Chapter Six

Strategy Analysis and Choice/Strategy Formulation

6.1The Nature of Strategy Analysis and Choice

Strategy analysis and choice seeks to determine alternative courses of action that could best enable the firm to achieve its mission and objectives. The firm's present strategies, objectives, and mission, coupled with the external and internal audit information, provide a basis for generating and evaluating feasible alternative strategies.

Unless a desperate situation faces the firm, alternative strategies will likely represent incremental steps to move the firm from its present position to a desired future position. Alternative strategies do not come out of the wild blue yonder; they are derived from the firm's mission, objectives, external audit, and internal audit; they are consistent with, or build up on, past strategies that have worked well.

Strategists never consider all feasible alternatives that could benefit the firm, because there are an infinite number of possible actions and an infinite number of ways to implement those actions. Therefore, a manageable set of the most attractive alternative strategies must be developed. The advantages and disadvantages, trade-offs, costs, and benefits of these strategies should be determined.

Identifying and evaluating alternative strategies should involve many of the managers and employees who earlier assembled the organizational mission statement, performed the external audit, and conducted the internal audit.

6.2Long-Term Objectives

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

Objectives should be quantitative, measurable, measurable, realistic, understandable, challenging, hierarchical, obtainable, and congruent among organizational units. Each objective should also be associated with a time line. Objectives are commonly stated in terms such as growth in assets, growth in sales, profitability, market share, degree and nature of diversification, degree and nature of vertical integration, earnings per share and social responsibility. Clearly established objectives provide direction, allow synergy, aid in evaluation, establish priorities, reduce uncertainty, minimize conflicts, stimulate exertion, and aid in both the allocation of resources and the design of jobs.

Long-term objectives are needed at the corporate, divisional, and functional levels in an organization. They are an important measure of managerial performance. Without long-term objectives, an organization would drift aimlessly toward some unknown end!

6.3A Comprehensive Strategy-Formulation Framework

Important strategy-formulation techniques can be integrated into a three-stage decision-making framework, as shown below. The tools presented in this framework are applicable to all sizes and types of organizations and can help strategists identify, evaluate, and select strategies.

Stage-1 (Formulation Framework): called the input stage.

1. External factor evaluation
2. Competitive matrix profile
3. Internal factor evaluation

Stage 1 summarizes the basic input information needed to formulate strategies. The input tools require strategists to quantify subjectivity during early stages of the strategy-formulation process.

Stage-2 (Matching stage)

Strategy is sometimes defined as the match an organization makes between its internal resources and skills and the opportunities and threats created by external factors. The matching stage of the strategy formulation framework consists of five techniques that can be used in any sequence: the TOWS matrix, the SPACE matrix, the BCG matrix, the IE matrix, and the Grand Strategy Matrix. The tools rely upon the information derived from the input stage to match external opportunities and threats with internal strengths and weaknesses. Matching external and internal critical success factors is the key to effectively generate feasible alternative strategies.

1. **TOWS Matrix** (Threats-Opportunities-Weaknesses-Strengths)
2. **SPACE Matrix** (Strategic Position and Action Evaluation)
3. **BCG Matrix** (Boston Consulting Group)

4. **IE Matrix** (Internal and external)
5. **GS Matrix** (Grand Strategy)

Stage 2**,** called the *Matching Stage,* focuses upon generating feasible alternative strategies by aligning key external and internal factors. These tools rely up on information derived from the input stage to match external opportunities and threats with internal strengths and weaknesses.

1. **The *Threats-Opportunities-Weaknesses-Strengths (TOWS)***

It is also named as SWOT analysis. A TWOS Analysis is a strategic planning tool used to evaluate the Threats, Opportunities and Strengths, Weaknesses, involved in a project or in a business venture or in any other situation requiring a decision.

This is an important tool in order to formulate strategy. This Matrix is an important matching tool that helps managers develops four types of strategies: SO Strategies (strength-opportunities), WO Strategies (weakness- opportunities), ST Strategies (strength-threats), and WT Strategies (weakness-threats).The most difficult part of TOWS matrix is to match internal and external factor.

Once the objective has been identified, TOWS are discovered and listed. TOWS are defined precisely as follows:

Strengths are attributes of the organization that are helpful to the achievement of the objective.

Weaknesses are attributes of the organization that are harmful to the achievement of the objective.

Opportunities are external conditions that are helpful to the achievement of the objective.

Threats are external conditions that are harmful to the achievement of the objective.

Strengths and weaknesses are internal factors. For example, strength could be your specialist marketing expertise. A weakness could be the lack of a new product.

Opportunities and threats are external factors. For example, an opportunity could be a developing distribution channel such as the Internet, or changing consumer lifestyles that potentially increase demand for a company's products. A threat could be a new competitor in an important existing market or a technological change that makes existing products potentially obsolete. It is worth pointing out that SWOT analysis can be very subjective - two people rarely come-up with the same version of a SWOT analysis even when given the same information about the same business and its environment. Accordingly, SWOT analysis is best used as a guide and not a prescription. Adding and weighting criteria to each factor increases the validity of the analysis.

a) **SO Strategies:** Every firm desires to obtain benefit form its resources such benefit can only be obtained if utilize its strength to take external opportunity. Resources (Assets) an important firm's strength to get opportunity for external resources. For example the firm enjoying a good financial position which is strength for a firm and externally opportunity to expand business. The strong financial position provides an opportunity to expand the business. The matched strategy is known as SO strategy.
b) **WO Strategies:** WO Strategies developed to match weakness with opportunities of the firm. WO strategy is very useful if the firm take advantage to external resources in order to overcome the weakness. For example the firm is in the critical financial problems that is weakness and firm is availing merger with Multinational Corporation.
c) **ST Strategies:** ST Strategies is an important strategy to overcome external threats. This does not mean that a strong organization should always meet threats in the external environment head-on. This strategy is adopted by various colleges by opening new branches in order to overcome competitive threat. These threats also explain by the Porter in its competitive model.
d) **WT Strategies:** Every firm has a desire to overcome its weakness and reducing threats. This type of strategy is helpful when weaknesses are removed to overcome external threats. It is difficult to target WT strategy. For example weak distribution network creating many problems for the firm if it strong many external threats can be removed.

2. **The Strategic Position and Action Evaluation (SPACE)**

It explains that what is our strategic position and what possible action can be taken. This follows counter clock wise direction. It contains four-quadrant named aggressive, conservative, defensive, or competitive strategies. The axes of the SPACE Matrix represent two internal dimensions financial strength [FS] and competitive advantage [CA]) and two external dimensions (environmental stability [ES] and industry strength [IS]). These four factors are the most important determinants of an organization's overall strategic position.

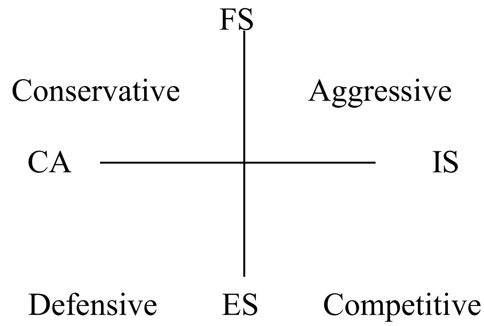

Figure 6.1 The SPACE Matrix

These dimensions are explained below:

Internal Strategic Position **Financial Strength (FS)** Risk involved in business Debt to equity ratio Working capital condition Leverage Liquidity Ease of exit from market Cash flow statement Return on investment	**External Strategic Position** **Environmental Stability (ES)** Impact of technology Price elasticity of demand Political situation Demand variability Price range of competing products Rate of inflation Competitive pressure
Competitive Advantage (CA) Access to the market Market share Quality of product and services Product life cycle Customer loyalty Capacity, location and layout Technological know-how Backward and forward integration	**Industry Strength (IS)** Demand and supply factors Resource utilization Growth potential Profit potential Financial stability Technological know-how Productivity, capacity utilization Capital intensity Ease of entry into market

3. The Boston Consulting Group Box ("BCG Box")

Using the BCG Box (an example is illustrated above) a company classifies all its SBU's according to two dimensions:

On the horizontal axis: relative market share- this serves as a measure of SBU strength in the market

On the vertical axis: market growth rate- this provides a measure of market attractiveness

By dividing the matrix into four areas, four types of SBU can be distinguished:

Stars - Stars are high growth businesses or products competing in markets where they are relatively strong compared with the competition. Often they need heavy investment to sustain their growth. Eventually their growth will slow and, assuming they maintain their relative market share, will become cash cows.

Cash Cows- Cash cows are low-growth businesses or products with a relatively high market share. These are mature, successful businesses with relatively little need for investment. They need to be managed for continued profit - so that they continue to generate the strong cash flows that the company needs for its Stars.

Question marks- Question marks are businesses or products with low market share but which operate in higher growth markets. This suggests that they have potential, but may require substantial investment in order to grow market share at the expense of more powerful competitors. Management have to think hard about "question marks" - which ones should they invest in? Which ones should they allow to fail or shrink?

Dogs- Unsurprisingly, the term "dogs" refers to businesses or products that have low relative share in unattractive, low-growth markets. Dogs may generate enough cash to break-even, but they are rarely, if ever, worth investing in.

Using the BCG Box to determine strategy

Once a company has classified its SBU's, it must decide what to do with them. In the diagram above, the company has one large cash cow (the size of the circle is proportional to the SBU's sales), a large dog and two, smaller stars and question marks. Conventional strategic thinking suggests there are four possible strategies for each SBU:

(1) Build Share here the company can invest to increase market share (for example turning a “question mark" into a star)

(2) Hold here the company invests just enough to keep the SBU in its present position

(3) Harvest here the company reduces the amount of investment in order to maximize the short term cash flows and profits from the SBU. This may have the effect of turning Stars into Cash Cows

(4) Divest: the company can divest the SBU by phasing it out or selling it - in order to use the resources elsewhere (e.g. investing in the more promising "question marks").

4. The Internal-External (IE) Matrix

It relates to internal (IFE) and external factor evaluation (EFE). The findings from internal and external position and weighted score plot on it. It contains nine cells. Its characteristics are as follows:

- Positions an organization's various divisions in a nine-cell display.
- Similar to BCG Matrix except the IE Matrix:
  - ✓ Requires more information about the divisions
  - ✓ Strategic implications of each matrix are different
- Based on two key dimensions
  - ✓ The IFE total weighted scores on the x-axis
  - ✓ The EFE total weighted scores on the y-axis
- Divided into three major regions
  - ✓ Grow and build – Cells I, II, or IV
  - ✓ Hold and maintain – Cells III, V, or VII
  - ✓ Harvest or divest – Cells VI, VIII, or IX

The IFE total weighted scores

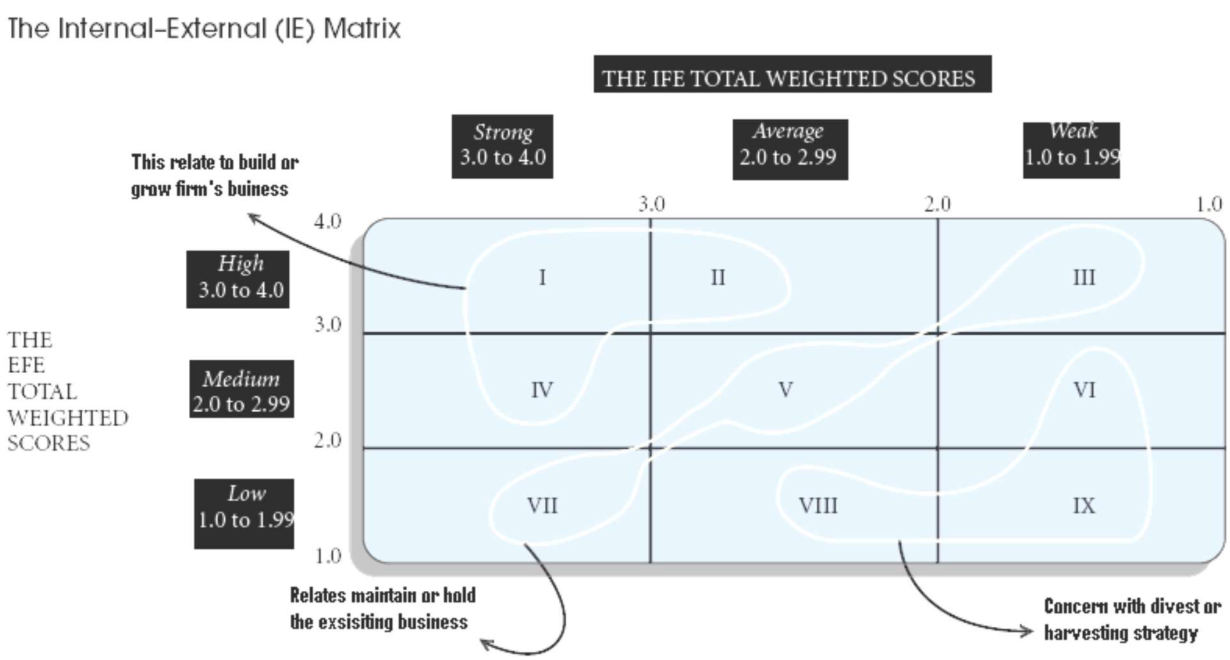

Figure 6.3 The internal-external (IE) matrix

Steps for the development of IE matrix

1. Based on two key dimensions IFE and EFE.
2. Plot IFE total weighted scores on the *x*-axis and the EFE total weighted scores on the *y* axis
3. On the *x*-axis of the IE Matrix, an IFE total weighted score of 1.0 to 1.99 represents a weak internal position; a score of 2.0 to 2.99 is considered average; and a score of 3.0 to 4.0 is strong.
4. On the *y*-axis, an EFE total weighted score of 1.0 to 1.99 is considered low; a score of 2.0 to 2.99 is medium; and a score of 3.0 to 4.0 is high.
5. IE Matrix divided into three major regions.

Grow and build – Cells I, II, or IV

Hold and maintain – Cells III, V, or VII

Harvest or divest – Cells VI, VIII, or IX

5. Grand Strategy Matrix

It is popular tool for formulating alternative strategies. In this matrix all organization divides into four quadrants. Any organization should be placed in any one of four quadrants. Appropriate strategies for an organization to consider are listed in sequential order of attractiveness in each quadrant of the matrix.

It is based on two major dimensions:

1. Market growth

2. Competitive position

All quadrant contain all possible strategies

RAPID MARKET GROWTH

Quadrant II	*Quadrant I*
Market development	Market development
Market penetration	Market penetration
Product development	Product development
Horizontal integration	Forward integration
Divestiture	Backward integration
Liquidation	Horizontal integration
	Concentric diversification

WEAK COMPETITIVE POSITION   **STRONG COMPETITIVE POSITION**

Quadrant III	*Quadrant IV*
Retrenchment	Concentric diversification
Concentric diversification	Horizontal diversification
Horizontal diversification	Conglomerate diversification
Conglomerate diversification	Conglomerate diversification
Liquidation	

SLOW MARKET GROWTH

Figure 6.4 The Grand Strategy Matrix

Qurdant-1 contains that company's strong having competitive situation and rapid market growth. Firms located in Quadrant I of the Grand Strategy Matrix are in an excellent strategic position. These firms must focus on current market and appropriate to follow market penetration, market development and products development are appropriate strategies

Qurdant-2 contains that company's having weak competitive situation and rapid market growth. Firms positioned in Quadrant II need to evaluate their present approach to the marketplace seriously. Although their industry is growing, they are unable to compete effectively, and they need to determine why the firm's current approach is ineffectual and how the company can best change to improve its competitiveness. Because Quadrant II firms are in a rapid-market-growth industry, an intensive strategy (as opposed to integrative or diversification) is usually the first option that should be considered.

Qurdant-3 contains that company's weak competitive situation and slow market growth. The firms fall in this quadrant compete in slow-growth industries and have weak competitive positions. These firms must make some drastic changes quickly to avoid further demise and possible liquidation. Extensive cost and asset reduction (retrenchment) should be pursued first. An alternative strategy is to shift resources away from the current business into different areas. If all else fails, the final options for Quadrant III businesses are divestiture or liquidation.

Qurdant-4 contains that company's strong competitive situation and slow market growth. Finally, Quadrant IV businesses have a strong competitive position but are in a slow-growth industry. These firms have the strength to launch diversified programs into more promising growth areas. Quadrant IV firms have characteristically high cash flow levels and limited internal growth needs and often can pursue concentric, horizontal, or conglomerate diversification successfully. Quadrant IV firms also may pursue joint ventures.

Stage-3 (Decision stage)

1. **QSPM** (Quantitative Strategic Planning Matrix)

Stage 3, called the *Decision Stage,* and involves a single technique, the Quantitative Strategic Planning Matrix (QSPM). A QSPM uses input information from Stage 1 to objectively evaluate feasible alternative strategies identified in Stage 2. A QSPM reveals the relative attractiveness of alternative strategies and, thus, provides an objective basis for selecting specific strategies.

All nine techniques included in the *strategy-formulation framework* require integration of intuition and analysis. Autonomous divisions in an organization commonly use strategy-formulation techniques to develop strategies and objectives. Divisional analyses provide a basis for identifying, evaluating, and selecting among alternative corporate-level strategies.

Strategists themselves, not analytic tools, are always responsible and accountable for strategic decisions. Lenz emphasized that the shift from a words-oriented to a numbers-oriented planning process can give rise to a false sense of certainty; it can reduce dialogue, discussion, and argument as a means to explore understandings, test assumptions and foster organizational learning. Strategists, therefore, must be wary of this possibility and use analytical tools to facilitate, rather than diminish, communication. Without objective information and analysis, personal biases, politics, emotions, personalities, and *halo error* (the tendency to put too much weight on a single factor) unfortunately may play a dominant role in the strategy-formulation process.

Preparation of matrix

Now the question is that how to prepare QSPM matrix. First it contains key internal and external factors. An internal factor contains (strength and weakness) and external factor include (opportunities and threats). It relates to previously IFE and EFE in which weight to all factors. Weight means importance to internal and external factor. The sum of weight must be equal to one. After assigning the weights examine stage-2 matrices and identify alternatives strategies that the organization should consider implementing. The top row of a QSPM consists of alternative strategies derived from the TOWS Matrix, SPACE Matrix, BCG Matrix, IE Matrix, and Grand Strategy Matrix. These matching tools usually generate similar feasible alternatives. However, not every strategy suggested by the matching techniques has to be evaluated in a QSPM. Strategists should use good intuitive judgment in selecting strategies to include in a QSPM. After assigning the weight to strategy, determine the attractiveness score of each and afterwards total attractiveness score. The highest total attractiveness score strategy is most feasible.

Steps in preparation of QSPM

1. List of the firm's key external opportunities/threats and internal strengths/weaknesses in the left column of the QSPM.
2. Assign weights to each key external and internal factor
3. Examine the Stage 2 (matching) matrices and identify alternative strategies that the organization should consider implementing
4. Determine the Attractiveness Scores (AS)
5. Compute the Total Attractiveness Scores
6. Compute the Sum Total Attractiveness Score

Limitations

1. Requires intuitive judgments and educated assumptions
2. Only as good as the prerequisite inputs
3. Only strategies within a given set are evaluated relative to each other

Advantages

1. Sets of strategies considered simultaneously or sequentially
2. Integration of pertinent external and internal factors in the decision making process