

Economic Environment and Business Strategy
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Strategic Management – II

Welcome back. In our last session, we explored environmental scanning: how organizations monitor their external environment and internal capabilities to identify opportunities and threats. Today, we move to the next stage of the strategic management process, strategy formulation. This is where analysis is translated into a clear roadmap for action. At this stage, firms define their missions, set objectives, and establish guiding policies that shape how they compete and grow. Think of it as drawing the blueprint before construction begins.

But real-world strategy is rarely straightforward because most markets are imperfect. Firms face monopolistic competition, oligopolies, duopolies, and monopolies, where pricing, innovation, and cooperation all come into play. We will examine not only how firms compete but also how they sometimes collaborate through alliances, partnerships, and joint ventures to strengthen their positions. By the end of this lecture, I hope you will see that strategy formulation is about making deliberate choices in a complex, imperfect, and often interdependent environment.

As I mentioned, we have four dimensions of strategic management. The first is strategic formulation. Strategic formulation is the process of setting the foundation for how a firm competes in its environment. It is not just about choosing goals but also about carefully analyzing strengths, identifying weaknesses, and recognizing growth opportunities. At this stage, firms define their mission, establish achievable objectives, and create guiding policies.

Think of it like designing the blueprint before construction begins. In this figure, as I showed in the previous section, the focus is on the second block; it shows how the complete strategic formulation takes place. First, you can see the mission, then the objectives, and then the strategies and policies. The process is dynamic, not a one-time occurrence; it is a loop of continuous improvement, starting with environmental scanning and ending with evaluation and control. In this case, strategy formulation becomes an important component of strategic management.

Let me show you the SFAS matrix. The SFAS matrix is a practical tool that goes beyond the SWOT analysis. I am sure you are familiar with the SWOT analysis, which lists the

strengths, weaknesses, opportunities, and threats. Instead of a long list of strengths, weaknesses, opportunities, and threats, it forces managers to prioritize and condense them into fewer key factors. These strategic factors are then weighted and scored using tools such as the SFAS matrix, which helps decision-makers focus on what really matters to the firm when formulating strategy. Here is a real example of the SFAS matrix applied to Maytag. Notice how each factor—the strength, weakness, opportunity, or threat—is assigned a weight and rating. You can see the first one here: the internal strategic factors; these are the strengths and the weaknesses. Then, for the external strategic factors, they have listed out key opportunities and key threats.

In the real world, there can be many strengths, weaknesses, opportunities, and threats. However, after careful research, they have narrowed down the key dimensions, aspects, and elements. These are listed here, for example, S1, S2, S3, S4, S5. You can go through them one by one, for example, quality, meta, and culture, which are internal because they relate to culture. Similarly, the firm's process-oriented R&D is a weakness.

Then, looking at the external strategic factors associated with this firm, you can see the opportunities; they have listed 5 opportunities and 5 threats. You can also see that all these strengths, weaknesses, opportunities, and threats are not equally weighted. For example, the quality matter culture has been given a weight of 0.15. Finally, the total is 100.

You can see the weightings in the internal strategic factors. There are 10 factors here; you can see them, but the weightings are not uniformly distributed. For instance, the last one, the 10th in the internal strategic factors, has a global positioning with a weight of 20 percent. Then, moving to the external strategic factors, 10 factors have been identified under opportunities and threats, but they are not given equal weight. For instance, opening Eastern Europe has only a small weighting, while the Japanese appliance companies have a 10 percent weighting here.

Not only do they assign weightage, but they also assign different ratings on a scale. This framework helps managers quantify which areas are most critical. For example, Meta had a strong culture but was weak in global positioning. Accordingly, the weightage is assigned. Using this tool, managers can decide whether to leverage strengths, address weaknesses, or respond to threats.

Each firm develops these metrics by internalizing its own strategic factors and external strategic factors. This is the real world, as I mentioned; it is a real example of metrics applied to MATAAC. Moving forward, the potters have also listed competitive strategies. They have listed firms that pursue competitive strategies, sometimes emphasizing cost leadership. In a particular industry, if some firms can produce goods or services at a lower cost, they can offer lower prices and attract more customers.

They are then providing cost leadership. So, if there are cost leaders in the industry, other firms try to follow them. And then there is product differentiation. Product differentiation is another competitive strategy used by firms. They do it by offering unique products.

Product differentiation occurs through quality, design, and service. Even in the mobile phone segment, you can see that different firms operate, but each may offer a unique product. This means that when you buy a mobile phone from Samsung, Oppo, or another company, they are not the same; they are all different products. Though their purpose is the same, which is to make phone calls, browse, and do other related activities on the phone, you know that. The kind of product differentiation that they have achieved through R&D, and through advertising.

They create product differentiation that establishes a unique market value for their products and is valued by a distinct group of customers. In the industry, firms normally focus either on cost leadership or product differentiation, and often try to focus on both. When they can, they try to achieve their advantage. The research evidence shows that these strategies work differently depending on the context. In emerging economies like Iran, cost leadership tends to improve financial leverage and performance.

In China, studies have found that differentiation performs better in highly concentrated markets. The key lesson is that there is no universal best strategy; it must align with the industry environment and the firm's capabilities. Importantly, competitive advantage does not last forever. In hyper-competitive markets, new technologies, short product cycles, and new entrants constantly erode advantages. You may recall that at one point, Kodak produced films and cameras.

They had a unique market advantage at one point. But when the digital camera came, Kodak's unique competitive advantage disappeared from the market. That means they need to be aware of potential threats from technological advances, shorter product cycles, and new entrants constantly eroding their competitive advantage. The industry structure matters, too. Fragmented industries are tougher to compete in than very consolidated ones.

Just for instance, consider Ford's \$5-a-day wage strategy in 1914. So, just a brief overview of how Ford, the owner of Ford Motor Company in 1914, used the \$5-a-day wage. So, what is the objective behind it? The main concern is that when a firm hires a laborer, it wants to improve productivity, and the laborer should be incentivized accordingly. So, what Ford did was pay a wage well above their opportunity cost, well above their marginal product, or the wage they could earn by working elsewhere. So, suppose the market wage has been, for example, \$3 per day; Ford gave \$5 per day.

This made the workers more loyal to the company, and there was no attrition. As a result, the retention rate was very high. When any firm hires new employees, it needs to provide

training; there are HR and recruitment costs, as well as the cost of training. Additionally, over time, as they work at this company, they acquire new skills and techniques, so it is important that they retain this skill set. In that way, Ford thought that by paying a higher wage, a higher wage compared to their market wage, and as I mentioned, Ford paid \$5 per day.

At that time, the prevailing market wage was only \$3. Initially, it gave him many dividends because the retention rate was very high, the firm's productivity increased, and it began to make substantial profits because he had a very competitive and loyal workforce. But eventually, other firms did not sit idle. They also began to implement the same strategy.

They also began to increase wages. That means that when others raise wages, as Ford did, the strategy's effectiveness diminishes over time because competitors follow suit. Initially, the strategy was revolutionary; everyone thought, "Okay, this is what Ford is going to have a competitive advantage," but once others copied it, the advantage faded. This highlights the importance of innovation and adaptability. Let me now relate this to competitive strategy formulation and another key aspect, market power, which is captured in the market power matrix. Market power refers to the degree of control firms have over price and competition.

The greater a firm's market power, the more influence it has. Economists classify markets into four main types. These are perfect competition, monopolistic competition, monopoly, and oligopoly. Each structure shapes how strategies are formulated and how firms compete with one another. To classify the market structure, a few criteria are followed.

This includes how much control a firm has over price, how many firms compete in the market, how large the firms are, the product characteristics, and how easy it is for new firms to enter. Let us begin by discussing each market form individually. One type is perfect competition. Perfect competition is an idealized form of a market. In this market, firms can enter and exit freely, and products are homogeneous.

That means each product is comparable to the others, and no single firm can influence the price. The price is set by the market mechanism, by demand and supply, and a single firm cannot be the price setter but only a price taker. Similarly, as an individual buyer, he or she is only a price taker, not a price maker. In the overall market mechanism, market demand and supply jointly determine the price charged and the quantity produced. And here, as I mentioned, both sellers and buyers are price takers, and the market has perfect information to ensure transparency.

We can see glimpses of this in stock exchanges, currency markets, and even agricultural markets like wheat. But the real question is whether these markets fully or only partially

fit the model, since the real world is not perfectly competitive. These are all imperfectly competitive markets. So, today, as I mentioned, we will mostly move beyond perfect competition and look at imperfect market structures. These markets better reflect reality because products are not identical, firms may have market power, and entry barriers often exist.

More specifically, we will focus on four types of imperfect market forms. These are monopolistic competition, oligopoly, monopoly, and monopsony. Each of these market forms has unique features and implications for pricing, output, and strategy. We will begin with the first market form: the monopolistically competitive market. This is the most prevalent market form we see in our day-to-day lives.

That means the real world we live in is mostly characterized by monopolistic-competitive market structures. In this market form, products are similar but not identical. For example, in the garment market, there are many producers. You can see that there are many producers, some of whom brand their products in their advertisements, and there are quality differences. So, each firm will have some kind of monopoly power over its product.

At the same time, they need to compete with others. That means a kind of monopoly plus competition; that is, monopolistic competition. So, you can think of how firms differentiate through branding, packaging, or advertising. Consider restaurants or clothing shops; each offer something unique. While there are many sellers, each firm enjoys a small degree of monopoly due to product differentiation.

And then moving to another market form, called the oligopoly market form. In an oligopoly, there are only a few large firms. They dominate the market, and there are high entry barriers. Because the firms are interdependent, there is some non-price competition.

As I mentioned, the interdependencies are very high. This is in the interest of all these firms; there are only a few, and it is in their best interest to maintain price stability in the market where they operate. There is also a risk of collusion; they often collude with each other to make a profit. Overall, there is a high degree of interdependence among firms. Examples of oligopoly firms include airlines. In the Indian airline market, there are only a few airlines.

Similarly, there are only a few banks, oil companies, car companies, and telecoms. These are all examples of oligopoly markets. Then let us move on to another imperfect market form: duopoly. A duopoly is a special case of an oligopoly in which only two firms dominate. Here, rivalry is intense, but price leadership often emerges.

For instance, in aircraft manufacturing, Boeing and Airbus are dominant, and their pricing and innovation strategies largely shape the industry. Another market form is the

extreme case of an imperfect market, called a monopoly firm. Monopoly firms exist when one firm controls the entire supply. Here, the firm and the industry are one and the same. Entry barriers, mainly due to patents, natural resource ownership, or large infrastructure requirements, prevent newcomers from entering.

You can just think about Indian Railways: if someone wants to enter, it is very difficult because the railways already have extensive infrastructure, and it will be difficult for a new transportation company to establish all of it. All these factors prevent new entrants. So, utilities like electricity are natural monopolies. So, monopolies can charge higher prices, practice price discrimination, and restrict consumer choice. So, a monopoly exists when, as I mentioned, a firm controls the entire supply.

Monopolies can be good or bad. On the one hand, economies of scale reduce costs, and monopolies may invest heavily in R&D. On the other hand, monopolies may exploit consumers by charging higher prices and offering fewer options. That is why regulation is important. It is in the public interest and in the interest of social welfare to regulate the emergence of monopolies in the economy. While monopoly refers to a single seller, monopsony refers to a single buyer.

For instance, when a government is the only buyer of a vaccine, it controls the price. You know that the government is a major buyer of vaccines, so it has control over price. Similarly, large supermarkets may dominate negotiations with farmers because they are the single largest buyers of agricultural products from the farmers.

This power imbalance can lead to inefficiencies. Competition is not the only path to survival. Sometimes, firms cooperate. This cooperation can take the form of coalitions, which are often illegal, or strategic alliances, which can be legitimate and mutually beneficial. Turning to cooperative strategies, the first is collusion.

Collusion occurs when firms cooperate rather than compete. So, explicit collisions, like forming a cartel, are illegal in most countries. However, there can be tacit collusion in which firms' indirectly aligned behavior is harder for our policymakers to detect. For example, airlines sometimes follow each other's price changes without explicit agreement, and similarly, airlines sometimes won't enter routes operated by other airlines. This means that some kind of tacit collusion is present, so strategic alliances often lead to a decline in consumer welfare; however, from the firm's perspective, they help maximize profit. So, the second aspect, called the cooperative strategy, is called a strategic alliance.

They are formal partnerships, such as those among airlines. Instead of competing fiercely, firms collaborate on routes, logistics, and technology. You might have heard of Star Alliance, SkyTeam, or OneWorld. These are strategic alliances among airlines. Studies show that alliances increase profitability and market presence. However, the line between legitimate cooperation and anticompetitive behavior can sometimes be blurry.

Companies often form alliances because going solo is risky and expensive. By partnering, firms can gain access to skills, technology, and expertise. Alliances are also a quick way to enter new markets, especially foreign ones where political barriers may exist. Another big reason is risk-sharing. When projects involve high costs or uncertainty, alliances spread the risk among partners. Strategic alliances come in many forms. A mutual service consortium is when firms share resources to develop expensive innovations, as IBM and Sony do with chips. Joint ventures are probably the most well-known arrangement, in which two companies create a new entity to share risks and rewards, as P&G did with Clorox. Licensing allows firms like KFC and Subway to expand globally without directly investing in every market.

And finally, value chain partnerships or long-term collaborations with suppliers and distributors that strengthen the entire supply chain, such as Facebook teaming up with news organizations like The New York Times and NBC to post stories directly on its platform. While alliances offer many benefits, they also come with challenges. The main advantages include cost-sharing, faster market access, and new technology. But conflicts often arise when partners have different goals or when one feels they are contributing more than the other.

Another concern is knowledge leakage. Partners might gain access to your expertise and later become competitors. Strategic alliances are powerful but require careful management. To conclude, we began with the idea of strategic formulation: how firms set their foundational mission and objectives before moving into action. Firms operate in imperfect markets, including monopolistic competition, oligopoly, duopoly, and monopoly, each with unique challenges and opportunities for shaping strategy.

We also saw that strategy is not always about pure competition. Sometimes cooperation is evident through alliances, partnerships, and joint ventures. These elements are essential for survival and growth. With that in mind, we have set the stage for understanding how firms craft strategies not only to compete but also to thrive in a dynamic business environment. Thank you for watching this session. See you in the next one.