Strategic Management Process:

**Strategy formulation**

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HUNGARY
Tasks of strategic management

Outline

- Strategy formulation
- Develop vision
- Develop mission
- Why mission statement
- External assessment
- Internal assessment
- Establish long term objectives

Strategy formulation

Strategy Implementation

Strategy Evaluation
Strategy formulation

Outline

- Strategy formulation
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Business mission

ANALYSIS

Internal analysis

External analysis

Establishing long term objectives
First stage of the strategic management

**Outline**

- Strategy formulation
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<table>
<thead>
<tr>
<th>Develop Vision and Mission Statements</th>
</tr>
</thead>
<tbody>
<tr>
<td>Establish long term objectives</td>
</tr>
<tr>
<td>Generate, evaluate, and select strategies</td>
</tr>
</tbody>
</table>

(Strategy formulation)

Strategic planning
Strategy formulation

• Developing vision and mission
• Identifying external opportunities and threats
• Determining internal strengths and weaknesses

• Establishing long term objectives

• Generating alternative strategies
• Choosing particular strategies to pursue
• Deciding what new business to enter
  • How to allocate resources
  • Expand or diversify operations
  • Entering or not international market
  • Merge or form joint venture
  • How to avoid a hostile takeover

Outline

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Strategy formulation

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Developing vision and mission
Terms to remember

**STRATEGIC VISION**

A view of an organization’s future direction and business course; a guiding for what the organization is trying to do and to become.

What do we want to become?
Henkel is want to be a leader with brands and technologies that make people's lives easier, better and more beautiful.

We will provide knowledge and take action to ensure the national security of the United States and the preservation of American life and ideals.

What do we want to become?
Vision

To be the leading food company in knowledge, consumer relations and revenues among companies headquartered in the region of Southeast, Central and Eastern Europe, as well as a pharmaceutical company which achieves more through a distinctive partnership approach.

What do we want to become?
Terms to remember

STRATEGIC MISSION

A mission statement broadly outlines the organization’s future direction and serves as an guiding concept for what the organization is to do and to become. Overriding premise in line with the values or expectations of stakeholders.

What is our business?
**The mission**

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**Az üzleti küldetés**
The mission

We believe our first responsibility is to the doctors, nurses, and mothers who use our products and services.

We offer a wide range of home furnishings with good design and function at prices so low that as many people as possible will be able to afford them.

**What is our business?**

**IKEA**

**Johnson & Johnson**
The mission

We are the eyes and ears of the nation and at times its hidden hand.

To create high-quality branded products that acquire the trust of clients and consumers.

To pioneer the future in space exploration, scientific discovery and aeronautics research.

What is our business?
Throughout each day in my life I strive to be loyal to my friends and family, lead a successful career that I will enjoy, stay healthy, and take on any challenges that come my way.

I value my family members, friends, spiritual fulfillment, sense of accomplishment, and respect for others.
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Profit NOT mission or vision is a primary corporate motivator!
The process of developing a mission statement

- First to select several articles about mission statements and ask all managers to read these as background information
- Ask managers themselves to prepare a mission statement for the organization
- Committee of top managers should then merge these statements into a single document,
- Than distribute this draft mission statement to all managers as a request for modifications
- Finalize the modified statement in front of CEO’s
An effective mission statement

• should not be too lengthy; recommended is less than 200 words
• arouses positive feelings and emotions about an organization
• generates the impression that a firm is successful, has direction
• distinguishes a given organization from all others
• is widely understood throughout the organization
• identifies the utility of a firm’s products to its consumers
Do not offer me things.

Do not offer me clothes. Offer me attractive looks.
Do not offer me shoes. Offer me comfort feet of walking.
Do not offer me a house. Offer me security, comfort, and place that is clean and happy.
Do not offer me books. Offer me hours of pleasure and benefit of knowledge.
Do not offer me records. Offer me leisure and sound of music.

Do not offer me things. Offer me ideas, emotions, ambience, feelings and benefits.
Characteristic of a mission statement

- **Declaration of attitude**
  - Not allowed to move wrong diversification
  - Not designed to concrete ends, rather to provide motivation, general direction, image and philosophy

- **Customer orientation**
  - To attract customers who give meaning to an organization

- **Declaration of social policy**
  - Different kind of responsibility
Why mission statement?

1. To ensure unanimity of purpose within the organization.
2. To provide a basis or standard for allocating organizational resources.
3. To establish a general tone or organizational climate.
4. To serve a focal point for individuals to identify with the organization’s purpose and direction.
5. To facilitate the translation of objectives into a work structure involving the assignment of tasks to responsible elements within the organization.
6. To specify organizational purposes or motion and then to translate these purposes into objectives.
Why mission statement?

Our Credo

We believe our first responsibility is to the doctors, nurses and patients, to mothers and fathers and all others who use our products and services. In meeting their needs everything we do must be of high quality.

We must constantly strive to reduce our costs in order to maintain reasonable prices.

Customers’ orders must be serviced promptly and accurately. Our suppliers and distributors must have an opportunity to make a fair profit.

We are responsible to our employees, the men and women who work with us throughout the world.

Everyone must be considered as an individual. We must respect their dignity and recognize their merit. They must have a sense of security in their jobs.

Compensation must be fair and adequate and working conditions clean, orderly and safe. We must be mindful of ways to help our employees fulfill their family responsibilities.

Employees must feel free to make suggestions and complaints. There must be equal opportunity for employment, development and advancement for those qualified. We must provide competent management, and their actions must be just and ethical.

We are responsible to the communities in which we live and work and to the world community as well.

We must be good citizens - support good works and charities and bear our fair share of taxes.

We must encourage civic improvements and better health and education.

We must maintain in good order the property we are privileged to use, protecting the environment and natural resources.

Our final responsibility is to our stockholders. Business must make a sound profit. We must experiment with new ideas.

Research must be carried on, innovative programs developed and mistakes paid for.

New equipment must be purchased, new facilities provided and new products launched.

Reserves must be created to provide for adverse times. When we operate according to these principles, the stockholders should realize a fair return.

Johnson-Johnson
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External assessment

“ORGANIZATION”
The nature of an external audit

The purpose is to develop a finite list of opportunities that could benefit a firm and threats that should be avoided.

Methods for external assessment:

1. Key external forces; (STEP analysis)
2. Competitive Analysis (Porter’s Five Forces Model)
3. The External Factor Evaluation Matrix (EFE)
4. The Competitive Profile Matrix (CPM)
Key external forces; (STEP analysis)

- **Social**, cultural, demographic, and environment
- **Technological**
- **Economic**
- **Political**, governmental, and legal
- **Competitive**
Social, Cultural, Demographic, and Environmental Forces

Outline

1. Strategy formulation
2. Develop vision
3. Develop mission
4. Why mission statement
5. External assessment
6. Internal assessment
7. Establish long term objectives

1. What is the dominant religion?
2. What are attitudes to foreign products and services?
3. Does language impact upon the diffusion of products onto markets?
4. How much time do consumers have for leisure?
5. What are the roles of men and women within society?
6. How long are the population living? Are the older generations wealthy?
7. Do the population have a strong/weak opinion on green issues?
Social, Cultural, Demographic, and Environmental Variables

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Number of marriages
Number of divorces
Number of births
Number of death
Immigration rates
Social security programs
Life expectancy rates
Trust in government
Ethical concerns
Average level of education
Sex roles
Average disposable income
Retirement age
Attitudes tow. leisure time
Pollution control
Social programs
Number of churches
Attitudes tow. product qal.
Attitudes tow. authority
Waste management
Number of school, college
Recycling
Water pollution
Ozone depletion
Air pollution
Social responsibility
1. Does technology allow for products and services to be made more cheaply and to a better standard of quality?

2. Do the technologies offer consumers and businesses more innovative products and services such as Internet banking, new generation mobile telephones, etc?

3. How is distribution changed by new technologies e.g. books via the Internet, flight tickets, auctions, etc?

4. Does technology offer companies a new way to communicate with consumers e.g. banners, Customer Relationship Management (CRM), etc?
Economic Forces

Strategists need to consider the state of a trading economy in the short and long-terms. This is especially true when planning for international marketing.

You need to look at:
1. Interest rates
2. The level of inflation Employment level per capita
3. Long-term prospects for the economy Gross Domestic Product (GDP) per capita, and so on
Key Economic Variables to be Monitored

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- Why mission statement

Availability of credit
Level of disposable income
Interest rates
Inflation rates
Government budget deficit
Consumption patterns
Unemployment rates
Import/export factors
Price fluctuations
Monetary policies
Fiscal policies

Gross domestic product trend
Worker productivity levels
Value of the local currency
Stock market trends
Export of labor and capital
Income differences by region and consumer groups
Tax rates
Change of European Economic Policy
The political arena has a huge influence upon the regulation of businesses, and the spending power of consumers and other businesses. You must consider issues such as:

1. How stable is the political environment?
2. Will government policy influence laws that regulate or tax your business?
3. What is the government's position on marketing ethics?
4. What is the government's policy on the economy?
5. Does the government have a view on culture and religion?
6. Is the government involved in trading agreements such as EU, NAFTA, ASEAN, or others?
### Some Political, Governmental, and Legal Variables to be Monitored

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<table>
<thead>
<tr>
<th>Government regulations</th>
<th>Political conditions in foreign countries</th>
</tr>
</thead>
<tbody>
<tr>
<td>Changes in tax laws</td>
<td>Special local laws, taxes</td>
</tr>
<tr>
<td>Special tariffs</td>
<td>Lobbying activities</td>
</tr>
<tr>
<td>Number of patterns</td>
<td>Size of governmental budget</td>
</tr>
<tr>
<td>Political action committees</td>
<td>Government fiscal and monetary policy changes</td>
</tr>
<tr>
<td>Environmental protection laws</td>
<td>National/local elections, regulations</td>
</tr>
<tr>
<td>Level of governmental subsidies</td>
<td>Location and severity of terrorist activities</td>
</tr>
<tr>
<td>Import/export regulation</td>
<td>Relationships between neighbor countries</td>
</tr>
<tr>
<td>Government fiscal and monetary policy changes</td>
<td>Antitrust legislation</td>
</tr>
</tbody>
</table>
Collecting and evaluating information on competitors is essential for successful strategy formulation.

1. What are the major competitor’s strengths?
2. What are the major competitor’s weaknesses?
3. What are the major competitor’s objectives and strategies?
4. How will the major competitors most likely respond to STEP affecting our industry?
5. How vulnerable are the major competitors to our alternative company strategies?
6. How are our products or services positioned relative to major competitors?
To what extent are new firms entering and old firms leaving this industry?

7. What key factors have resulted in our present competitive position in this industry?

8. How have sales and profit rankings of major competitors in the industry changed over recent years? Why have these rankings changed that way?

9. What is the nature of supplier and distributor relationships in this industry?

10. To what extent could substitute products or services be a threat to competitors in this industry?
The nature of an external audit

The purpose is to develop a finite list of opportunities that could benefit a firm and threats that should be avoided.

Methods for external assessment;

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Competitive Analysis Porter’s Five-Forces Model

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Potential development of substitute products

Bargaining power of suppliers

Rivalry among competing firms

Bargaining power of consumers

Potential entry of new competitors
Rivalry among competing firms

The most powerful

Tools

1. Lowering prices
2. Enhancing quality
3. Adding features
4. Providing services
5. Extending warranties
6. Increasing advertising
The intensity of Rivalry increases

1. Number of competitor increases
2. Competitors become more equal
3. Demand for the products declines
4. Price cutting become common
5. Consumers can switch brands easily
6. Fixed costs are high
7. Consumer demand decline or stagnates
8. Mergers and acquisitions are common

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Bargaining power of suppliers

Rivalry among competing firms

Bargaining power of consumers

Potential entry of new competitors
Potential entry of new competitors

**BARRIERS**

1. The lack of experience
2. Strong consumer royalty
3. Strong brand preferences
4. Government regulatory policies
5. Tariffs
6. Lack of process to raw materials
7. Possession of patterns
8. Undesirable location
9. Market saturation

**OPPORTUNITIES**

1. Higher quality products
2. Lower prices
3. Substantial marketing resources
4. All the opposite listed in barriers

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Rivalry among competing firms

Bargaining power of consumers

Potential entry of new competitors
Potential development of substitute products

Competitive pressures arising from substitute products increase as the relative price of substitute products declines and consumer’s switching costs decrease.

Substitutes

Eyeglasses, contact lens >>>>>>> Laser surgery
Sugar >>>>>>>>>> Artificial sweeteners
Newspapers >>>>>>>>>> Internet
Bargaining power of suppliers

WHEN bigger?

1. Large number of suppliers
2. Few good substitute raw materials
3. Cost of switching raw materials is especially costly

Tools against the bargaining power of suppliers
- Backward integration
- Self manufacture
Competitive Analysis Porter’s Five-Forces Model

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Potential development of substitute products

Bargaining power of suppliers

Rivalry among competing firms

Bargaining power of consumers

Potential entry of new competitors
Bargaining power of consumers

WHEN bigger?

1. When costumers are concentrated
2. Products are standard or undifferentiated
3. If they can inexpensively switch to competing brands or substitutes
4. If they are particularly important to the seller
5. When sellers extremely need consumer demand
6. If they are informed about seller’s product prices and costs
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External Factor Evaluation (EFE) Matrix

EFE allows strategists to summarize and evaluate all external factors in one sum.

1. Collect 10 to 20 factors both opportunities and threats that affect the firm and its industry.
2. Assign to each factor a weight from 0,00 (not important) to 1,00 (extremely important). The weight indicates the relative importance of that factor to being successful in the firm’s industry. The sum of all weights is 1.
3. Assign a rating between 1 and 4 to each external factor to indicate how effectively the firm’s current strategies respond to the factor: where 4 is superior, 3 is above average, 2 is average and 1 is response is poor.
4. Multiply each factor’s weight by rating to determine a weighted score.
5. Sum the weighted score to determine the total weighted score for organization.
### External Factor Evaluation (EFE) Matrix

<table>
<thead>
<tr>
<th>Key external factors</th>
<th>Weight</th>
<th>Rating</th>
<th>Weighted score</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Opportunities</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1. Demand for prepared food increasing 10% annually</td>
<td>0.07</td>
<td>4</td>
<td>0.28</td>
</tr>
<tr>
<td>2. Packaging technology offers 15% annual cost savings</td>
<td>0.03</td>
<td>2</td>
<td>0.06</td>
</tr>
<tr>
<td>3. &gt;&gt;&gt;&gt;…..9 or 10 items</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Threats</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1. Increasing governmental regulation in the industry</td>
<td>0.04</td>
<td>2</td>
<td>0.08</td>
</tr>
<tr>
<td>2. Leading rival firms are more fully integrated</td>
<td>0.07</td>
<td>1</td>
<td>0.07</td>
</tr>
<tr>
<td>3. &gt;&gt;&gt;&gt;9 or 10 key items</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td></td>
<td>1.00</td>
<td>Σ (1 to 4)</td>
</tr>
</tbody>
</table>

- **Importance to the firm’s industry**
- **Importance to the firm’s current strategy**
External Factor Evaluation (EFE) Matrix

The highest weighted score is 4 the lowest is 1 the average is 2.5.

4 means: the firm's strategies effectively take advantage of existing opportunities and minimize the potential adverse of external threats.

1 means: The firm's strategies are not capitalizing on opportunities or avoiding external threats.
The nature of an external audit

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Methods for external assessment;

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The Competitive Profile Matrix (CPM)

Identifies a firm’s major competitors and its particular strengths and weaknesses in relation to a sample firm’s strategic position

1. Collect 10 to 20 critical success factors (CSF) that affect the firm and its industry. The SCF include both internal and external issues.
2. Assign to each factor a weight from 0,00 (not important) to 1,00 (extremely important). The weight indicates the relative importance of that factor to being successful in the industry. The sum of all weights is 1.
3. Assign a rating between 1 and 4 to each external factor to refer to strengths and weaknesses: where 4 is major strength, 3 is minor strength, 2 is minor weakness, and 1 is major weakness.
4. Multiply each factor’s weight by rating to determine a weighted score.
5. Sum the weighted score to determine the total weighted score for organization.

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The Competitive Profile Matrix (CPM)

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**AN EXAMPLE**

<table>
<thead>
<tr>
<th>Critical Success Factors</th>
<th>Weight</th>
<th>Rating</th>
<th>Score</th>
<th>Rating</th>
<th>Score</th>
</tr>
</thead>
<tbody>
<tr>
<td>Advertising</td>
<td>0,20</td>
<td>1</td>
<td>0,2</td>
<td>3</td>
<td>0,60</td>
</tr>
<tr>
<td>Product quality</td>
<td>0,10</td>
<td>4</td>
<td>0,4</td>
<td>3</td>
<td>0,30</td>
</tr>
<tr>
<td>Price competitiveness</td>
<td>0,10</td>
<td>3</td>
<td>0,3</td>
<td>4</td>
<td>0,40</td>
</tr>
<tr>
<td>Management</td>
<td>0,10</td>
<td>4</td>
<td>0,4</td>
<td>3</td>
<td>0,30</td>
</tr>
<tr>
<td>Financial position</td>
<td>0,15</td>
<td>4</td>
<td>0,6</td>
<td>3</td>
<td>0,45</td>
</tr>
<tr>
<td>Customer loyalty</td>
<td>0,10</td>
<td>4</td>
<td>0,4</td>
<td>2</td>
<td>0,20</td>
</tr>
<tr>
<td>Global expansion</td>
<td>0,20</td>
<td>4</td>
<td>0,8</td>
<td>2</td>
<td>0,40</td>
</tr>
<tr>
<td>Market share</td>
<td>0,05</td>
<td>1</td>
<td>0,05</td>
<td>3</td>
<td>0,15</td>
</tr>
<tr>
<td><strong>TOTAL</strong></td>
<td><strong>1,00</strong></td>
<td></td>
<td><strong>3,15</strong></td>
<td></td>
<td><strong>2,80</strong></td>
</tr>
</tbody>
</table>

**Score Rating Weight**
The Competitive Profile Matrix (CPM)

Important differences between EFE and CPM

**CPM**
- are broader, they do not include specific or factual data and even may focus on internal issues.
- Not grouped into opportunities and threats.
- CPM ratings and total weighted scores for rival firms can be compared to the sample firm.
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Strategy formulation

Business mission

Internal analysis

External analysis

Establishing long term objectives
Internal strengths/weaknesses, coupled with external opportunities/threats and clear statement of mission provide the basis for establishing objectives and strategies.

**Methods for internal assessment:**

1. Resource Based View (RBV) Approach
2. Analyzing Key Internal Forces
3. Value Chain Analysis (VCA), (ABC)
4. Internal Factor Evaluation (IFE) Matrix
Internal assessment Methods

1. Resource Based View approach
   - Physical resources
     Plant, equipment, location, technology, raw materials, machines
   - Human resources
     Employees, training, experience, intelligence, knowledge, skills, abilities
   - Organizational resources
     Firm structure, planning processes, information systems, patents, trademarks, copyrights, databases
Internal assessment Methods

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Key internal forces:

1. Management
2. Marketing
3. Finance/accounting
4. Production/operation
5. Research and development
6. Management Information System
Internal assessment Methods

2. Analyzing key internal forces

1. Management
   Planning, organizing, motivating, staffing, and controlling.

2. Marketing
   Customer analysis, selling products and services, product and service planning, pricing, distribution, marketing research, opportunity analysis

3. Finance/ accounting
   Firm’s liquidity, leverage, working capital, profitability, asset utilization, cash flow, and equity
Internal assessment Methods

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2. Analyzing key internal forces

4. Production/operation
   Decision on process, capacity, inventory, workforce and quality.

5. Research and development

6. Management information system
   Data become information only when they are evaluated, filtered, condensed, analyzed, and organized for a specific purpose, problem, individual, or time.

3. Value Chain Analysis
   Refers to the process whereby a firm determines the costs associated with organizational activities.

4. Internal Factor Evaluation (IFE) Matrix
Key Internal Forces Management

1. **planning:** consists of all those managerial activities related to preparing for future. Specific tasks: forecasting, establishing objectives, devising strategies, developing policies, and setting goals.

2. **Organizing:** includes all those managerial activities that result in a structure of task and authority relationships. Specific areas: organizational design, job specialization, job description, coordination, job analysis.
3. **Motivating:** involves efforts directed towards shaping human behavior. Specific topics: leadership, communication, work groups, delegation of authority, job satisfaction, employee morale.

4. **Staffing:** are centered on personnel or HRM. Wage and salary administration, interviewing, hiring, firing, training, employee safety, union relation, career development, personnel research, public relations.
5. **Controlling:** ensuring that actual results are consistent with planned results. Key areas: quality control, financial control, sales control, inventory control, expense control, analysis of variances, rewards, and sanctions.
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Key internal forces:

1. Management
2. Marketing
3. Finance/accounting
4. Production/operation
5. Research and development
6. Management Information System
Key Internal Forces Finance/accounting

1. **Investment decision:** (capital budgeting) is the allocation and reallocation of capital and resources to projects, products, assets, and divisions of an organization.

2. **Financing decision:** determines the best capital structure, how the firm can raise capital. Issuing stock, increasing dept, selling assets or using a combination of these.

3. **Dividend decision:** percentage of earnings paid to stockholders.
Key Internal Forces Finance/accounting

Key financial ratios:
Like a blood test: reflect a situation at just one point in time.

1. Liquidity
2. Leverage
3. Activity
4. Profitability
5. Growth

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1. Liquidity

<table>
<thead>
<tr>
<th>RATIO</th>
<th>How calculated</th>
<th>What it measures</th>
</tr>
</thead>
<tbody>
<tr>
<td>Current</td>
<td>Current assets</td>
<td>A firm can (not) meet its short term obligations</td>
</tr>
<tr>
<td></td>
<td>Current liabilities</td>
<td></td>
</tr>
<tr>
<td>Quick ratio</td>
<td>Current assets – inventory</td>
<td>A firm can (not) meet its short term obligations</td>
</tr>
<tr>
<td></td>
<td>Current liabilities</td>
<td>Without relying upon the sale of its inventories</td>
</tr>
</tbody>
</table>
### Key Internal Forces Finance/accounting

#### Outline

- **Strategy formulation**
- **Develop vision**
- **Develop mission**
- **Why mission statement**
- **External assessment**
- **Internal assessment**
- **Establish long term objectives**

#### 2. Leverage ratios

<table>
<thead>
<tr>
<th>RATIO</th>
<th>How calculated</th>
<th>What it measures</th>
</tr>
</thead>
<tbody>
<tr>
<td>Dept to total assets</td>
<td>Total dept / Total assets</td>
<td>The % of total funds that are provided by creditors</td>
</tr>
<tr>
<td>Dept to equity</td>
<td>Total dept / Total stockholder’s equity</td>
<td>The % of total funds provided by creditors versus by owners</td>
</tr>
<tr>
<td>Long term dept to equity</td>
<td>Long term dept / Total stockholder’s equity</td>
<td>A balance between dept and equity in a firm’s long term capital structure</td>
</tr>
<tr>
<td>Times interest earned ratio</td>
<td>Profit before interest and taxes / Total interest charges</td>
<td>The extent to which earnings can decline without the firm becoming unable to meet its annual interest costs</td>
</tr>
</tbody>
</table>
### Key Internal Forces: Finance/Accounting

#### 3. Activity ratios

<table>
<thead>
<tr>
<th>RATIO</th>
<th>How calculated</th>
<th>What it measures</th>
</tr>
</thead>
<tbody>
<tr>
<td>Inventory turnover</td>
<td>Sale / Inventory of finished goods</td>
<td>Whether a firm holds excessive stocks of inventories</td>
</tr>
<tr>
<td>Fixed assets turnover</td>
<td>Sale / Fixed assets</td>
<td>Sales productivity and plant and equipment utilization</td>
</tr>
<tr>
<td>Total assets turnover</td>
<td>Sale / Total assets</td>
<td>Sales productivity on total assets</td>
</tr>
<tr>
<td>Account receivable turnover</td>
<td>Annual credit sales Account receivable</td>
<td>The average length of time it takes a firm to collect credit sales (%)</td>
</tr>
<tr>
<td>Average collection period</td>
<td>Account receivable Total credit sales/365 days</td>
<td>The average length of time it takes a firm to collect credit sales (days)</td>
</tr>
</tbody>
</table>
Key Internal Forces **Finance/accounting**

## 4. Profitability ratios

<table>
<thead>
<tr>
<th>RATIO</th>
<th>How calculated</th>
<th>What it measures</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gross profit margin</td>
<td>Sales minus cost of good sold</td>
<td>A total margin available to cover operating expenses and yield a profit</td>
</tr>
<tr>
<td></td>
<td>Sales</td>
<td></td>
</tr>
<tr>
<td>Operating profit margin</td>
<td>Earnings before interest and taxes</td>
<td>Profitability exclude I&amp;T</td>
</tr>
<tr>
<td></td>
<td>Sales</td>
<td></td>
</tr>
<tr>
<td>Net profit margin</td>
<td>Net income</td>
<td>After tax profits of sales</td>
</tr>
<tr>
<td></td>
<td>Sales</td>
<td></td>
</tr>
</tbody>
</table>
### 4. Profitability ratios (continued)

<table>
<thead>
<tr>
<th>RATIO</th>
<th>How calculated</th>
<th>What it measures</th>
</tr>
</thead>
<tbody>
<tr>
<td>Return on total assets (ROA)</td>
<td>Net income</td>
<td>After tax profits of assets (Return on investment)</td>
</tr>
<tr>
<td></td>
<td>Total assets</td>
<td></td>
</tr>
<tr>
<td>Return on stockholders’ equity</td>
<td>Net income</td>
<td>After tax profits of stockholder’s investment</td>
</tr>
<tr>
<td></td>
<td>Total stockholders’ equity</td>
<td></td>
</tr>
<tr>
<td>Earnings per share (EPS)</td>
<td>Net income</td>
<td>Earnings available to the owners of common stock</td>
</tr>
<tr>
<td></td>
<td>Number of shares of common stock</td>
<td></td>
</tr>
<tr>
<td>Price earning ratio</td>
<td>Market price per share</td>
<td>Attractiveness of firm on equity market</td>
</tr>
<tr>
<td></td>
<td>Earnings per share</td>
<td></td>
</tr>
</tbody>
</table>

**What it measures**

- **Net income**
- **Total assets**
- **Total stockholders’ equity**
- **Number of shares of common stock**
- **Market price per share**
- **Earnings per share**
## 5. Growth ratios

<table>
<thead>
<tr>
<th>RATIO</th>
<th>How calculated</th>
<th>What it measures</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales</td>
<td>Annual % growth in total sales</td>
<td>Firms growth rate in sales</td>
</tr>
<tr>
<td>Net income</td>
<td>Annual % growth in profits</td>
<td>Firms growth rate in profits</td>
</tr>
<tr>
<td>Earnings per share</td>
<td>Annual % growth in EPS</td>
<td>Firms growth rate in EPS</td>
</tr>
<tr>
<td>Dividends per share</td>
<td>Annual % growth in dividends per share</td>
<td>Firms growth rate in dividends per share</td>
</tr>
</tbody>
</table>
**Internal assessment**

**Outline**
- Strategy formulation
- Develop vision
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- Why mission statement
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- **Internal assessment**
- Establish long term objectives

**Key internal forces:**

1. Management
2. **Marketing**
3. Finance/accounting
4. **Production/operation**
5. Research and development
6. Management Information System
Key Internal Forces Production/operation

This function of a business consists of all those activities that transform inputs into good and services.

5 functions or decision areas:

- Process
- Capacity
- Inventory
- Workforce
- Quality

Outline

- Strategy formulation
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### Key Internal Forces: Production/Operation

<table>
<thead>
<tr>
<th>FUNCTION</th>
<th>DESCRIPTION</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Process</td>
<td>Design of physical production system. Specific: choice of technology, facility layout, process flow analysis, process control, transportation analysis</td>
</tr>
<tr>
<td>2. Capacity</td>
<td>Determination of optimal output level for the firm. Specific: forecasting, facilities planning, aggregate planning, scheduling, capacity planning.</td>
</tr>
<tr>
<td>3. Inventory</td>
<td>Managing the level of raw materials, work-in process, and finished goods. Specific: what to order, how much to order, materials handling.</td>
</tr>
<tr>
<td>4. Workforce</td>
<td>Managing the skilled, unskilled, clerical, and managerial employees. Specific: job design, work measurement, job enrichment, work standards and motivation techniques.</td>
</tr>
<tr>
<td>5. Quality</td>
<td>Ensuring the certain quality goods and services are produced. Specific: quality control, sampling, quality assurance and cost control</td>
</tr>
</tbody>
</table>
Internal strengths/weaknesses, coupled with external opportunities/threats and clear statement of mission provide the basis for establishing objectives and strategies.

**Methods for internal assessment:**

1. Resource Based View (RBV) Approach
2. Analyzing Key Internal Forces
3. Value Chain Analysis (VCA) Activity Based Costing (ABC)
4. Internal Factor Evaluation (IFE) Matrix
Outline

- Strategy formulation
- Develop vision
- Develop mission
- Why mission statement
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- Internal assessment
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Value chain analysis refers to the process whereby a firm determines the costs associated with organizational activities from purchasing raw materials to manufacturing products to marketing those products.

Aims to identify where low cost advantages or disadvantages exist anywhere along the value chain.
Value Chain Analysis

Outline

- Strategy formulation
- Develop vision
- Develop mission
- Why mission statement
- External assessment
- Internal assessment
- Establish long term objectives
### Value Chain Analysis

**Outline**
- Strategy formulation
- Develop vision
- Develop mission
- Why mission statement
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- **Internal assessment**
- Establish long term objectives

<table>
<thead>
<tr>
<th>Supplier</th>
<th>Production</th>
<th>Distribution</th>
<th>Sales + marketing</th>
<th>Customer service</th>
</tr>
</thead>
<tbody>
<tr>
<td>Raw mat.</td>
<td>Inventory system</td>
<td>Loading</td>
<td>Salespersons</td>
<td>Postage</td>
</tr>
<tr>
<td>Fuel</td>
<td>Receiving</td>
<td>Shipping</td>
<td>Web site</td>
<td>Phone</td>
</tr>
<tr>
<td>Energy</td>
<td>Plant layout</td>
<td>Budgeting</td>
<td>Internet</td>
<td>Internet</td>
</tr>
<tr>
<td>Transportaion</td>
<td>Maintenance</td>
<td>Personnel</td>
<td>Publicity</td>
<td>Warranty</td>
</tr>
<tr>
<td>Truck drivers</td>
<td>Plant location</td>
<td>Internet</td>
<td>Promotion</td>
<td></td>
</tr>
<tr>
<td>Component parts</td>
<td>Computer</td>
<td>Trucking</td>
<td>Advertising</td>
<td></td>
</tr>
<tr>
<td>Inspection</td>
<td>R and D</td>
<td>Railroads</td>
<td>Transportatio</td>
<td></td>
</tr>
<tr>
<td>Storing</td>
<td>Cost accounting</td>
<td>Fuel</td>
<td>Food and lodging</td>
<td></td>
</tr>
<tr>
<td>Warehouse</td>
<td>Maintenance</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Value Chain Analysis

Outline
- Strategy formulation
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Traditional Cost Accounting Vs. Activity-Based Costing

<table>
<thead>
<tr>
<th>Traditional Cost Accounting Categories in Department Budget</th>
<th>Departmental Activities Using Activity-Based Cost Accounting</th>
</tr>
</thead>
<tbody>
<tr>
<td>Wages &amp; Salaries</td>
<td>Evaluate Suppliers</td>
</tr>
<tr>
<td>350,000</td>
<td>135,750</td>
</tr>
<tr>
<td>Employee Benefits</td>
<td>Process Purchase Orders</td>
</tr>
<tr>
<td>115,000</td>
<td>82,100</td>
</tr>
<tr>
<td>Supplies</td>
<td>Expedite Deliveries</td>
</tr>
<tr>
<td>6,500</td>
<td>23,500</td>
</tr>
<tr>
<td>Travel</td>
<td>Expedite Internal Process</td>
</tr>
<tr>
<td>2,400</td>
<td>15,840</td>
</tr>
<tr>
<td>Depreciation</td>
<td>Check Item Quality</td>
</tr>
<tr>
<td>17,000</td>
<td>94,300</td>
</tr>
<tr>
<td>Other Fixed Charges</td>
<td>Check Deliveries Against</td>
</tr>
<tr>
<td>124,000</td>
<td>Purchase Orders</td>
</tr>
<tr>
<td>Miscellaneous</td>
<td>Resolve Problems</td>
</tr>
<tr>
<td>Operating Expenses</td>
<td>Internal Administration</td>
</tr>
<tr>
<td>25,520</td>
<td>48,450</td>
</tr>
<tr>
<td></td>
<td>110,000</td>
</tr>
<tr>
<td></td>
<td>130,210</td>
</tr>
</tbody>
</table>

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Value Chain Analysis

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Supplier • Production • Distribution • Sales + marketing • Customer service

The Value Chain System

Upstream Value Chains
Activities, Costs, & Margins of Suppliers

Company Value Chains
Internally Performed Activities, Costs, & Margins

Downstream Value Chains
Activities, Costs, & Margins of Forward Channel Allies
Buyer/User Value Chains
Internal assessment

Internal **strengths/weaknesses**, coupled with external opportunities/threats and clear statement of mission provide the basis for establishing objectives and strategies.

**Methods for internal assessment:**

1. **Resource Based View (RBV) Approach**
2. **Analyzing Key Internal Forces**
3. **Value Chain Analysis (VCA), (ABC)**
4. **Internal Factor Evaluation (IFE) Matrix**
Identifies a firm’s major strengths and weaknesses allows strategists to summarize and evaluate all internal factors in one sum.

1. Collect 10 to 20 internal factors including both strengths and weaknesses. Use percentage, ratios and comparative numbers.
2. Assign to each factor a weight from 0.00 (not important) to 1.00 (extremely important). The weight indicates the relative importance of that factor to being successful in the industry. The sum of all weights is 1.
3. Assign a rating between 1 and 4 to each external factor to refer to strengths and weaknesses: where 4 is major strength, 3 is minor strength, 2 is minor weakness, and 1 is major weakness.
4. Multiply each factor’s weight by rating to determine a weighted score.
5. Sum the weighted score to determine the total weighted score for organization.
## Internal Factor Evaluation (IFE) Matrix

<table>
<thead>
<tr>
<th>Key internal factors</th>
<th>Weight</th>
<th>Rating</th>
<th>Weighted score</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Strengths</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1. Our company provide 24-hour, 7 day services</td>
<td>0,08</td>
<td>3</td>
<td>0,24</td>
</tr>
<tr>
<td>2. Our company has 50 subsidiary in Europe and Asia</td>
<td>0,06</td>
<td>4</td>
<td>0,24</td>
</tr>
<tr>
<td>3. &gt;&gt;&gt;&gt;…..9 or 10 items</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Weaknesses</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1. Our company total dept to equity ratio is 0,36 compared to the industry average of 0,9</td>
<td>0,03</td>
<td>2</td>
<td>0,06</td>
</tr>
<tr>
<td>2. 86 % of the trade revenues come from Europe</td>
<td>0,07</td>
<td>1</td>
<td>0,07</td>
</tr>
<tr>
<td>3. &gt;&gt;&gt;&gt;9 or 10 key items</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>1,00</td>
<td></td>
<td>Σ (1 to 4)</td>
</tr>
</tbody>
</table>
Internal Factor Evaluation (IFE) Matrix

The highest weighted score is 4 the lowest is 1 the average is 2.5.

Total weighted scores well below 2.5 characterize organizations that are weak internally, whereas scores significantly above 2.5 indicate a strong internal position.
Strategy formulation

Outline

- Strategy formulation
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Business mission

Internal analysis

External analysis

Establishing long term objectives

Generating alternative strategies
Choosing particular strategies to pursue
Deciding what new business to enter