Module 9

An overview of strategic business concepts for managers

Introduction

Previous modules have focused on providing the tools for consistent, rigorous analysis of a business situation to allow managers to make informed, substantiated decisions. However, in as much as the understanding of economics and finance drive business decisions, there is also the more creative side to rounding out decisions – understanding what your competitors are going to do, or understanding general trends in the industry and how to stay ahead of them. This component, the 'art' of business, can be summed up in one word: strategy.

The study of strategy for business situations has parallels to strategies for battle in war, or legal battles in a court case. Just as high-profile prosecutors would do everything in their power to understand the context of the case, the players involved, the motives of each player, and the evidence available, so must managers understand not just the issue at hand, but also its context, their competitors, and whether they have enough information to make a good decision. Business strategy ties together the analytical rigour of managerial economics to the art of understanding the customer and customer trends, or drivers of consolidation in an industry, or how to make your company achieve the goals you set for it.

Understanding strategy and how to implement it is essential to running a successful organisation, or completing a project for a superior. No court case is ever won by an ill-prepared, poorly organised legal team. Similarly, all successful business ventures rely on being highly knowledgeable both in the task at hand, and the context of that task.

Johnson and Scholes (*Exploring Corporate Strategy*) define strategy as:

> *Strategy is the direction and scope of an organisation over the long-term: which achieves advantage for the organisation through its configuration of resources within a challenging environment, to meet the needs of markets and to fulfil stakeholder expectations.*

In other words, strategy is about:

- Where is the business trying to get to in the long-term? (Direction)

- Which markets should a business compete in and what kinds of activities are involved in such markets? (Markets, scope)
- How can the business perform better than the competition in those markets? (Advantage)
- What resources (skills, assets, finance, relationships, technical competence, and facilities) are required in order to be able to compete? (Resources)
- What external, environmental factors affect the businesses' ability to compete? (Environment)
- What are the values and expectations of those who have power in and around the business? (Stakeholders)

Upon completion of this module you will be able to:

Outcomes

- *demonstrate* knowledge of 'business strategy,' both in the context of institutional definitions and specific strategy models.
- *analyse* the necessary elements to conduct a strategic analysis of an industry, a company, or a business opportunity.
- *evaluate* alternatives and make decisions based on the information you have available to you regarding an industry or business opportunity.
- *apply* the basic principles of game theory, to be extrapolated and put towards understanding how one firm's action affects, and is affected by, all other firms in that industry.
- *demonstrate* knowledge on creating an 'analytical tool kit' for application in any business situation.

Terminology

Business unit strategy:	How a business competes successfully in a particular market.
Corporate strategy:	Overall purpose and scope of the business to meet stakeholder expectations.
Operational strategy:	How each part of the business is organised to deliver the corporate and business-unit level strategic direction.

Strategic decisions

There are countless books available in the marketplace that disseminate what great minds have conceived strategy to be. Inherently, they touch on many of the topics outlined above – markets available, competitive advantages regarding specific firms and competitors, and resources available to them. While there is no single book or definition that

provides the ‘magic bullet’ answer in creating a business strategy, the following definitions encompass the most accepted views of strategy.

Strategy according to George Steiner

George Steiner, a professor of management and one of the founders of *The California Management Review*, is generally considered a key figure in the origins and development of strategic planning. His book, *Strategic Planning*, is close to being a bible on the subject. Yet, Steiner does not bother to define strategy except in the notes at the end of his book. There, he notes that strategy entered the management literature as a way of referring to what one did to counter a competitor’s actual or predicted moves. Steiner also points out in his notes that there is very little agreement as to the meaning of strategy in the business world. Some of the definitions then in use to which he pointed include:

1. Strategy is that which top management does that is of great importance to the organisation.
2. Strategy refers to basic directional decisions, that is, to purposes and missions.
3. Strategy consists of the important actions necessary to realise these directions.
4. Strategy answers the question: What should the organisation be doing?
5. Strategy answers the question: What are the ends we seek and how should we achieve them?

Steiner was writing in 1979, at roughly the mid-point of the rise of strategic planning. Perhaps the confusion surrounding strategy contributed to the demise of strategic planning in the late 1980s. The rise and subsequent fall of strategic planning brings us to Henry Mintzberg.

Strategy according to Henry Mintzberg

Henry Mintzberg, in his 1994 book, *The Rise and Fall of Strategic Planning*, points out that people use ‘strategy’ in several different ways, the most common being these four:

1. Strategy is a *plan*, a ‘how’, a means of getting from here to there.
2. Strategy is a *pattern* in actions over time; for example, a company that regularly markets very expensive products is using a ‘high end’ strategy.
3. Strategy is *position*; that is, it reflects decisions to offer particular products or services in particular markets.
4. Strategy is *perspective*, that is, vision and direction.

Mintzberg argues that strategy emerges over time as intentions collide with and accommodate a changing reality. Thus, one might start with a *perspective* and conclude that it calls for a certain *position*, which is to be achieved by way of a carefully crafted *plan*, with the eventual outcome

and strategy reflected in a *pattern* evident in decisions and actions over time.

Strategy according to Michael Treacy and Fred Wiersema

The notion of restricting the basis on which strategy might be formulated has been carried one step farther by Michael Treacy and Fred Wiersema, authors of *The Discipline of Market Leaders*. In the 1993 *Harvard Business Review* article that presaged their 1994 book, Treacy and Wiersema assert that companies achieve leadership positions by narrowing, not broadening their business focus. Treacy and Wiersema identify three 'value-disciplines' that can serve as the basis for strategy: operational excellence, customer intimacy, and product leadership. As with driving forces, only one of these value disciplines can serve as the basis for strategy. Treacy and Wiersema's three value disciplines are briefly defined below:

Table 9-1 Treacy and Wiersema's three value disciplines

Operational Excellence	Strategy is predicated on the production and delivery of products and services. The objective is to lead the industry in terms of price and convenience.
Customer Intimacy	Strategy is predicated on tailoring and shaping products and services to fit an increasingly fine definition of the customer. The objective is long-term customer loyalty and long-term customer profitability.
Product Leadership	Strategy is predicated on producing a continuous stream of state-of-the-art products and services. The objective is the quick commercialisation of new ideas.

Each of the three value disciplines suggests different requirements. Operational excellence implies world-class marketing, manufacturing, and distribution processes. Customer intimacy suggests staying close to the customer and entails long-term relationships. Product leadership clearly hinges on market-focused R&D as well as organisational nimbleness and agility.

Strategy at different levels of a business

Strategies exist at several levels in any organisation – ranging from the overall business (or group of businesses) through to individuals working in it.

Corporate strategy is concerned with the overall purpose and scope of the business to meet stakeholder expectations. This is a crucial level since it is heavily influenced by investors in the business and acts to guide

strategic decision-making throughout the business. Corporate strategy is often stated explicitly in a 'mission statement.'

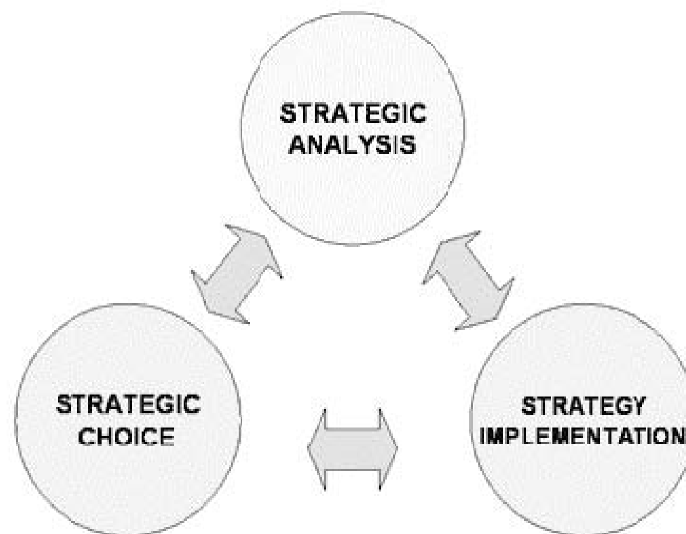
Business unit strategy is concerned more with how a business competes successfully in a particular market. It concerns strategic decisions about choice of products, meeting needs of customers, gaining advantage over competitors, exploiting or creating new opportunities, etc.

Operational strategy is concerned with how each part of the business is organised to deliver the corporate and business-unit level strategic direction. Operational strategy therefore focuses on issues of resources, processes, people, and so-on.

How strategy is managed – strategic management

In its broadest sense, strategic management is about taking 'strategic decisions' – decisions that answer the questions above.

In practice, a thorough strategic management process has three main components, shown in the figure below.



Strategic analysis

This is all about analysing the strength of a businesses' position and understanding the important external factors that may influence that position. There are many processes, models and theories regarding strategy, and this module provides only an overview of the main ones. The process of strategic analysis can be assisted by a number of tools, including:

PEST analysis – a technique for understanding the 'environment' in which a business operates.

Five forces analysis – a technique for identifying the forces that affect the level of competition in an industry.

SWOT analysis – a useful summary technique for summarising the key issues arising from an assessment of a business's 'internal' position and 'external' environmental influences.

Ansoff product/market matrix **–** A basic analytic tool to help a company understand how its growth strategy in specific markets can correlate to existing or potential products.

Introduction to PEST analysis

PEST analysis is concerned with the environmental influences on a business.

The acronym stands for the Political, Economic, Social and Technological issues that could affect the strategic development of a business.

Identifying PEST influences is a useful way of summarising the external environment in which a business operates. However, it must be followed up by consideration of how a business should respond to these influences.

The table below lists some possible factors that could indicate important environmental influences for a business under the PEST headings:

Table 9-2 PEST factors

Political/-Legal	Economic	Social	Technological
Environmental regulation and protection	Economic growth (overall; by industry sector)	Income distribution (change in distribution of disposable income	Government spending on research
Taxation (corporate; consumer)	Monetary policy (interest rates)	Demographics (age structure of the population; gender; family size and composition; changing nature of occupations)	Government and industry focus on technological effort
International trade regulation	Government spending (overall level; specific spending priorities)	Labour/social mobility	New discoveries and development
Consumer protection	Policy towards unemployment (minimum wage, unemployment benefits, grants)	Lifestyle changes (e.g. Home working, single households)	Speed of technology transfer

Political/-Legal	Economic	Social	Technological
Employment law	Taxation (impact on consumer disposable income, incentives to invest in capital equipment, corporation tax rates)	Attitudes to work and leisure	Rates of technological obsolescence
Government organisation/ attitude	Exchange rates (effects on demand by overseas customers; effect on cost of imported components)	Education	Energy use and costs
Competition regulation	Inflation (effect on costs and selling prices)	Fashions and fads	Changes in material sciences
	Stage of the business cycle (effect on short-term business performance)	Health & welfare	Impact of changes in Information technology
	Economic 'mood' – consumer confidence	Living conditions (housing, amenities, pollution)	Internet

Porter's five forces model-analysing competitive industry structure

In his book, *Competitive Strategy* (Free Press: 1980), Michael Porter identifies three fundamental competitive strategies and lays out the required skills and resources, organisational elements and risks associated with each strategy. The table below is a shorthand way of referring to what Porter has to say.

Table 9-3 Porter's fundamental strategies

Competitive strategy	Required skills and resources	Organisational elements	Associated risks
Overall cost leadership	Sustained capital investment and access to capital.	Tight cost control.	Technological change that nullifies past investments or learning.
	Process engineering skills.	Frequent, detailed reports.	Low-cost learning by industry newcomers or followers through imitation, or through their ability to invest in state-of-the-art facilities.

Competitive strategy	Required skills and resources	Organisational elements	Associated risks
	Intensive supervision of labour.	Structured organisation and responsibilities.	Inability to see required product or marketing change because of the attention placed on cost.
	Products designed for ease of manufacture.	Incentives based on meeting strict quantitative targets.	Inflation in costs that narrow the firm's ability to maintain enough of a price differential to offset competitors' brand images or other approaches to differentiation.
Differentiation	Strong marketing abilities.	Strong coordination among functions in R&D, product development, and marketing.	The cost differential between low-cost competitors and the differentiated firm becomes too great for differentiation to hold brand loyalty. Buyers thus sacrifice some of the features, services, or image possessed by the differentiated firm for large cost savings.
	Product engineering with creative flair.	Subject measurement and incentives instead of quantitative measures.	
	Strong capability in basic research.		
	Corporate reputation for quality or technological leadership.	Amenities to attract highly skilled labour, scientists, or creative people.	Buyers need for the differentiating factor falls. This can occur as buyers become more sophisticated.
	Long tradition in the industry or unique combination of skills drawn from other businesses.		Imitation narrows perceived differentiation, a common occurrence as industries mature.
	Strong co-operation from channels.		
Focus	Combination of the above policies directed at the particular strategic target.	Combination of the above policies directed at the particular strategic target.	The cost differential between broad-range competitors and the focussed firm widens to eliminate the cost

Competitive strategy	Required skills and resources	Organisational elements	Associated risks
			advantages of serving a narrow target or to offset the differentiation achieved by focus.
			The differences in desired products or services between the strategic target and the market as a whole narrows. Competitors find submarkets within the strategic target and outfocus the focuser.

Porter is considered the undisputed guru of competitive strategy. In the same book he identifies five forces that drive competition within an industry:

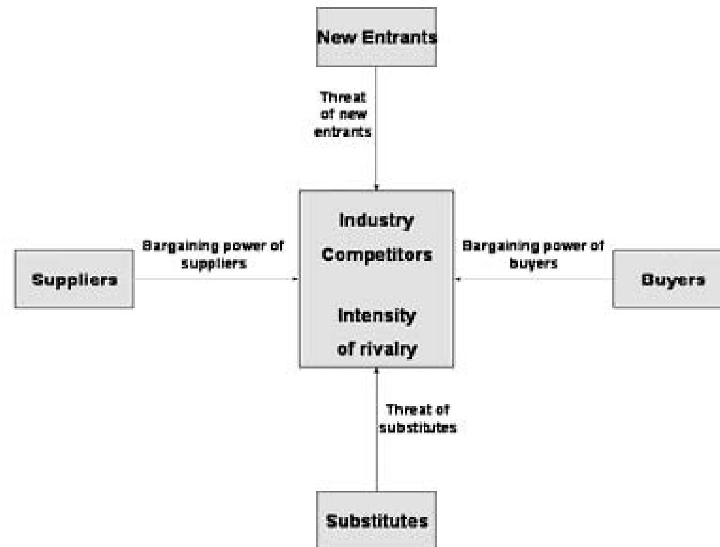
1. The threat of entry by new competitors.
2. The intensity of rivalry among existing competitors.
3. Pressure from substitute products.
4. The bargaining power of buyers.
5. The bargaining power of suppliers.

One obvious application of all this is to would-be entrants and the problem of entering new markets. Another is to the current competitors and the ongoing task of staying competitive in markets where they already operate.

Perhaps the most important thing to keep in mind is the inverse relationship between profit margins or returns and the intensity of competition: as the intensity of competition goes up, margins and returns are driven down. This can require changes in competitive strategy to remain in an industry and, under some circumstances, it can occasion the decision to exit a business or an industry.

The diagram in Figure 9-2 is a handy way of depicting the five forces Porter identifies and providing some elaborating detail. However, the diagram is no substitute for reading what Porter has to say.

Figure 9-2



Threat of new entrants

New entrants to an industry can raise the level of competition, thereby reducing its attractiveness. The threat of new entrants largely depends on the barriers to entry. High entry barriers exist in some industries (e.g., shipbuilding) whereas other industries are very easy to enter (e.g., estate agency, restaurants). Key barriers to entry include:

- Economies of scale
- Capital/investment requirements
- Customer switching costs
- Access to industry distribution channels
- The likelihood of retaliation from existing industry players.

Threat of substitutes

The presence of substitute products can lower industry attractiveness and profitability because they limit price levels. The threat of substitute products depends on:

- Buyers' willingness to substitute
- The relative price and performance of substitutes
- The costs of switching to substitutes.
- Bargaining power of suppliers (Suppliers are the businesses that supply materials and other products into the industry).

The cost of items bought from suppliers (e.g. raw materials, components) can have a significant impact on a company's profitability. If suppliers have high bargaining power over a company, then in theory the company's industry is less attractive. The bargaining power of suppliers will be high when:

- There are many buyers and few dominant suppliers
- There are undifferentiated, highly valued products
- Suppliers threaten to integrate forward into the industry (e.g., brand
  manufacturers threatening to set up their own retail outlets)
- Buyers do not threaten to integrate backwards into supply
- The industry is not a key customer group to the suppliers.

Bargaining power of buyers

Buyers are the people/organisations who create demand in an industry. The bargaining power of buyers is greater when:

- There are few dominant buyers and many sellers in the industry
- Products are standardised
- Buyers threaten to integrate backward into the industry
- Suppliers do not threaten to integrate forward into the buyer's industry
- The industry is not a key supplying group for buyers.

Intensity of rivalry

The intensity of rivalry between competitors in an industry will depend on:

- The structure of competition – for example, rivalry is more intense where there are many small or equally sized competitors; rivalry is less when an industry has a clear market leader.
- The structure of industry costs – for example, industries with **high fixed costs** encourage competitors to fill unused capacity by price cutting.
- Degree of differentiation – industries where products are commodities (e.g., steel, coal) have greater rivalry; industries where competitors can differentiate their products have less rivalry.
- Switching costs – rivalry is reduced where buyers have high switching costs, i.e., there is a significant cost associated with the decision to buy a product from an alternative supplier.
- Strategic objectives – when competitors are pursuing aggressive growth strategies, rivalry is more intense. Where competitors are

‘milking’ profits in a mature industry, the degree of rivalry is less.

- Exit barriers – when barriers to leaving an industry are high (e.g., the cost of closing down factories) – then competitors tend to exhibit greater rivalry.

SWOT analysis

SWOT is an abbreviation for Strengths, Weaknesses, Opportunities, and Threats and is an important tool for auditing the overall strategic position of a business and its environment.

Once key strategic issues have been identified, they feed into business objectives, particularly marketing objectives. SWOT analysis can be used in conjunction with other tools for audit and analysis, such as the PEST analysis and Porter’s Five-Forces analysis. It is also a very popular tool with business and marketing students because it is quick and easy to learn.

The key distinction: internal and external issues

Strengths and weaknesses are internal factors. For example, strength could be your specialist marketing expertise. A weakness could be the lack of a new product.

Opportunities and threats are external factors. For example, an opportunity could be a developing distribution channel such as the Internet, or changing consumer lifestyles that potentially increase demand for a company’s products. A threat could be a new competitor in an important existing market or a technological change that makes existing products potentially obsolete.

It is worth pointing out that SWOT analysis can be very subjective – two people rarely come up with the same version of a SWOT analysis even when given the same information about the same business and its environment. Accordingly, SWOT analysis is best used as a guide and not a prescription. Adding and weighting criteria to each factor increases the validity of the analysis.

Areas to Consider

Some of the key areas to consider when identifying and evaluating Strengths, Weaknesses, Opportunities, and Threats are listed in the example SWOT analysis below.

Table 9-4 SWOT analysis

	Positive	**Negative**
	Strengths	**Weaknesses**
Internal factors	Technological skills Leading Brands Distribution Channels Customer Loyalty/Relationship Production Quality Scale Management	Absence of important skills Weak brands Poor access to distribution Low customer retention Unreliable product/service Sub-scale Management
	Opportunities	**Threats**
External factors	Changing customer tastes Liberalisation of geographic markets Technological advances Changes in government politics Lower personal taxes Change in population age structure New distribution channels	Changing customer tastes Closing of geographic markets Technological advances Changes in government politics Tax increases Change in population age structure New distribution channels

Ansoff product/market matrix

The Ansoff growth matrix is a tool that helps businesses decide their product and market growth strategy.

Ansoff's product/market growth matrix suggests that the attempts of a business to grow depend on whether it markets new or existing products in new or existing markets.

The output from the Ansoff product/market matrix is a series of suggested growth strategies that set the direction for the business strategy. These are described below:

Table 9-5 Ansoff product/market matrix

	Existing Products	New Products
Existing Markets	**Market Penetration**	**Product Development**
New Markets	**Market Development**	**Diversification**

Market penetration

Market penetration is the name given to a growth strategy where the business focuses on selling existing products into existing markets.

Market penetration seeks to achieve four main objectives:

1. Maintain or increase the market share of current products – this can be achieved by a combination of competitive pricing strategies, advertising, sales promotion and perhaps more resources dedicated to personal selling.
2. Secure dominance of growth markets.
3. Restructure a mature market by driving out competitors; this would require a much more aggressive promotional campaign, supported by a pricing strategy designed to make the market unattractive for competitors.
4. Increase usage by existing customers – for example by introducing loyalty schemes.

A market penetration marketing strategy is very much about 'business as usual.' The business is focusing on markets and products it knows well. It is likely to have good information on competitors and on customer needs. It is unlikely, therefore, that this strategy will require much investment in new market research.

Market development

Market development is the name given to a growth strategy where the business seeks to sell its existing products into new markets.

There are many possible ways of approaching this strategy, including:

- New geographical markets; for example, exporting the product to a new country
- New product dimensions or packaging
- New distribution channels
- Different pricing policies to attract different customers or create new market segments.

Product development

Product development is the name given to a growth strategy where a business aims to introduce new products into existing markets. This strategy may require the development of new competencies and requires the business to develop modified products which can appeal to existing markets.

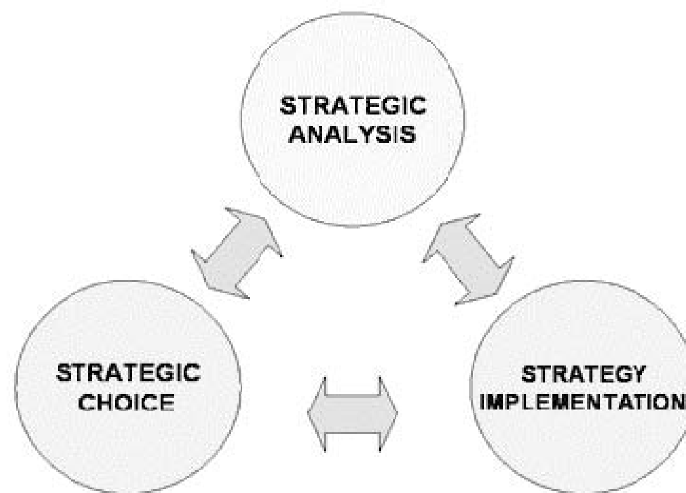
Diversification

Diversification is the name given to the growth strategy where a business markets new products in new markets.

This strategy is inherently more risky because the business is moving into markets in which it has little or no experience.

For a business to adopt a diversification strategy, therefore, it must have a clear idea about what it expects to gain from the strategy and an honest assessment of the risks.

Strategic choice and implementation



Recall the above diagram from earlier in this module. It is important to note that the analytic tools described in brief above are of no use if the manager cannot apply them, develop alternatives from the information they produce, pick a recommendation he or she feels meets the goals of the project, department or company, and implements it. The application of any of the models above is fairly straightforward – using the models, compartmentalising the information at hand to create an understanding of an industry, the company, or its opportunities. But how do you choose the best one?

The answer to this question relies on understanding your strengths and weaknesses (from the SWOT model), and how the company can best

outweigh the weaknesses with the strengths to become more competitive. In other words, how do you leverage what you do best, your competitive advantages, to create a sustainable market or competitive position – this is the real question asked in choosing a recommended strategy. There are many components that play into this – the company's financial situation, the human resources available inside the company, and the skill set inherent in the company as a whole. Ultimately, choosing your strategy must fit with both what the company is able to do and what the company wants to do – the models above are simple guidelines to help you understand more completely what the details are to those components.

However, what is often more challenging to determine is what your competition is doing, and how your decisions affect your competitors' choices. This is the focus of the next section, Game Theory.

Game theory

An excellent introductory definition to Game Theory comes from the *Economist*:

> *Stripped to its essentials, game theory is a tool for understanding how decisions affect each other. Until the theory came along, economists assumed that firms could ignore the effects of their behaviour on the actions of rivals, which was fine when competition was perfect or a monopolist held sway, but was otherwise misleading. Game theorists argue that firms can learn from game players: no card player plans his strategy without thinking about how other players are planning theirs.*
>
> *Economist*, June 15, 1996

Building on this definition, then, Game Theory analyses strategic interactions in which the outcome of one's choices depends upon the choices of others. Perhaps the easiest-to-understand, and most famous, example of Game Theory is what is known as the Prisoner's Dilemma, and can be illustrated as follows.

Sasha and Richard are two hard-bitten criminals who have recently been caught for a crime that they committed together. They are being held in separate cells, and each has been offered the opportunity to confess to the crime. Now, Sasha and Richard have no special feeling for each other, they just want to do as little time as possible. The prosecuting attorney visits Sasha and says he's willing to make a deal with her. He's also offering the same deal to Richard, and she is aware of that.

He says, "We have some circumstantial evidence on both of you, and if neither of you tells me anything we can still get both of you a year in jail, the way things stand right now. But, if you confess, and admit your partner was with you, then we'll let you off scot-free because you were helpful, and he'll get three years in jail. Of course, if *he* confesses and you don't, then *you're* the one who gets the three years and he walks free.

Now, if you both confess, then we've got you both dead to rights and you both get two years in jail."

The crown attorney leaves and goes back to his office, after telling Sasha he'll be back in half an hour to get her answer. Here's the dilemma: she can either co-operate with her partner and not confess, or try to leave Richard in the dust by confessing. If she confesses, she does either no time (if Richard doesn't confess) or does two years (if Richard confesses, as well). If she doesn't confess – if she co-operates with Richard – she either does one year in jail (assuming Richard doesn't confess), or does three years (if Richard confesses and she doesn't).

The kicker, of course, is that Richard is thinking exactly the same thing. This, then, is the dilemma. By doing what is best for themselves – by being selfish – they will do worse than by following a different, and apparently illogical, plan. Both will confess, assuming the other will, and therefore get two years in jail. Ideally, neither of them would confess, and get only one year in jail. However, the risk that the other criminal will confess in order to hedge his or her bets is too high.

This illustration of the Prisoner's Dilemma highlights a number of key parts of Game Theory important for any analysis:

- The players: Identify who the decision makers affecting the game are.
- Strategies: Understand all the feasible actions that can be taken in this game.
- Payoffs: Recognise the objectives each player has.
- Incentives: Understand the motives behind what the decision makers will do.

This example also helps the flesh out some of the basic rules of Game Theory:

- Time frame: All games happen in a time frame, so identify it! Are the moves simultaneous or sequential?
- Nature of the conflict: Is it in the player's interests to conflict or co-operate? Furthermore, will the players interact once, or repeatedly?
- Nature of interaction: What is driving the decisions of the players?
- Information: Identify the information, and you've identified another aspect of the strategies involved.

And, in any game, you want to keep the following in mind:

- Are the threats by the parties credible?
- Can co-operation be sustained?
- Are there informational advantages out there?

- Assume that your opponent is as rational as you are – namely, that he or she is going to maximise his or her payoffs, and are perfect calculators of those payoffs.
- Assume that your opponent has access to the same common knowledge that you do.

The Game Matrix, equilibrium, dominant strategies and Nash equilibrium

So, Game Theory is the description of strategic interaction between mutually aware players. You are self-interested and selfish, and so is everyone else.

The most useful way to develop an understanding of the Prisoner's Dilemma is if we quantify it. To do this, we use what is termed a game matrix, and it looks like this:

Table 9-6 Prisoner's Dilemma

		Richard	
		Co-operate	Confess
Sasha	Co-operate	(1,1)	(3,0)
	Confess	(0,3)	(2,2)

If Sasha and Richard co-operate with each other, the result can be read as (1, 1) for (Sasha, Richard). As we have noted before, the theory behind the Prisoner's Dilemma predicts that Sasha and Richard will sell each other out, as they are selfish and are following their own self-interest.

This, however, illustrates the central concept to Game Theory – the equilibrium – which is also a central component to the study of economics. The difference is that this particular example illustrates what is called a dominant strategy equilibrium – that is, the incentive of each player to confess does not depend on how the other player plays. Dominant strategy is the most persuasive notion of equilibrium known to game theorists.

However, obviously, there are games without Dominant Strategies. David K. Levine, a professor of economics at UCLA, proposes the following example to contrast with the Prisoner's Dilemma.

Consider the following game matrix:

Table 9-7 Battle of the Sexes Game Matrix

		Wife	
		opera	ballgame
Husband	opera	1,2	0,0
	ballgame	0,0	2,1

This is known as the *Battle of the Sexes* game. The story goes that a husband and wife must agree on how to spend the evening. The husband prefers to go to the ballgame (2 instead of 1), and the wife to the opera (also 2 instead of 1). However, they prefer agreement to disagreement, so if they disagree both get 0. This game does not admit a dominant strategy equilibrium. If the husband thinks the wife's strategy is to choose the opera, his *best response* is to choose opera rather than ballgame (1 instead of 0). Conversely, if he thinks the wife's strategy is to choose the ballgame, his best response is ballgame (2 instead of 0). While in the prisoner's dilemma the best response does not depend on what the other player is thought to be doing, in the battle of the sexes the best response depends entirely on what the other player is thought to be doing. This is sometime called a *coordination game* to reflect the fact that each player wants to coordinate with the other player.

For games without dominant strategies the equilibrium notion most widely used by game theorists is that of *Nash equilibrium*. In a Nash equilibrium, each player plays a best response, and correctly anticipates that her opponent will do the same. The battle of the sexes game has two Nash equilibria: both go to the opera, or both go to the ball game; if each expects the other to go to the opera (ballgame), the best response is to go to the opera (ballgame). By way of contrast, one going to the opera and one to the ballgame is not a Nash equilibrium, since each correctly anticipates that the other is doing the opposite, neither one is a playing a best response.

Game Theory is an essential component of business strategy, as it can be applied to the cornerstone of any decision in business. It teaches managers about strategy – commitment versus flexibility, decision-making in uncertain conditions, and gives them the opportunity to look forward and reason backwards. It can, in the words of Tom Copland, Director of corporate finance for McKinsey and Company, "explain why oligopolies tend to be unprofitable, the cycle of overcapacity and overbuilding, and the tendency to execute real options earlier than optimal".

Game Theory should never be applied in a vacuum – there is no substitute for experience and learning on the job – but it can certainly provide a framework within which that experience can be applied at the theoretical level before any action is taken. Good managers will be able to look at their strategic alternatives and choose among them based not only on internal competitive advantage, but also with an understanding of how their choices are affected by, and will affect, the choices of their competitors.

Module summary

Summary

Strategy combines three key elements: analysis, strategic choice, and strategic implementation. This module focuses on helping the student understand how to properly analyse a situation to understand its strategic significance, using the following models:

PEST analysis – a technique for understanding the 'environment' in which a business operates, this analysis helps the manager understand the Political, Environmental, Social and Technological influences on a given industry or business opportunity.

Five forces analysis – a model that helps managers understand the five key forces influencing an industry, namely Supplier Power, Buyer Power, the threat of new Entrants, the Substitute products available to the market, and the internal rivalry in the industry. By completing this analysis, a manager will have a strong idea of trends and pressures at work that help define the industry, including what the industry drivers are and how concentrated the industry is.

SWOT analysis – This is an internal/external analysis model that focuses on the Strengths and Weaknesses of a company, and compares them to the Opportunities and Threats that lie in the industry. Once completed, this model helps a manager understand how a company's strengths best match up to take advantage of the opportunities in the marketplace, despite the weaknesses of the company and the threats to, and in, the industry.

***Ansoff product/market matrix* –** A basic analytic tool to help a company understand how its growth strategy in specific markets can correlate to existing or potential products, including market penetration, market development, product development, and product diversification.

Developing strategic alternatives, choosing and implementing a strategy, is done only after as much information has been gathered as possible. Strategic implementation relies on what resources, both capital and human, are available to the company, given the constraints of the situation it faces.

Assignment

Assignment

Do a PEST analysis on the viability of an Internet-based marketing business specialising in agricultural products. Do you believe that the business environment would be able to sustain such a business venture? Explain your reasoning.

Assessment

Assessment

Assume that the firm as stated in the assignment above now plans to venture into the international market. Explain the sort of strategies this firm need to employ in a foreign market. You are expected to use Ansoff product/market mix to explain your answers.

References

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