Business Strategy Definition

According to Johnson & scholes (2005, Page 9) strategy is "the direction and scope of an organisation over the long period, ideally which seeks to match its resources to its changing environment and in particular its markets, customers or clients so as to meet stakeholder's expectations".

Strategy is viewed as a link between the firm and its environment (Grant, 2008). For a strategy to be successful it should be in harmony with the firms internal environment such as goals, values, resources, capabilities and systems, and the external environment in which it operates. Developing effective strategies cannot take place without firstly (Vignali et al, 2003) analysing the external environment in which the company operates. Vignali & Vrontis, (2004) further suggested that environmental scanning of both the external and internal environment is necessary to formulate the strategy to reach their objectives.

For an organisation it is important to analyse the macro environment which comprises of political, social, technological and economical issues; industry experts use PESTLE to analyse this macro environment.

PESTLE is a tool used to analyse the external business macro environment in identifying how future trends might impact on organisations within an industry. Macro environment factors will impact to a greater or lesser extent on all companies in the business environment (Johnson & Scholes, 2008). Pestle stands for Political, economical, social, technological, legal and environmental.

Political- legal, factors include antitrust regulations, environmental protection laws, tax laws, foreign trade regulations, stability of government, European issues ;Economical factors such as GDP trends, interest rates, money supply, inflation rates, unemployment levels, exchange rates, foreign trade regulations; Sociocultural- lifestyle changes, consumer activism, career expectations, demographics; Technological changes such as New products, internet, telecom, networking.

An example of PESTLE ANALYSIS for Airline Industry

The political factors such as government support for national carriers, security control, restrictions on migrations will have a major impact on the industry. Economic factors such as national growth rates, fuel prices, recession, employment affects the airlines business. Social factors such as consumer spending, international holidays and International student exchange programmes, Olympics directly increase the sales of the business where as in technological factors such as fuel efficient engines, security check machines, online ticketing systems and environmental issues such as noise pollution, carbon emission regulations changes in any of the above factors will have a impact on the airlines industry.

According to (Johnson & Scholes, 2008) it is very important to find the key drivers for change rather than overwhelming on all the details of the environment factors, as the key drivers may vary within industries.

The external forces impact the "immediate environment" (Johnson et al, 2005) creating competitive forces on the organisation in the industry. It is very important for managers to be aware of the company's environmental factors, competitive forces in the industry, which showcase the attractiveness of the industry and the success or failure of a particular company (Mintzberg et al, 1998). These environmental factors can be categorised either as opportunities or threat and are included in the strategic formulation.

Porter's five forces:

Porters five forces model provides a useful basis to examine the extent of competition in an industry. Attractiveness of an industry with competitive forces can be identified with the help of "five forces framework". The profit potential of an industry can be determined by "collective strength of the five forces" (Mintz berg et al). The five forces are: threat of new entrants, threat of substitute products or services, bargaining power of suppliers, bargaining power of buyers and rivalry among existing firms. Customers, suppliers, substitutes, and potential entrants are all "competitors" to firms in the industry (Porter, 2004, 2008). If all these forces are strong, the more limited is the ability of established companies to raise prices and earn greater profits (Wheelen & Hunger, 2002; Hagen, 2010). A company can earn greater profits if there is a low competition force in the industry and a high competitive force can be viewed as threat since it may reduce profits. Many authors Johnson et al, 2008; Mintzberg et al,1998 ;Wheelen & Hunger, 2002 ; Thompson & Martin 2005;Grant, 2008 have used the porter five forces frame work in the academic texts.

Threat of new entrants:

New entrants bring new capacity; desire to gain market share and substantial resources (Mintzberg et al, 1998). The threat of entry depends on the "height of barriers "(Porter, 2004) and the reaction from existing competitors. Some of the entry barriers are

- Economies of scale: Economies of scale prevent the entry by forcing the potential competitor to come in on a large scale or to accept cost disadvantage. As the existing firms gain economies of scale through mass production and standard products from the suppliers there by enjoying lower cost per unit.
- Product differentiation: Existing firms have a brand differentiation and customer loyalty which has achieved by creating value to the customer,
- Differentiation creates a barrier to entry as the potential competitors needs to spend heavily to gain the market.

- Capital requirements: Capital requirements create a barrier to potential competitors as they need to invest huge amount, although it creates a barrier, if the returns are attractive then the potential competitors may enter the industry.
- Cost disadvantages independent of size: established companies enjoy cost advantage, which is not available to the potential competitor, as the existing firms have proprietary technology, availability of best raw materials, proprietary product knowledge
- Access to distribution channels will deter the entry of potential competitors and even the government regulations which prevents or limit entry into certain industries by restricting access to raw materials.

Rivalry among existing firms:

Rivalry among existing competitors takes place to gain market share from each other in the industry. The intensity of rivalry depends on several factors such as

- Number of competitors: if the competitors are equal in size there would be high rivalry as all the competitors try to gain dominance in the industry.
- Rate of industry growth: slow growth leads to price wars to gain market share.
- Height of exit barriers: it's the opposite side of entry, as the firm's investments in specialised assets, or "management's loyalty" (Porter, cited in Mintzberg et al,1998) huge amount in a particular business, keeps companies in market even though if they are running in loss or earning low returns.

Bargaining power of buyers:

Buyers may be the end consumer. Buyers compete within the industry by reducing the price and demanding for higher quality of products and services and playing competitors against each other. A buyers group may be powerful if the following factors hold true.

Switching cost locks the buyer to particular sellers; on the other hand the buyer's power will be improved if the seller faces switching cost and it earns low profits, thereby creating great incentive to lower purchasing cost. Buyers can threaten to enter the industry partially and pose a credible threat of backward integration and bargain to bring the prices down.

Bargaining power of suppliers:

The organisations that produce inputs such as material and labour in to the industry are called suppliers, these suppliers can affect the industry as they have the capability to increase the price or reduce the quality of the goods and services. The supplier group will be more powerful if they have few substitutes in the industry and if the product is functional. A supplier group will be more powerful if they are dominated by a few companies. Firms may pursue a backward integration strategy to gain control of suppliers, but this strategy will be effective when the suppliers are not reliable and charging high prices or not meeting the deadlines.

Pressure from substitutes:

It is the competition stirred from products outside the industry. According to Porter (2004), substitutes are the products that can serve the same purpose and depends on the willingness of the buyer. They have a tendency to attract a considerable proportion of the market volume and decrease the probable sales volume of the existing players. Also Porter (2004), states that, the price elasticity of a product is affected by substitute products if there are more number of substitutes available, the demand is more elastic since customers have more choices.

Limitations: Porter's five forces model is a strategic tool that is utilised to identify if a new business, product or service has the potential to be profitable. However, it is important to understand that this model has further limitations in current market environment, since it visualizes somewhat still market structure.

Porter's model is formerly based on the economic situation in the 80's with tough competition and comparatively stable market structure; it is not able to consider the new business models and viability of the industries like dynamic market entrants and technological innovations which will entirely alter the business models within a small time. For example, computer and software industry is considered highly competitive. However, Five Forces Model is of limited value as it represents nothing more then the snapshots of moving pictures, since the structure of the industry is persistently transformed by innovation. Therefore, as stated by Kippenberger (1998) and Haberberg & Rieple (2001), it is not prudent to develop strategy only on the basis of Porter's Five Forces Model and should also be examined in addition to other strategic frameworks of SWOT and PEST analysis.

Moreover, many academics and strategist have repeatedly challenged Porter's framework. According to Coyne & Subramaniam (1996), there are three ambiguous assumptions that underlie the five forces:

- That buyers, competitors & suppliers are unrelated and do not interact and collude.
- That the source of value is structural advantage (creating barriers to entry).
- That uncertainty is low, allowing participants in a market to plan for and respond to competitive behaviour.

In mid 1990s an important extension to the Porter's Model was found with the help of the Game Theory (Brandenburger & Nalebuff, 1995). The concept of Complementors also referred to as "the 6th force" was added, which helped in explaining the reasons behind strategic alliances. For example tourism industry and the airline industry are complementary industries.

Also it is perhaps not reasonable to assess the attractiveness of an industry autonomous of the resources a company brings to that industry. Therefore to develop a more sound strategy for a firm a Resource Based View (RBV) should be used together with this theory (Wernerfelt, (1984); Rumelt, (1984)). The model should be adopted with the knowledge of its limitations and their use as a part of a bigger framework of management tools, techniques and theories.

The five forces determine industry profitability as they influence cost, prices, and investments of firms in an industry and the elements of return on investment (porter, 1990), even though it is criticised but it is still one of the widely accepted model to analyse the competitive forces.

After identifying the forces affecting competition and their causes in the industry, the firm will be in a position to identify its strength and weakness relative to that industry.

Resource based view (RBV):

Resource Based View (RBV) is an economic tool utilized to identify a firm's potential key resources. It is more frequently linked with the work of Prahalad & Hamel (1990); Rumelt (1991); Grant (1991) and Peteraf (1993). It has an 'inside-out' approach since it deals with the competitive environment facing the organization. Therefore, its beginning point is an organization's internal environment. According to Draft (1983) cited in Barney (1991, p. 101), firm resources include all assets, capabilities, organizational processes, firm attributes, information, knowledge, etc; controlled by a firm that enable the firm to conceive of and implement strategies that improve its efficiency and effectiveness.

According to Mahoney & Pandian (1992); Hooley & Greenley (2005) and Smith & Rupp (2002), RBV of a firm describe its capability to delivering sustainable competitive advantage while the resources are managed in way that the end product cannot be replicated the competitors, hence creating a competitive barrier. Barney (2001), states that "RBV explains that a firm's sustainable competitive advantage is reached by virtue of unique resources, while these resources have the characteristics of being rare, valuable, inimitable, non-tradable, non-substitutable as well as firm specific". According to Prahalad & Hamel(1990) cited in Thomspon & Martin, Once the core competenecies are developed in the organisations they should be exploited and these core competencies should be flexible and responsive to the changing customer demands in market.

The limitation of the resource based view is that it says very little on how resource can develop or change over time (Henry, 2008). The self-motivated role played by individuals within organisations is often assumed to be obvious and therefore rarely addressed. According to Priem & Butler (2001), resource based view of strategy lacks details and hence is difficult for organisations to put into practice.

Value chain analysis:

The concept of value chain was developed in 1980 by Michael Porter, also known as value chain analysis. Value Chain helps in analysing specific activities so that a firm can create value and competitive advantage. It's a chain of activities for a firm operating in a particular industry. Every organisation has certain activities that link together to increase value of the business and these activities form the organisation's value chain. According to Lynch (2003), these activities may include purchasing, manufacturing of products and distribution & marketing of the organisation's products and services. The competitive advantage in value chain is obtained from two sources: (i) differentiation advantage: customer perceives more value from the firm's product, and (ii) low cost advantage: a firm provides the product or service at a lower cost than the average market cost.

According to Svensson (2003), the value for the final customer is the value only in its theoretical context and not practical terms, which is a limitation of the model. The true value of the product is measured only when it reaches the final customer. Many academics and researchers have questioned the model and its applicability in context of the service industry.

Generic strategies: TARGETING AND POSITIONING

Positioning determines the profitability of firm in the industry. A firm that positions well in the industry may earn high rates of returns even though if the industry structure is unfavourable (porter, 2004 Pg. 11). "Michael porter proposes 2 generic competitive strategies for outperforming other corporations in a particular industry: lower cost and differentiation" (Wheelen & Hunger, 2002)

These competitive advantages combined with scope of activities, for which the firm seeks to achieve them lead to three generic strategies for by performing above there average in an industry: cost leadership, differentiation and focus (porter, 1990)

Lower cost and differentiation strategies seek broad mass market while focus strategies aim at niche (narrow) market. The diagram below represents the porter's generic strategies

Cost leadership and differentiation strategies seek competitive advantage in a broad range of industry segments while focus strategies aim at cost advantage in the narrow segment.

The focus has two variants, cost focus and differentiation focus.

Cost leadership:

This strategy focuses mainly on gaining competitive advantage by having the lowest cost in the industry (Porter, 2004), Mintzberg et al, 1998; Johnson et al 2008). According to (Malburg, 2000) to achieve the low cost benefit, the firm should have low cost leadership, low cost manufacturing and low work force strategies but (Hyatt, 2001) states the firms should have a large market share to gain the cost advantage, contrary to this Malburg (2001), Davidson, (2001) state that the cost leadership can be achieved by mass production, economies of scale, product design, R& D, access to raw materials, proprietary technology, mass distribution. Having a low cost position yields the company above average returns even if they have strong competitive advantage. But according to porter (1985), only one firm in the industry can have the advantage of cost leader but Malburg (2000) stated that competitors fight through low cost leadership roles. Since low cost leadership firms have bigger market share, they will have high bargaining power with suppliers and enjoy above average on investments(Wheelen & Hunger,2002) contrary to this(Cross, 1999) states cost leadership have certain disadvantages, as they create little loyalty to the customers and if the firm reduces the prices it may loose profits.

Differentiation:

The second generic strategy, companies using this strategy focus to be unique in the industry by offering products or services which are highly valued by buyers (Porter, 2004; cross, 1991; Hyatt, 2001).

Differentiation is done by tailoring the customer needs and charging a premium for the customisation in the market. Differentiation strategy is more likely to generate revenue higher profits than low cost strategy as it creates a "defensible position" (Porter, 2004. pg .37) for coping with five forces. The customer loyalty and need for uniqueness creates a barrier of entry for potential competitor (Wheelen & Hunger, 2002, Porter, 2004).According to (Mc Cracken, 2002) the key step in developing a differentiation strategy is to find how the company is different from the competitors. Mc Cracken & Davidson suggested that the differentiation can be the market sector, quality of work, product, delivery system and the marketing approach and to be effective the message of differentiation should reach the end users. (Hyatt, 2001) says that firms must add a premium to the cost when using differentiation strategy however Hlavacka et al (2001) argued that cost and prices are not considered as the main focus but on the other hand Cross (1999) stated that since customers are loyal to the company and are willing to pay the higher price for its product.

Focus:

According to Porter; Davidson, (2001); Cross, (1991), the firms which follow this strategy target a specific segment of the market, this strategy is completely different from the others as it relies on narrow competitive scope in an industry (porter), the company can focus on a selected group of customers, geographical area, product range, focus strategies are effective when consumers have preferences and if the niche market is not recognised by rival firms. The focus strategy has two variants.

Cost focus:

Firms seeks cost advantage in the target market segment. Cost focus is a low cost competitive strategy and exploits cost behaviour differences in some segments. In using this strategy the company seeks a cost advantage in its target segment.

Differentiation focus:

Firms seek differentiation in its target market. Differentiation exploits needs of buyers.

According to Wheelen & Hunger (2002) there are various risks involved in implementing competitive strategies, none of the strategy guarantees to achieve success and some companies implemented porters strategy and failed to sustain the strategy. Some companies that try to attempt cost leadership and differentiation is "stuck in the middle" (porter). Helms et al, 1997 says that there is much debate on using two generic strategies at the same time. But according to Porter differentiation and cost leadership are "mutually exclusive" (Porter), on the other hand Helms et al (1997) found companies that used combination strategies have higher returns on investments.

Ansoff Matrix

The Ansoff "product/market growth matrix" Ansoff, (1988), cited in Johnson et al(2008), provides four alternative directions for strategic development, according to this model the firm can decide their strategy depending on the resources. This matrix helps the firm to determine the growth strategies of the firms.

Market penetration: The strategy of increasing the sales in the current market with the existing products. They spend heavy budgets on advertising to create customer satisfaction and to attract the customers from the competitors, there by creating a high competition.

Product development is the strategy of increasing sales with the development of current product or by developing new product. Developing a new product in the current market needs lot of innovation as they should match the customer taste.

Market development is the strategy of increasing sales of the existing products in a new market attracting new customers, moving to new geographical area, new segments.

Diversification takes the firm completely away from the existing market and the existing products. Diversification takes place when new products are developed and sold in new markets. Diversification allows the firms to spread the risks in a wide array of markets.

Swot Analysis:

Swot is an acronym of strengths, weakness, opportunities and threats. Scanning of external environment STEP, Porter's five forces, for opportunities and threats and internal environment such as resources, capabilities, financial, marketing, value chain, technology for strengths and weakness is an important part in developing strategic planning. According to Vrontis, (1999), "it is very important if the companies want to capitalise on their strengths and minimise weakness, exploit market opportunities as they arise and avoid threats". SWOT gives us the key issues that may impact on strategy development (Johnson et al, 2008).

It can also be used to convert weakness into threats and threats into opportunities.

RYAN AIRWAYS AND BRITISH AIRWAYS

They would like to understand the underpinning logic of the strategy choices/generic strategies available to them and you have asked you to provide some detailed illustrations from the airline industry.

The product/service differentiation visions and strategies of SIA, BA and UAL, as they prepare for the new millennium, provide interesting contrast and comparison insights and lessons on product/service differentiation for the industry as a whole SIA is strategically positioned in the premium service, quality and value market segment of the international airline industry. Service is the raison d'e tre of SIA, and at the heart of its service reputation is the Singapore Girl. Since the late 1980s, SIA has always held the view that: ``The airline industry is, by its very nature, a service industry. In a free market, the success or failure of an individual airline is largely dictated by the quality of the service it provides'' (Harvard Business School, 1989).

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Executive summary

This report provides the strategic tools and techniques used in formulating strategy.

This report starts with the external analysis of macro environment by using PESTLE and industry analysis to identify the profit potential by using the "porters five forces frame work". The external analysis is carried to identify the threats and opportunities in the operating environment.

Internal analysis of the firm is carried out to identify the strengths and weakness of the firm using by using Porters value chain, Resource based view. Porter's three generic strategies have been explained for positing of the firm and Ansoff growth/productmatrix is also explained.

An overview of ryan airways and british airways has been provided with

and to identify then internal analysis frameworks using RBV , porters value chain and porters generic strategies.