DSK SCHOOL OF MANAGEMENT

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STRATEGIG MANAGEMENT (DPHU 3633)

CHAPTER 5:

APPROACHES AND THEORIES IN BUSINESS STRATEGIES

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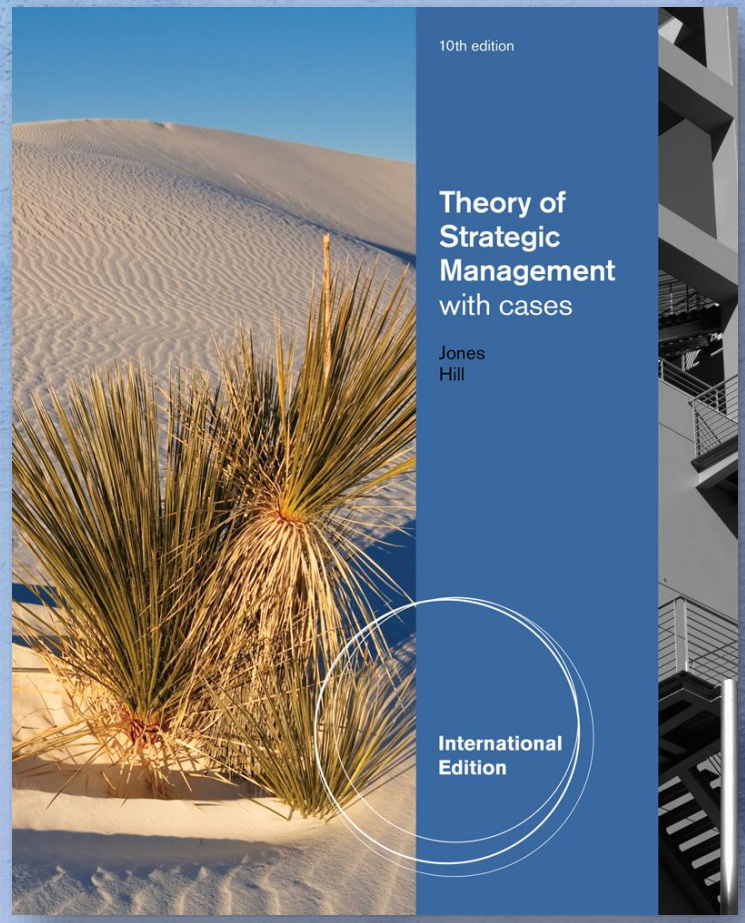
Approaches and Theories in Business Strategies:

1. Strategies in Strategic Management
2. Profit- Maximizing and Competition-based Theory
3. Resource-Based Theory
4. Agency Theory
5. Survival-Based Theory
6. Human-Based Theory
7. Contingency Theory



STRATEGIES IN STRATEGIC MANAGEMENT

- Good **strategic management** is essential for long-term business success.
- It involves defining a **business strategy** with clear objectives, creating clear plans as to how these objectives will be achieved, aligning business activities to support the objectives, and allocating the resources needed to achieve the objectives.
- Beyond improving business results, good strategic management also contributes to a company's social license to operate - an increasingly important business aspect in today's ever-more informed multi-stakeholder environment.
- Consumers are now more aware and more interested not only in a company's products, but also in **the way it conducts its business** from an ethical and environmental point of view.
- These elements should be included at the heart of strategic management to help ensure the long-term survival of the business.

strategies in strategic management – cont'd

- To start with, strategic management requires highly developed **analytical skills**.
- Business leaders involved in strategy development need a wide, interconnected view of their company - including the business environment in which it operates, global trends, the competitive landscape, customer needs and stakeholder expectations.
- Strategic management can only be successful if it starts with a clear and honest understanding of the **internal and external factors** that will determine the company's success - **today and in the future**.
- Strategic management also requires strategy skills to go from business analysis to business strategy - that is, identifying opportunities from the business analysis, choosing which ones to follow, and then developing a strategy that defines how the company will leverage the chosen opportunities.
- Finally, strategic management requires strong leadership skills for implementing the business strategy.
- Business leaders need to engage with stakeholders both inside their organization and out, be aware of challenges to strategy implementation, and **have the personal leadership skills to overcome these**.

WHAT IS A THEORY?

- Theory in modern English is a concept which originally derives from classical Greek philosophy, for example that of Plato, and is derived from ancient Greek theoria, which original meant "a looking at, viewing, beholding".
- It is a well-substantiated explanation of some aspect of the natural world; an organized system of accepted knowledge that applies in a variety of circumstances to explain a specific set of phenomena; "theories can incorporate facts and laws and tested hypotheses"; "true in fact and theory."
- Theories are analytical tools for understanding, explaining and making predictions about a given subject matter.
- There are theories in many and varied fields of study, including the arts and sciences.
- A formal theory is syntactic in nature and is only meaningful when given a semantic component by applying it to some content (i.e. facts and relationships of the actual historical world as it is unfolding).
- Theories in various fields of study are expressed in natural language, but are always constructed in such a way that their general form is identical to a theory as it is expressed in the formal language of mathematical logic.
- Theories may be expressed mathematically, symbolically, or in common language, but are generally expected to follow principles of rational thought or logic.
- Theory is constructed of a set of sentences, which consist entirely of true statements about the subject matter under consideration.

STRATEGIC MANAGEMENT THEORY

- Having explained both the terms *strategic management* and *theory*, what then is *strategic management theory?*
- A strategic management theory may be said to be a supposition, proposition or a system of ideas intended to explain the origin, evolution, principles and applications of strategic management.
- *Strategic management theories* actually derive mainly from the systems perspective, contingency approach and information technology approach to corporate management.

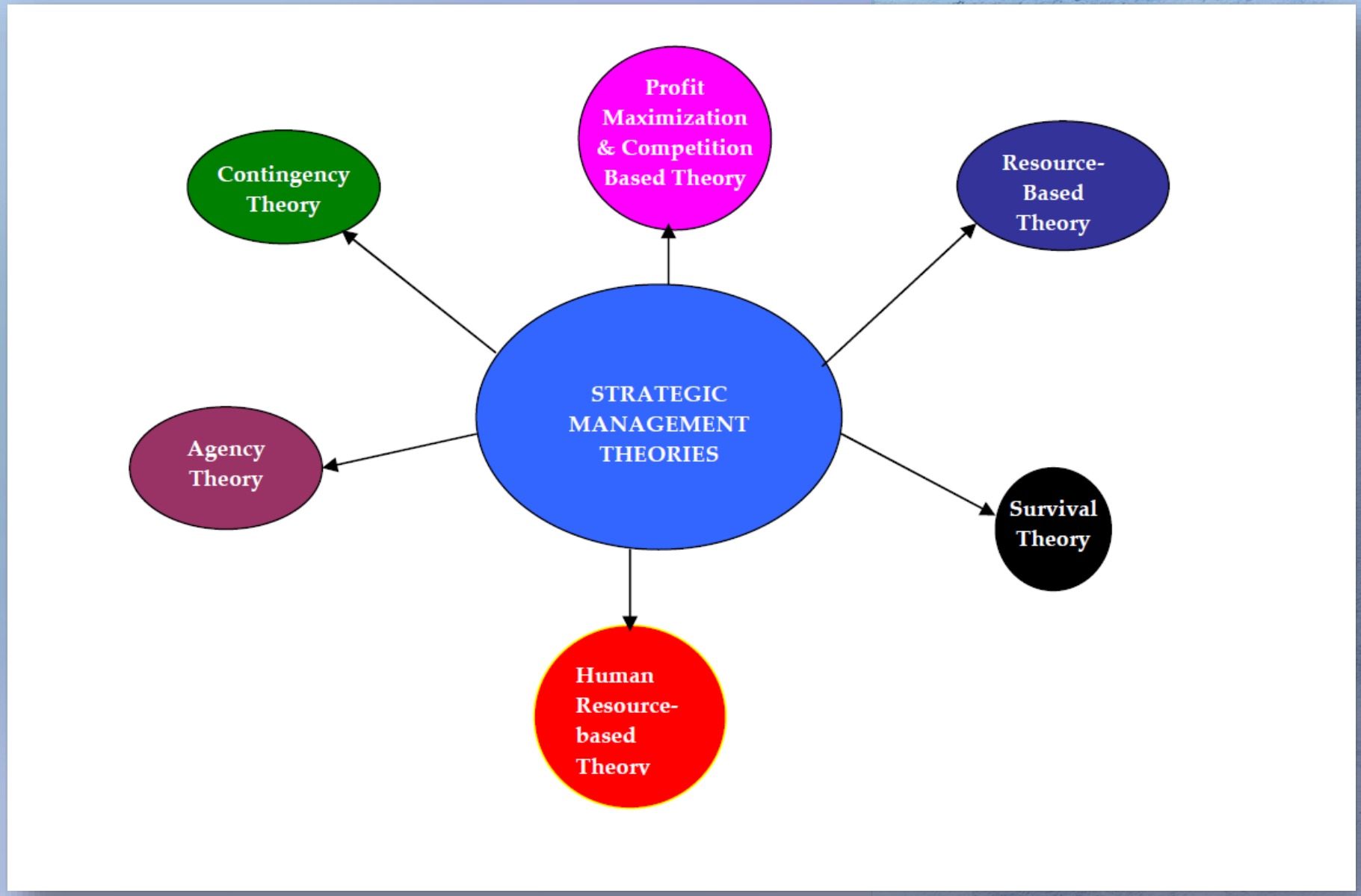
Among the common strategic management theories noted and applicable to modern industrial and governmental organizations are the:

1. ***profit-maximizing and competition-based theory***
2. ***resource-based theory***
3. ***survival-based theory***
4. ***human resource based theory***
5. ***agency theory***
6. ***contingency theory***

strategic management theory – cont'd

- The *profit-maximizing and competition-based theory* is based on the notion that a business organization's main objective is to maximize long term profit and developing sustainable competitive advantage over competitive rivals in the external market place.
- The industrial organization (I/O) perspective is the basis of this theory as it views the organization's external market positioning as the critical factor for attaining and sustaining competitive advantage, or in other words, the traditional I/O perspective offered strategic management a systematic model for assessing competition within an industry.
- This is tantamount to economist philosophy of business objectives.
- On the other hand, *the resource based theory* stems from the management philosophy that the resource of firms' competitive advantage lies in their internal resources, as opposed to their positioning in the external environment.
- That is rather than simply evaluating environmental opportunities and threats in conducting business; competitive advantage depends on the unique resources and capabilities that a firm possesses.
- The *resource-based philosophy* of the firm predicts that certain types of resources owned and controlled by firms have the potential and promise to generate competitive advantage and eventually superior firm performance.

6 STRATEGIC MANAGEMENT THEORIES



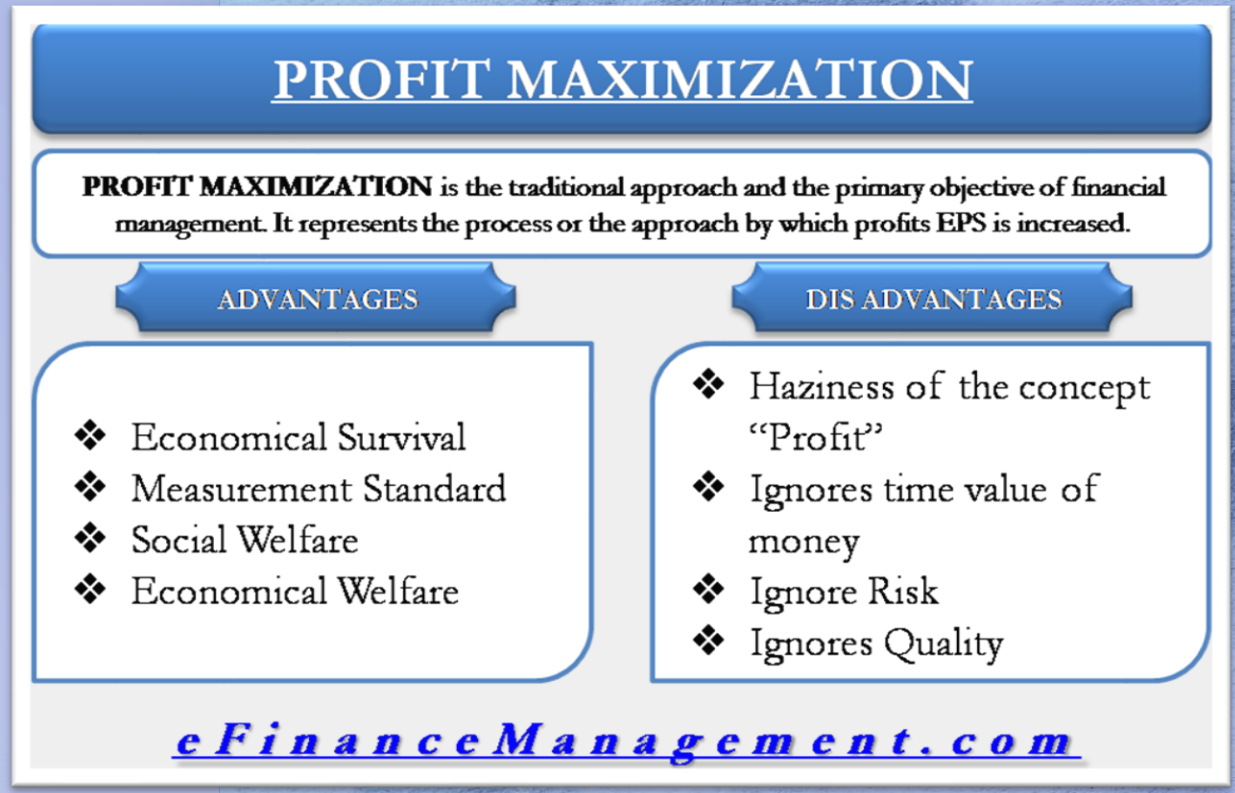
1. THE PROFIT-MAXIMIZING AND COMPETITION-BASED THEORY

- The **profit-maximizing and competition-based theory** is **based** on the notion that a business organization's main objective is to **maximize** long term **profit** and developing sustainable **competitive** advantage over **competitive** rivals in the external market place.

- Profit Maximization Theory in traditional economic model of the firm it is assumed that a firm's objective is to maximise short-run profits, that is, profits in the current period which is generally taken to be a year.

- In various forms of market structure such as perfect competition, monopoly, monopolistic competition the traditional microeconomic theory explains the determination of price and output by assuming that firm's aim is to maximise current or short-run profits.

- This current short-run profit maximisation model of the firm has provided decision makers with useful framework with regard to efficient management and allocation of resources.



the profit-maximizing and competition-based theory-cont'd

- Although the industry-based view of business strategy emphasizes the importance of industry structure and resource based view (RBV) emphasizes the value of firm resources for competitive advantage, it is also recognized that the decisions a firm makes in terms of its actions and reactions in relation to its competitors in a market is a major determinant of firm performance.

- The competition-based theories of business strategy emerged to fill this gap and ensure attention to the dynamics of competition between rivals. It is important to emphasize that the need for firms to think strategically is driven by the existence of competition.

- If there is no competition, there is no need to make strategy a priority. Firms that hold monopolistic positions within their industries do not face competition and therefore have little need for thinking strategically.

WHAT IS PROFIT MAXIMIZATION?

- In economics, every company, small or large, seeks to make a profit.
- They will do everything possible to ensure there is proper market capitalization, and the available resources are being utilized in the desired manner.
- In this case, profit maximization can be defined in terms of short-run or long-run processes through which a firm sets its price, input, and output levels that bring in the highest profits.
- And mainstream view normal theorizes the firm as profit maximization.
- Understanding profit maximization may not be as straightforward as you may have imagined.
- It is a subject that takes different forms with a number of perspectives.
- For instance, considering that profit is equal to revenue less cost, you can draw a graph, where revenue and cost variable stand as the extent of output than produces a maximum difference.
- Or, taking that there are known specific functional forms for the output of revenue and cost, one can apply calculus to bring out maximum profits based on how far the output goes.
- The third approach includes using equations of marginal revenue and marginal cost; in which case, the first order for maximization is equal to the two variables, if marginal revenue and minimal costs are available as functions where output is involved.

PROFIT MAXIMIZATION STRATEGIES FOR MANAGERS

- The main objective, and indeed, the primary motivation of a business come from the need to make profits.
- This is true, of course, unless one is running a non-profit organization.
- In which case, the company must still make some profit, and it could be in terms of the social health of the society they are serving.
- This means no matter what, every business must have a goal, which upon achieving, the organization can count a profit.
- A profit calculated as what remains after expenses and cost of production has been deducted from the overall income.
- Expenses, in this case, include taxes.
- For the case of a non-profit organization, they don't pay taxes, and they don't make monetary profits, but their success is seen through the results of their input.
- If, for instance, an organization is created to feed a starving community, they profit when the community receives all the necessary items for survival.
- Their focus is not on gaining monetary value but in creating a more conducive environment for human existence.

profit maximization strategies for managers-cont'd

- Whatever the case, the organization has to reap maximum benefits.
- And many factors determine how a company reaches these objectives.
- For a start, it will depend on the size of the company, the industry, the profit margin, and the volume of sales, factors that vary from business to business.
- Business owners and managers, regardless of their individual situations, share the desire to utilize the available resources with optimum efficiency.
- They all strive to improve their business' performance. And for this to happen, there are two important competing methods: profit maximization and revenue maximization.
- Profit maximizers include strategies that companies following to build more net income as much as possible utilizing the resources and market share currently available.
- In other words, the company will use every weapon in their arsenal to reap as many profits as possible from an investment.
- To many, it is the goal of every company to make profits. It is logical. However, if a company focuses only on profit maximization, chances are they will lose on the opportunities that don't offer and immediate financial gain.
- They may, for instance, fail to establish a good relationship with consumers, which is critical for long-term benefits.

profit maximization strategies for managers-cont'd

- Revenue maximization is where a company may put its primary focus on maximizing their revenues.
- Such companies do not care much about the current profit margin from their sales.
- Instead, they focus more on controlling market share.
- This is a behavior, for instance, of a company entering a new market and is trying to market a new product before focusing on sales.
- This is a good strategy for large and competitive markets where consumers are highly sensitive to prices.
- Companies that use this strategy mostly focus on long-term profits from the business.
- Chances are they will not be making any profits currently, but they know sooner or later ways will open.

2. RESOURCE-BASED THEORY

- **Resource-based theory** suggests that **resources** that are valuable, rare, difficult to imitate, and non substitutable best position a firm for long-term success.
- These strategic **resources** can provide the foundation to develop firm capabilities that can lead to superior performance over time.
- A resource is valuable to the extent that it helps a firm create strategies that capitalize on opportunities and ward off threats.
- Resource-based theory contends that the possession of strategic resources provides an organization with a golden opportunity to develop competitive advantages over its rivals.
- These competitive advantages in turn can help the organization enjoy strong profits and sustained competitive advantage.

Four Characteristics of Strategic Resources

A strategic resource is an asset that is:

1. **Valuable**
2. **rare**
3. **difficult to imitate**
4. **Non substitutable.**

resource-based theory – cont'd

- Competitors have a hard time duplicating resources that are difficult to imitate.
- Some difficult to imitate resources are protected by various legal means, including trademarks, patents, and copyrights.
- Other resources are hard to copy because they evolve over time and they reflect unique aspects of the firm.
- These resources can provide not only a competitive advantage but also a sustained competitive advantage—one that will endure over time and help the firm stay successful far into the future.
- Resources that do not have all four qualities can still be very useful, but they are unlikely to provide long-term advantages.
- A resource that is valuable and rare but that can be imitated, for example, might provide an edge in the short term, but competitors can overcome such an advantage eventually.

resource-based theory – cont'd

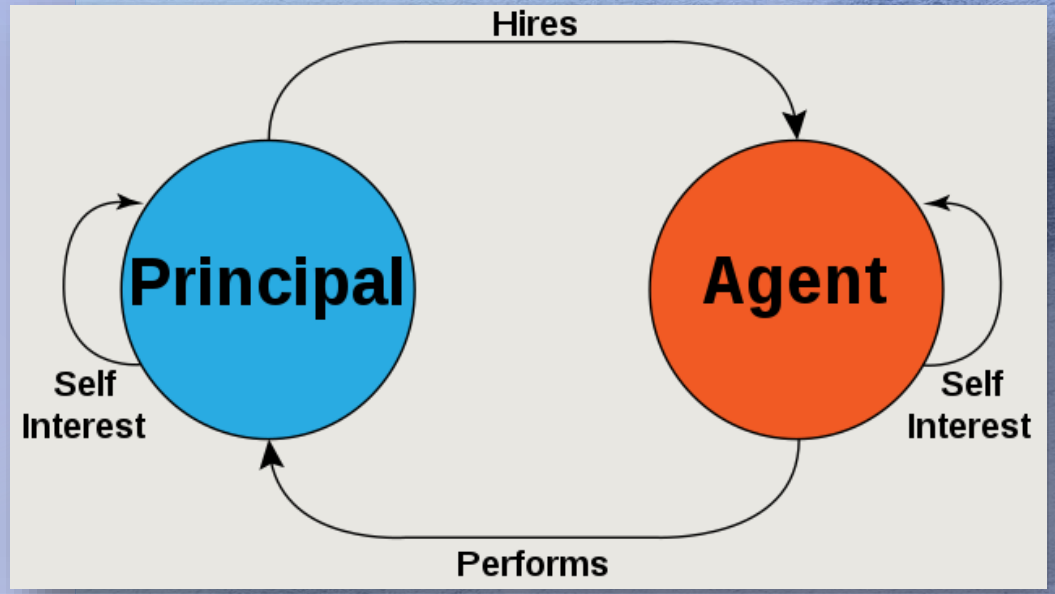
- Resource-based theory also stresses the merit of an old saying: the whole is greater than the sum of its parts.
- Specifically, it is also important to recognize that strategic resources can be created by taking several strategies and resources that each could be copied and bundling them together in a way that cannot be copied.
- For example, Southwest's culture is complemented by approaches that individually could be copied—the airline's emphasis on direct flights, its reliance on one type of plane, and its unique system for passenger boarding—to create a unique business model whose performance is without peer in the industry.
- Resource-based theory can be confusing because the term *resources* is used in many different ways within everyday common language.
- It is important to distinguish strategic resources from other resources.
- To most individuals, cash is an important resource.
- Tangible goods such as one's car and home are also vital resources.
- When analyzing organizations, however, common resources such as cash and vehicles are not considered to be strategic resources.
- Resources such as cash and vehicles are valuable, of course, but an organization's competitors can readily acquire them.
- Thus an organization cannot hope to create an enduring competitive advantage around common resources.

3. AGENCY THEORY

- **Agency theory** is a principle that is used to explain and resolve issues in the relationship between business principals and their agents.
- Most commonly, that relationship is the one between shareholders, as principals, and company executives, as agents.
- Agency theory attempts to explain and resolve disputes over priorities between principals and their agents.
- Principals rely on agents to execute certain transactions, particularly financial, resulting in a difference in agreement on priorities and methods.
- The difference in priorities and interests between agents and principals is known as the principal-agent problem.
- Resolving the differences in expectations is called "reducing agency loss.“
- Performance-based compensation is one way that is used to achieve a balance between principal and agent.
- Common principal-agent relationships included in agency theory include shareholders and management, financial planners and their clients, and lessees and lessors.

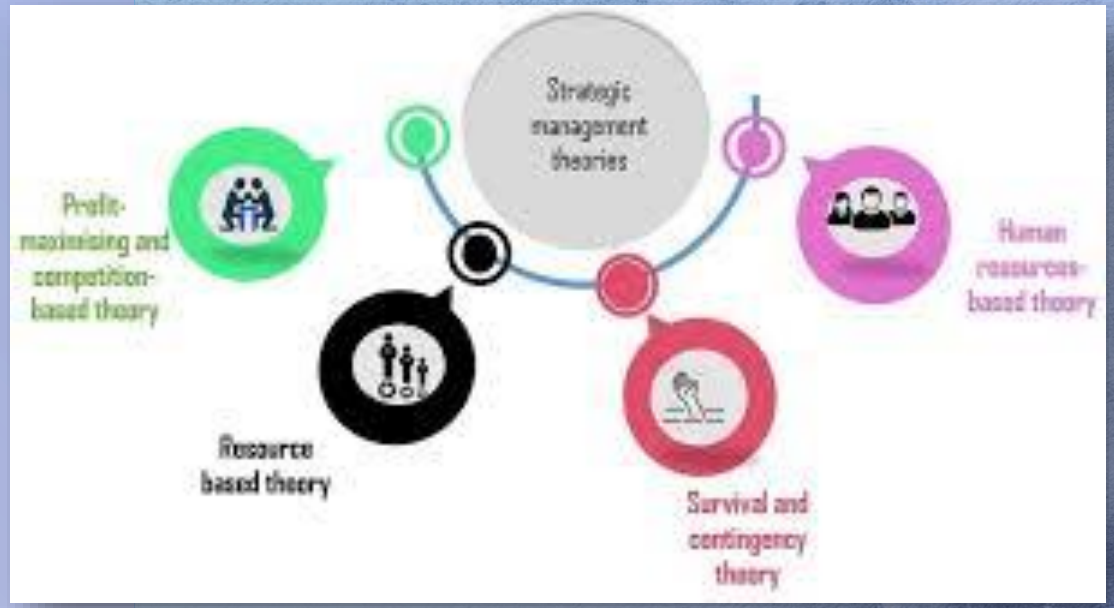
Understanding Agency Theory

- An agency, in broad terms, is any relationship between two parties in which one, the agent, represents the other, the principal, in day-to-day transactions.
- The principal or principals have hired the agent to perform a service on their behalf.
- Principals delegate decision-making authority to agents.
- Because many decisions that affect the principal financially are made by the agent, differences of opinion, and even differences in priorities and interests, can arise.
- Agency theory assumes that the interests of a principal and an agent are not always in alignment.
- This is sometimes referred to as the principal-agent problem.
- By definition, an agent is using the resources of a principal.
- The principal has entrusted money but has little or no day-to-day input.
- The agent is the decision-maker but is incurring little or no risk because any losses will be borne by the principal.



4. THE SURVIVAL-BASED THEORY

- The **survival-based theory** centres on the concept that organizations need to continuously adapt to its competitive environment in order to **survive**.
- This differs from the human resource-**based theory**, which emphasizes the importance of the human element in the process of strategy development of organizations.
- This theory, which was quite popular during late 19th and early 20th century, emphasized on the notion that by following the principle of nature, only the best and the fittest of competitors will win, which in the end would lead to the improvement of the organization as a whole.



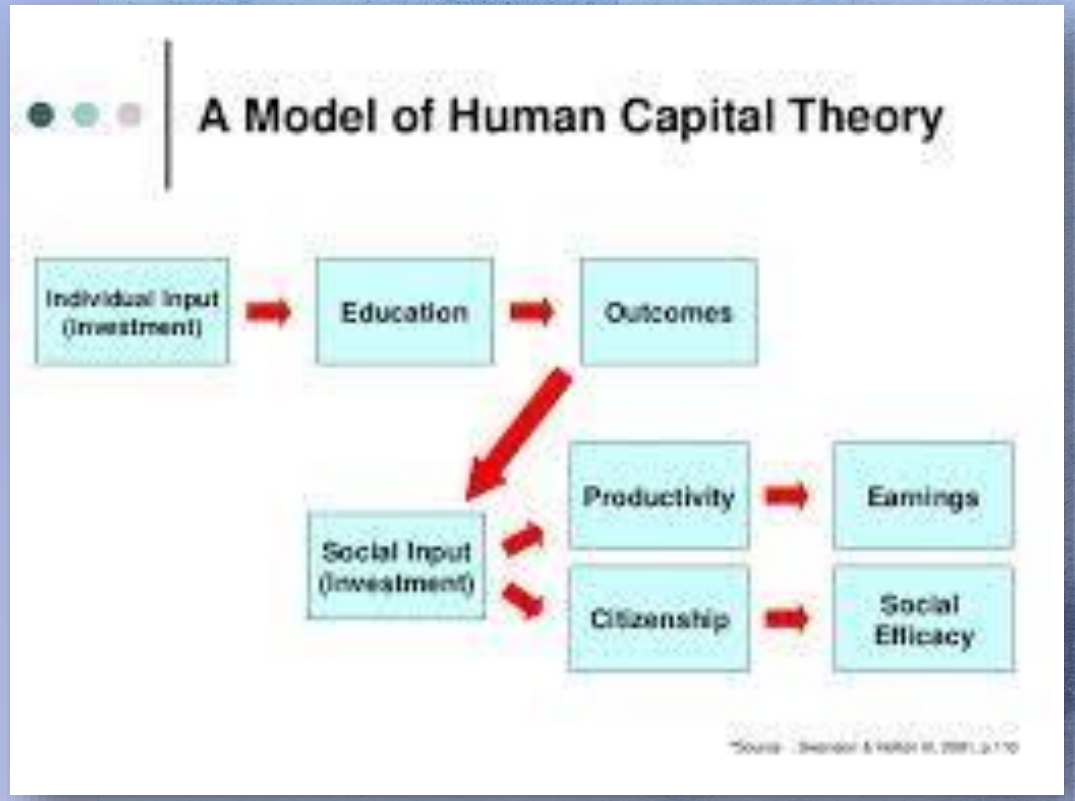
the survival-based theory - cont'd

- In survival based theory it is normal for the competition to behave in hedonistic ways to produce the fittest business, who survived and prospered by successfully adapting to its environment or become the most efficient and economic producer.
- Hence, ruthless business rivalry and unprincipled politics is acceptable under this assumption.
- He proposed that organizations have to constantly adapt to changes in environment so that they can survive.
- It's only natural for the organizations that change with
  the environment to survive.
- The organizations survive if they offer the best product that is produced in the least amount of time using the least amount of resources.
- This strategy further reiterates that an organization cannot focus on one strategy. They have to select a set of strategies that lead to efficiency and by nature the best strategy is the one that adapts to the current environment.
- This theory is also applied in turning around the company based on the fact that most of the problems that companies face are related to inefficient systems, and all that is needed is to build efficiency to get back on track.
- The objective of turning around an organization is to primarily run that organization in an efficient manner to adapt to its environment.
- To achieve the ultimate goal of survival and improvement of profitability a company has to aim to become efficient in a competitive market.
- Therefore, the survival-based theory stresses that if a company does not adapt to the environment which is ever changing, it basically will not survive.

5. HUMAN RESOURCES THEORY

- **Human resources theory** is a general term for the strategies, tactics and objectives used by business owners and managers to administer policies and procedures related to employees.

- While the specific HR objectives will vary between organizations depending on their particular needs and composition of the workforce, there are several major, overarching objectives that are generally seen to be important.



human resources theory – cont'd

i. Cost-Effectiveness

- One of the most important objectives of human resources theory, but perhaps one that is often overlooked, is the HR role in managing cost-effectiveness for the organization.
- While the finance and accounting function of a business is ultimately responsible for balancing the budget and controlling expenses, HR policies play a large role in managing the business's outgoing costs.
- When hiring employees, a business should be cognizant that its pay rates are competitive in order to attract skilled workers, but that they are not excessive and therefore end up costing the company more than they should.
- Part of managing this process is working to minimize staff turnover, because the recruitment and hiring of employees takes valuable time and money away from the business.
- The HR function can also measure the cost-effectiveness of employee benefit programs, the availability of training and the efficiency of the time employees take to complete their jobs.
- All of these areas indirectly impact the company's bottom line.

human resources theory – cont'd

ii. Leveraging Potential

- Part of the organization's focus on effectiveness and efficiency can be controlled through the second major objective of human resources theory: leveraging employee potential.
- HR managers and business owners should work to ensure that employees have an achievable workload.
- This is about balancing two competing priorities -- making sure that the employee isn't overwhelmed but also making sure that the employee has enough to do so that she isn't wasting company time.
- As such, HR has to work to not over-stretch the staff and at the same time not under-utilize its most valuable resource: its people.

human resources theory – cont'd

iii. Matching Needs

- Closely related to leveraging potential is HR's objective of matching the company's needs to the employees' skills and career objectives.
- This is sometimes called "workforce planning," because the business works to put the right person in the right job at the right time.
- This can be challenging in smaller businesses where one person might be asked to take on a number of different roles.
- However, effective recruitment to match the needs of the organization can normally work to solve this problem.
- If the company needs someone with skills in technology, customer service and accounting, then it must recruit such as person or otherwise be willing to train someone on those diverse areas.
- Indeed, training programs, both on- and off-site, can help to cover skills gaps and to educate employees on new trends and technologies.

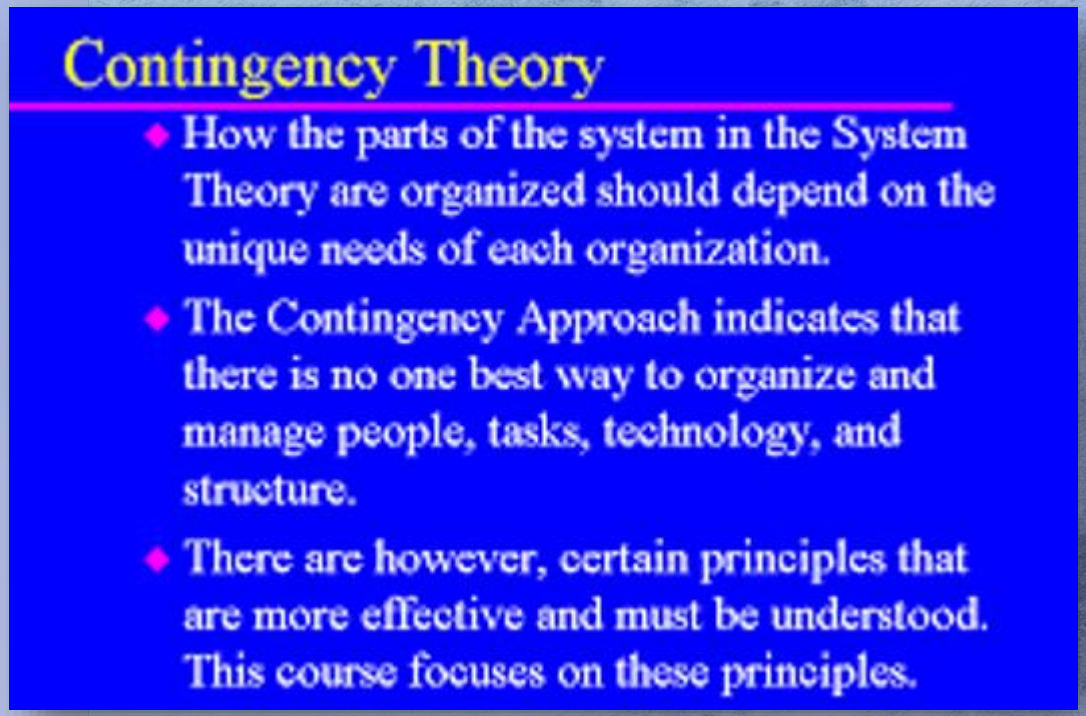
human resources theory – cont'd

iv. Maintaining Good Relationships

- A final objective for human resources theory is in maintaining good relationships between the organization's stakeholders.
- Stakeholders are anyone who has a vested interest in the business's success, including the owner, managers, employees and customers.
- Open and positive communication must be the hallmark of maintaining good working relationships and this depends on timely responses to both successes and failures within the workplace.
- Managers should be sensitive to employee needs and problems and in turn employees should be sensitive to customer wants and needs.
- All of this has to be balanced with a respect for labor laws and anti-discrimination policies which govern workplace relations.
- The HR function has an important role to play here as the repository of the legal and social regulations to which stakeholders must adhere.

6. CONTINGENCY THEORY

- The **contingency approach** is a management **theory** that suggests the most appropriate style of management is dependent on the context of the situation and that adopting a single, rigid style is inefficient in the long term.
- A **contingency theory** is an organizational theory that claims that there is no best way to organize a corporation, to lead a company, or to make decisions.
- Instead, the optimal course of action is contingent (dependent) upon the internal and external situation.
- A contingent leader effectively applies their own style of leadership to the right situation.
- Contingent leaders are flexible in choosing and adapting to succinct strategies to suit change in situation at a particular period in time in the running of the organization.



contingency theory - cont'd

- The Contingency theory is broadly applied in strategic management and it is considered to have the most influence on studies on strategy and the organization.
- The contingency theory's main principle states that every organization is unique and what works for one organization cannot be applied in another.
- Also, no organization can depend on one strategy to succeed managers must adopt strategies based on the current situation that the organization is facing.
- The strategic management approach used should be the tools applied to assist managers develop, implement and evaluate strategy, and to guide them to make other strategic decisions.
- The contingency theory states that the organization seeks to be effective by adapting itself with the current situation that organization is in at the moment.
- So the early contingency theories held that the organization's that perform highly are projecting the fact that the company is suitably adapted to its environmental situation such as in terms of its size, its level of adaptation to the new technology, and changing its products to the changing needs of customers.
- Therefore if the current situation of an organization changes and the company does not immediately change to reflect these changes, then that company will perform poorly.

Contingency approaches

Summary of the main ideas underlying contingency:

- ✓ Organizations are open systems that need careful management to satisfy and balance internal needs and to adapt to environmental circumstances
- ✓ There is not one best way of organizing. The appropriate form depends on the kind of task or environment one is dealing with.
- ✓ Management must be concerned, above all else, with achieving alignments and good fits
- ✓ Different types or species of organizations are needed in different types of environments

THE END