.e., to ₹ 10,000 crore) by 2020. Building on the strengths and capabilities, the company now aspires to become a globally respected healthcare conglomerate. With this aim, it has redefined its business purpose – 'To be a globally respected organisation, focusing on inclusiveness by providing affordable and quality healthcare solutions through continuous innovations' and has laid down mission and objectives to accomplish the vision. In order to facilitate mobilisation of requisite funds to undertake and implement new projects based on the Corporate Plan and Vision-2020 at most economical cost through various sources, viz., share capital, debentures, deposits from public etc., HLL Lifecare was converted into Public Limited Company with effect from 21st February, 2012.

Areas of Business

HLL Lifecare, a Miniratna today, has emerged as a multi-product organisation, with seven manufacturing units, and a vast array of innovative products and services. It has several subsidiaries and a joint venture company.

HLL is not only one of the top manufacturers of wide range of contraceptives globally, but also of hospital and Ayurvedic products and a range of women's healthcare products. It has also diversified into vaccine manufacturing, diagnostic/lifecare services, pharma retail, sanitary napkin manufacturing and medipark, besides engaging in procurement consultancy, infrastructure development of healthcare

institutions and facility management. The company is addressing various public health challenges in the area of maternal and child health, population stabilisation and HIV/AIDS control. It is also the only company in the world which manufactures and markets such a wide range of contraceptives.

To improve the overall performance and to support the execution of the corporate strategy, HLL has taken a number of administrative and operating decisions. One of the important decisions was the following: Consequent to the expansion/diversification of the company's business, HLL faced various challenges in managing a diversified businesses portfolio. To meet this challenge, the company restructured its business operations into three independent Strategic Business Units (SBUs), with a view to bring in more accountability, efficiency and operational autonomy, They are: Contraceptives and Pharmaceuticals SBU; Hospital Products SBU; and Services SBU.

LifeSpring Hospitals Private Limited – the 50 : 50 joint venture company formed by HLL Lifecare and Acumen Fund Inc., USA – has 12 hospitals in and around Hyderabad. While the LifeSring is planning a substantial expansion of its hospital networks of hospitals (the business plan 2011-15 envisages setting up 100 hospitals, including the existing 12 hospitals), an important decision taken was to close down business operations of hospitals in coastal districts of Vijayawada, Nellore and Rajahmundry because of the realisation that for LifeSpring Hospitals, cluster approach would work better than dispersed approach.

Making a foray into the arena of healthcare education, the company has launched a new arm named HLL Academy. The vision of the academy is to become a center of excellence in providing learning, research, training and consultancy in the higher education sector in healthcare and allied areas with emphasis on social marketing and relevant disciplines.

HLL was a small company which dreamed big. The strategic maneuvers demanded of big companies are of gigantic order and very complex. They will also require a series of administrative and operating decisions of large and complex order.

Discussion Questions

1. Discuss the factors which have driven the fast growth of HLL Lifecare.
2. Evaluate the vision and strategic changes of HLL Lifecare.
3. Evaluate the vision, mission and objectives of HLL Lifecare. You shall examine how well they are logically aligned and are effective in driving the development of the company.
4. Identify the strategic, administrative and operational decisions in the description of the HLL Lifecare given above.
5. Suggest a further big push strategy for HLL Lifecare Ltd. You shall also explain the rationale, advantages and risks of the proposed strategy.

Case 2

CORPORATE REJUVENATION

The following is the text of the Speech of Mr. T. Thomas, Chairman, Glaxo India Ltd. on the occasion of the Company's Annual General meeting on June 20, 1997. The case is very relevant for discussion now too, although some of the situations have undergone a change. It covers various areas like role of Board of Directors in corporate governance and strategic management, portfolio restructuring, business environment, functional strategies etc.

Background

As companies with a comfortable past mature and grow older, it is advantageous and may even become necessary to subject them to a process of rejuvenation. This is achieved by a thorough review of the composition of various business units and the structure of the whole company. Such a review can often result in changes that will not only improve performance but also add dynamism to the company and its management. Glaxo in India had embarked on such rejuvenation 5 years ago and it has definitely changed the nature of the business and its performance. A major discontinuity has been introduced into the company over this period which liberated the company from its past. I would like to share with you how and why the process of rejuvenation has taken place and what its impact has been. The process is still continuing and the organisation and quality of management is now such that the process will hopefully never stop.

As a result of a rigours of price controls on drugs, industrial licensing and import restrictions, as well as FERA, Glaxo India had felt somewhat beleaguered in the 1970s and the 1980s especially in its core pharmaceutical business. This was a feeling shared by all foreign pharmaceutical companies in India. The setback was accentuated by the adoption of the Indian Patents Act in 1970 which deprived the companies of product patent protection and made the business less profitable. Glaxo Holdings UK had been forced to reduce its shareholding to 40 per cent and its patented drug Zantac was being freely copied by Indian companies as there was no protection under product patent. Naturally, the parent company, like many foreign companies operating in India at that time, must have become disenchanted about the future of its business in India. A measure of its disenchantment was that the name of the 40 per cent owned Indian company was changed from Glaxo India to Glindia for some years.

To offset the problems facing the pharma business, the management of the Indian company began to look for non-pharmaceutical diversification in several projects mostly related to the foods business in which it had a presence through the Family Products Division. Capital and management attention were diverted to such projects. None of these projects could have changed the fortunes of the company significantly. And the culture of the company remained that of an organisation that had been traditionally comfortable almost to the extent of being complacent. During the same period, the parent company in the UK had grown phenomenally and had become extremely profitable due to the success of Zantac. The fact of belonging to such a thriving international Group provided comfort to the Indian company which did not feel any urgency to change. Nor was there a coherent long-term plan or a firm direction on how it was going to work its way out of the difficult situation.

By 1990, the company had to resort to increased borrowings to meet its commitments for the diversification projects and the increase in working capital. Profitability was declining and the

company was potentially heading for a financial crisis. It was obvious that there was need for a fundamental change in understanding and attitudes right from the Board level. This process was initiated from 1992 which fortunately coincided with the initiation of economic liberalisation in India. Some of the key changes that were introduced are outlined below.

1. Composition and quality of the board

The company had a Board consisting of several non-executive and executive members. Board meetings did not usually focus much on the performance of the business or its new investments, but dealt with a number of formal legal and accounting matters. Some of the non-executives had been on the Board for over a decade with the resultant natural tendency to resist change and defend the past. The Executive Directors as individuals did not have much independence of views as the tradition of the company was that they toed the line laid down by the Managing Director in charge, as people do in any gentlemen's Club.

Therefore, one of the first steps was to change the functioning and the composition of the Board by arranging for the older non-executives to retire and to replace them by younger non-executives with experience in finance and marketing.

It is very essential that on any company's Board there should be some independent, professionally qualified non-executive Directors. At the same time, there should be a regular retirement policy for non-executive directors with a clear understanding of the term period for which they are appointed, so that there is no misunderstanding when the time comes for them to step down. This is an essential part of Corporate Governance. Sometimes, it is very difficult for a Chief Executive who has been steeped in the tradition of a company and had been involved in many of its investments which are not performing, to accept the need to change or to extricate from the past. There are loyalties and sentiments to be overcome, especially if the CEO is a humane and sensitive individual. A change could become necessary even at that level in order to facilitate the process of change.

Looking back, perhaps the most important change in the company was this change in the composition and quality of the Board. It is not easy to change a Board and it takes time but if a business has to be rejuvenated the first place to start is at the Board level. Whether it is a company or a nation, the quality of leadership has the single largest impact on its performance.

2. Greater attention to profits and finance

The rigours of price control which existed in the 1970s and 80s had caused considerable decline in margins. Inadequate attention to margins and to the utilisation of capital, had made the situation worse. Unprofitable external and non-productive investments added to the burden. As a result, the company had a high gearing and heavy interest burden of nearly 4 per cent of the sales value. The profit margin after tax had declined to about 2 per cent, making the business extremely vulnerable to any downturn due to competition or change in demand.

From 1992, these facts were highlighted and Board discussions shifted more in the performance of the company in terms of achieving sales targets; control on use of capital both as working capital and for projects; the margin of profits on different parts of business as well as on cost reduction. The attention of management was focused on the need to improve volumes and margins and to reduce costs. In addition to providing only information, the Executive Directors had now to explain at Board meetings reasons for shortfalls and the plans for correcting deviations. Executive Members of the

Board were encouraged to shed their compartmental attitudes and participate in such discussions and contribute ideas towards better performance in any part of the business.

Board meetings can be useful brainstorming sessions if the discussions are focussed on key issues and on strategy. They can also be used as a means of making individual Board members accountable to their peers for the performance of their division or function at each Board meeting. That sense of accountability to peers is probably the best incentive for most people to perform better. In other words, Board meetings are not merely a gathering of Directors who needed to be brought up to date with information and be consulted. It is much more than that — a brainstorming and decision-making session when the company has problems to resolve; an accountability session and a goal setting session.

3. Shifting government policy on price control

Instead of accepting the prevalent highly restrictive price control policy, a campaign was started to persuade and educate the public, the media, rest of the industry and government officials that price controls were against the interest of the consumer in the long run as had been proved in several industries and several countries. The pace was set by the AGM speech in 1992 on "Price Control — A Policy that Fails". Several discussions were held with the politicians and bureaucrats concerned to convince them of the need to modify the price control policy — which they gradually accepted. Several other companies, Indian and foreign, joined the campaign. Seminars were organised to propagate the need to relax controls as part of the general liberalisation policy which had been extended to most other industries. A consensus was created that there was need to review the existing price control mechanism.

Since then, the liberalisation process has been extended to the drug industry and there has been a gradual relaxation of price controls on drugs and also of licensing rules over the last few years. The percentage of drugs under control have been reduced. It can now be reasonably expected that there will be continuing realism in pricing although abolition of price controls could still be sometime away.

4. Extrication from diversification projects

During the 1980s, the company had invested in and taken on responsibility to manage four projects outside the core pharmaceutical business, the future of which at that time was mistakenly considered to be limited. These projects were Dempo Dairy, Hindustan Foods, Vegepro and K.G. Gluco Biols. The first step was to expose to the Board the unprofitable nature of these investments, their dubious long-term prospects and the lack of expertise within Glaxo India to manage any of these. The Board was persuaded by 1992-93 that Glaxo India should withdraw from all of these.

Withdrawal from each of these was a painful process which involved some losses but also a great deal of determination to sever the ties. We terminated all the four joint ventures at minimum cost and with no litigations. If we had continued with any of them, Glaxo India would have suffered continued and higher losses and would have had to divert its management attention to areas where we had no expertise. The lesson was brought home that diversification is fraught with risks which are phenomenally higher when a company has no expertise in the new diversified business.

5. Disinvestment of Family Products Division (FPD)

As part of the fundamental strategy to focus on the core pharmaceuticals business which is the business of the parent company, the management and Board of the company was persuaded that FPD should be divested. There was considerable opposition and doubts from several of the Management at the top. However, ultimately the logic become clear to everyone as follows:

(i) The parent company, Glaxo Holding, had divested its milk based products more than a decade ago to concentrate on pharmaceuticals and had achieved great success. Therefore, there was no support for FPD either in products or in marketing from the parent. For any subsidiary, it is very risky to go out of a limb on its own.

(ii) With the opening up of the economy, several large international food companies like Unilever, Nestle, BSN, Pepsi and Coca Cola were expanding their foods business in India. In this scenario, Glaxo India with a relatively small size and limited range of products in FPD and without any support from a parent foods company, could not sustain its position without development of new products for which it had neither the size nor the internal resources.

(iii) Furthermore, the skills required for marketing consumer products are very different from those required for pharmaceuticals. The mainstream of managers were in the pharmaceutical business. FDP was increasingly becoming an isolated cash cow within the business and could be entering a phase of declining growth rate due to milking of brands like Complan to compensate for shortfalls in profits of pharmaceuticals. It was, therefore, prudent to disinvest the business while it was still profitable and its brands were still not under threat. Later on, the value could diminish as competition intensified.

Once the strategy was accepted, the actual negotiations offer documents were issued to Nestle, Heinz, Unilever and several others. Of these, Nestle and Heinz decided to put a hurdle rate of ₹ 2,000 million and set a cut-off date for the two final bidders, viz., Nestle and Heinz.

Heinz crossed the hurdle and offered ₹ 2,100 million (approx. $ 70 million or a 30 p/e) in early 1994. After evaluating the competing bids both internally and by an independent agency, the Board decided to choose the Heinz bid.

The case for this divestment was made to the public, the employees and the shareholders through the AGM speech of 1993 on “Vision and Focus”. The actual price, the choice of bid and the plans to utilise sale proceeds were explained at the EGM and the proposal was approved. All necessary government and RBI approvals were obtained and the physical transfer took place by September 1994.

It is to be noted that the whole exercise was carried out internally. It not only saved expenses on merchant bankers but also gave valuable training to our management in sale/acquisition transactions and appropriate tax planning.

The sale proceeds were retained as part of the investment portfolio of the company. The yield on investment of FPD sale proceeds exceeded the profits which were traditionally made from FPD. The disinvestment helped to increase profits and also simplified the structure and management of the business; facilitating more effective concentration on pharmaceuticals. It has also created the financial resources for expansion of the core business through possible acquisitions.

6. Investment of surplus funds

When a company receives large sums of money, there is a natural temptation to use it in the business to finance capital projects or for additional working capital. Manufacturing Managers will formulate schemes for modernisation and expansion on a more ambitious scale. Sales Managers will advocate that with more favourable credit terms they could sell more. Purchase Managers will advocate the same to get better prices for supplies. We decided to save them from these temptations by: (a) placing the surplus funds from sale proceeds of FPD in a separate account to which the operating management had no access, (b) requiring the Finance Committee of the Board with Non-executive Directors on it, for monitoring and directing the investment of the surplus funds in instruments that gave best yields, and (c) appointing a reputed international commercial bank to advise on such investment and to audit the whole process.

These surplus funds were further enhanced when Glaxo Holdings brought in additional equity (see later). The discipline enforced through the Finance Committee stood us in good stead when we faced this further enhancement of funds.

7. Increase in shareholding of Glaxo Holdings to 51 per cent

In order to ensure continued in-depth involvement of Glaxo Group in the Indian company and to avoid possible outside intervention, it was necessary to restore majority holding for Glaxo Group. As a part of economic liberalisation when Government announced the policy that foreign investors like Glaxo Holdings could raise stake from 40 per cent to 51 per cent, a joint effort among similar foreign companies was organised to agree on a pricing formula for the injection of new equity. A reasonable formula of a P/E multiple of 15 times the average earnings per share of the previous 3 years was accepted by the major Government-owned Institutions who were our shareholders. The logic was that these same foreign companies had been forced to disinvest their original shareholding under FERA regulations in an earlier period on the basis of a more adverse formula. This was, therefore, a very fair basis. Glaxo Holdings brought in the requisite additional capital as by now they were convinced about the viability and management of the Indian company. In addition to restoring majority control through the injection of ₹ 688 million of equity.

Some other companies which hesitated or waited lost this window of opportunity which closed within a year and the cost of increasing equity by the principal shareholder was increased considerably as the P/E multiple of 15 formula did not apply anymore. Very often, it is prudent to take advantage of favourable changes in Government policy as early as possible.

8. Improving profitability

Increasing Volume and Market Share: Although Glaxo India managed to maintain its position as the No. 1 pharma company with an all India market share of about 5.5 per cent, it had been losing its market share in metro cities to Indian competitors who were increasing their sales effort in the metros. Glaxo had been compensating for this loss of urban market share by spreading to the smaller towns.

This was unwise as the population in metro cities is relatively more prosperous and offers a concentrated market. Furthermore, urbanisation is taking place in India at a very fast pace and retreating to the smaller towns was to run away from the more prosperous and growing market. In any case having won in the larger markets, competitors were going to attack us in the small town market as

well, leaving us no place to retreat to! Even in terms of costs, if a salesman coasted ₹ 1,50,000 p.a., the margin on sales being over 15 per cent he had to sell only ₹ 1 million p.a. worth of goods to meet his costs, while the average sales per salesman was over ₹ 3.5. million p.a.

This logic was explained and realised within the company and from early 1994, the selection and induction of additional salesman has been in progress. The number of salesman in metros and the number of doctors they call on, have steadily increased. This had resulted in increased sales and profits.

Business to be Cash Positive: Business units had a tendency to concentrate exclusively on profits and ignore cash flow which is equally important and in some cases more critical in judging its performance and ability to grow.

The pharmaceutical business was profitable. But it had been cash negative for a number of years due to lower margins and increased use of working capital. It was decided that the pharmaceuticals business had to become cash positive by improving margins, reducing costs and controlling its own working capital and capital expenditure. It took a year to achieve this but since 1994/95 the pharmaceutical business has been operating on a cash positive basis. It has reduced its stocks and debtors by over 25 per cent. This has been achieved by educating all levels of management about the need to become cash positive.

Outsourcing of Products/Downsizing Worli: Like all large cities throughout the world (e.g., London, New York, Tokyo, etc.), Mumbai has become exceedingly uneconomic for labour-intensive manufacturing operations of the type carried out in Worli. This is because of the very high cost of labour, transportation and infrastructure, and urban restrictions.

On the other hand, the value of space in the City has risen steadily as it is an island with limited transportation to main land and restrictive rent and land ceiling laws. With the current value of land in Worli and with over 300,000 sq.ft. of space available there, it does not make commercial sense any more to use such space indefinitely for manufacturing operations. This asset could be much more profitably redeployed, as has been done in several other countries or by other companies in Mumbai.

Despite very strong initial resistance from the older generation of managers, the Board took a decision in 1994 to offer voluntary retirement to employees in Worli. The scheme was also offered to Thane employees. It was marketed and implemented smoothly with over 460 employees taking advantage of it by December 1994 and leaving the company.

The payback on such separation payment is short and certain which makes it an attractive investment by itself. Such Voluntary Separation Schemes have been continued since then with satisfactory results.

In order to reduce costs even further, a policy of outsourcing products with simpler manufacturing profiles has been adopted. Gelatin capsules, animal health products, tableting, etc. are being outsourced from third parties with strict quality supervision. This enables the company management to concentrate more in the manufacture of more complex products and on growth in these areas.

C&F Agents Instead of Company Depots: The company used to have own depots in the metro towns as well as in places like Patna, Cochin, etc. In the earlier part of this century, it was necessary for companies to run and operate such depots as local distribution trade was not sophisticated enough to be relied upon to receive, stock and distribute products from storage depots in main towns. But the

distribution trade in India had developed very fast in the last few decades. Consumer product companies like Hindustan Lever realised the advantages of replacing company owned depots by Carrying and Forwarding agents (C&Fs) almost 30 years ago. It is not only less expensive to engage such agents but it is also immensely more efficient as such local agents operate with much greater speed, flexibility and entrepreneurship than staff employed by large companies. We have now introduced C&Fs throughout the country with the major advantage being speedier despatches and the resultant reduction in stocks, costs and better service to the market.

9. Management development

One of the weaknesses of Glaxo India was that in the past there had been no sustained recruitment of management trainees or systematic training and development of managers. In this respect, the company had lagged behind the subsidiaries of many international companies operating in India. Most multinationals operating in India recruit and train managers in India which is a very fertile source. There is an increasing tendency to use such Indian Managers in their subsidiaries abroad. In the case of Glaxo India, there was no regular recruitment and training of young managers for some years. As a result, there has been a paucity of suitable managers to succeed existing ones or to cope with the expansion of the business – leave alone to spare for international postings. It is necessary to inject a proportion of young specially trained managers into the system rather than rely entirely on promotion from the non-management staff. A mix of both gives the best results and the more formally trained managers increase the choice of candidates available for further promotions at a faster pace. Glaxo had missed out on this process for some years.

To correct this situation, it was decided in 1994 to introduce regular recruitment of Management Trainees — technical, sales/marketing and commercial, from universities and management institutes.

A general management training course for existing middle level managers who have further potential has been initiated and this has covered all such managers.

Further, steps for more effective reporting systems, assessment of performance and potential of managers and planned development are to be introduced. The Personnel function which had traditionally focused on Industrial Relations has been strengthened to pay more attention to the HRD function. A dedicated Training Centre to cater to the needs of sales training as well as management training is being planned. The company is now reaching a stage where Indian managers can be used by the parent company in other countries. As you know, Mr. Thyagarajan who was the previous MD has been promoted as Area Director, Glaxo Wellcome in Asia. It is an indication of the confidence that he parent company has now placed in the quality of Glaxo India's management.

10. Initiatives on acquisition

To increase our market share and profits, beyond what was possible through organic growth, we had decided to explore the possibility of acquiring suitable pharmaceutical businesses in India by using the funds available. Now, it can be revealed that one of our first targets was Burroughs Wellcome (India). We as Glaxo India had opened a dialogue in 1994 directly with Wellcome Group with the knowledge and support of Glaxo Group. But while these discussions progressed, Glaxo Group itself decided in 1995 to acquire the Wellcome Group. Burroughs Wellcome (India) Ltd. (BWIL), thus, became part of the new Glaxo Wellcome Group in the UK and therefore a sister company of Glaxo India. We now have a common Chairman and common MD for Glaxo India Ltd.

and BWIL. Since then the holding of the parent company BWIL has been raised to 51 per cent. The stage is, therefore, set for a merger of the two companies which we hope to accomplish in the near future. That will further enhance our position in the market.

We are also exploring the possibility of acquiring other suitable pharmaceutical companies in India to widen our product range and to increase our market share, although we will be very selective. Fortunately, we have enough financial resources for such acquisitions.

11. Returning funds to shareholders

When it became obvious that the surplus funds created from disposal of FPD was unlikely to be fully utilised for an acquisition in the near future, we decided to return approximately half of the surplus funds to the shareholders through a special dividend in 1996. This was because we believe that the money belongs to the shareholders and they may be in a better position to invest it in their own best interests rather than we as a company trying to do it for them. You as shareholders had welcomed the move and benefited from it. It was an unusual occurrence in India. At the same time, we have retained half of the funds so that we have enough funds for any possible acquisitions.

12. R&D initiative

As a part of the reorganisation drive in Glaxo Wellcome Group, it was decided that a local R&D Centre may be set up in India to develop drug formulations that are relevant to the subcontinent and the Asia Pacific Region. A small beginning has been made with the establishment of such a Centre at Thane. It is planned to expand this over time into a larger Development Centre, which will work in close conjunction with the Group R&D and respond to local needs. This should facilitate the development and marketing of new products for this market in the years ahead.

Impact of the Changes

The impact of the changes outlined above on the performance of the company during the five years 1991-92 to 1996 has been very significant.

Sales have more than doubled over the period growing at over 20 per cent p.a. compounded against an industry growth rate of 16 per cent.

Productivity per employee in the company as a whole measured in terms of sales over employee has growth by over 150 per cent while sales per field staff has grown over 70 per cent.

Profit margins as a percentage of gross sales has improved from the previous 2.3 per cent level in 1991-92 to a healthy 11.9 per cent — that is by five times. This has been achieved by all-round improvement in efficiencies.

Working capital as a percentage of sales has been brought down from 25.2 per cent to 17.2 per cent in an increasingly competitive market.

Interest charges as a percentage of sales has fallen from the high of 3.8 per cent to 1.2 per cent.

The net worth of the company has more than trebled from ₹ 826 million to ₹ 2,565 million with increases in equity and reserves.

Market capitalisation of the company has improved from about ₹ 6,000 million in March 92 to a current figure of about ₹ 19,500 million.

A shareholder who invested in 100 shares of Glaxo India in 1992 at a price of ₹ 300 per share will have today 240 shares including 20 rights and 120 bonus shares. The value of these 240 shares today will be about ₹ 80,000 as against his original investments of ₹ 30,000 plus investment of ₹ 1,300 in rights shares, i.e., a total investment of ₹ 31,300. Therefore, over the last five years, each shareholder has increased the value of his holding by over 155 per cent. And in the interim period of five years, he has received increasing dividends plus the Special Interim Dividend. A rejuvenated Glaxo India has certainly served you well. I am sure in the years ahead the company will perform even better and continue to grow ahead of the market. The ability and the motivation are in place.

Discussion Questions

1. Discuss the role of the Board of Directors of a company. Describe the provisions of the Companies Act, 2013, regarding composition of the Board and its significance.
2. Analyse the factors of management of change indicated in this case.
3. Identify the strategic, administrative and operational decisions.
4. Explain the factors which brought about the rejuvenation of Glaxo India Ltd.
5. What are your comments on the decision to divest the family products business? Was it a right decision or was there a better alternative?

Case 3

KSRTC AND KSRTC

This case illustrates how proper vision and mission, customer orientation, organisational restructuring and proper attention to operational strategies can contribute to good corporate performance and how failure on these can doom the future of an organisation.

The Kerala State Road Transport Corporation (KSRTC) and the Karnataka State Road Transport Corporation (KSRTC) present a very interesting contrast. While the Kerala SRTC is characterised by shrinking services, mounting losses and increasing customer dissatisfaction, the Karnataka counterpart presents a very dynamic case of strategic development, innovative product mix expansion attuned to serve the diverse needs of customers and measures aimed at improving operational efficiency and passenger comfort.

The Kerala State Road Transport Corporation, one of the oldest public sector transport undertaking in India which had its beginning in 1938, is in the ventilator, while the Karnataka Corporation presents a picture of a customer-oriented forward looking dynamic enterprise.

In 2014, the High Court of Kerala made a very damaging and eye opening comment on the Kerala SRTC; the Court wondered what public purpose does the Corporation serve by operating it the way it has been done, dolling out huge sums of money from the public exchequer every month to keep the loss making debt-ridden enterprise alive. For the Corporation which has been surviving over the years on borrowed funds from financial institutions and help from the state government, the current situation is such that it finds it difficult to even borrow from institutions as it has crossed all its limits. Chief Minister Oommen Chanday stated that the Corporation cannot function the way it is presently being run and there has to be a complete overhaul of the system and for that, the employees have to co-operate.

The Kerala SRTC, which is sitting on a huge mountain of debt and heavy accumulated loss, is incurring a loss of about ₹ 100 crore every month (2014 figures). In 2012-13, The Karnataka counterpart had a profit of more than ₹ 64 crore and no accumulated loss.

Karnataka is geographically a much more vast State than Kerala. As the operations of the Karnataka Transport Corporation grew substantially, the need for organisational restructuring to improve the operational efficiency and strategic reorientation was felt. The Karnataka enterprise, whose fleet size had grown to more than 10,000 buses by 1997, was divided and a new corporation by the name Bangalore Metropolitan Transport Corporation (BMTC) was formed in August 1997. In November 1997, another new corporation called North Western Karnataka Road Transport Corporation (NWKRTC) was carved out of KSRTC to cater to the transportation needs of North Western parts of Karnataka. Later, a North Eastern Karnataka Road Transport Corporation (NEKRTC) was also formed with its corporate office in Gulbarga. In 2013, the Karnataka SRTC had 8,243 vehicles, BMTC which has a monopoly of the public passenger transport by bus in Bengaluru, had 6720 vehicles, NWKRTC 4716 vehicles and NEKRTC 4295 vehicles. In other words, the combined fleet size of all the four Public transport undertakings of Karnataka more than doubled from 10,400 buses in August 1997 to nearly 24,000 at the end of March 2013. The fleet of buses of the Kerala Corporation, operating in the entire State, stood at 6,083 in July 2014 (about one-fourth of the

Karnataka Corporations and less than that of either the Karnataka State Road Transport Corporation or BMTC.).

In 2012-13, while the Karnataka SRTC had a profit of ₹ 64 crore and BMTC made a profit of ₹ 21 crore, NWKRTC and NEKRTC incurred losses of ₹ 23 crore and ₹ 18 crore respectively, leaving a profit of about ₹ 44 crore considering the profit/loss position of all the four corporations.

As in several other sectors, Kerala miserably failed to take advantage of the head start it had in public sector road transportation, mainly because of the inefficiency of successive managements and too conservative, self-defeating and derogatory attitude of the trade unions and political parties. Kerala has always been ruled by coalition governments formed either by rightist parties or leftist parties — the left and right alliances have been voted to power alternatively in every five years. The Ministry of Transport was headed by, from time to time, several parties of the right and left wings at different periods but things only went from bad to worse.

Monopolisation of certain routes by the State public undertaking and not serving those routes satisfactorily have really been amounting to harassing the passengers. To a number of places where both public and private sectors operated, KSRTC monopolised the direct routes with better roads and private operators were permitted only the roundabout routes with relatively poor roads. Further, the trunk routs of the State were nationalised to favour the Corporation. Inspite of these, all these advantages, the KSRTC has been in deep red.

Despite operating a large fleet, Kerala SRTC has not been able to provide good and hygienic bus stations with minimum public amenities, even in important places like Cochin, the industrial and commercial capital of the State.

Often, the Kerala Corporation had to cancel large number of services because of non-availability of tyres, other spares or diesel for want of money to buy them. For example, according to some reports in August 2014, around 1500 buses (about 25 per cent of the total of number of buses) were off the road due to such problems. Even many of the buses which run are in a very dilapidated condition because of very poor maintenance. Many buses which are on the road do not have proper shutters to save the passengers from rain water blowing in (Kerala is State with heavy rains). Buses with leaking roof and holes/cracks on the bottom platform trough which dirty water on the road flush in are also found. Sharp and rusted edges of inside parts of the buses harming the passengers is also not very uncommon. Seats of many buses are in a dilapidated, unhygienic and pathetic condition.

Attempts to organisational restructuring or modernisation of the fleet are resisted by the trade unions and political parties. Long ago, there was a proposal to establish a company to develop the passenger transport facilities of an underdeveloped region of the State, but it was opposed on the ground of privatisation although what was proposed was a government company. Even the very term ‘company’ is dubbed as synonym for capitalism. The buses which Kerala government got under the Central Government scheme, ‘JnNURM’, remained idle for a long period due to a controversy as to whether they should be operated by KSRTC or the City Corporations.

When an young person who was the Minister for Transport introduced a Volvo bus on a trial basis, it was strongly opposed by trade unions and political parties. In fact, many Keralites always look for more and more comfortable transportation. The interstate transport system linking Kerala is dominated by luxury and high-tech buses operated by private firms and public sectors of other states. Except a very insignificant percentage, all the interstate passengers are Keralites. Kerala SRTC was

the pioneer in introducing interstate buses but today its position is deplorable. Although the State undertaking has some luxury buses, passengers express high dissatisfaction about the maintenance and services provided, including non-supply of blankets and drinking water which other operators provide.

Compare this with the Karnataka. As of 2010, KSRTC of Karnataka was the largest state-owned Volvo fleet operator in India. The situation of Kerala is deplorable in this respect. The Karnataka Corporation has been very innovative and has always been in the forefront of fleet modernisation and improving customer services. Its fleet includes most modern buses. Some of the buses provide almost all the facilities available in an aircraft, including modern chemical toilets, on-board pantry service, WiFi on the move and individual television screens with multiple channels.

The Karnataka Corporation has a large number of booking outlets kiosks spread throughout Bengaluru and other places, including other States. The Corporation also franchises booking business to private agents. Another product augmentation by Karnataka Corporation is that any body who has booked a long distance travel from Bengaluru by its bus can travel free to the bus station from any where in Bengaluru by BMTC bus.

The Karnataka SRTC runs different types of buses to suit every section of the society. For example, in the Mysore-Bangalore route (about 2.50 to 3 hours of journey), which is one of the most dynamic sectors of the Corporation, it operates non-stop services by different types of non-AC and AC buses. There are different categories of AC buses – AC buses with ordinary seats, semi-luxury, luxury and super-luxury buses. There are different types of non-AC buses too. In this route, KSRTC is offering a stiff competition to other product forms, like train, car and flight. Within Bengaluru, BMTC is offering different types of bus services, ordinary, AC, limited stop etc.

According to the Website of Karnataka SRTC, its main mission is “Meeting Challenges with Innovation”. In the official website of the Kerala Corporation, no mission or vision statement is found. In the website, there is a heading “Future” but there is no mention about the future strategy, plan or anything of that sort under this heading.

The websites of the Karnataka Corporations give many indices of operational efficiency and performance in their Annual Administration Reports which are very elaborate, in both English and Kannada. This is an indication of the importance these Corporations assign to monitoring important parameters with a view to improving the operational efficiency. Important performance parameters monitored and sought to be improved include kilometers operated, average vehicle utilisation, tyre life, fuel efficiency, rate of breakdowns per 10,000 kilometer, rate of accidents per lakh kilometer , earning per kilometer, profit/loss etc.

These Annual Administration Reports of the Karnataka Corporations are very elaborate covering a gamut of aspects related to their operations.

The website of the Kerala Corporation is very deficient. Its website has a Table titled Financials but several items of information one expects in such a Table, like the annual profit/loss, accumulated loss, capital, investment, reserves, debt etc. are missing in the Table (perhaps deliberate).

Karnataka SRTC and BMTC have won a large number of national and international awards/recognitions for performance excellence on very diverse points. These organisations indeed have an organisational environment which encourages them to drive towards excellence. The vision and mission of MBTC (see Annexure C3.1), if imbibed in letter and spirit, should mobilise the organisation towards constantly improving the performance.

A person who has frequent experiences with Kerala SRTC and Karnataka SRTC/BMTC has sarcastically remarked, comparing the Kerala and Karnataka Corporations: The attitude of the Kerala Corporation is no to the customer while the approach of its counterpart is know the customer. Whatever may be the truth about this, it reflects some public perception.

The huge loss of KSRTC becomes handy for private bus operators for frequent demand for fare hike.

It is not that the Karnataka Corporations are without problems/deficiencies or that the Kerala Corporation has no strengths and positives. The purpose of this case is to provide a background to trigger a discussion on factors which are important to organisational development and performance.

Discussion Questions

1. Analyse the important factors which have contributed to the comparatively good performance of the public transport corporations of Karnataka.
2. With reference to this case, identify and explain the strategic, administrative and operational decision perspectives for the growth and performance of an organisation.
3. With reference to the vision and mission of BMTC, discuss the role of vision and mission in driving the development and operational efficiency of an organisation.
4. What are the reasons for the poor show by Kerala SRTC?
5. What are your suggestions in respect of Kerala SRTC?

Annexure C3.1

VISION AND MISSION OF BMTC

Vision

"Make BMTC sustainable, people-centered and choice mode of travel for everyone"

The Bangalore Metropolitan Transport Corporation is the sole public bus transport provider for Bengaluru, serving urban, sub-urban and rural areas. BMTC is committed to provide quality, safe, reliable, clean and affordable travel. The testimony of its success lies in increasing passenger trips everyday by a wide range of customer base. In an effort to modernise its services for commuter comfort, BMTC strives to strengthen information systems and improve processes through introduction of intelligent technology solution, make capacity enhancement through infrastructure development, user-friendly interchange facilities, fleet upgradation and augmentation, apart from its core activities, which includes fare structuring, route network optimisation, planning and monitoring. BMTC reaches far and wide, in every nook and corner of the city, making public transport an attractive travel choice for everyone. BMTC's stronghold in the area of public transport in Bengaluru is a testimony to its adoption of sound Management, HR, Quality and Environmental policies and strong support from the Government of Karnataka and esteemed passengers.

Mission

1. Provide people-centered (quality, efficient, integrated and safe) services
2. Commuter responsive service planning and promotion
3. Optimise resources and build capacity
4. Adopt environment-friendly and sustainable practices
5. Strengthen commuter feedback mechanism
6. Modernise and maintain zero breakdown fleet
7. Evolve effective mechanism to monitor service performance
8. Conduct safety training, performance audits and awareness for stakeholders
9. Increase commercial revenue through monetising land, buildings and buses
10. Increase efficiency in operations and administration
11. Ensure inter-agency co-ordination and multimodal integration
12. Formulate and enforce police measures for sustainability of the service provision
13. Implement Intelligent Transport System to improve the quality of service
14. Extend travel concession to the weaker sections of the society
15. Act as an agent for cultural synthesis and national integration
16. Promote research on urban transport

Case 4

CORE HEALTHCARE LTD.

This case exposes risks of fast growth and impact of environmental changes on the performance of companies.

The Core Healthcare Ltd., established in 1987 (then called Core Parenterals Ltd.), with gross assets of about ₹ 14 crore, turnover of ₹ 133 crore, profit after tax of ₹ 26 crore and exports of ₹ 6.6 crore in 1991 was on the fast growth track and the company set a vision: "To become a $ 1 billion international healthcare company operating in over 100 countries with strategically-located manufacturing facilities across the globe, thereby not only achieving leadership in India, but also a respectable market share in all the markets in which we operate." Asserts Sushil K. Handa, the CEO, for whom Akio Morita, who built up Sony to renowned global player from a humble beginning, was a role model. "Having had a global dream from the start, we have always had a vision."

The Core Group had its formal beginning in 1985 with the establishment of the Core Laboratories by the enterprising and dynamic Handa brothers — Sushil Handa who was qualified in finance and management and Sunil Handa who had a flair for both technical operations and marketing. The Handas, who were doing consultancy since 1979, chose the pharmaceutical industry after evaluating the prospects of a number of industries *vis-à-vis* their capabilities and resources.

Not very satisfied with the performance and potentials of their business, the Handas embarked upon diversifying into a promising pharmaceuticals related business — Parenterals (intravenous fluids and sterile preparations) and drew up a project report involving an outlay of ₹ 4.5 crore. The approach of the financial institutions was not very encouraging. There were hundreds of players, all, except a dozen or so with medium scale operations, being small players. The Handas, having had a dream of becoming global player, have had a thirst for modern technology. Although several of the medium scale players had the same technology as that of Core, only one was doing reasonably well and most others were either sick or limping. The conditions of the industry, however, did not discourage the Handas. They not only had a vision and project proposal but also determination. Finally, IFCI and Bank of Baroda came forward to support the project, moved more by the promoters' professional approach than by their appraisal of the project's intrinsic merit, and the promoters went public to mobilise resources.

The Core grew vertically and horizontally. Core Parenterals, established in1987 and commenced production in early 1998, achieved phenomenal growth in production capacity and domestic and international business.

Quality and productivity were among the cardinal principles of Core. Recognising fully well the importance of quality in the pharmaceutical industry, particularly for a global player, not only that there was no compromise on quality but also the company made its quality norms stricter than the international or other relevant standards and the quality mantra has been prevalent throughout the processes and the organisation. Use of latest technology contributed to the quality and productivity. Core became the first IV fluid manufacturer in India to win the Quality Excellence Award of the Indian Drug Manufacturers Association (IDMA). It also bagged the Good Manufacturing Practices Certificate as per the GMP norm laid down the by the WHO, the award for Excellence in Productivity and Udyog Rattan Award (both conferred by the Institute of Economic Studies.)

Price competitiveness was recognised as a very important factor in obtaining business, particularly in international markets. Economies of scale, latest technology, emphasis on productivity and cost control contribute to this objective in the Core.

Core's Human Resource Management has won high acclaim. Core could boast of a highly motivated, efficient and dedicated management team. Challenging tasks and responsibilities, and ample recognition of performance boost achievement motivation and commitment. In the pharmaceutical business, it is common that foreign buyers visit the manufacturer's plant and leading hospitals to evaluate the manufacturing conditions and practices, capabilities and credibility of manufacturer. Core had, in fact, been promoting such visits. It has been flying down doctors and distributors from abroad to visit its manufacturing facilities in India.

The turnover of Core Healthcare increased from less than ₹ 2.5 crore in 1989 to over ₹ 13 crore in 1991, to nearly ₹ 180 crore in 1996-97 and further to ₹ 267 crore in 1997-98.

The high profile of Core, however, came under shadow in 1997. One of its financiers (American Express Bank to which it owed ₹ 30 crore and out of which 50 per cent had been repaid) moved a wind-up petition against the company in the Ahmedabad High Court against its failure to honour the repayment schedule. Although the court dismissed the petition, it brought the financial strain of the company into the open. For the first time in its history, it incurred a loss in 1996-97.

Handa disclosed that the development was not entirely unexpected. "While drawing up our investment plans, we decided that we must have a plan which is disproportionally large as compared to our size. This meant some element of risk and we knew there would be a phase which may be called tough, financially speaking. It was a conscious decision to make an investment of ₹ 100 crore and to plan for an investment of ₹ 900 crore. This was done to attain a level of operation which otherwise may not be possible considering the time available to us."

Export has been a thrust area of Core almost since the beginning. A separate company, Core International Ltd., was set up to do the export of products of Core Healthcare and other group companies. According to Sushil Handa, "It is more fun doing overseas business. We make more money through our exports than Indian operations.' In 1998, Core was exporting more than 40 per cent of its total production to over 60 countries and was planning to expand its international operations to over 40 more countries.

Core had been spending heavily on promotion abroad. As much as 20 per cent to 25 per cent of its export turnover was spent on advertising and promotions. The company had been trying to build up brand awareness among surgeons, anesthetists and nurses by audiovisual conferences. For example, in 1997-98, a large delegation consisting of 146 representatives from Uzbekistan flew down to Ahmedabad by a chartered aircraft. It consisted of qualified doctors and professionals, media persons, Core's stockists, distributors and sales professionals based in Uzbekistan. This visit was a significant step towards strengthening the relationship between both the countries for mutual benefit in the context of Core having set up a joint venture at Tashkent.

The object of all these, according to Handa, were to "make the users of our products brand conscious, which helps simplify decision-making. Brand building takes time. But we are taking it much beyond IV fluids and syringes. We are not just filing tenders to get orders." Along with brand building, the company has been investing in training local staff in different countries.

The company had been planning to enter developed markets possibly through mergers and strategic alliance. Strategic alliances contemplated include manufacturing brands for foreign firms, marketing foreign firms' brands in India and the foreign firms in turn marketing Core brands abroad. Since around the mid-1990s, with the domestic manufacturers of IV fluid like Wockhardt and Albert David putting up stiff fight to control the market and global majors like Barter and D'Braun readying strategies to enter the Indian market, the emerging competitive situation seemed to be highly challenging. In response, Core drew up a ₹ 800 crore expansion plan that would not only treble its capacity to 240 million units per annum — 80 per cent of India's total annual requirement and the fifth largest capacity in the world — but would also broad-base its overall product portfolio by setting up plants to manufacture syringes, blood bags, and a total parental nutrition range. It also decided to put up a 30 MW captive power plant costing ₹ 120 crore.

In 1995-96, with an equity of ₹ 33 crore and reserves of ₹ 413 crore, the company had a debt of ₹ 572 crore. In 1996-97, it incurred a loss of about ₹ 45 crore on a sales of ₹ 184 crore and capital employed of about ₹ 1,145 crore. The net worth fell to ₹ 346 crore. By the end of 1997, the debt burden soared to ₹ 800. By the end of June 1988, it increased to about ₹ 970 crore.

There were several reasons for the financial problems that culminated in 1997. At a time when Core expanded its capacity, margins on the IV fluid declined. Handa outlined the reasons for the state of affairs of the company as follows: Expansion of capacity of IV fluids and simultaneous addition of new products — both at the same speed — was difficult to manage. Especially because the new range of products came with their set of problems such as teething troubles in absorption of technology. This also resulted in existing capacities jumping three to four times while sales could not keep pace. The company created a large salesforce of 1800 people, resulting in higher overheads. The disbursement of loans from the 20 member bankers' consortium led by ICICI went away in 1995-96, delaying the project and causing cost overrun to the extent of ₹ 60 crore. Further, because of the delay in getting funds, the cash flow targets slipped by a year. To make matters worse, the increase in competition in the IV fluid caused margins to dip.

A split in the Handa family in September 1995 resulted in a substantial payout. Sunil Handa who parted ways with Core, had to be paid a reported sum of ₹ 75 crore for his stake.

The investments in the power project seriously affected the financial position. Some observers remarked that the investment in power project was a blunder to which Handa's reply was that it was necessary to ensure continuous power supply.

It was apparent that infusion of additional funds was necessary to come out of the crisis of 1997. The debt-equity ratio being what it was, financial institutions were unwilling to increase their exposure. The promoters being unable to bring in additional funds, there was a suggestion to infuse external funding to increase equity, causing a dilution of Handa family's stake. Handa, obviously, did not like it. As a way out, Handa had put the power project and the formulations division on the block but could not get any offer that matched his expectation.

With accumulated losses of ₹ 377.39 crores as on December 31, 1999 totally wiping out the company's net worth at ₹ 346.17 crores, the company became an BIFR case.

Core was acquired by Nirma in 2008. The pharmaceutical products of Nirma's pharmaceutical division is marketed under the brand name Nirlife.

Discussion Questions

1. Evaluate the vision and growth strategy of Core.
2. Were vaulting ambitions of the promoters responsible for the problems of Core? Can they be justified for the fast expansions of business.
3. Discuss whether there were strategic intent and stretch in respect of Core.
4. What are the lessons to be learned from the experiences (problems encountered) of Core?

Case 5

MARKETING WARFARE AND EVOLUTION OF CORPORATE STRATEGIES *VIS-À-VIS* INDIAN DETERGENT INDUSTRY

This case illustrates how homegrown firms have successfully fought MNC giants, the strengths and weaknesses of domestic firms *vis-à-vis* MNCs and the influence of business environment on business and corporate strategies.

Indian Detergent Market – Bird's Eye View

In the last half a century or so, the fabric washing habits of the Indian population and the fabric washing products market has undergone a significant transformation and the changes continue.

Traditionally, the material used in India for washing of cloths was soap cakes/bars. Soda ash had also been largely used, particularly by low income groups. Washing was done, after applying soap/soda ash, by beating the cloth on a hard surface like stone or by beating the cloth with a log of wood.

Washing soap, brand named Sunlight, was manufactured for the first time in India by Lever Brothers India Limited in 1934 in its Sewri (Mumbai) factory [In 1956, this company was merged in to the newly formed Hindustan Lever Ltd. (HLL), which was rechristened as Hindustan Unilever Ltd. (HUL) in June 2007]. Marketed at quarter, the price of toilet soaps like Lux, Sunlight was used for both washing cloths and bathing. But gradually, it emerged predominantly as a laundry soap and HLL's Lifebuoy emerged as the dual purpose soap of the low income strata. The other major washing soap brand of the past was '501' bar of Tata Oil Mills Company [(TOMCO) – TOMCO was acquired by and merged into HLL in 1993.]. The laundry soap industry was highly fragmented and the low priced products of a large number of local small-scale units scattered in different parts of the country made the lion's share of the supply.

Detergent powder was introduced in India in the late 19950s. Swastik, an Indian firm, launched in 1957 the first brand of detergent (Det) in India. Surf, a blue detergent powder, which was test marketed by Hindustan Lever during 1956-58, was commercially produced since 1959. Det, a white detergent powder, became very successful in Eastern India and Surf became market leader nationally. HLL did high promotion to generate demand for Surf as a product (detergent) and a brand, demonstrating the method of use of it and the superiority of it.

The demand for detergent increased steadily. Its production in the country increased five-fold between 1960 and 1965, from 1,600 to 8000 tonnes. In 1966, TOMCO entered the detergent market with a brand called Magic. The detergent production in that year was estimated at 11,000 tonnes. However, even in early 1970s, laundry soap accounted for about 95 per cent of the laundry products.

The introduction of a detergent cake by TOMCO, brand named Bonus, ushered in the detergent cake segment. Companies came out with different brands of detergent powder and cake creating different price segments (presumably with different quality levels). Government of India encouraged the growth of detergent to free vegetable oil from laundry products manufacture (soaps are vegetable oil based). The crude oil price hikes since 1973 substantially increased the cost of production of

detergents due to this rise in the price of the raw material, compelling companies to increase detergent price. For example, HLL doubled the price of Surf between 1974 and 1975. However, new firms entered the scene. Important ones were, Karnataka Soaps/Mysore Sales International Limited (MISL)which introduced the brand Point; Godrej, which had been in the toilet soap's business for long, which launched a brand named Key and Detergents India Limited (DIL) which came with the brand Sixer. Some of these firms/brands have disappeared from the scene.

Today, powders account for more than two-thirds of the detergent market and the rest mostly by bars.

The competition in the detergent market intensified since the 1970s, as described in the following sections. The major chunk of the Indian detergent market is in the hands of a very small number of firms. Two popular (i.e., low priced) brands – Wheel of HUL and Ghari of RSPL, a firm started as a small enterprise in 1989 – account for about one-third of the Indian detergent market. With Nirma, the brand which was responsible for the explosive expansion of the market for low-priced detergent and the market leader for nearly two decades since the mid-1980s whose market share had fallen steeply to about 6 per cent in the early this decade, the combined share rises to about 40 per cent. Tide, the mid-priced detergent brand of Procter & Gamble (P&G), is the third largest selling detergent brand (estimated share in 2013 about 13 per cent). Taking all the brands of the companies, HUL has a share of about 38 per cent of the detergent market, RSPL 17 per cent, P&G 16 per cent and Nirma 7 per cent. That is, these five firms account for more than two-thirds of the Indian detergent market. Another important player is the Jyothi Laboratories which also possesses the Henko brands resulting from its acquisition of Henkal in 2011.

Growth of Indian firms like Nirma and RSPL into giant size and certain brands of MNCs like Wheel of HUL have been, to a large extent, at the expense of the unorganised sector firms. The unorganised sector firms suffer severely when raw material prices rise and/or when large firms cut prices. It is reported, for example, that the price war between multinationals and rapid growth of the Ghari brand across the country have washed hundreds of regional detergent brands out of the market. More than 500 local detergent brands such as XXX, T-Series, Vidsha, Tran Keri and Power Detergents have lost 10 per cent of the Indian detergent market according to Nielsen data. As a result, their combined market share slipped to nearly 3 per cent in 2010 from 13 per cent in the year earlier. This is mainly because the small players could not hold their price lines in a situation of inflating input costs, while national players such as Hindustan Unilever and Procter & Gamble either cut or hold on to prices, bridging the price differences with local brands. Consumers tend to move to 'reputed' brands when the price differential narrows down. Besides pricing, organised sector players get aggressive on other fronts too, like new launches and strengthening distribution and promotion.

Although the market penetration of detergents has been fast, reaching a fairly high stage, the consumption level is low. The per capita detergent consumption in India is around 2.7 kg per year, whereas in countries like Philippines and Malaysia, the per capita consumption is about 3.7 kg, and in USA it is around 10 kg.

The Indian detergent market may be broadly divided into four segments, viz., concentrates and compact segment for washing machines (brands such as, Surf Excel, Henko, Ariel, etc.); premium segment (examples: Surf, Ariel); mid-priced segment (examples: Rin, Henko, Tide) and popular/economy (i.e. low priced) segment (examples: Ghari, Wheel, Nirma, Mr. White).

The premium segment, including the concentrates and compacts, accounts for an estimated 15 per cent, mid-priced segment 40 per cent and popular segment 45 per cent of the market.

Like the Indian FMCG segment in general, the detergent market too has high growth potential. The detergent sector in the nation is estimated to have grown from ₹ 57 billion in 2003 to INR 130 billion in 2011, registering a growth of 11 per cent during the period. Almost similar growth trend is expected for quite some time in future.

We may distinguish the following phases in the transformation of the Indian detergent market.

Nirma's Uninhibited Growth

As the company website puts it, "Nirma, the proverbial 'Rags to Riches' saga of Dr. Karsanbhai Patel, is a classic example of the success of Indian entrepreneurship in the face of stiff competition" in a market dominated by multinationals and large Indian firms.

(Nirma was the pet name of Karsanbhai Patel's daughter Nirupama. She died in a car accident)

The beginning of Nirma indeed was very humble and too modest in every respect. However, what started in 1969 as a part-time activity by Karsanbhai, son of a small-time farmer, in a 10 × 10 ft backyard of his house in Saraspur, a suburb of Ahmedabad, has steadily and rapidly grown in to a conglomerate business house with an annual turnover of more than ₹ 7,000 crore, 18,000+ employee base.

Young Patel, a science graduate who was working as a junior chemist in a Government laboratory, started making detergent, mixing chemicals by bare hand and this washing powder that was to rewrite the history of Indian entrepreneurship and the marketing experiences of many a firm, particularly of a mighty multinational, was packed in polythene bags which were 'sealed' by stapling and sold door to door with money back guaranty by Karsanbhai on his way to office on bicycle some 15 km away. He was able to sell 15-20 packets a day.

It was a time when the Indian detergent market had, virtually, only the premium segment, ruled by Hindustan Lever's Surf. When Karsanbhai started his business, he would have never dreamt that he was cutting open a new market segment with enormous business opportunities and setting in motion a turbulent shake-up of the market structure and corporate strategies. He is reported to have stated: "It all started to earn a side income, and at that stage, I had never imagined this kind of success."

The growth of Nirma in the early period was not from market share gains at the expense of established players like the large firms such as Hindustan Lever; it was rather from market expansion. The low price of Nirma encouraged a change in the washing habits. There was a widespread conversion from oil soap and soda ash to detergent powder, because the low income households got, at last, a useful product they could afford and the size of the detergent market expanded manifold in no time. Fortune at the bottom of the pyramid was eloquently demonstrated by Nirma much earlier than this idea was propagated by Management guru C.K. Prahalad. In fact, Nirma became one of the cases chosen by Prahalad to explain fortune at the bottom of the pyramid.

In a short span, Nirma created an entirely new, and a very vast, segment in the washing products market and shattered the understanding of markets and marketing by multinationals and Marketing gurus. Nirma became one of the widely discussed Marketing Cases across the world.

With a product-price synergy that appealed to the huge mass market, excellently supported by appropriate distribution and promotion strategies, in a 'market' devoid of competition from major players, Nirma achieved an unbridled growth. Of course, encouraged by the Nirma story, several small firms made their best in this market. Some new start-ups did a high decibel promotion, including TV ad blitz to replicate the Nirma story but in vain, except the Rohit Surfactants Pvt. Ltd. (RSPL) which very successfully replicated the Nirma story more profoundly in a very tough business environment.

The performance of Nirma during the decade of 1980s has been labelled as 'Marketing Miracle' of an era. During this period, the brand surged well ahead Surf, a well-established detergent product of HLL which had been ruling the market. It was a severing battering for the MNC as it recorded a sharp drop in its market share. It was in 1985 that David had finally beaten Goliath – Nirma evicted HLL's Surf from the top position in the detergents market. Nirma went on increasing its share of the Indian detergent market and in 2004 it was a whopping 38 per cent. A change in the detergent usage pattern of upper income groups was observed. They used products of the like Nirma for washing coarse cloths or when the washing is done by servants and premium products for costly cloths.

Hiren K Patel, younger son of Karsanbhai Patel and CMD of Nirma Consumer Care Ltd. (Nirma's marketing arm) revealed: "Like other FMCGs, we have not concentrated only on marketing strategy. From the very beginning, operational strategy in cost containment, backward integration, economies of scale, innovative production, packaging and penetration schemes have received equal attention."

The business strategy of Nirma for the FMCGs is depicted in Figure C5.1.

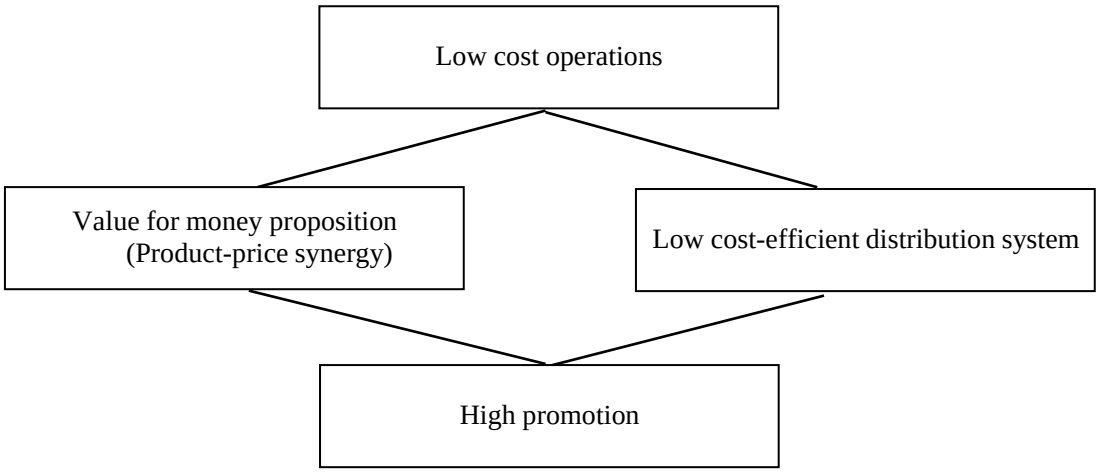

Fig. C5.1: Business Strategy of Nirma

Nirma grew by adopting the strategy purported by the Ansoff Matrix (See Appendix C.5.1 at the end of this Case). The backward integration strategy pursued by Nirma resulted in Nirma becoming a diversified company.

HLL and Nirma had been operating in two different income segments and the HLL managers had not considered, in the early days, Nirma a threat. "Nirma was inferior to Surf and other premium powders on every single characteristic normally measured." Despite the candid superiority of Surf, by 1977, Nirma was selling more than one-third the volume of Surf. Surf's volume market share had

fallen from about 41 per cent in 1975 to about 31 per cent in 1977; Nirma gained a share of nearly 12 per cent by 1977. A bit concerned about this trend, the branch manager of HLL in Ahmedabad was asked by Mr. Sen, Director, Marketing of HLL, to give him information on a brand called Nirma but the branch manager replied dismissively: 'You don't expect me to know about every junk product coming out of Ahmedabad." But this "junk product" continued to grow fast as it spread its wings to more or and more geographically and by 1980 captured a market share of 31 per cent pushing down Surf's share to about 22 per cent (nearly half of its share in 1975). Supported by its fast growth of the market coverage encompassing all geographical regions of the country, between 1977 and 1985, Nirma's annual sales grew at an astounding annual compound rate of 49 per cent and by 1985 it unseated the crowned king in value terms too. With a sale of 200,000 tonnes (a volume share of 58 per cent of the Indian detergent market, compared to Surf's share of 8 per cent), Nirma was one of the largest selling detergent brands in the world.

Product Mix – FMCG

Over the years, Nirma successively and successfully introduced products in the categories of fabric wash, dish wash, salt, and personal care (soaps, shampoos and toothpaste), thus offering the consumer a broad product portfolio, particularly with a value for money proposition.

Its first product, detergent powder, which became a runaway success and which laid the foundation for the enterprise's growth and expansion, was not of a comparable quality with that of Surf, the ruling brand in the market. But it was a right product for the enormously huge mass market which could not afford the price of Surf. (The price of Nirma was ₹ 3 per kg compared to ₹ 13 of Surf). According to the Nirma website, "it converted a luxury into a bare necessity product by placing the product within the reach of common man." Further, many rural and poor consumers upgraded from soda ash to this affordable detergents brand. There was also conversion from oil soap to detergent. In short, Nirma changed the washing habits of a large segment of the market. The result was that the size of the detergent market multiplied manifold in no time and Nirma emerged as the largest player in the Indian detergent market and one of the largest selling detergent brands in the world.

In 1985, incidentally the year in which Nirma became the market leader in detergent powder, Nirma detergent cake, the second product from Nirma, was launched as a line extension with the same strategy – low price and high promotion – and it too became a huge success, with the highest market penetration in the product category, repeating the Nirma detergent powder history. The Nirma cake took HLL's Rin head on. Nirma offered one detergent bar free with every packet of Nirma washing powder. This encouraged purchase of the powder and gave instant sampling of the bar by a very large number of consumers.

Having well established in the popular segment, Nirma decided to move up-market. In 1990, Nirma Super Detergent, a spray-dried blue detergent powder, was launched. With the value for money proposition, it was priced at about 40 per cent lesser than the competing brands. Within a short span of two years, it had cornered a substantial share of the mid-price segment. As a line extension, the company introduced Super Nirma Detergent Cake, in 1992, in 125 gms and 250 gms pack sizes, with a high detergency value and better quality than the Nirma Popular Detergent Cake. Like its counterpart Super detergent powder, within a short span it could win over consumers from competitor brands and achieve such a fast growth that it was ranked as the fastest climber for the year 1997-98 in the detergent cake/bars category.

Encouraged by the tremendous success in the fabric wash products market, Nirma entered the toilet soaps market with the same strategy, i.e., low priced product. The first such product from Nirma stable was a red colour carbolic soap (carbolic soap is a disinfectant soap which contains carbolic acid – a compound that is extracted from coaltar) named Nirma Bath. The brand name originally used by Nirma was Nirma Boy. The carbolic soap segment was dominated by Hindustan Levers' Lifebuoy. By imitating the colour scheme and brand name, Nirma wanted to piggyback on the enormous popularity of Lifebuoy. However, as Hindustan Lever took legal objection, Nirma was constrained to change the name and it was branded as Nirma Bath. It was alleged that with similar packaging, Super Nirma had a Surf look alike.

Available in 75 gms and 150 gms pack sizes, Nirma Bath has a total fatty matter (TFM) of 60 per cent (same as that of Lifebuoy and Mysore Carbolic soap).

Although the carbolic soap segment was on decline, Nirma Bath generated larger volumes each year.

In 1992, Nirma entered the non-carbolic segment of the toilet soap too with Nirma Beauty Soap. This low priced well promoted product with TFM content of 70 per cent and fragrance popularly liked, introduced in three different variants and pack sizes, within a short span of five years had achieved the status of the third largest selling toilet soap brand. It is claimed that Nirma Beauty Soap stagnated growth of Lux, a brand of HLL which had been dominating the market for a very long time.

Several companies sought to counter Nirma's entry to the toilet soap market by the same strategy – low price and high promotion. Godrej introduced Vigil and then No. 1 and HLL launched Breeze.

Nirma strengthened its presence in the toilet soap market, moving up-market by introducing brands such as Nirma Lime Fresh and Nirma Sandal. The strategy of Nirma was to introduce high TFM soaps with the right scents, and priced much lower than other brands. This created the 'sub-premium' segment. Nirma's game also encompassed managing the geographical diversity of consumer preferences. Explaining how Nirma hoped to win this game, playing by HLL's rules, Hiren said, "Worldwide, there are only four or five platforms – floral, beauty, health, freshness – which account for most of the soaps sold. For instance, the North preferred pink soaps while the South preferred green ones. Sandal soaps were more popular in the South.

Nirma positioned Nirma Bath against Lifebuoy, Nirma Beauty Soap against Lux, Nima Rose against Breeze, and Nima Lime against Jai Lime.

In 2000, the company entered the hair care market with Nirma Shikakai, Nirma Beauty Shampoo. It also introduced Toothpaste.

Promotion

As mentioned earlier, market penetration by low price and high promotion was critical plank of Nirma's marketing strategy. In the early days, Nirma portrayed a conventional theme of a lady washing garments. However, in 1973, it was modified and made very attractive and distinctive by featuring a small dancing girl.

Nirma's marketing was characterised by very high promotion. The promotion was innovative too. It was the first company to introduce bucket scheme to promote product hampers. It was very appealing to the consumer class of Nirma. In 1974 and 1976, the brand was promoted, *inter alia*, through prize draws of ₹ 30,000 and ₹ 60,000, very handsome amounts during those period even for

middle income and high income groups. For the third draw held in 1982, the prize money was a fabulous ₹ 2.2 lakh. At the Moscow Olympics (1980), Nirma was the only Indian advertiser, besides State Bank of India.

It is also reported that in the early days, to gain trade acceptance, young women were hired to visit retail shops in Ahmedabad asking for Nirma to give the retailers a feeling that the product had a god demand and thereby to encourage them to stock the product.

Outdoor advertisements were given a lot of importance by Nirma. In 1980, it launched Nirma calendar and plastic shop boards. Nirma advertisements were very conspicuous and ubiquitous in urban and rural shops, hoardings, moving vans and print media. Commercials in movie theatres caught great attention. Nirma was a pioneer of product sponsorship through electronic media. Besides radio advertising, Nirma made splendid use of the expansion of television broadcasting in the country since late 1970s. The attractive TV commercial with the jingle "*dudh si safedi Nirma se aye, rangin kapada bhi khil jaye*" (Nirma washes cloths white as milk) lingered in the minds of people, particularly housewives and children. The same jingle continues to be aired in Nirma ads even today. The TV ad blitz and other promotions shot Nirma's promotion budget by leaps and bounds. It went up from ₹ 2 million in 1980 to ₹ 4.5 million in 1983 and to an estimated ₹ 20 million in 1985 (about 2 per cent of the net sales). The impact of the promotion campaign was stupendous as indicated by the top-of-the-mind recall, unaided recall and an awareness level of over 90 per cent. The impact on sales is clear from the figures of sales and market share cited elsewhere in this case.

Initially, the advertising spend of the company was very low, as compared to other FMCG companies. Nirma spent only 1.25 per cent to 2 per cent of its turnover on advertising, a minuscule ratio compared to those of the its MNC peers. This helped it sustain its low-margin, high-volume strategy.

While introducing toilet soaps and detergents in the premium segment, Nirma relied on its time-tested weapon – price. The company planned to concentrate on volumes in these segments as well. But there was a change in the margins given to retailers. Unlike the economy products, where the cost benefits were passed on to the consumers, Nirma passed on this benefit to the retailers too. It gave them huge margins. For instance, for Nirma premium soap, it offered 52 per cent and for Nirma shampoo, it offered an unbelievable margin of 140 per cent.

Nirma's image appears to be a problem in moving on to high value segments. According to a survey conducted by Samsika Marketing Consultants, Nirma's marketing firm, Nirma was considered to be a cheap brand. Many people were almost ashamed to admit that they were using it. To shed this image, in the late nineties, Nirma released corporate advertisements on a huge budget.

Operations

Since the very beginning, Karsanbhai paid great attention to cost saving, be it raw material sourcing, transportation and distribution or manpower usage strategy.

As sales increased, Patel began adding production facilities. The second production unit was set up in 1973 at Rakhial and the next one in 1976 at Vatwa GIDC. As the sales grew by leaps and bounds, more and more production facilities were established in different parts.

For mixing the raw material, Nirma employed contract workers hired by job contractors and their wages were linked to the output of work.

Until 1985, all the operations were completely manual and this enabled Nirma to enjoy 15 per cent excise duty concession granted to small scale manufacturers not using any power. Following the withdrawal of this benefit in 1985, Patel began to introduce partial automation.

Low labour cost was one of the very important contributors to Nirma's low production cost. For example, in 1989, wages paid to its employs were estimated at between ₹ 15 to ₹ 25 per day whereas HLL's cost for unskilled labour were approximately estimated between ₹ 30 and ₹ 40. Further, the manual production process kept investment in plant and machinery also very low, at about ₹ 200 per tonne, as opposed to about ₹ 4000 per tonne for HLL's more capital-intensive production system.

As the business grew, it has gone, in due course, for adoption of modern technology and establishing an efficient supply chain of its own.

Important features Nirma's operations strategy have been the following.

- Backward integration to ensure sooth supply of quality raw materials at low cost
- Invest in capacities
- Employ state-of-the-art technology
- Efficient project implementation
- Cost control at every stage of operation
- Distribution and channeling in conjunction with other operations

Nirma, which started with a capital of few hundreds of rupees, has gone for massive backward integration, involving investments of thousands of crores of rupees. To keep production costs at a minimum, Nirma established captive production facilities, employing state-of-the-art technology, for raw materials. Nirma has also established the full range of packaging facilities. Almost 90 per cent of all raw materials – including linear alkyl benzene, soda ash, salt and packaging materials are manufactured in-house now.

Because of efficient project execution, its projects were commissioned well ahead of the schedule and resulted in large savings in cost savings. There is also substantial labour savings.

It also invested heavily in the expansion and modernisation of consumer goods manufacturing facilities. The production facilities located in different places employ state-of-the-art technologies.

Distribution

Nirma followed a flat, low cost and speedy distribution strategy. The distribution system is depicted in Figure C5.2.

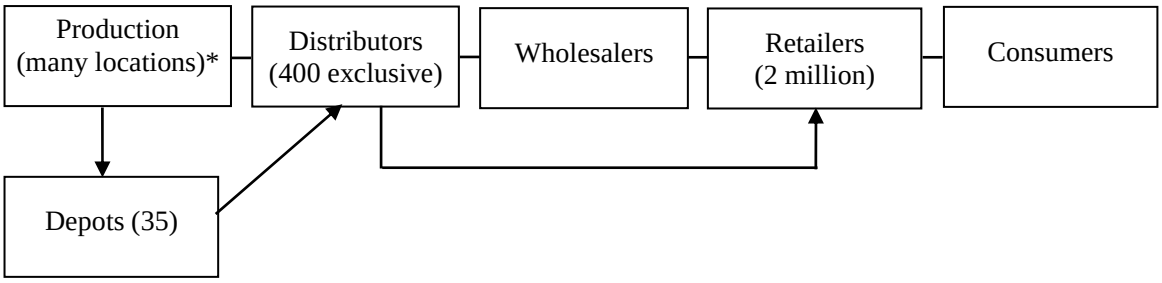

Fig. C5.2: Distribution System of Nirma

It has two separate channels for Nirma and Nima brands, each of which have a number of variants.

It has a dynamic channel feed system – channel is fed through both direct and dispatch and stock points. Stock point helps in reducing stock outs. Besides the fleet of trucks for uninterrupted distribution, it also uses railway for bulk transport.

Although Nirma had fast expanded its distribution infrastructure, it is pointed out that in the light of the growth of RSPL with Ghari brand and beefing up of the distribution by the MNCs and others, Nirma's position is week, particularly in urban areas. The biggies in the industry are further strengthening their distribution. For example, HUL recently added a large number outlets despite having the largest network of retail outlets.

Corporate Growth of Nirma

As mentioned in the beginning, what stated as a part-time tiny business enterprise, has rapidly grown into a conglomerate company with presence in several industries. We shall take a bird's eye view of the growth strategy of Nirma.

The growth strategy of Nirma reflects the Ansoff Matrix.

Nirma pursued the following corporate strategy:

- Diversification within the fabric wash products, personal care products and dish wash products
- Diversification by backward integration and entry into chemical products
- Entry into food products (edible salt)
- Entry into retail business
- Entry in to businesses like fertilizer and cement
- Entry into pharmaceuticals business.

Today, Nirma is one of the largest and most integrated manufacturer of detergents and toiletries in the world. It has a marketing and distribution network of 400 distributors and over a million retailers, reaching out to 300 million customers (FMCG). However, as indicated earlier, The battle in the soaps and detergents market is becoming more and more fierce. Nirma now has to fight a very strong firm of its genre (RSPL – maker of Ghari detergent) and other national/regional (like Jyothi Laboratories) and local firms on the one hand and on the other hand multinationals (HUL and P&G) that have strong marketing muscle like deep pockets for promotion, commendable R&D set-up, and distribution strength.

The backward integration made Nirma a conglomerate, i.e., a company with diversified business and producer of industrial products which are important raw materials for its washing products business.

Acquisitions also played a part in its diversification and growth. In 2007, the company acquired Searle Valley Minerals, a US-based producer of soda ash making it the world's seventh largest producer.

Today, Nirma is one of the largest and most integrated manufacturer of detergents and toiletries in the world. It is among the largest producers of LAB and soda ash, the two most important raw materials for soaps and detergents manufacturing.

Before the entry of Nirma, the production of soda ash and LAB (linear alkyl benzene), key raw materials in soap and detergent manufacturing, was controlled by a small clutch of manufacturers with GHCL and Tata Chemicals controlling the soda ash; while Tamil Nadu Petro Products and Reliance Industries supplied most of the LAB.

Nirma entered an entirely new business – pharmaceuticals – by acquiring the Ahmedabad based Core Healthcare Ltd., a Parenteral's manufacturing giant.

The pharmaceutical products of Nirma are marketed under the brand name Nirlife. Core was a sick company when Nirma took over it. Nirlife began its operations in 2006 with Parenteral preparations, and within less than six years, expanded into eight manufacturing facilities. It now has capabilities to offer a basket of 1000 plus healthcare and wellness products. These includes Hospital Care Products, Disposable Medical Devices, Critical Care Medicines like Anesthesia Products, Plasma Volume Expanders, Total Parenteral Nutrition, Antibiotics, Blood Related Products and Pharmaceutical Formulations like Pain Management Products, Gastric Preparations, Gynecological Preparations, Hormones, Anti-rheumatoids, Anti-allergy, Anti-Asthamatics, Growth Preparations, Vasodilators, Diagnostics, Steroids, and many more branded Over The Counter (OTC) products.

Nirlife is market leader in Hospital Care Products, Medical Disposable Devices and Formulations and India's largest manufacturer in Parenteral preparations and beat the giants through marketing Large Volume Parenteral (LVP), Small Volume Parenteral (SVP), High-end Parenteral Nutrition Products, Medical Devices and Consumer Healthcare Products.

The company's state-of-the-art integrated manufacturing facility is one of the largest in the world for several products. Its manufacturing facility is approved by WHO-GMP, CE and ISO 13485 Certifications, besides FDA's Schedule M Approvals. The Nirlife facility has approvals from several national bodies of different countries.

Nirlife has a global presence too. Its products are registered and marketed in almost 70 countries world over. It also partners with many MNCs by offering various product range through contract manufacturing and related services.

Nirma is also into education and several philanthropic activities. Karsanbhai Patel is a recipient of various awards and accolades, national and international. He was awarded an Honorary Doctorate by Florida Atlantic University, Florida, USA in the year 2001 in recognition of his exceptional accomplishments as a philanthropist and businessman. His contributions are also acknowledged by Government of India, and he has been endowed with Padmshri in 2010. Patel has also served as a Chairman for two terms to the Government of India's Development Council for soaps and detergents, as a Member of Bureau of Indian Standards Committee for Soaps and Detergent Industries and President of Gujarat Detergent Manufacturers Association.

In 1980, Nirma was incorporated as a Private Limited Company to carry on the business of manufacturing and selling Synthetic Detergents, Soaps, Chemicals and Allied Products. The Company is promoted by Shri Karsanbhai K. Patel.

In 1993, the company became a deemed public limited Company under Section 43-A of the Companies Act, 1956 and was then converted into a Public Limited Company by passing a special resolution at the Extraordinary General Meeting.

In 1994, Nirma came out with its maiden public issue of Equity Shares of ₹ 10/- each for cash at a premium of ₹ 100/- per share aggregating for ₹ 44.78 crore in February.

In 1997, it went in for a mega public offer totaling ₹ 350 crore, through the 100 per cent book building process, whereby the sale price of the share and the total size of the offer were to be driven by demand for the stock.

In the same year, the company established Nirma Consumer Care Ltd. – a wholly owned subsidiary in August, which is the sole licensee of the brand name Nirma within India.

With effect from March 28, 2012, Nirma Ltd. voluntarily delisted, pursuant to the Securities and Exchange Board of India (Delisting of Equity Shares) Regulations, 2009.

STING

HLL did take note of Nirma, particularly its growth since the late 1990s, but concluded that 'in the end, we can't make this product. It is so different in terms of product quality, unit cost etc.' Further, there were government policy constraints imposed by the Licence Raj which made capacity expansion by large firms very hard. Although HLL and Nirma were operating in two different income segments, the multinational had to take the Nirma 'threat' with all seriousness, particularly because of its future implications. HLL decided to take Nirma head-on and formulated a well orchestrated competitive strategy, viz., STING (Strategy To Inhibit Nirma's Growth). The core of the strategy was to introduce a product better than that of Nirma at comparable price, deploying the marketing muscle and other strengths of the company. The major complaint against Nirma was that its prolonged use damaged the fabric and harmed the user's skin due to the high soda ash content. Since 1984, HLL's R&D team was working on developing a non-soap detergent (NSD) powder and the mix was ready by 1986. Using this mix, HLL launched, in 1986, the Wheel brand of washing powder to counter Nirma, at a competitive price. Wheel was definitely superior in quality to Nirma.

HLL resorted to a low cost business model. Polythene packaging was used for Wheel to reduce cost, compared to the carton packaging of Surf. Wheel was contract manufactured by geographically dispersed SMEs so that the concessions offered by governments to such units translated into cost saving – one advantage enjoyed by Nirma. Further, the overheads and labour costs of these units were significantly lower than of the HLL. The company sourced soda ash and other raw materials from Gujarat cheaply and supplied to the manufacturing units. HLL also established its own production facility for Wheel where the overhead costs were low than in other factories of HLL.

To score over Nirma, HLL employed a direct attack strategy. Wheel's advertising strategy aimed at projecting, indirectly, the superiority of Wheel over Nirma and to encourage Nirma consumers to switch over to Wheel. The ad campaigns emphasised that Wheel provided extra power, extra lather and was safe on hands and cloths. In 2002, 16 years since the launch, Wheel clocked in sales of ₹ 814 crore compared to ₹ 1,182 crore of Nirma and within the next few years Wheel succeeded in pushing Nirma down to the second position.

It may be recalled here that in 1985, HLL unleashed a big ad campaign to position Surf against Nirma, emphasising the price-quality equation and the cost per wash consideration, figuring a

character named Lalithaji, portrayed by TV artist Kavitha Chaudary. Lalithaji, a loyal Surf consumer, was depicted as a shrewd and pennywise housewife, astutely bargaining for vegetables, with a typical shopping basket in her hand with a Surf packet conspicuously positioned in the basket, conveying the message that good quality always came at a price. She retorted to the vegetable vendor's offer of bad tomatoes at a low price "*Sasti cheez me farak hota hai saab*" (There is a difference between cheap goods and quality goods). Giving out the idea that the quantity of Surf required per wash was lower (than that of cheaper alternatives), it was sought to drive home the idea that Surf works out cheaper than what it outwardly appeared by indiscriminate price comparison. Lalithaji's statement "*Sasti cheez me farak hota hai saab*" became so popular that old timers recall them even now. Lalithaji is alive in writings and conversations today in contexts of common consumer, shrewd consumer and, of course more commonly in discussions of promotional campaigns. This is generally regarded as a very successful campaign. Surf's volume stagnated between 1980 and 1985, resulting in a decline in its share in the growing market. However, its sales increased from 30,000 to 42,000 between 1985 to 1990 (an increase of 40 per cent). In 1985, HLL introduced a white low priced detergent brand, Sunlight.

New Pitch

The warfare for the Indian detergent market has witnessed several new battles in the last two-and-a-half decades, with the entry new warriors. The entry of P&G, in the early 1990s, the emergence of Rohit Surfactants Pvt. Ltd. (RSPL) with its Ghari brand as a power to be reckoned with, and the consolidation of the market power of Jyothi Laboratories with the acquisition of Henkal brands etc. have led to a high pitch battle.

While Nirma and Wheel had been fighting for leadership, another brand of detergent – Ghari – introduced in 1987 by a small start-up, RSPL, established in Kanpur by two brothers, Muralidhar Gyanchandani and Bimal Kumar Gyanchandani, made rapid inroads and became the Number 1 detergent brand in India by 2011-2012 with a market share of more than 17 per cent; Wheel was at Number 2 with a share of slightly less than 17 per cent; P&G's Tide was 3rd with a market share of 13.5 per cent and Nirma's market share had fallen to less than 6 per cent. In fact, Nirma' detergent's total sales as well as market share have fallen sharply. Now, Nirma is not seen in some markets where it was present in the past, like Kerala. According to Hiren Patel, "Instead of focusing only on volume growth, Nirma strives to maintain its margins by adopting a judicious mix of volume, price and quality-driven strategies."

The Indian detergent market has undergone a drastic transformation since the early 1990s with the entry of Procter and Gamble (P&G), the largest MNC in the FMCG sector and Unilever's arch rival globally. In 1991, P&G commercially launched Ariel Microsystem, a product based on its advanced proprietary enzyme based technology, with heavy promotion. Ariel was considered superior to Surf and was priced at ₹ 32 for 500 gms pack compared to Surf's ₹ 15.80 and Nirma's ₹ 4.90. The main plank of the promotion theme was that Ariel was a superior product which was not costly as it outwardly appeared because of the lower quantity of the high quality product needed in washing. HLL which had prided itself about the superiority of its products suddenly got a severe blow. Although HLL had introduced a detergent concentrate in the 1980s under the Rin brand name, its technology was not a match to that of Ariel.

In fact, Unilever, HLL's parent company, had its own product of enzyme based technology, HLL did not favour the idea of launching it in India because of the feeling that the Indian market was not ripe for such an advanced product costing high. Moreover, in the absence of competition, Surf could sweep the entire premium segment. However, P&G carved out a 'super-premium' segment with Ariel and stole the show away from HLL. HLL acted swiftly to introduce a new product, Surf Ultra, to counter P&G, compressing the product development cycle to four months compared to the hitherto normal two years. Surf Ultra was launched nationally in early 1992.

In 1996, HLL replaced Surf Ultra with international Surf Excel, emphasising its stain removing property in the advertisements. Following this, P&G upgraded Ariel to Ariel Microshine. HLL roped in Bombay Dyeing, a popular textile firm, to endorse Surf Excel. P&G retaliated by tying up with Reliance, another textiles firm, to endorse Ariel Microshine. India, a fast growing and one of the most potential markets in the world, became the battlefield fiercely fought between multinational giants Unilever and P&G. They fought head on by launching new product variants with new/improved features and at different price bands. Some of the ads of P&G and HLL were of the type of directly attacking the competitor, some times laughing at the competitor. Tide variants are in the mid-price segment while Ariel variants are in the premium segment. HUL is spread in all segments with different brands and extensions.

Indian washing products market has been becoming increasingly competitive with fierce battle for market share by multinationals (HUL and P&G), home grown large players (Nirma, Rohit Surfactants and Jyothi) and many local and regional players. Low priced brands of HUL, Nirma, Rohit Surfactants, Fena and Jyothi (including some of the brands of Henkal which Jyothi acquired) took away a substantial share of the detergent market by the value for money proposition. In 2001, P&G slashed the price of Tide substantially from ₹ 135 to ₹ 85 per kg. This set in motion a price war.

The price war between the MNCs and their planking strategy of attacking/defending the popular and mid-priced segments with brands in different price points made the fight for the market by homegrown national and regional/local players difficult.

The Ghari Express

Ghari's growth has been rather astonishing Nirma grew in a vast unexploited segment without any competition from large players (until late 1980s Ghari, which reached the market when Nirma was at its peak, however, has had two strong brands to compete with – the well-established Nirma and Wheel from the mighty multinational HLL/HUL. Ghari followed Nirma's strategy of keeping low price and targeting customers at the bottom of the market. The Gyanchandanis stated that "We have been inspired by Nirma's low-cost model."

Both, Ghari and Nirma, incidentally, operate at the lower end of the detergent market, known as the economy segment. Ghari's market share gain came largely at expense of Nirma. It has also been getting customers converted from poor local products. Although Ghari detergent is a mediocre product, it claims to have certain significant features, viz., resistance against moth and shrinkage, no toxic chemicals present, leaves a pleasant fragrance in clothes washed with it, formulated in accordance with the well-defined parameters of the industry and is subjected to strict quality checks. Priced about 20 per cent higher than rival brands (Nirma and Ghari), the company has marketed its product on the back on a 'better quality proposition', Ghari ad with its classical logo – "Pehle Iste Maal Karein Phir Vishvaas Karein" which means "first use and then trust" has been well accepted and the rapid growth

of Ghari indicates that a very substantial size of the consumers trust the product. It is also observed that part of the success was helped by Nirma digressing from brand building to putting up soda ash business and HUL focusing more on the top end of the market.

Launched in 1987, it took almost 15 years for Ghari to hit ₹ 500 crore in sales. But the next 10 years saw it adding another ₹ 1,700 crore to annual sales. In the fiscal ended 2011, RSPL had a net sales of ₹ 2,200 crore, of which Ghari contributed ₹ 2,083 crore.

Both Nirma and RSPL have been spending less than 2 per cent of the sales revenue on promotion compared to as against 12-14 per cent spent by its MNC peers. This helps them to sustain its low-margin, high-volume strategy.

RSPL participates in exhibitions, melas and roadshows mostly in rural India. RSPL also flagged off the 'Ghari Detergent Express', a train whose exteriors are painted with Ghari branding that ran between Lucknow and Guwahati for two months. This was followed by other such trains connecting northern regions with both west and south of India, in line with the company's geographical ambitions.

RSPL's hyper growth was made possible by very rapid expansion of production capacity and marketing infrastructure. In the first two decades, Ghari's market was confined mostly to Uttar Pradesh, the most populous State of India, which, with a population of 187 million, accounted for an estimated FMCG market share of about 12 per cent. It then entered the adjoining State of Bihar, Madhya Pradesh and Punjab which along with UP account for about one-third share of the total consumer products market of the country. "Ghari is simply strong in the north. People love the brand there, especially in the 'Bimaru' belt of Bihar, Madhya Pradesh, Rajasthan and Uttar Pradesh," according to an executive with an FMCG firm.

Ghari steadily expanded to other States. By 2012, marketing of Ghari covered 19 States through more than 3,500 dealers; 10 of these States were in the last three years. It had 21 manufacturing units, 15 of which were added since 2006. It would be spreading to other States and places where it is not present, particularly South India. In other words, its tally is not over.

Ghari's impeccable hold over its distribution system in the north, according to analysts, has helped the player gain share at the cost of Nirma. It sits well entrenched in its home State with about 900 dealers. According to some estimates, the North is the largest when the detergent market is split geographically. Its share stands at 35 per cent, compared to the West's 30 per cent, South's 25 per cent and East's 10 per cent, say analysts. "Anybody who has a grip on the northern market then can't be taken for granted,"

RSPL has a strong, wide and cost-efficient distribution system. While most other consumer companies rely on clearing and forwarding agents, RSPL, like Nirma, supplies its products from factories to dealers, saving at least 2 per cent in costs. "The promoter's domain and geographical knowledge has been very strong" Adriver-cum-Porter-cum-Salesman used to distribute Ghari to dealers when its rivals employed three people to do the same job.

Besides detergent powder, RSPL has detergent cakes in 340 gms, 190 gms and 95 gms. Keeping in view the expanding market of personal and home care products in India, the company has set up a unit in Haridwar for the manufacturing of personal and home care products like Shampoo, Hair Oil, Toothpaste, Moisturiser, Shaving Cream, Liquid Hand Wash, Floor Cleaner, Liquid Detergent and Toilet Cleaner. The unit has become operational in March 2010. By 2014, RSPL was a diversified company with a turnover of about ₹ 3800 crore.

In March 2013, RSPL moved up-market by introducing UniWash brand in the mid-price detergent segment. At ₹ 95 a kilo, the new product commands a 10 per cent premium over competitors Rin and Tide's basic variants and costs double as much as Ghari. RSPL's strategy in respect of UniWash has been in contrast to what it adopted for its runaway success Ghari detergent a quarter of a century ago. UniWash is targeted more at the urban consumers. To start with, it was launched in Punjab, Haryana and New Delhi while Ghari confined itself to Uttar Pradesh in for a very long time the first two decades of its existence and then expanded to the Bhimaru States.

Conclusion

Competition has been intensifying in the top, middle and bottom segments of the pyramid.

The socio-economic changes and the resultant changes in the consumer behaviour is causing a shift in the demand pattern. The increasing washing machine usage is increasing the demand for premium products, including concentrates and compacts. Companies have also been introducing more pack sizes, including 200 gms and 20 gms, to better cater to the diverse consumer needs.

Multinationals have learnt that the corporate strategy and business strategies have to zero in the idiosyncrasies of the national and local markets. National firms have a long way to move to the top of the market pyramid.

Discussion Questions

1. Explain the factors which contributed to the growth of Nirma.
2. What were the deficiencies, if any, in HLL's understanding of the Indian market and the flaws in its strategy during the pre-STING period?
3. Discuss the corporate growth strategy of Nirma with reference to the Ansoff Matrix.
4. Why did Nirma detergents slip in market share in the recent period?
5. Give a comparative analysis of the growth of Nirma and RSPL, with particular reference to the differences and similarities in the business environments.
6. What are the problems for moving upmarket by Nirma and Ghari?
7. Why, in your opinion, P&G has not entered the popular segment? Explain whether it should enter this segment?
8. What differences do you notice in the strategies of the major players in the detergent market?
9. Analyse the strengths and weaknesses of the major players in the Indian detergent market.

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Appendix C5.1

ANSOFF MATRIX

H. Igor Ansoff, primarily a mathematician, had an expert insight into business management and is a renowned name in Strategic Management.

The Ansoff Matrix, also known as the Ansoff Product and Market Growth Matrix proposes a model four alternatives of marketing strategies encompassing existing products/markets and new markets/products. These strategies are market penetration, product development, market development and diversification.

Market Penetration

The strategy of market penetration is increasing sales of existing product in existing market. This may be achieved by:

- Converting non-consumers into consumers (for example, a large section of the Indian population does not use toothpaste who can be turned consumers of toothpaste)
- Winning over consumers from competitors (increasing sales at the cost of competitors)
- Increasing sales to existing consumers (for example, by convincing those who use toothpaste only once a day of the need to brush teeth more than once.)
- This strategy also entails keeping pace with, at least, the growth of the market (i.e., maintaining the market share in a growing market.)

Market penetration strategy employs strategies related to one or more of the four Ps of Marketing, viz.:

- Product (like product modification, product line extension)
- Promotion (like advertising and sales promotion)
- Distribution (like adding new channels/increasing reach of existing channels etc.)
- Pricing (like modification of price to increase sales, introducing product variants at different price points etc.)

Market penetration is regarded as the least risky of the four strategies. It is playing with the known product in the known market and additional capital investment required is either nil or relatively small.

Market Development

Market development strategy seeks to expand the market for the existing product. Market development may be done by:

- Entering new geographic market
- Entering new market segments

Although market development is riskier than market penetration strategy, it is less riskier than the other two strategies.

Product Development

The essence of this strategy is launching new products for the existing market. For example, a company which markets a motorcycle of a particular engine capacity may increase its two-wheeler business by introducing new variants of motor cycle or scooter or moped. This strategy is regarded as riskier than penetration and market development strategies but less riskier than diversification strategy.

Diversification

Diversification often is a dual strategy encompassing new product and new market. For example, for a company which launches the mobile phone for the first time, mobile phone is a new product and the market for mobile phone is a new market for this company.

Diversification is regarded as riskiest growth strategy, as it involves developing new markets and new products simultaneously. However, if the strategy succeeds, the rewards cold be very good. Further, it also tends to reduce the risk of keeping all the eggs in one basket.

It may be noted that the strategies mentioned above are not exclusive in themselves; there may be overlapping. For example, introduction of new product variants is often a part of market penetration and market development strategies, i.e., there is overlapping of some of the market penetration, market development and product development strategies.

The Ansoff Matrix is depicted in Figure C5.3.

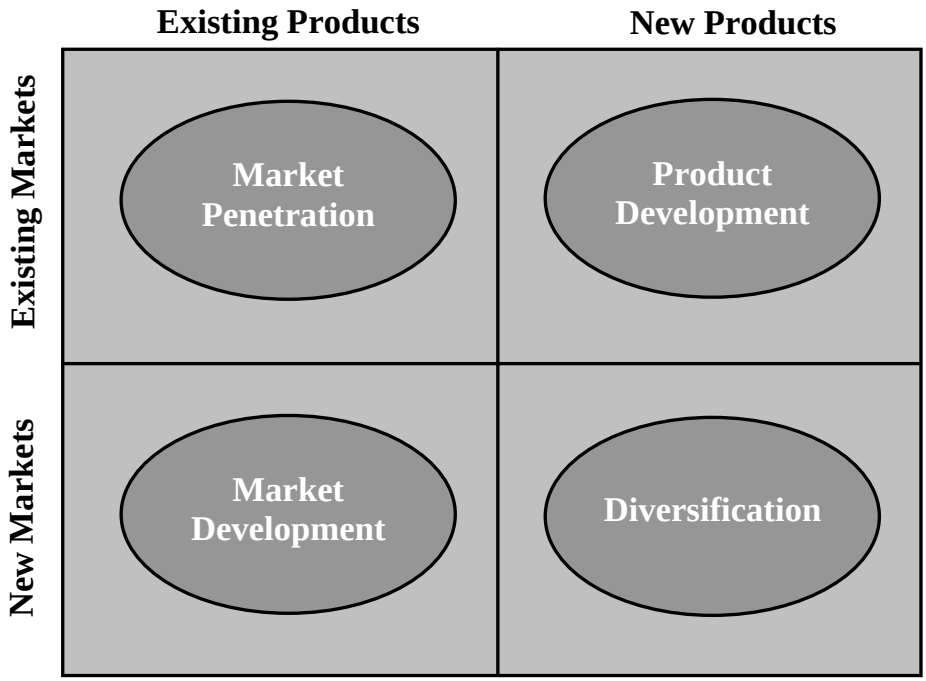

Fig. C5.3: Ansoff Product and Market Growth Matrix