

Strategy Generation and Selection

Chapter Eight

Learning Objectives

1. Describe the strategy analysis and choice process.
2. Diagram and explain the three-stage strategy-formulation analytical framework.
3. Diagram and explain the Strengths-Weaknesses-Opportunities-Threats (SWOT) Matrix.
4. Diagram and explain the Strategic Position and Action Evaluation (SPACE) Matrix.
5. Diagram and explain the Boston Consulting Group (BCG) Matrix.

Learning Objectives (cont.)

6. Diagram and explain the Internal-External (IE) Matrix.
7. Diagram and explain the Grand Matrix.
8. Diagram and explain the Quantitative Strategic Planning Matrix (QSPM).
9. Discuss the role of organizational culture in strategic analysis and choice.
10. Identify and discuss important political considerations in strategy analysis and choice.
11. Discuss the role of a board of directors (governance) in strategic planning.

A Comprehensive Strategic-Management Model

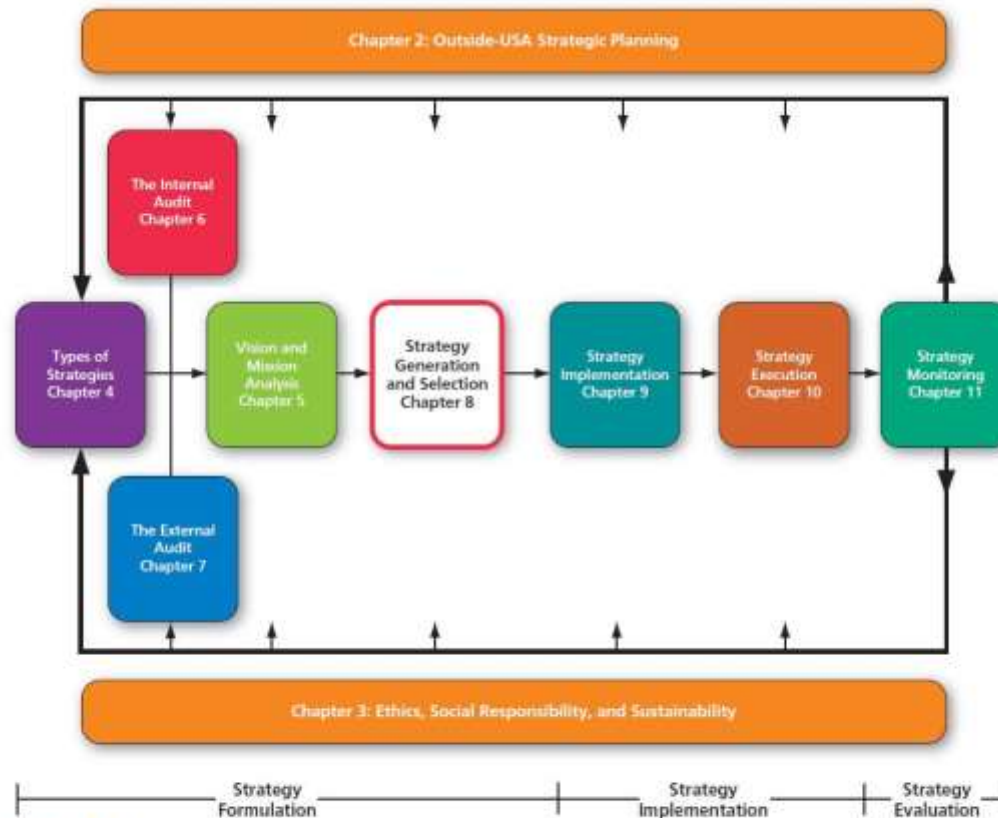


FIGURE 8-1

A Comprehensive Strategic-Management Model

Source: Fred R. David, adapted from "How Companies Define Their Mission," *Long Range Planning* 22, no. 3 (June 1988): 40, © Fred R. David.

The Process of Generating and Selecting Strategies

- ❖ A manageable set of the most attractive alternative strategies must be developed.
- ❖ The advantages, disadvantages, trade-offs, costs, and benefits of these strategies should be determined.

The Process of Generating and Selecting Strategies

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

The Process of Generating and Selecting Strategies

- ❖ Alternative strategies proposed by participants should be considered and discussed in a series of meetings.
- ❖ Proposed strategies should be listed in writing.
- ❖ When all feasible strategies identified by participants are given and understood, the strategies should be ranked in order of attractiveness.

The Strategy-Formulation Analytical Framework

STAGE 1: THE INPUT STAGE

External Factor
Evaluation (EFE)
Matrix

Competitive
Profile
Matrix (CPM)

Internal Factor
Evaluation (IFE)
Matrix

STAGE 2: THE MATCHING STAGE

Strengths-Weaknesses-
Opportunities-Threats
(SWOT) Matrix

Strategic Position and
Action Evaluation
(SPACE) Matrix

Boston Consulting
Group (BCG)
Matrix

Internal-External
(IE) Matrix

Grand Strategy
Matrix

STAGE 3: THE DECISION STAGE

Quantitative Strategic Planning Matrix (QSPM)

A Comprehensive Strategy-Formulation Framework

❖ Stage 1 - Input Stage

- ❖ summarizes the basic input information needed to formulate strategies
- ❖ consists of the EFE Matrix, the IFE Matrix, and the Competitive Profile Matrix (CPM)

A Comprehensive Strategy-Formulation Framework

❖ Stage 2 - Matching Stage

- ❖ focuses on generating feasible alternative strategies by aligning key external and internal factors
- ❖ techniques include the Strengths-Weaknesses-Opportunities-Threats (SWOT) Matrix, the Strategic Position and Action Evaluation (SPACE) Matrix, the Boston Consulting Group (BCG) Matrix, the Internal-External (IE) Matrix, and the Grand Strategy Matrix

A Comprehensive Strategy-Formulation Framework

❖ **Stage 3 - Decision Stage**

- ❖ involves the Quantitative Strategic Planning Matrix (QSPM)
- ❖ reveals the relative attractiveness of alternative strategies and thus provides objective basis for selecting specific strategies

Matching Key External and Internal Factors to Formulate Alternative Strategies

TABLE 8-1 Matching Key External and Internal Factors to Formulate Alternative Strategies

Key Internal Factor	Key External Factor	Resultant Strategy
Excess working capital (an internal strength)	+ 20 percent annual growth in the cell phone industry (an external opportunity)	= Acquire Cellfone, Inc.
Insufficient capacity (an internal weakness)	+ Exit of two major foreign competitors from the industry (an external opportunity)	= Pursue horizontal integration by buying competitors' facilities
Strong R&D expertise (an internal strength)	+ Decreasing numbers of younger adults (an external threat)	= Develop new products for older adults
Poor employee morale (an internal weakness)	+ Rising health care costs (an external threat)	= Develop a new wellness program

The Matching Stage

- ❖ **The Strengths-Weaknesses-Opportunities-Threats (SWOT) Matrix** helps managers develop four types of strategies:
 - ❖ SO (strengths-opportunities) Strategies
 - ❖ WO (weaknesses-opportunities) Strategies
 - ❖ ST (strengths-threats) Strategies
 - ❖ WT (weaknesses-threats) Strategies

The Matching Stage

❖ **SO Strategies**

- ❖ use a firm's internal strengths to take advantage of external opportunities

❖ **WO Strategies**

- ❖ aim at improving internal weaknesses by taking advantage of external opportunities

The Matching Stage

❖ **ST Strategies**

- ❖ use a firm's strengths to avoid or reduce the impact of external threats

❖ **WT Strategies**

- ❖ defensive tactics directed at reducing internal weakness and avoiding external threats

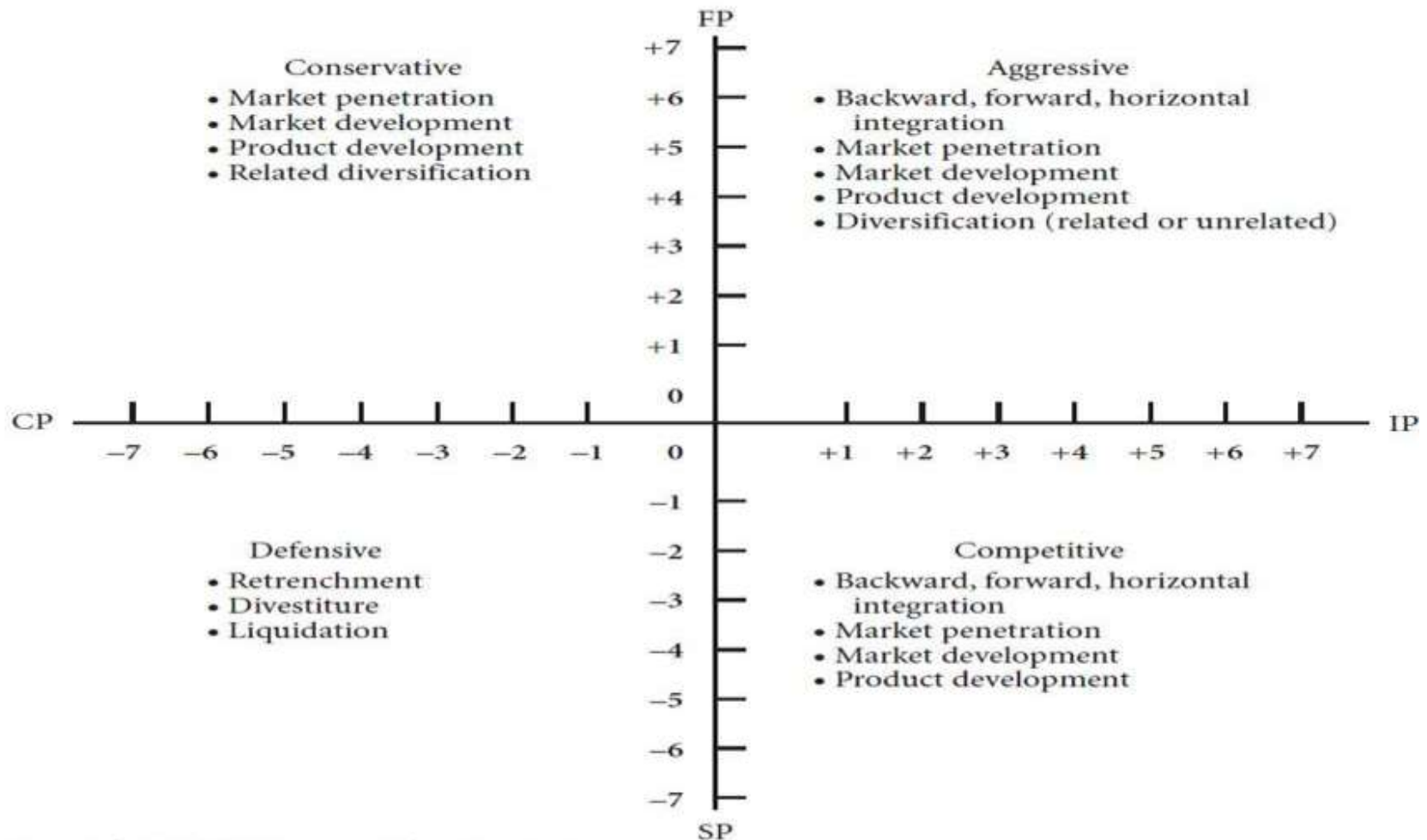
SWOT Matrix

- 1.** List the firm's key external opportunities.
- 2.** List the firm's key external threats.
- 3.** List the firm's key internal strengths.
- 4.** List the firm's key internal weaknesses.
- 5.** Match internal strengths with external opportunities, and record the resultant SO strategies.

SWOT Matrix (cont.)

6. Match internal weaknesses with external opportunities, and record the resultant WO strategies.
7. Match internal strengths with external threats, and record the resultant ST strategies.
8. Match internal weaknesses with external threats, and record the resultant WT strategies.

The SPACE Matrix



The SPACE Matrix

❖ Strategic Position and Action Evaluation (SPACE) Matrix

- ❖ four-quadrant framework indicates whether aggressive, conservative, defensive, or competitive strategies are most appropriate for a given organization

The SPACE Matrix

- ❖ Two internal dimensions (financial position [FP] and competitive position [CP])
- ❖ Two external dimensions (stability position [SP] and industry position [IP])
- ❖ Most important determinants of an organization's overall strategic position

SPACE Matrix Axes

TABLE 8-2 Example Factors That Make Up the SPACE Matrix Axes

Internal Strategic Position	External Strategic Position
<i>Financial Position (FP)</i>	<i>Stability Position (SP)</i>
Return on investment	Technological changes
Leverage	Rate of inflation
Liquidity	Demand variability
Working capital	Price range of competing products
Cash flow	Barriers to entry into market
Inventory turnover	Competitive pressure
Earnings per share	Ease of exit from market
Price earnings ratio	Price elasticity of demand
	Risk involved in business
<i>Competitive Position (CP)</i>	<i>Industry Position (IP)</i>
Market share	Growth potential
Product quality	Profit potential
Product life cycle	Financial stability
Customer loyalty	Extent leveraged
Capacity utilization	Resource utilization
Technological know-how	Ease of entry into market
Control over suppliers and distributors	Productivity, capacity utilization

Steps to Develop a SPACE Matrix

1. Select a set of variables to define financial position (FP), competitive position (CP), stability position (SP), and industry position (IP).

Steps to Develop a SPACE Matrix

2. Assign a numerical value ranging from +1 (worst) to +7 (best) to each of the variables that make up the FP and IP dimensions.

Assign a numerical value ranging from –1 (best) to –7 (worst) to each of the variables that make up the SP and CP dimensions.

Steps to Develop a SPACE Matrix

3. Compute an average score for FP, CP, IP, and SP.
4. Plot the average scores for FP, IP, SP, and CP on the appropriate axis.
5. Add the two scores on the x -axis and plot the resultant point on X . Add the two scores on the y -axis and plot the resultant point on Y . Plot the intersection of the new xy point.

Steps to Develop a SPACE Matrix

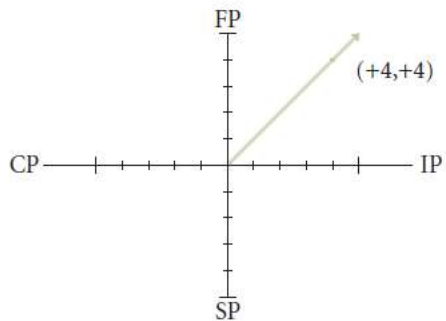
6. Draw a *directional vector* from the origin of the SPACE Matrix through the new intersection point.

- ▶ This vector reveals the type of strategies recommended for the organization: aggressive, competitive, defensive, or conservative

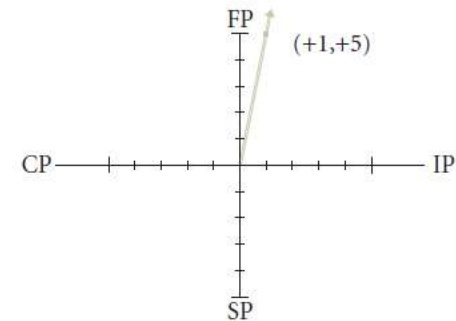
Example Strategy Profiles

FIGURE 8-5

Example Strategy Profiles

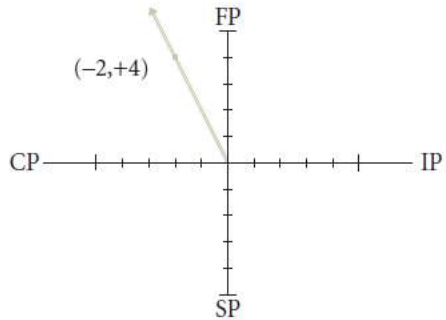


Aggressive Profiles

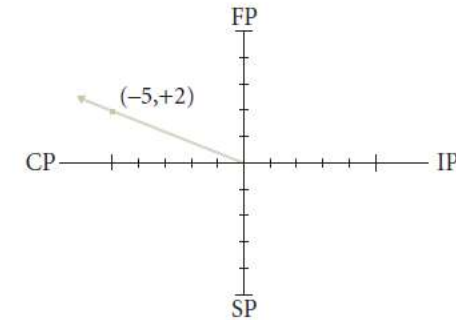


A financially strong firm that has achieved major competitive advantages in a growing and stable industry

A firm whose financial strength is a dominating factor in the industry



Conservative Profiles



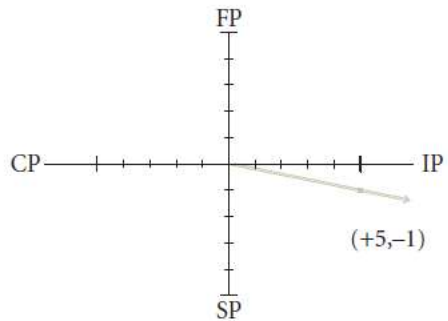
A firm that has achieved financial strength in a stable industry that is not growing; the firm has few competitive advantages

A firm that suffers from major competitive disadvantages in an industry that is technologically stable but declining in sales

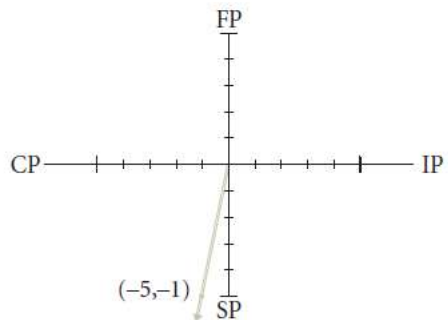
Example Strategy Profiles

FIGURE 8-5

Example Strategy Profiles

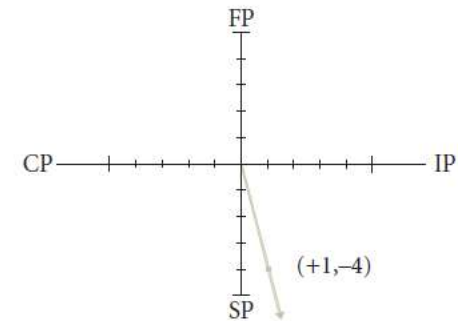


A firm with major competitive advantages in a high-growth industry



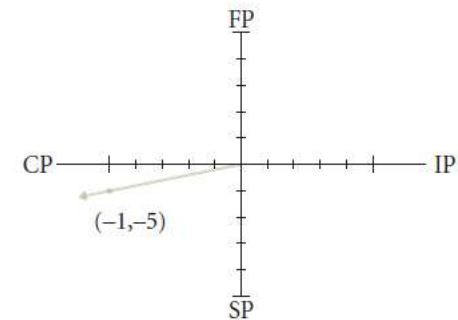
A firm that has a very weak competitive position in a negative growth, stable industry

Competitive Profiles



An organization that is competing fairly well in an unstable industry

Defensive Profiles



A financially troubled firm in a very unstable industry

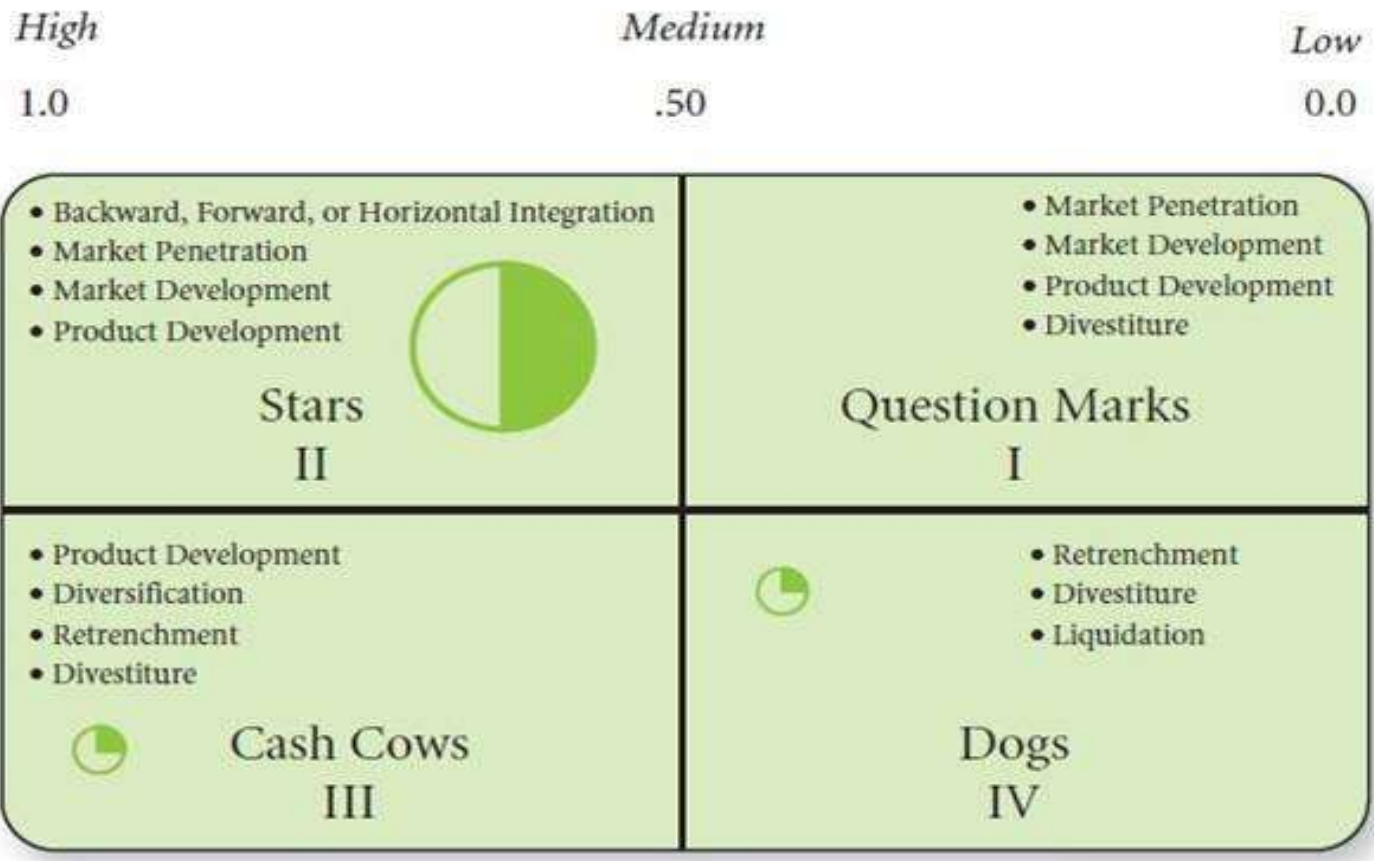
The Boston Consulting Group (BCG) Matrix

❖ BCG Matrix

- ❖ graphically portrays differences among divisions in terms of relative market share position and industry growth rate
- ❖ allows a multidivisional organization to manage its portfolio of businesses by examining the relative market share position and the industry growth rate of each division relative to all other divisions in the organization

The BCG Matrix

RELATIVE MARKET SHARE POSITION



The BCG Matrix

❖ Question Marks – Quadrant I

- ❖ Organization must decide whether to strengthen them by pursuing an intensive strategy (market penetration, market development, or product development) or to sell them

❖ Stars – Quadrant II

- ❖ represent the organization's best long-run opportunities for growth and profitability

The BCG Matrix

❖ Cash Cows – Quadrant III

- ❖ generate cash in excess of their needs
- ❖ should be managed to maintain their strong position for as long as possible

❖ Dogs – Quadrant IV

- ❖ compete in a slow- or no-market-growth industry
- ❖ businesses are often liquidated, divested, or trimmed down through retrenchment

The BCG Matrix

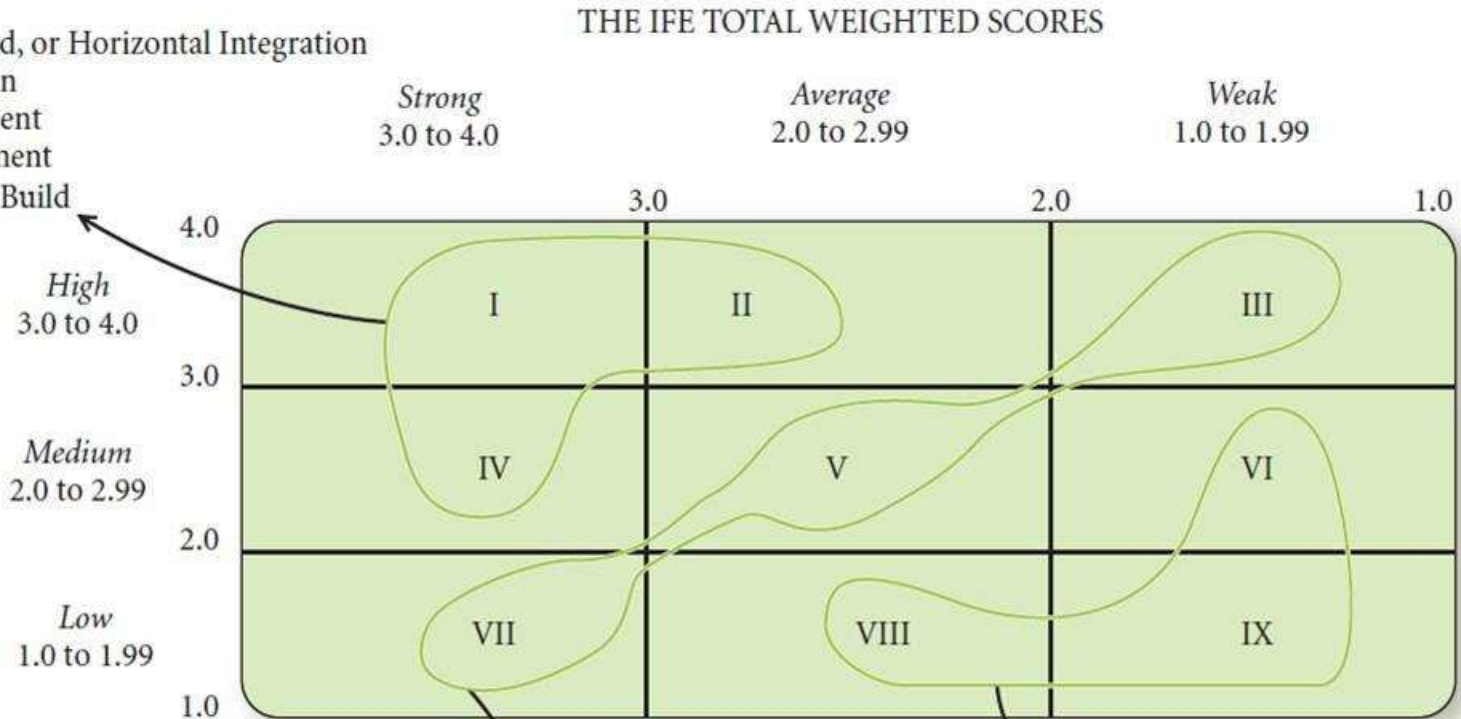
- ❖ The major benefit of the BCG Matrix is that it draws attention to the cash flow, investment characteristics, and needs of an organization's various divisions.

The Internal-External (IE) Matrix

- Backward, Forward, or Horizontal Integration
- Market Penetration
- Market Development
- Product Development

Grow and Build

THE
EFE
TOTAL
WEIGHTED
SCORES



- Hold and Maintain
- Market Penetration
 - Product Development

- Harvest or Divest
- Retrenchment
 - Divestiture

The Internal-External (IE) Matrix

- ❖ The **IE Matrix** is based on two key dimensions: the IFE total weighted scores on the x-axis and the EFE total weighted scores on the y-axis
- ❖ **Three Major Regions**
 - ❖ Grow and build
 - ❖ Hold and maintain
 - ❖ Harvest or divest

The IE Matrix

THE IFE TOTAL WEIGHTED SCORES



Division	Sales	Percent Sales	Profits	Percent Profits	IFE Scores	EFE Scores
1	\$100	25.0	\$10	50	3.6	3.2
2	200	50.0	5	25	2.1	3.5
3	50	12.5	4	20	3.1	2.1
4	50	12.5	1	5	1.8	2.5
Total	\$400	100.0	\$20	100		

The Grand Strategy Matrix

❖ **Grand Strategy Matrix**

- ❖ based on two evaluative dimensions:
competitive position and market (industry)
growth

The Grand Strategy Matrix



The Grand Strategy Matrix

❖ Quadrant I

- ❖ continued concentration on current markets (market penetration and market development) and products (product development) is an appropriate strategy

❖ Quadrant II

- ❖ unable to compete effectively
- ❖ need to determine why the firm's current approach is ineffective and how the company can best change to improve its competitiveness

The Grand Strategy Matrix

❖ Quadrant III

- ❖ must make some drastic changes quickly to avoid further decline and possible liquidation
- ❖ Extensive cost and asset reduction (retrenchment) should be pursued first

❖ Quadrant IV

- ❖ have characteristically high cash-flow levels and limited internal growth needs and often can pursue related or unrelated diversification successfully

The Quantitative Strategic Planning Matrix (QSPM)

❖ Quantitative Strategic Planning Matrix (QSPM)

- ❖ objectively indicates which alternative strategies are best
- ❖ uses input from Stage 1 analyses and matching results from Stage 2 analyses to decide objectively among alternative strategies

The Quantitative Strategic Planning Matrix (QSPM)

Key Factors	Weight	Strategic Alternatives		
		Strategy 1	Strategy 2	Strategy 3
<i>Key External Factors</i>				
Economy				
Political/Legal/Governmental				
Social/Cultural/Demographic/Environmental				
Technological				
Competitive				
<i>Key Internal Factors</i>				
Management				
Marketing				
Finance/Accounting				
Production/Operations				
Research and Development				
Management Information Systems				

Steps in a QSPM

- 1.** Make a list of the firm's key external opportunities and threats and internal strengths and weaknesses in the left column.
- 2.** Assign weights to each key external and internal factor.
- 3.** Examine the Stage 2 (matching) matrices, and identify alternative strategies that the organization should consider implementing.

Steps in a QSPM (cont.)

4. Determine the Attractiveness Scores (AS).
5. Compute the Total Attractiveness Scores.
6. Compute the Sum Total Attractiveness Score.

Positive Features of the QSPM

- ❖ Sets of strategies can be examined sequentially or simultaneously
- ❖ Requires strategists to integrate pertinent external and internal factors into the decision process
- ❖ Can be adapted for use by small and large for-profit and nonprofit organizations

Limitations of the QSPM

- ❖ Always requires informed judgments
- ❖ It is only as good as the prerequisite information and matching analyses on which it is based

A QSPM for a Retail Computer Store

		STRATEGIC ALTERNATIVES			
		1		2	
		Buy New Land and Build New Larger Store		Fully Renovate Existing Store	
Key Factors	Weight	AS	TAS	AS	TAS
<i>Opportunities</i>					
1. Population of city growing 10%	0.10	4	0.40	2	0.20
2. Rival computer store opening 1 mile away	0.10	2	0.20	4	0.40
3. Vehicle traffic passing store up 12%	0.08	1	0.08	4	0.32
4. Vendors average six new products/year	0.05	—	—	—	—
5. Senior citizen use of computers up 8%	0.05	—	—	—	—
6. Small business growth in area up 10%	0.10	—	—	—	—
7. Desire for websites up 18% by Realtors	0.06	—	—	—	—
8. Desire for websites up 12% by small firms	0.06	—	—	—	—
<i>Threats</i>					
1. Best Buy opening new store nearby in 1 year	0.15	4	0.60	3	0.45
2. Local university offers computer repair	0.08	—	—	—	—
3. New bypass for Hwy 34 in 1 year will divert traffic	0.12	4	0.48	1	0.12
4. New mall being built nearby	0.08	2	0.16	4	0.32
5. Gas prices up 14%	0.04	—	—	—	—
6. Vendors raising prices 8%	0.03	—	—	—	—
	1.00				

A QSPM for a Retail Computer Store (cont.)

Strengths

1. Inventory turnover increased from 5.8 to 6.7	0.05	—	—	—	—
2. Average customer purchase increased from \$97 to \$128	0.07	2	0.14	4	0.28
3. Employee morale is excellent	0.10	—	—	—	—
4. In-store promotions resulted in 20% increase in sales	0.05	—	—	—	—
5. Newspaper advertising expenditures increased 10%	0.02	—	—	—	—
6. Revenues from repair/service segment of store up 16%	0.15	4	0.60	3	0.45
7. In-store technical support personnel have MIS college degrees	0.05	—	—	—	—
8. Store's debt-to-total-assets ratio declined to 34%	0.03	4	0.12	2	0.06
9. Revenues per employee up 19%	0.02	—	—	—	—

Weaknesses

1. Revenues from software segment of store down 12%	0.10	—	—	—	—
2. Location of store negatively impacted by new Hwy 34	0.15	4	0.60	1	0.15
3. Carpet and paint in store somewhat in disrepair	0.02	1	0.02	4	0.08
4. Bathroom in store needs refurbishing	0.02	1	0.02	4	0.08
5. Revenues from businesses down 8%	0.04	3	0.12	4	0.16
6. Store has no website	0.05	—	—	—	—
7. Supplier on-time delivery increased to 2.4 days	0.03	—	—	—	—
8. Often customers have to wait to check out	0.05	2	0.10	4	0.20
Total	1.00		4.36		3.27

The Culture and Politics of Strategy Choice

- ❖ Strategies that require fewer cultural changes may be more attractive because extensive changes can take considerable time and effort
- ❖ Political maneuvering consumes valuable time, subverts organizational objectives, diverts human energy, and results in the loss of some valuable employees
- ❖ Political biases and personal preferences get unduly embedded in strategy choice decisions

Tactics to Aid Strategists

Choose Methods That Afford Employee Commitment

Achieve Satisfactory Results with a Popular Strategy

Shift from Specific to General Issues

Focus on Long-Term Issues and Concerns

Involve Middle Level Managers in Decisions

Governance Issues

❖ **Board of Directors**

- ❖ a group of individuals who are elected by the ownership of a corporation to have oversight and guidance over management and who look out for shareholders' interests

Board of Director Duties and Responsibilities

1. Control and oversight over management
2. Adherence to legal prescriptions
3. Consideration of stakeholders/ interests
4. Advancement of stockholders' rights

Principles of Good Governance

1. No more than two directors are current or former company executives.
2. The audit, compensation, and nominating committees are made up solely of outside directors.
3. Each director owns a large equity stake in the company, excluding stock options.

Principles of Good Governance

4. Each director attends at least 75 percent of all meetings.
5. The board meets regularly without management present and evaluates its own performance annually.
6. The CEO is not also the chairperson of the board.
7. There are no interlocking directorships (where a director or CEO sits on another director's board).