CHAPTER 4

CORPORATE LEVEL STRATEGIES

LEARNING OUTCOMES

After studying this chapter, you will be able to:

- Identify the directional/grand strategies.
- Understand the nature and relevance of stability strategy.
- Understand the nature and relevance of expansion/growth strategy.
- Learn why organisations retrench or turnaround their businesses.
- Know about combination strategies and strategic alliances.

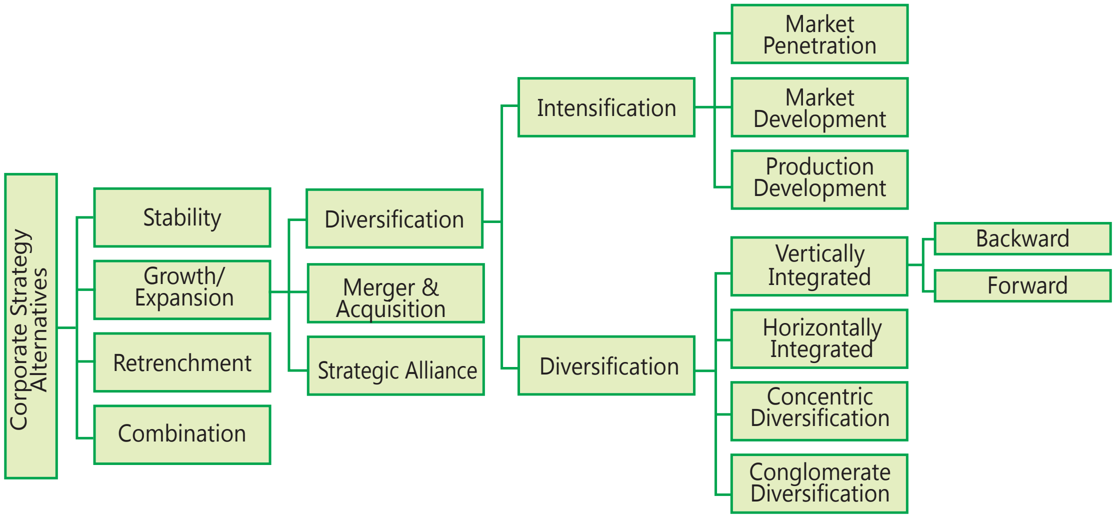
Chance favours the prepared mind.

Louis Pasteur

Strategy is a deliberate search for a plan of action that will develop a business competitive advantage and compound it.

Bruce D. Henderson

CHAPTER OVERVIEW



4.1 INTRODUCTION

As discussed in chapter 1, strategies are formulated at different levels of an organization – corporate, business and functional. Corporate level strategies occupy the highest level of strategic decision making and cover actions dealing with the objective of the firm, acquisition and allocation of resources and coordination of strategies of various SBUs for optimal performance. Top management of the organization makes strategic decisions. The nature of strategic decisions tends to be value-oriented, conceptual and less concrete than decisions at the business or functional level.

4.2. TYPOLOGIES OF STRATEGIES

Businesses follow different types of strategies to enter the market and to stay and grow in the market. A large number of strategies with different nomenclatures have been employed by different businesses and also suggested by different authors on strategy. For instance, William F Glueck and Lawrence R Jauch discussed four generic strategies including stability, growth, retrenchment and combination. These strategies have also been called Grand Strategies/Directional Strategies by many other authors. Michael

E. Porter suggested competitive strategies including Cost Leadership, Differentiation, Focus Cost Leadership and Focus Differentiation which could be used by the corporates for their different business units. Besides these, we come across functional strategies in the literature on Strategic Management and Business Policy. Functional Strategies are meant for strategic management of distinct functions such as Marketing, Financial, Human Resource, Logistics, Production etc.

We can classify the different types of strategies on the basis of levels of organisation, stages of business life cycle and competition as given in the table – 1.

Table – 1

Basis of Classification	**Types**
Level	Corporate Level Business Level Functional Level
Stages of Business Life Cycle	Entry/Introduction Stage - Market Penetration Strategy Growth Stage - Growth/Expansion Strategy Maturity Stage - Stability Strategy Decline Stage - Retrenchment/ Turnaround Strategy
Competition	Competitive Strategies - Cost Leadership, Differentiation, Focus Collaboration Strategies - Joint Venture, Merger & Acquisition, Strategic Alliance

It may be noted that there is no water tight compartmentation between different typologies. For instance, a startup or a new enterprise might follow either a competitive strategy i.e., entering the market where a number of rivals are already operating, or a collaborative strategy, i.e., enter into a joint venture with an established company. However, majority of startups are launched on a small scale and their main strategy is to penetrate the market and to reach the breakeven stage at the earliest and later pursue growth strategy.

Reality Bite: Patanjali Ayurved adopted market penetration strategy and to be successful. It concentrated on product development and high quality at low cost. It is now at the growth stage and is following competitive strategies. It is competing with both domestic and multinational companies.

A going concern can continue with the competitive strategy or resort to collaborative strategy to ensure business growth.

Business conglomerates having multiple product folios formulate strategies at different levels, viz., corporate, business unit and functional. Corporate level strategies also known as grand strategies are meant to provide 'direction' to the company. Business level strategies are formulated for each product division known as strategic business unit. Further to implement the corporate and business level strategies, functional strategies are formulated in business areas like production/operations, marketing, finance, human resources etc. In fact, big corporates follow an elaborate system of strategy formulation, implementation and control at different levels in the company to survive and grow in the turbulent business environment. In this chapter, we shall discuss the corporate level strategies. Business level and Functional level strategies have been discussed in chapter 5 and chapter 6 respectively.

The corporate strategies a firm can adopt may be classified into four broad categories:

1. Stability strategy
2. Expansion strategy
3. Retrenchment strategy
4. Combinations strategy

The basic features of the corporate strategies are as follows:

Strategy	Basic Feature
Stability	The firm stays with its current businesses and product markets; maintains the existing level of effort; and is satisfied with incremental growth.
Expansion	Here, the firm seeks significant growth-maybe within the current businesses; maybe by entering new business that are related to existing businesses; or by entering new businesses that are unrelated to existing businesses.
Retrenchment	The firm retrenches some of the activities in some business (es), or drops the business as such through sell-out or liquidation.
Combination	The firm combines the above strategic alternatives in some permutation/combination so as to suit the specific requirements of the firm.

4.2.1. Stability Strategy

One of the important goals of a business enterprise is stability - to safeguard its existing interests and strengths, to pursue well established and tested objectives, to continue in the chosen business path, to maintain operational efficiency on a sustained basis, to consolidate the commanding position already reached, and to optimise returns on the resources committed in the business.

A stability strategy is pursued by a firm when:

- It continues to serve in the same or similar markets and deals in same or similar products and services.
- The strategic decisions focus on incremental improvement of functional performance

Stability strategy is not a 'do nothing' strategy. It involves keeping track of new developments to ensure that the strategy continues to make sense. This strategy is typical for those firms whose product have reached the maturity stage of product life cycle. Small organizations may also follow stability strategy to consolidate their market position and prepare for the launch of growth strategies.

I. Characteristics of Stability Strategy

- A firm opting for stability strategy stays with the same business, same product-market posture and functions, maintaining same level of effort as at present.
- The endeavour is to enhance functional efficiencies in an incremental way, through better deployment and utilization of resources. The assessment of the firm is that the desired income and profits would be forthcoming through such incremental improvements in functional efficiencies.
- Stability strategy does not involve a redefinition of the business of the corporation.
- It is basically a safety-oriented, *status quo* oriented strategy.
- It does not warrant much of fresh investments.
- It involves minor improvements in the product and its packaging.
- The risk is also less.
- With the stability strategy, the firm has the benefit of concentrating its resources and attention on the existing businesses/products and markets.
- The growth objective of firms employing this strategy is quite modest. Conversely, only firms with modest growth objective choose for this strategy.

II. Major Reasons for Stability Strategy

- A product has reached the maturity stage of the product life cycle.
- It is less risky as it involves less changes and the staff feels comfortable with things as they are.
- The environment faced is relatively stable.

- Expansion may be perceived as being threatening.
- Consolidation is sought through stabilizing after a period of rapid expansion.

4.2.2. Growth/Expansion Strategy

Growth/Expansion strategy is implemented by redefining the business by enlarging the scope of business and substantially increasing investment in the business. It is a popular strategy that tends to be equated with dynamism, vigour, promise and success. An enterprise on the move is more agreeable stereotype than a steady-state enterprise. It is often characterised by significant reformulation of goals and directions, major initiatives and moves involving investments, exploration and onslaught into new products, new technology and new markets, innovative decisions and action programmes and so on. Expansion also includes diversifying, acquiring and merging businesses. This strategy may take the enterprise along relatively unknown and risky paths, full of promises and pitfalls.

I. Characteristics of Growth/Expansion Strategy

- Expansion strategy involves a redefinition of the business of the corporation.
- Expansion strategy is the opposite of stability strategy. While in stability strategy, rewards are limited, in expansion strategy they are very high. In the matter of risks, too, the two are the opposites of each other.
- Expansion strategy leads to business growth. A firm with a mammoth growth ambition can meet its objective only through the expansion strategy.
- The process of renewal of the firm through fresh investments and new businesses/ products/markets is facilitated only by expansion strategy.
- Expansion strategy is a highly versatile strategy; it offers several permutations and combinations for growth. A firm opting for the expansion strategy can generate many alternatives within the strategy by altering its propositions regarding products, markets and functions and pick the one that suits it most.
- Expansion strategy holds within its fold two major strategy routes: Intensification Diversification. Both of them are growth strategies; the difference lies in the way in which the firm actually pursues the growth.

II. Major Reasons for Growth/Expansion Strategy

- It may become imperative when environment demands increase in pace of activity.
- Strategists may feel more satisfied with the prospects of growth from expansion; chief executives may take pride in presiding over organizations perceived to be growth-oriented.

- Expansion may lead to greater control over the market vis-a-vis competitors.
- Advantages from the experience curve and scale of operations may accrue.

III. Types of Growth/ Expansion Strategy

1. Expansion through Diversification

Diversification is defined as entry into new products or product lines, new services or new markets, involving substantially different skills, technology and knowledge. When an established firm introduces a new product, which has little or no affinity with its present product line and which is meant for a new class of customers different from the firm's existing customer groups, the process is known as conglomerate diversification. Both the technology of the product and the market are different from the firm's present experience.

Innovative and creative firms always look for opportunities and challenges to grow, to venture into new areas of activity and to break new frontiers with the zeal of entrepreneurship. They feel that diversification offers greater prospects of growth and profitability than expansion.

For some firms, diversification is a means of utilising their existing facilities and capabilities in a more effective and efficient manner. They may have excess capacity or capability in manufacturing facilities, investible funds, marketing channels, competitive standing, market prestige, managerial and other manpower, research and development, raw material sources and so forth. Another reason for diversification lies in its synergistic advantage. It may be possible to improve the sales and profits of existing products by adding suitably related or new products, because of linkages in technology and/or in markets.

Expansion or growth strategy can either be through intensification or diversification: Igor Ansoff gave a framework as shown in figure which describes the intensification options available to a firm.

Market Penetration Increase market share Increase product usage Increase the frequency used Increase the quantity used Find new application for current users	**Product Development** Add product features, product refinement Develop a new-generation product Develop new product for the same market
Market Development Expand geographically target new segments	**Diversification involving new products and new markets** Related / Unrelated

Figure: Product-Market Expansion Grid

(a) Intensification

(i) **Market Penetration:** Highly common expansion strategy is market penetration/ concentration on the current business. The firm directs its resources to the profitable growth of its existing product in the existing market.

(ii) **Market Development:** It consists of marketing present products, to customers in related market areas by adding different channels of distribution or by changing the content of advertising or the promotional media.

(iii) **Product Development:** Product development involves substantial modification of existing products or creation of new but related items that can be marketed to current customers through establish channels.

(b) Diversification

Diversification endeavours can be related or unrelated to existing businesses of the firm. Based on the nature and extent of their relationship to existing businesses, diversification endeavours have been classified into four broad categories:

(i) Vertically integrated diversification

(ii) Horizontally integrated diversification

(iii) Concentric diversification

(iv) Conglomerate diversification`

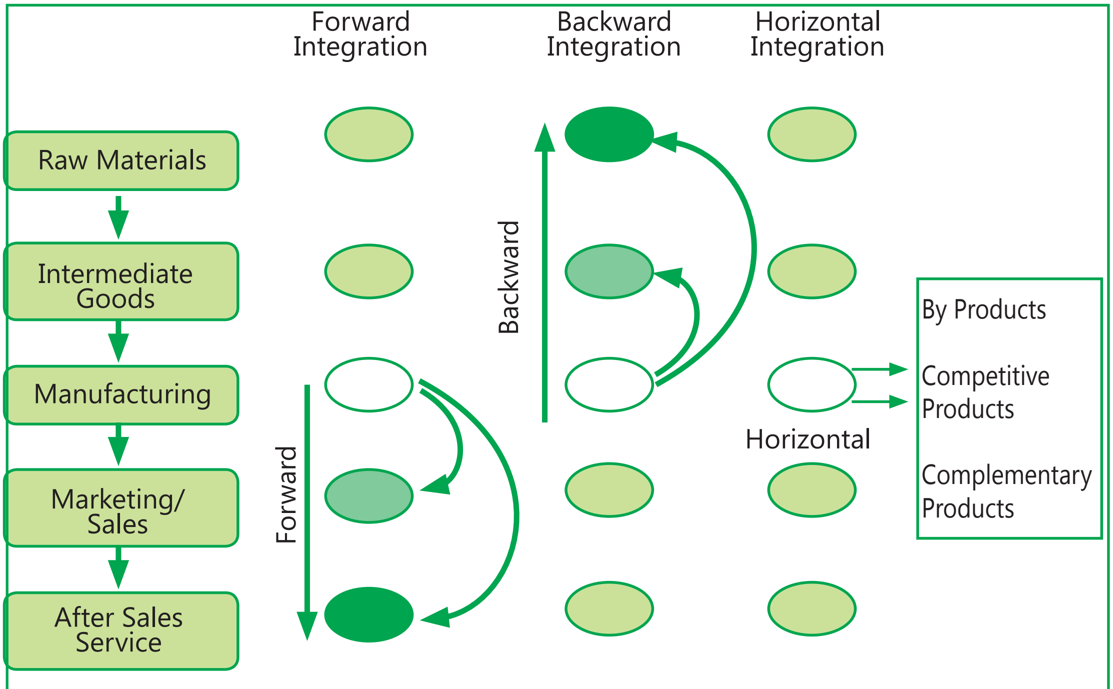


Figure: Diversification

(i) Vertically Integrated Diversification: In vertically integrated diversification, firms opt to engage in businesses that are related to the existing business of the firm. The firm remains vertically within the same process sequence moves forward or backward in the chain and enters specific product/process steps with the intention of making them into new businesses for the firm. The characteristic feature of vertically integrated diversification is that here, the firm does not jump outside the vertically linked product-process chain.

Forward and Backward Integration: Forward and backward integration forms part of vertically integrated diversification. In vertically integrated diversification, firms opt to engage in businesses that are vertically related to the existing business of the firm. The firm remains vertically within the same process. While diversifying, firms opt to engage in businesses that are linked forward or backward in the chain and enter specific product/process steps with the intention of making them into new businesses for the firm.

Backward integration is a step towards, creation of effective supply by entering business of input providers. Strategy employed to expand profits and gain greater control over production of a product whereby a company will purchase or build a business that will increase its own supply capability or lessen its cost of production. *For example, A large supermarket chain considers to purchase a number of farms that would provide it a significant amount of fresh produce.*

On the other hand, forward integration is moving forward in the value chain and entering business lines that use existing products. Forward integration will also take place where organizations enter into businesses of distribution channels. *For example, A coffee bean manufacture may choose to merge with a coffee cafe.*

(ii) Horizontal Integrated Diversification: Through the acquisition of one or more similar business operating at the same stage of the production-marketing chain that is going into complementary products, by-products or taking over competitors' products.

RELATED DIVERSIFICATION	**UNRELATED DIVERSIFICATION**
Exchange or share assets or competencies by exploiting • Brand name • Marketing skills • Sales and distribution capacity • Manufacturing skills • R&D and new product capability • Economies of scale	• Investment in new product portfolios. • Employment of new technologies. • Focus on multiple products. • Reduce risk by operating in multiple product markets. • Defend against takeover bids. • Provide executive interest.

Figure: Related vs. Unrelated Diversification

(iii) Concentric Diversification: Concentric diversification too amounts to related diversification. In concentric diversification, the new business is linked to the existing businesses through process, technology or marketing. The new product is a spin-off from the existing facilities and products/processes. This means that in concentric diversification too, there are benefits of synergy with the current operations. However, concentric diversification differs from vertically integrated diversification in the nature of the linkage the new product has with the existing ones. While in vertically integrated diversification, the new product falls within the firm's current process-product chain, in concentric diversification, there is a departure from this vertical linkage. The new product is only connected in a loop-like manner at one or more points in the firm's existing process/technology/ product chain.

(iv) Conglomerate Diversification: In conglomerate diversification, no such linkages exist; the new businesses/ products are disjointed from the existing businesses/products in every way; it is a totally unrelated diversification. In process/technology/function, there is no connection between the new products and the existing ones. Conglomerate diversification has no common thread at all with the firm's present position. *For example, A cement manufacturer diversifies into the manufacture of steel and rubber products.*

2. Expansion through Mergers and Acquisitions

Acquisition or merger with an existing concern is an instant means of achieving the expansion. It is an attractive and tempting proposition in the sense that it circumvents the time, risks and skills involved in screening internal growth opportunities, seizing them and building up the necessary resource base required to materialise growth. Organizations consider merger and acquisition proposals in a systematic manner, so that the marriage will be mutually beneficial, a happy and lasting affair.

Apart from the urge to grow, acquisitions and mergers are resorted to for purposes of achieving a measure of synergy between the parent and the acquired enterprises. Synergy may result from such bases as physical facilities, technical and managerial skills, distribution channels, general administration, research and development and so on. Only positive synergistic effects are relevant in this connection which denotes that the positive effects of the merged resources are greater than the some of the effects of the individual resources before merger or acquisition.

Merger and acquisition in simple words are defined as a process of combining two or more organizations together. There is a thin line of difference between the two terms but the impact of combination is completely different in both the cases. Some organizations prefer to grow through mergers. Merger is considered to be a process when two or more companies come together to expand their business operations. In such a case the deal gets finalized on friendly terms and both the organizations share profits in the newly created entity. In a merger two organizations combine to increase their strength and financial gains along with breaking the trade barriers.

When one organization takes over the other organization and controls all its business operations, it is known as acquisitions. In this process of acquisition, one financially strong organization overpowers the weaker one. Acquisitions often happen during recession in economy or during declining profit margins. In this process, one that is financially stronger and bigger establishes it power. The combined operations then run under the name of the powerful entity. A deal in case of an acquisition is often done in an unfriendly manner, it is more or less a forced association where the powerful organization either consumes the operation or a company in a weaker position is forced to sell its entity.

Types of Mergers

(a) Horizontal Merger

The types of mergers are similar to types of diversification.

Horizontal merger is a combination of firms engaged in the same industry. It is a merger with a direct competitor. The principal objective behind this type of merger is to achieve economies of scale in the production process by shedding duplication of installations and functions, widening the line of products, decrease in working capital and fixed assets investment, getting rid of competition and so on. *For example, formation of Brook Bond Lipton India Ltd. through the merger of Lipton India and Brook Bond.*

(b) Vertical Merger:

It is a merger of two organizations that are operating in the same industry but at different stages of production or distribution system. This often leads to increased synergies with the merging firms. If an organization takes over its supplier/producers of raw material, then it leads to backward integration. On the other hand, forward integration happens when an organization decides to take over its buyer organizations or distribution channels. Vertical merger results in many operating and financial economies. Vertical mergers help to create an advantageous position by restricting the supply of inputs to other players, or by providing the inputs at a higher cost.

(c) Co-generic Merger:

In Co-generic merger two or more merging organizations are associated in some way or the other related to the production processes, business markets, or basic required technologies. Such merger include the extension of the product line or acquiring components that are required in the daily operations. It offers great opportunities to businesses to diversify around a common set of resources and strategic requirements. *For example, an organization in the white goods category such as refrigerators can diversify by merging with another organization having business in kitchen appliances.*

(d) Conglomerate Merger:

Conglomerate mergers are the combination of organizations that are unrelated to each other. There are no linkages with respect to customer groups, customer functions and technologies being used. There are no important common factors between the organizations in production, marketing, research and development and technology. In practice, however, there is some degree of overlap in one or more of these factors.

3. Expansion through Strategic Alliance

A strategic alliance is a relationship between two or more businesses that enables each to achieve certain strategic objectives which neither would be able to achieve on its own. The strategic partners maintain their status as independent and separate entities, share the benefits and control over the partnership, and continue to make contributions to the alliance until it is terminated. Strategic alliances are often formed in the global marketplace between businesses that are based in different regions of the world.

Advantages of Strategic Alliance

Strategic alliance usually are only formed if they provide an advantage to all the parties in the alliance. These advantages can be broadly categorised as follows:

1. **Organizational:** Strategic alliance helps to learn necessary skills and obtain certain capabilities from strategic partners. Strategic partners may also help to enhance productive capacity, provide a distribution system, or extend supply chain. Strategic partners may provide a good or service that complements thereby creating a synergy. Having a strategic partner who is well-known and respected also helps add legitimacy and creditability to a new venture.

2. **Economic:** There can be reduction in costs and risks by distributing them across the members of the alliance. Greater economies of scale can be obtained in an alliance, as production volume can increase, causing the cost per unit to decline. Finally, partners can take advantage of co-specialization, creating additional value, such as when a leading computer manufacturer bundles its desktop with a leading monitor manufacturer's monitor.

3. **Strategic:** Rivals can join together to cooperate instead of compete. Vertical integration can be created where partners are part of supply chain. Strategic alliances may also be useful to create a competitive advantage by the pooling of resources and skills. This may also help with future business opportunities and the development of new products and technologies. Strategic alliances may also be used to get access to new technologies or to pursue joint research and development.

4. **Political:** Sometimes strategic alliances are formed with a local foreign business

to gain entry into a foreign market either because of local prejudices or legal barriers to entry. Forming strategic alliances with politically-influential partners may also help improve your own influence and position.

Disadvantages of Strategic Alliance

Strategic alliances do come with some disadvantages and risks. The major disadvantage is **sharing.** Strategic alliances require sharing of resources and profits, and also sharing knowledge and skills that otherwise organisations may not like to share. Sharing knowledge and skills can be problematic if they involve trade secrets. Agreements can be executed to protect trade secrets, but they are only as good as the willingness of parties to abide by the agreements or the courts willingness to enforce them.

Strategic alliances may also create a potential competitor. An ally may become a competitor in future when it decides to separate out.

4.2.3. Retrenchment/Turnaround Strategy

(a) **Retrenchment Strategy:** It is followed when an organization substantially reduces the scope of its activity. This is done through an attempt to find out the problem areas and diagnose the causes of the problems. Next, steps are taken to solve the problems. These steps result in different kinds of retrenchment strategies. If the organization chooses to focus on ways and means to reverse the process of decline, it adopts at turnaround strategy. If it cuts off the loss-making units, divisions, or SBUs, curtails its product line, or reduces the functions performed, it adopts a divestment (or divestiture) strategy. If none of these actions work, then it may choose to abandon the activities totally, resulting in a liquidation strategy. We deal with each of these strategies below.

(b) **Turnaround Strategy:** Retrenchment may be done either internally or externally. For internal retrenchment to take place, emphasis is laid on improving internal efficiency, known as turnaround strategy.

There are certain conditions or indicators which point out that a turnaround is needed if the company has to survive. These danger signals are:

- Persistent negative cash flow from business(es)
- Uncompetitive products or services
- Declining market share
- Deterioration in physical facilities
- Over-staffing, high turnover of employees, and low morale
- Mismanagement

Action Plan for Turnaround

For turnaround strategies to be successful, it is imperative to focus on the short and long-term financing needs as well as on strategic issues. A workable action plan for turnaround would involve the following stages:

- **Stage One – Assessment of current problems**: The first step is to assess the current problems and get to the root causes and the extent of damage the problem has caused. Once the problems are identified, the resources should be focused toward those areas essential to efficiently work on correcting and repairing any immediate issues.
- **Stage Two – Analyze the situation and develop a strategic plan:** Before you make any major changes; determine the chances of the business's survival. Identify appropriate strategies and develop a preliminary action plan. For this one should look for the viable core businesses, adequate bridge financing and available organizational resources. Analyze the strengths and weaknesses in the areas of competitive position. Once major problems and opportunities are identified, develop a strategic plan with specific goals and detailed functional actions.
- **Stage Three – Implementing an emergency action plan**: If the organization is in a critical stage, an appropriate action plan must be developed to stop the bleeding and enable the organization to survive. The plan typically includes human resource, financial, marketing and operations actions to restructure debts, improve working capital, reduce costs, improve budgeting practices, prune product lines and accelerate high potential products. A positive operating cash flow must be established as quickly as possible and enough funds to implement the turnaround strategies must be raised.
- **Stage Four – Restructuring the business**: The financial state of the organization's core business is particularly important. If the core business is irreparably damaged, then the outlook for the entire organization may be bleak. Prepare cash forecasts, analyze assets and debts, review profits and analyze other key financial functions to position the organization for rapid improvement.

  During the turnaround, the "product mix" may be changed, requiring the organization to do some repositioning. Core products neglected over time may require immediate attention to remain competitive. Some facilities might be closed; the organization may even withdraw from certain markets to make organization leaner or target its products toward a different niche.

  The 'people mix' is another important ingredient in the organization's competitive effectiveness. Reward and compensation systems that encourage dedication and creativity encourage employees to think profits and return on investments.

- **Stage Five – Returning to normal**: In the final stage of turnaround strategy process, the organization should begin to show signs of profitability, return on investments and enhancing economic value-added. Emphasis is placed on a number of strategic efforts such as carefully adding new products and improving customer service, creating alliances with other organizations, increasing the market share, etc.

The important elements of turnaround strategy are as follows:

- Changes in the top management
- Initial credibility-building actions
- Neutralising external pressures
- Identifying quick payoff activities
- Quick cost reductions
- Revenue generation
- Asset liquidation for generating cash
- Better internal coordination

(c) Divestment Strategy: Divestment strategy involves the sale or liquidation of a portion of business, or a major division, profit centre or SBU. Divestment is usually a part of rehabilitation or restructuring plan and is adopted when a turnaround has been attempted but has proved to be unsuccessful. The option of a turnaround may even be ignored if it is obvious that divestment is the only answer.

A divestment strategy may be adopted due to various reasons:

A business that had been acquired proves to be a mismatch and cannot be integrated within the company.

Persistent negative cash flows from a particular business create financial problems for the whole company, creating the need for divestment of that business.

Severity of competition and the inability of a firm to cope with it may cause it to divest.

Technological upgradation is required if the business is to survive but where it is not possible for the firm to invest in it, a preferable option would be to divest.

A better alternative may be available for investment, causing a firm to divest a part of its unprofitable businesses.

(d) Liquidation Strategy: A retrenchment strategy considered the most extreme and unattractive is liquidation strategy, which involves closing down a firm and selling its assets. It is considered as the last resort because it leads to serious consequences such as loss of employment for workers and other employees, termination of opportunities where a firm could pursue any future activities, and the stigma of failure. Many small-scale units, proprietorship firms, and partnership ventures liquidate frequently but medium-and large-sized companies rarely liquidate in India. The company management, government, banks and financial institutions, trade unions, suppliers and creditors, and other agencies are extremely reluctant to take a decision, or ask, for liquidation.

Selling assets for implementing a liquidation strategy may also be difficult as buyers are difficult to find. Moreover, the firm cannot expect adequate compensation as most assets, being unusable, are considered as scrap.

Liquidation strategy may be unpleasant as a strategic alternative but when a "dead business is worth more than alive", it is a good proposition. For instance, the real estate owned by a firm may fetch it more money than the actual returns of doing business. When liquidation is evident (though it is difficult to say exactly when), an abandonment plan is desirable. Planned liquidation would involve a systematic plan to reap the maximum benefits for the firm and its shareholders through the process of liquidation.

I. Characteristics of Retrenchment/Turnaround Strategy

- This strategy involves retrenchment/divestment of some of the activities in a given business of the firm or sell-out of some of the businesses as such.
- Divestment is to be viewed as an integral part of corporate strategy without any stigma attached.
- Like expansion strategy, divestment strategy, too, involves a redefinition of the business of the corporation.
- Compulsions for divestment can be many and varied, such as
  - a). Obsolescence of product/process
  - b). Business becoming unprofitable and unviable
  - c). Inability to cope up with cut throat competition
  - d). Industry overcapacity
  - e). Failure of existing strategy

II. Major Reasons for Retrenchment/Turnaround Strategy

- The management no longer wishes to remain in business either partly or wholly due to continuous losses and unviability.
- The management feels that business could be made viable by divesting some of the activities or liquidation of unprofitable activities.
- A business that had been acquired proves to be a mismatch and cannot be integrated within the company.

- Persistent negative cash flows from a particular business create financial problems for the whole company, creating the need for divestment of that business.
- Severity of competition and the inability of a firm to cope with it may cause it to divest.
- Technological upgradation is required if the business is to survive but where it is not possible for the firm to invest in it, a preferable option would be to divest.
- A better alternative may be available for investment, causing a firm to divest a part of its unprofitable businesses.

4.2.4. Combination Strategy

The above strategies are not mutually exclusive. It is possible to adopt a mix of the above to suit particular situations. An enterprise may seek stability in some areas of activity, expansion in some and retrenchment in the others. Retrenchment of ailing products followed by stability and capped by expansion in some situations may be thought of. For some organizations, a strategy by diversification and/or acquisition may call for a retrenchment in some obsolete product lines, production facilities and plant locations.

I. Major Reasons for Combination Strategy

- The organization is large and faces complex environment.
- The organization is composed of different businesses, each of which lies in a different industry requiring a different response.

SUMMARY

Strategies are formulated at different levels of an organization – corporate level, business level, and functional level. The strategy changes based on the levels of strategy. Corporate level strategy occupies the highest level of strategic decision making and covers actions dealing with the objective of the firm, acquisition and allocation of resources and coordination of strategies of various SBUs for optimal performance.

This chapter dealt with various corporate strategic alternatives such as stability strategy, expansion strategy, retrenchment strategy, combination strategy and turnaround strategy. Expansion strategy covers expansion through intensification, diversification, acquisitions & mergers, strategic alliances etc.

TEST YOUR KNOWLEDGE

Very Short Answer Type Questions

Question 1

(a) Explain the meaning of Directional Strategies.

(b) Explain the meaning of the Combination Strategies.

Answer

(a) Directional strategies also called grand strategies provides basic directions for strategic actions towards achieving strategic goals. Such strategies are formulated at the corporate level so are also known as corporate strategies. The corporate strategies a firm can adopt have been classified into four broad categories: stability, expansion, retrenchment, and combination known as directional/grand strategies.

(b) Combination Strategies refer to a mix of different strategies like stability; expansion, diversification or retrenchment to suit particular situations that an enterprise is facing. For instance, a strategy of diversification/acquisition may call for retrenchment in some obsolete product lines.

Short Answer Type Questions

Question 2

State with reasons which of the following statements is correct / incorrect:

(a) Divesting a major product line or market is termed as retrenchment strategy.

(b) Acquisition is a type of growth strategy.

(c) Diversification only involves entering in new businesses that are related to the existing business of an organisation

(d) Vertical diversification integrates firms forward or backward in the product chain.

(e) Concentric diversification amounts to unrelated diversification.

(f) Liquidation is the last resort option for a business.

(g) Retrenchment implies downsizing of business.

(h) Stability strategy is not a 'do-nothing' strategy.

Answer

(a) **Correct:** An organization can redefine its business by divesting a major product line or market. The divesting can be termed as retrenchment strategy. The enterprise may withdraw from marginal markets, withdraw some brands or sizes of products. It may also withdraw some of slow moving products. In an extreme manner it may seek retirement either from the production or the marketing activity.

(b) **Correct:** An acquisition is a type of growth strategy through which one firm buys a controlling or complete interest in another firm. Acquisition of an existing concern is an instant means of achieving growth through expansion and/or diversification. Ideally, acquisition strategy should be used when the acquiring firm is able to enhance its economic value through ownership and the use of the assets that are acquired.

(c) **Incorrect:** Although, organisations can diversify into businesses that are vertically or horizontally related to the existing businesses, the diversification is not limited to the related businesses. In conglomerate diversification; the new businesses/ products are disjointed from the existing businesses/products in every way. There is no connection between the new products and the existing ones in process, technology or function.

(d) **Correct:** In vertically integrated diversification, firms opt to engage in businesses that are related to the existing business of the firm. It moves forward or backward in the chain and enters specific product with the intention of making them part of new businesses for the firm.

(e) **Incorrect:** Concentric diversification amounts to related diversification. Concentric diversification takes place when the products or services added are in different industry but are similar to the existing product or service line with respect to technology or production or marketing channels or customers.

(f) **Correct:** Liquidation as a form of retrenchment strategy is considered as the most extreme and unattractive. It involves closing down a firm and selling its assets. It is considered as the last resort because it leads to serious consequences such as loss of employment for workers and other employees, termination of opportunities a firm could pursue, and the stigma of failure. The company management, government, banks and financial institutions, trade unions, suppliers, creditors, and other agencies are extremely reluctant to take a decision, or ask for liquidation.

(g) **Incorrect:** In the context of strategic management, retrenchment implies giving up certain products and reducing the level of business as a compulsive measure to cope up with certain adverse developments on which the firm has little control. Downsizing (or rightsizing) is planned elimination of positions or jobs. Retrenchment does not imply downsizing, however, the latter is often used to implement a retrenchment strategy.

(h) **Correct:** Stability strategies are implemented by approaches wherein few functional changes are made in the products or markets. It is not a 'do nothing' strategy. It involves keeping track of new developments to ensure that the strategy continues to make sense. This strategy is typical for mature business organizations. Some small organizations will also frequently use stability as a strategic focus to maintain comfortable market or profit position.

Question 3

Briefly answer the following questions:

(a) What is meant by concentric diversification?

(b) Explain conglomerate diversification.

(c) Why a Turnaround Strategy is required for a business?

(d) What strategic alternative should be followed during recession?

(e) What is meant by retrenchment strategy?

(f) What is Divestment strategy? When is, it adopted?

(g) Write short note on expansion through acquisitions and mergers.

(h) Write short note on Conglomerate Merger.

(i) Distinguish between the following:

(i) Forward Integration and Backward Integration.

(ii) Concentric Diversification and Conglomerate Diversification

(iii) Expansion Strategy and Retrenchment Strategy.

(iv) Vertically Integrated Diversification and Horizontally Integrated Diversification.

(v) Divestment strategy and Liquidation strategy.

Answer

(a) Concentric diversification amounts to related diversification. In this form of diversification, the new business is linked to the existing businesses through existing systems such as process, technology or marketing. The new product is a spin-off from the existing facilities and products/processes. There are benefits of synergy with the current operations. However, concentric diversification differs from vertically integrated diversification in the nature of the linkage the new product has with the existing ones.

While in vertically integrated diversification, the new product falls within the firm's current process-product chain, in concentric diversification, there is a departure from this vertical linkage. The new product is only connected in a loop-like manner at one or more points in the firm's existing process/technology/product chain. In concentric diversification, there are benefits of synergy with the current operations.

(b) When an organization adopts a strategy, which requires taking up those activities which are unrelated to the existing businesses, either in terms of their respective customer groups, customer functions or alternative technologies, it is called conglomerate diversification. Conglomerate diversification has no common thread at all with the firm's present position. *For example, the businesses of Godrej are diversified into furniture, soaps, oils, insecticides and so on.*

(c) Turnaround is needed when an enterprise's performance deteriorates to a point that it needs a radical change of direction in strategy, and possibly in structure and culture as well. It is a highly-targeted effort to return an organization to profitability and increase positive cash flows to a sufficient level. It is used when both threats and weaknesses adversely affect the health of an organization so much that its basic survival is difficult.

The overall goal of turnaround strategy is to transform an under performing or distressed company to normalcy in terms of acceptable levels of profitability, solvency, liquidity and cash flow. To achieve its objectives, turnaround strategy must reverse causes of distress, resolve the financial crisis, achieve a rapid improvement in financial performance, regain stakeholder support, and overcome internal constraints and unfavourable industry characteristics.

(d) Stability strategy is an advisable option for the organisations facing recession. During recession businesses face reduced demand for their products even at low prices. Funds become scarce, expenditure on expansion is stopped, profits decline and businesses try to minimise the costs. They work hard to maintain the existing market share, so that company survives the recessionary period.

(e) Retrenchment strategy implies substantial reduction in the scope of organization's activity. A business organization can redefine its business by divesting a major product line or market. While retrenching, organizations might set objectives below the past level of objectives. It is essentially a defensive strategy adopted as a reaction to operating problems stemming from either internal mismanagement, unanticipated actions by competitors or hostile and unfavourable changes in the business environmental conditions. With a retrenchment strategy, the endeavour of management is to raise the level of enterprise achievements focusing on improvements in the functional performance and cutting down operations with negative cash flows.

(f) Divestment strategy involves the sale or liquidation of a portion of business, or a major division, profit centre or SBU. For a multiple product company, divestment could be a part of rehabilitating or restructuring plan called turnaround.

- A divestment strategy may be adopted due to various reasons:
- When a turnaround has been attempted but has proved to be unsuccessful.
- A business that had been acquired proves to be a mismatch and cannot be integrated within the company.
- Persistent negative cash flows from a particular business create financial problems for the whole company.
- Severity of competition and the inability of a firm to cope with it.
- Technological upgradation is required if the business is to survive but where it is not possible for the firm to invest in it.
- A better alternative may be available for investment.

(g) Acquisitions and mergers are basically combination strategies. Some organizations prefer to grow through mergers. Merger is considered to be a process when two or more companies come together to expand their business operations. In such a case the deal gets finalized on friendly terms and both the organizations share profits in the newly created entity. In a merger two organizations combine to increase their strength and financial gains along with breaking the trade barriers.

When one organization takes over the other organization and controls all its business operations, it is known as acquisition. In this process of acquisition, one financially strong organization overpowers the weaker one. Acquisitions often happen during recession in economy or during declining profit margins. In this process, one that is financially stronger and bigger establishes it power. The combined operations then run under the name of the powerful entity. A deal in case of an acquisition is often done in an unfriendly manner, it is more or less a forced association where the powerful organization either consumes the operation or a company in loss is forced to sell its entity.

(h) Merger is considered to be a process when two or more companies come together to expand their business operations. In such a case the deal gets finalized on friendly terms and both the organizations share profits in the newly created entity.

Conglomerate merger happens in case of organizations that are unrelated to each other combine together. There are no linkages with respect to customer groups, customer functions and technologies being used. There are no important common factors between the organizations in production, marketing, research and development and technology. In practice, however, there is some degree of overlap in one or more of these factors.

(i) (i) Forward and backward integration form part of vertically integrated diversification. In vertically integrated diversification, firms opt to engage in businesses that are vertically related to the existing business of the firm. The firm remains vertically within the same process. While diversifying, firms opt to engage in businesses that are linked forward or backward in the chain and enters specific product/process steps with the intention of making them into new businesses for the firm.

Backward integration is a step towards creation of effective supply by entering business of input providers. Strategy employed to expand profits and gain greater control over production of a product whereby a company will purchase or build a business that will increase its own supply capability or lower its cost of production. On the other hand, forward integration is moving forward in the value chain and entering business lines that use existing products. Forward integration will also take place where organisations enter into businesses of distribution channels.

(ii) Concentric diversification occurs when a firm adds related products or markets. On the other hand, conglomerate diversification occurs when a firm diversifies into areas that are unrelated to its current line of business.

In concentric diversification, the new business is linked to the existing businesses through process, technology or marketing. In conglomerate diversification, no such linkages exist; the new business/product is disjointed from the existing businesses/products.

The most common reasons for pursuing a concentric diversification are that opportunities in a firm's existing line of business are available. However, common reasons for pursuing a conglomerate growth strategy is that opportunities in a firm's current line of business are limited or opportunities outside are highly lucrative.

(iii) Expansion strategy is implemented by redefining the business by adding the scope of business substantially increasing the efforts of the current business. On the other hand, Retrenchment Strategy involves redefinition of business by divesting a major product line or market.

Expansion is a promising and popular strategy that tends to be equated with dynamism, vigour, promise and success. Retrenchment or retreat becomes necessary or expedient for coping with particularly hostile and adverse situations in the environment and when any other strategy is likely to be suicidal.

Expansion may take the enterprise along relatively unknown and risky paths, full of promises and pitfalls. Retrenchment involves regrouping and recouping of the resources.

(iv) In vertically integrated diversification, firms opt to engage in businesses that are related to the existing business of the firm. The firm remains vertically within the same process. Sequence moves forward or backward in the chain and enters specific product/process steps with the intention of making them into new businesses for the firm.

On the other hand, horizontal Integrated Diversification is the acquisition of one or more similar business operating at the same stage of the production-marketing chain that is going into complementary products, by-products or taking over competitors' businesses.

(v) Divestment Strategy: Divestment strategy involves the sale or liquidation of a portion of business, or a major division, profit center or SBU. Divestment is usually a part of rehabilitation or restructuring plan and is adopted when a turnaround has been attempted but has proved to be unsuccessful. The option of a turnaround may even be ignored if it is obvious that divestment is the only answer.

Liquidation Strategy: Liquidation as a form of retrenchment strategy is considered as the most extreme and unattractive. It involves closing down a firm and selling its assets. It is considered as the last resort because it leads to serious consequences such as loss of employment for workers and other employees, termination of opportunities a firm could pursue, and the stigma of failure.

Questions with Descriptive Answers

Question 4

Under what conditions would you recommend the use of Turnaround strategy in an organization? What could be a suitable work plan for this?

Answer

Rising competition, business cycles and economic volatility have created a climate where no business can take viability for granted. Turnaround strategy is a highly targeted effort to return an organization to profitability and increase positive cash flows to a sufficient level. Organizations that have faced a significant crisis that has negatively affected operations requires turnaround strategy. Turnaround strategy is used when both threats and weaknesses adversely affect the health of an organization so much that its basic survival is a question. When organization is facing both internal and external pressures making things difficult then it has to find something which is entirely new, innovative and different. Being organization's first objective is to survive and then grow in the market; turnaround strategy is used when organization's survival is under threat. Once turnaround is successful the organization may turn to focus on growth.

Conditions for turnaround strategies: When firms are losing their grips over market, profits due to several internal and external factors, and if they have to survive under the competitive environment they have to identify danger signals as early as possible and undertake rectification steps immediately. These conditions may be, inter alia, cash flow problems, lower profit margins, high employee turnover and decline in market share, capacity underutilization, low morale of employees, recessionary conditions, mismanagement, raw material supply problems and so on.

Action plan for turnaround strategy

Stage One – Assessment of current problems: The first step is to assess the current problems and get to the root causes and the extent of damage the problem has caused. Once the problems are identified, the resources should be focused toward those areas essential to efficiently work on correcting and repairing any immediate issues.

Stage Two – Analyze the situation and develop a strategic plan: Before you make any major changes; determine the chances of the business's survival. Identify appropriate strategies and develop a preliminary action plan. For this one should look for the viable core businesses, adequate bridge financing and available organizational resources. Analyze the strengths and weaknesses in the areas of competitive position. Once major problems and opportunities are identified, develop a strategic plan with specific goals and detailed functional actions.

Stage Three – Implementing an emergency action plan: If the organization is in a critical stage, an appropriate action plan must be developed to stop the bleeding and enable the organization to survive. The plan typically includes human resource, financial, marketing and operations actions to restructure debts, improve working capital, reduce costs, improve budgeting practices, prune product lines and accelerate high potential products. A positive operating cash flow must be established as quickly as possible and enough funds to implement the turnaround strategies must be raised.

Stage Four – Restructuring the business: The financial state of the organization's core business is particularly important. If the core business is irreparably damaged, then the outlook for the entire organization may be bleak. Prepare cash forecasts, analyze assets and debts, review profits and analyze other key financial functions to position the organization for rapid improvement.

During the turnaround, the "product mix" may be changed, requiring the organization to do some repositioning. Core products neglected over time may require immediate attention to remain competitive. Some facilities might be closed; the organization may even withdraw from certain markets to make organization leaner or target its products toward a different niche.

The 'people mix' is another important ingredient in the organization's competitive effectiveness. Reward and compensation systems that encourage dedication and creativity encourage employees to think profits and return on investments.

Stage Five – Returning to normal: In the final stage of turnaround strategy process, the organization should begin to show signs of profitability, return on investments and enhancing economic value-added. Emphasis is placed on a number of strategic efforts such as carefully adding new products and improving customer service, creating alliances with other organizations, increasing the market share, etc.

Question 5

What strategic option is available to the management of a sick company dealing in an electric home appliances? Give reasons for your answer.

Answer

A sick company has huge accumulated losses that have eroded its net worth. The electric home appliance company may analyse its various products to take decisions on the viability of each.

Retrenchment becomes necessary for coping with hostile and adverse situations in the environment and when any other strategy is likely to be suicidal. The nature, extent and timing of retrenchment are matters to be carefully decided by management, depending upon each contingency.

Retrenchment strategy is adopted because:

- The management no longer wishes to remain in business either partly or wholly due to continuous losses and unviability.
- The environment faced is threatening.
- Stability can be ensured by reallocation of resources from unprofitable to profitable businesses.

Retrenchment strategy is followed when an organization substantially reduces the scope of its activity. This is done through an attempt to find out the problem areas and diagnose the causes of the problems. Next, steps are taken to solve the problems. These steps result in different kinds of retrenchment strategies.

Turnaround strategy: If the organization chooses to transform itself into a leaner structure and focuses on ways and means to reverse the process of decline, it adopts a turnaround strategy. It may try to reduce costs, eliminate unprofitable outputs, generate revenue, improve coordination, better control, and so on. It may also involve changes in top management and reorienting leadership.

Divestment Strategy: Divestment strategy involves the sale or liquidation of a portion of business, or a major division, profit centre or SBU. Divestment is usually a part of rehabilitation or restructuring plan and is adopted when a turnaround has been attempted but has proved to be unsuccessful.

Liquidation Strategy: In the retrenchment strategy, the most extreme and unattractive is liquidation strategy. It involves closing down a firm and selling its assets.

It is considered as the last resort because it leads to serious consequences such as loss of employment for workers and other employees, termination of opportunities where a firm could pursue any future activities, and the stigma of failure. Many small-scale units, proprietorship firms, and partnership ventures liquidate frequently but medium- and large-sized companies rarely liquidate in India. The company management, government, banks and financial institutions, trade unions, suppliers and creditors, and other agencies are extremely reluctant to take a decision, or ask, for liquidation.

Liquidation strategy may be unpleasant as a strategic alternative but when a "dead business is worth more than alive", it is a good proposition.

The management of a Sick company manufacturing various electrical home appliances be explained about the each of the above three options of retrenchment strategy with their pros and cons. But the appropriate advice with respect to a particular option of retrenchment strategy will depend on the specific circumstances of each electrical home appliances and management goals of the company.

Question 6

What are acquisitions? Discuss with example of two companies resorting to this strategy?

Answer

Acquisition of or merger with an existing concern is an instant means of achieving the expansion. It is an attractive and tempting proposition in the sense that it circumvents the time, risks and skills involved in screening internal growth opportunities, seizing them and building up the necessary resource base required to materialise growth. Organizations consider merger and acquisition proposals in a systematic manner, so that the marriage will be mutually beneficial, a happy and lasting affair.

Apart from the urge to grow, acquisitions and mergers are resorted to for purposes of achieving a measure of synergy between the parent and the acquired enterprises. Synergy may result from such bases as physical facilities, technical and managerial skills, distribution channels, general administration, research and development and so on. Only positive synergistic effects are relevant in this connection which denote that the positive effects of the merged resources are greater than the some of the effects of the individual resources before merger or acquisition.

Some of the recent / popular instances of acquisition are listed below:

- Tata's acquisition of Anglo Dutch steelmaker Corus
- Tata's acquisition of British Jaguar Land Rover
- Mittal Steel's takeover of Arcelor
- HPCL's acquisition of Kenya Petroleum Refinery Ltd.
- Hindalco's acquisition of Canada based Novelis