# ENTERPRISE AND STRATEGY

DKIF Instructional material cell

# Objectives of the Firm

- Objectives are defined as a measure of efficiency of resource-conversion process
- Central purpose of firm is to maximize long term returns on resources employed by firm
- It contains
  - An attribute, used as a measure of efficiency
  - A yardstick, by which the attribute is measured
  - The goal which is a particular value attached which the firm seeks to attain

# Kinds of objectives and their approaches

- Formulation done by
  - Selecting profitability as a principal attribute
  - Selection of rate of return of investment as the yardstick of profitability
- Selection
  - Through philosophy
  - Historical analysis of business objectives
  - Constructing a system of objectives which is
    - Systematic
    - Consistent

    And can be related to business practices

- Controversial: Between profit maximization and very survival of the firm
- Philosophy of objectives
  - Complexity: structural changes in the firm
    - Growth in size and complexity of the firm
    - Shift of ownership from few individuals to many shareholders
  - Choice of philosophy has to be made by each firm itself

- Compatible:
  - Firm has
    - Economic objectives: Influence firm's behavior; firms a basis for control and guidance of firm by management
    - Social objectives: Exert a secondary modifying and constraining influence on management behavior

# Structure of business decisions

- Nature of business decisions is
  - Multifaceted
  - Continually variable
- Decisions can be
  - Strategic
  - Administrative
  - Operating

Each related to a different aspect of resource conversion process.

# Strategic decisions

- Concerned with external problem of firm, selection of product mix, markets at which it will sell
- Establish match between firm and environment
- Includes
  - Firm's objectives and goals
  - Decision of diversification etc.

# Administrative Decisions

- Concerned with attaching firm’s resources in such a way which creates maximum performance potential
- Includes
  - Structuring of authority and responsibility relationships
  - Workflows
  - Information flows
  - Development of raw materials
  - Personnel training and development
  - Financing

# Operating Decisions

- Absorb the bulk of the firm's energy and attention with the objective of maximising profitability of current operations
- These decisions are independent and complementary
- Includes
  - Resource allocation among functional areas and product lines
  - Scheduling of operations
  - Supervision of performance
  - Applying control actions

# Principle decision classes in the firm

| | Strategic | Administrative | Operating |
|---|---|---|---|
| **Problem** | To select product-market mix which optimizes firm's ROI potential | To structure firm's resources for optimum performance | To optimize realization of ROI potential |
| **Nature of Problem** | Allocation of total resources among product- market opportunities | Organization, acquisition and development of resources | Budgeting of resources among functional areas, scheduling ad conversion, supervision and control |

| | Strategic | Administrative | Operating |
|---|---|---|---|
| **Key Decisions** | Objectives and goals diversification strategy, expansion strategy, administrative strategy, finance strategy growth, method timing of growth | Organization, structure of information, authority and responsibility flows, structure of resource conversion, workflows, distribution system facilities, location resource acquisition and development; financing, facilities, equipment, raw material, personnel | Operating objectives and goals, pricing and output levels, operating levels, production schedules, inventory levels, warehousing etc. Marketing policy and strategy, R&D policy and strategy control |
| **Key Characteristics** | •Decisions centralized<br>•Partial ignorance<br>•Decisions non-repetitive<br>•Decisions not self-regenerative | •Conflict between strategy and operation<br>•Conflict between individual and institutional objectives<br>•Strong coupling between economic and social variables<br>•Decision bigger than | •Decentralized decisions<br>•Risk and uncertainty<br>•Repetitive decisions<br>•Large volume of decisions<br>•Sub-optimization forced by complexity<br>•Decisions self-regenerative |

- Understanding complex decision processes involves
  - Discover how people, particularly executives, make decisions, individually or in groups; the mental processes they go through and the group interaction
  - Study the alternatives, their consequences and understand the nature and structure of decisions
    - Identify the problem
    - Enumerate controllable and uncontrollable variables
    - Establish relationships among them to arrive at the best decision
    - This process does not penetrate the decision maker's mind but seeks to study the nature of the job and thus improve the decision

# Concept of strategy

- Strategy is when you are out of ammunition, but keep right on firing so the enemy won't know.
- It is well-defined in scope and growth direction
- Need for it arises due to
  - Strategic problem characteristics
  - Firm needs direction and focus for its growth

- Strategy should
  - Provide broad concept of firm’s business
  - Set forth guidelines to conduct research
  - Supplement firm’s objectives with decision rules
- More definitive description of the firm’s role in the environment is a requisite for growth and success

# Components of Strategy

Product market scope

Growth factor

Indicates the direction in which firm is moving w.r.t. its current product-market position

Competitive advantage

- Seeks to identify the particular product-market which will give a string competitive position to the firm.

- The following three describe the firm’s product-market path
  - External environment
  - Synergy
  - Firm’s ability to make good on a new product-market entry
- Market penetration
  - Denotes growth from the decision through increase of market share for present product-markets
- In market development new missions are sought for firm’s products

- Product development creates new products
- Common thread

| Is a | Can be |
| --- | --- |
| • Relationship between present and future product-markets<br>• Ensures proper direction and gives guidance | • Aggressive, requiring outstanding competence by new entrants<br>• Defensive, key competence by which the firm lacks new entrants |

- With no strategies, the firm will have the following advantages and disadvantages

| Advantages | Disadvantages |
| --- | --- |
| • Saving of time, money required for strategic analysis<br>• Potential requirements will not be restricted<br>• Firm reaps full advantage of 'delay principle' | • There are no rules to guide the search for new opportunities<br>• Project decisions will be of poorer quality<br>• No formal provision for partial ignorance<br>• No periodic appraisal<br>• Firm will lack internal ability to anticipate change |

- Growth factor components

| Product<br>Mission | Present | New |
|---|---|---|
| Present | Market penetration | Product development |
| New | Market development | Diversification |

- Strategy can be
  - Pure: a move by the firm
  - Grand/mixed: statistical decisions rule for selecting a particular pure strategy under a particular situation

- Strategy requirements would be different for different firms
  - A firm which needs a comprehensive strategy is a fully integrated operating firm
  - A holding company has less stringent strategy requirements
- Policy is a contingent decision whereas strategy is a rule for making decisions under partial ignorance

| Strategy requirement / Type of firm | Product-market scope | Growth vector | Synergy | Competitive advantage | Objectives |
|---|---|---|---|---|---|
| Operating firm | X | X | X | X | X |
| Holding company | X | | | X | X |
| Investment company | | | | | X |

# Appraisal

- The appraisal can be internal or external
- Internal appraisal is concerned with whether a firm can solve its problems without diversifying
- External appraisal is concerned with opportunities present outside the firm's present product-market scope
  - Produces the final decision on whether the firm shall diversify

# Internal appraisal

- Preparation of tentative objectives
- Current forecast of future performance
- Comparison between objectives and current forecast to measure total gap
- If gap exists, revised objects are prepared
- Analysis of strengths, weaknesses and industry potential
- Combine above two, construct a revised forecast for the firm

- Find revised total gap
- Find revised diversification gap
- Find revised expansion gap
- Estimate expansion requirements
- Estimate diversification resources
- Examine the diversification gap in relation to diversification resources
- Determine whether objectives need another revision and whether firm should decide against diversification

# External Appraisal

- The following will help establish the logic for external appraisal

- Proposal of firm is described by a multidimensional vector of objective
- Partial ignorance
- Averaging characteristics of industry data
- Synergy criteria

- It can be better off by
  - A need or management decision
  - The analysis commences with preparing the following criteria
    - Economic
    - Cost of entry
    - Synergy

- The following variants of the decisions to diversify are possible
  - When internal appraisal forecasts a decline in the firms business, the indicated decision is to liquidate the firm and reinvent diversification
  - When forecasts show low growth, the drastic decision is to keep the present business, but to devote most of the available resources to diversification
  - When both expansion and diversification opportunities are moderate, the expansion would be done and with the residual resources, diversification would be made
  - If diversification opportunities are attractive, resources for t are correspondingly increased, but a check is made to see whether the external appraisal needs to be modified

- If the information is not sufficient
  - Decision to develop more information may be made
  - Firm can follow expansion strategy
  - Decision by default, called 'diversification programmes'
- The particular course of action chosen will depend on the risk philosophy of management

# Synergy and structure

- Synergy rankings are viewed as modifiers of objective ratings to the economic and competitive assessment of industries
- Synergy and structure of organizations are dependent on each other
- If synergy is strong
  - At all levels of management: an integrated organization would be used
  - Only general management level: a decentralized organization is indicated
  - Weak, up and down the organization: a holding company structure is indicated
- Whether synergy will follow structure or vice-versa is a top management decision
  - This affects strategy
  - Thus affecting search and evaluation of opportunities

# Practical System of Objectives

- A system of objectives are developed with
  - Central objective: Maximization of rate of return
  - Subsidiary objectives: Contribute to the improvement in the return
- Time horizon of the firm can be divided into
  - Proximate period: firm is able to forecast with certain accuracy in this
  - Long-term period: Time from planning to the time horizon
  - Proxy period: There is no need of proxy objectives

- Reference level for ROI
  - Tentative values of ROI would be selected for each class
  - Opportunities in each class arranged in order of their ROI prospects
  - Assign range of values of ROI for the reference risk class, for which 'threshold' approach is followed based on the following factors
    - Past, present and future ROI characteristics
    - Estimate number of opportunities
    - Urgency of strategic action
    - Size of entry or the resource

- Goal threshold is the approximate yardstick for the evaluation of opportunities
  - Those below the threshold are rejected, those above are evaluated against the goal
- Management before selecting the final values will have to modify original aspirations in light of the firm’s capabilities and available opportunities
- For objectives to be long-term
  - Firm must continue to reshape itself
  - New resources must be brought in
  - New products and markets must be developed

- It is concerned with the
  - Continued improvement of the external competitive position
  - Continued growth of sales
  - Increase in relative market share
  - Growth in earnings for reinvestment
  - Continuing addition of new products
  - Continuous expansion of firm's customer population
- Each of these factors is a partial indicator of long-term profitability potential
- Taken together, they assure the firm will have a strong competitive position vis-à-vis the environment

- The direct indicators of efficiency are
  - Turnaround ratios
  - Depth of critical skills
  - Human and organizational assets
- These proxy yardsticks firm the hierarchy which relates to the overall long-term objective of the firm

# Flexibility objective

- A firm can effectively buy insurance against catastrophes and put itself in the way of potential discoveries
- This can be done by adding a flexibility objective whose flexibility can be measured by
  - External flexibility: Achieved through the diversified pattern of product-market investments
  - Internal flexibility: Through liquidity of resources

- External flexibility can be
  - Defensive: Failure to achieve it, indicates the difficulty of attaining flexibility
  - Aggressive: More elusive and harder to implement and measure and offer rewards
- Internal flexibility
  - Traditional yardstick is liquidity of the firm’s resources

- Noneconomic objectives, constraints and responsibilities
  - Noneconomic Objectives: Also directly influence the firm’s central objective
  - Constraints and responsibilities: Severely limit the freedom of strategic action
  - Objectives of individuals: Difficult to organize into hierarchical relationship

- Bargaining process: General characteristics described by Cyert and March
  - Important personal influences on the firm
    - Maximum capital gains
    - Capital gains
    - Liquidity of estate

- Social responsibility

### Enlightened self-interest

- Personal obligation by management to serve larger purposes of society

### Philanthropy

- Philanthropic objectives of influential participants lead to support of non-profit organizations

- Attitude towards risk
  - Must be taken into account in formulating objectives and in establishing priorities
- Personal objectives
  - Personal economic objectives
  - Personal noneconomic objectives
- Process of setting objectives
  - 3 major variables offer priorities
    - Current and past performance
    - Total resources available to the firm
    - Characteristics and opportunities in the external environment

- Characteristics of the product-market environment have a major effect on priorities
- Realistic objectives must be developed thought a continuing interaction and other elements of a strategic problem
- The process of objective formulation
  - Starts with a basic philosophy
  - Firm’s current objectives are summarized
  - Through appraisals, revisions are made