Chapter 4.

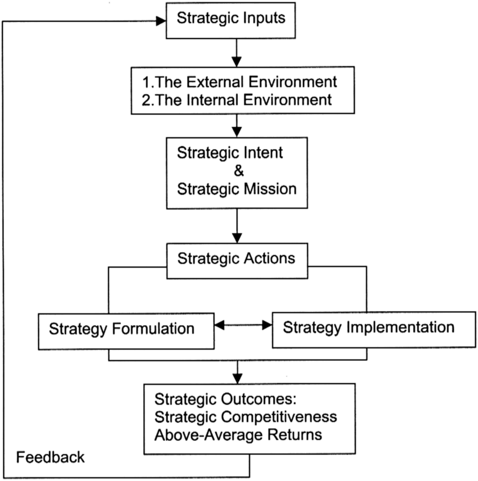
Strategic Management Process and Models

Developers have themselves to blame for their failure in their housing projects if they neglected SWOT analysis, risk management, and Strategic Management Process and Models. This part of the paper will discuss Strategic Management Process and Models, and use them to explain what firms should do to achieve strategic competitiveness and earn above-average returns. Through these explanations, it becomes clear why some firms consistently achieve competitive success and others fail to do so. Two models will be examined that suggest conditions organizations should study to gain the strategic inputs needed to select strategic actions in the pursuit of strategic competitiveness and above-average returns, that is, Industrial Organization (I/O) Model and the Resource-Based Model. Apart from that, Value-Chain Model and Porter's Five Forces Model of Analysis will also be explained which is applicable to developers to avoid failure and to gain strategic competitiveness and earn above-average returns.

Strategic Management Process

Dynamic in nature, the Strategic Management Process is the full set of commitments, decisions, and actions required for a firm to achieve strategic competitiveness and earn above-average returns. Relevant *strategic inputs*, from analyses of the internal and external environments, are necessary for effective strategy formulation and strategy implementation actions. In turn, effective *strategic actions* are a prerequisite to achieving the desired outcomes of strategic competitiveness and above-average returns. Thus, the Strategic Management Process is used to match the conditions of an ever-changing market and competitive structure with a firm's continuously evolving resources, capabilities, and competencies (the sources of strategic inputs). Effective *strategic actions* that take place in the context of carefully integrated strategy formulation and strategy implementation processes result in desired *strategic outcomes* (Hitt; Ireland and Hoskisson, 1999 p.5). Figure 1. shows the Strategic Managemeny Process.

Figure 1: The Strategic Management Process



Source: Hitt et al, 1999 p.6

Housing development is dynamic in nature. It changes with the environment. The national, regional, and global economy will affect its strategy and performance. The recent economic downturn had forced many developers into hardship with their properties overhang in the market. Some had abandoned their projects and went into liquidity and some rescued by Danaharta, the Asset Management Company to purchase non-performing loans and manage the recovery of these loans. Only if they were cautious and followed the Strategic Management Process, they would have avoided the catastrophe. The strategic inputs and the strategic intent and mission of their companies must guide their strategic actions. Without proper inputs and clear vision, they are doomed to be failure in their projects. Sunway City Berhad has successfully developed the Bandar Sunway, a self-contained township, through its four main strategies, that is, Philosophy (vision); Research & Development (strategic inputs); Planning (strategic formulation); and Commitment (strategic action). Details of its four main strategies are as follow.

Philosophy – to create a conducive environment where people can live, work, study, and play.

Research & Development – customers wants to live in townships, not just residential estates. Market research was carried out on what the best usage of the land should be, and what is lacking in the market. A product differentiation was conceptualized – a fully integrated township where customers can live, work, study and play. Customers not only buy the product, but a vision of 'Resort Living Within the City'.

Planning – in 1987, the company sponsored a competition organized by the Architect Association of Malaysia (PAM) to identify the most suitable type of development and the best layout proposals for the land (over 800 acres). A number of ideas were drawn from this event, which later served as a base from which a scheme was developed by the Hawaiian master planner, Helbert, Hastert & Kimura; together with landscape architect, Tongg, Clarke & Mechler. Extensive landscaping and intensive urban planning have contributed to the beautification of this premier township. Roads are neatly aligned, the streetscape is pleasantly consistent with coordinated designs for gates and fences and streetlamps are strategically placed. Facilities include healthcare, education, shopping, hospitality and entertainment.

Commitment – to complete, self-contained township is testimony to our commitment to our customers.

According to Wong Choon Kee, Managing Director of Sunway City Berhad, research and development is vital to any successful property development as the products are market driven. Timing is also crucial when planning for a successful property development. For example, if the economy is going through a recession, the development should be geared to more lower cost, value-for money accommodation. This ties back to research and development as well, whereby customer needs have to be determined in order to come up with appropriate products (Wong, 2000).

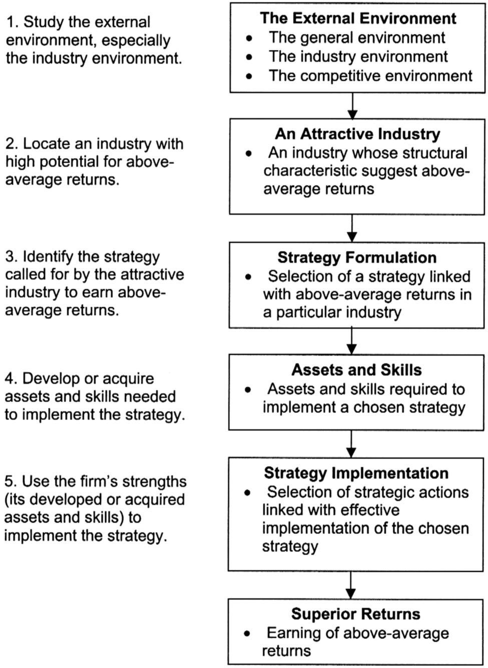
The Industrial Organization (I/O) Model of Above-Average Returns

The I/O model explains the dominant influence of the external environment on firm's strategic actions. This model specifies that the chosen industry in which to compete has a stronger influence on a firm's performance than do the choices managers make inside their organizations. Firm performance is believed to be predicted primarily by a range of an industry's properties, including economics of scale, barriers to entry, diversification, product differentiation, and the degree of concentration.

The I/O model challenges firms to locate the most attractive industry in which to compete. Because most firms are assumed to have similar strategically relevant resource that are mobile across companies, competitiveness generally can be increased only when they find the industry with the highest profit potential and learn how to use their resources to implement the strategy required by the structural characteristics in that industry. The *five forces model of competition* is an analytical tool used to help firms with this task. This model encompasses many variables and tries to capture the complexity of competition. This model will be explained in detail later.

The I/O model suggests that above-average returns are earned when firms implement the strategy dictated by the characteristics of the general, industry, and competitive environments. Companies that develop or acquire the internal skills needed to implement strategies required by the external environment are likely to succeed, while those that do not are likely to fail. As such, above-average returns are determined by external characteristics rather than the firm's unique internal resources and capabilities (Hitt et al, 1999). Figure 2 shows the I/O model of Superior Returns.

Figure 2: The I/O Model of Superior Returns



Source: Hitt et al, 1999 p.20

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The Resource-Based Model of Above-Average Returns

The resource-based model assumes that each organization is a collection of unique resources and capabilities that provides the basis for its strategy and is the *primary* source of its returns. In the new competitive landscape, this model argues that a firm is a collection of evolving capabilities that is managed dynamically in pursuit of above-average returns. Thus, according to this model, differences in firms' performances across time are driven *primarily* by their unique resources and capabilities rather than by an industry's structural characteristics. This model also assumes that over time, a firm acquires different resources and develops unique capabilities. As such, all firms competing within a particular industry may not possess the same strategically relevant resources and capabilities. Another assumption of this model is that resources may not be highly mobile across firms. The differences in resources form the basis of competitive advantage.

In contrast to the I/O model, the resource-based view is grounded in the perspective that a firm's internal environment, in terms of its resources and capabilities, is more critical to the determination of strategic actions than is the external environment. Instead of focusing on the accumulation of resources necessary to implement the strategy dictated by conditions and constraints in the external environment (I/O model), the resource-based view suggests that a firm's unique resources and capabilities provide the basis for a strategy. The strategy chosen should allow the firm to best exploit its core competencies relative to opportunities in the external environment.

Not all of a firm's resources and capabilities have the potential to be the basis for competitive advantage. This potential is realized when resources and capabilities are valuable, rare, costly to imitate, and non substitutable. Resources are *valuable* when they allow a firm to exploit opportunities and /or neutralize threats in its external environment; they are *rare* when possessed by few, if any, current and potential competitors; they are *costly to imitate* when other firms either cannot obtain them or are at a cost disadvantage to obtain them compared to the firm that already possesses them; and they are *non substitutable* when they have no structural equivalents.

When these four criteria are met, resources and capabilities become core competencies. *Core competencies* are resources and capabilities that serve as a source of competitive advantage for a firm over its rivals. Often related to a firm's functional skills (example, the marketing function is a core competence at Philip Morris), the development, nurturing, and application of core competencies throughout a firm may be highly related to strategic competitiveness. Managerial competencies are important in most firms. For example, such competencies have been shown to be critically important to successful entry into foreign markets. Such competencies may include the capability to effectively organize and govern complex and diverse operations and the capability to create and communicate a strategic vision. Another set of important competencies is product related. Included among these competencies are the capabilities to develop innovative new products and to reengineer existing products to satisfy changing customer tastes. Competencies must also be under continuous development to keep them up-to-date. This requires a systematic programme for updating old skills and learning new ones. Dynamic core competencies are especially important in rapidly changing environment such as those that exist in high technology industries. Thus, the resource-based model argues that core competencies are the basis for a firm's competitive advantage, its strategic competitiveness, and its ability to earn above-average returns. Figure 3 shows the Resource-Based Model of Superior Returns (Hitt et al, 1999).

Figure 3: The Resource-Based Model of Superior Returns

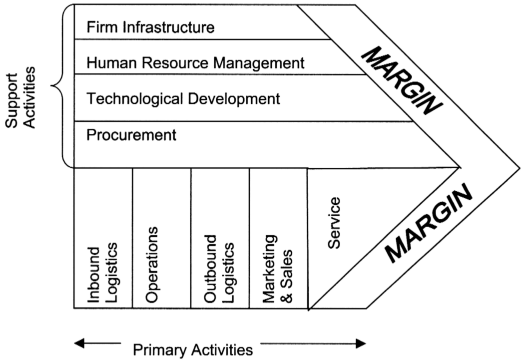
1. Identify the firm's resources. Study its strengths and weaknesses as compared to those of competitors.	**Resources** • Inputs into a firm's production process
2. Determine the firm's capabilities. What do the capabilities allow the firm to do better than its competitors?	**Capability** • Capacity of an integrated set of resources to integratively perform a task or activity
3. Determine the potential of the firm's resources and capabilities in terms of a competitive advantage.	**Competitive Advantage** • Ability of a firm to outperform its rivals
4. Locate an attractive industry.	**An Attractive Industry** • An industry with opportunities that can be exploited by the firm's resources and capabilities
5. Select a strategy that best allows the firm to exploit its resources and capabilities relative to opportunities in the external environment.	**Strategy Formulation and Implementation** • Strategic actions taken to earn above-average returns
	Superior Returns • Earning of above-average returns

Source: Hitt et al, 1999 p.23

The Basic Value Chain Model of Analysis

The value chain is a template that firms use to understand their cost position and to identify the multiple means that might be used to facilitate the implementation of their business-level strategy. A firm's value chain can be segmented into primary and support activities. *Primary activities* are involved with a product's physical creation, its sale and distribution to buyers, and its service after the sale. *Support activities* provide the support necessary for the primary activities to take place. The value chain shows how a product moves from the raw material stage to the final customer. Figure 4 shows the Basic Value Chain Model of Analysis (Hitt et al, 1999).

Figure 4: The Basic Value Chain Model of Analysis



Source: Hitt et al, 1999 p.105

Table 8 lists the items to be studied to assess the value-creating potential of primary activities. In table 9, the items to consider when studying support activities are shown. As with the analysis of primary activities, the intent in examining these items is to determine areas where the firm has potential to create and capture value. All items included in both tables are to be evaluated with competitors' capabilities in mind. To be a source of competitive advantage, a resource or capability must allow a firm to (1) perform an activity in a manner that is superior to competitors' performances or (2) perform a value-creating activity that competitors cannot compete. Only under these conditions does a firm create value for customers and have opportunities to capture that value. Sometimes, this requires firms to reconfigure or recombine parts of the value chain in unique ways. Alternatively, firms should study the possibility of outsourcing the work associated with primary and support activities in which they cannot create and capture value (Hitt et al, 1999).

Table 8: Examining the Value-Creating Potential of Primary Activities

Inbound Logistics
Activities, such as materials handling, warehousing, and inventory control, used to receive, store, and disseminate inputs to a product.
Operations
Activities necessary to convert the inputs provided by inbound logistics into final product form. Machining, packaging, assembly, and equipment maintenance are examples of operations activities.
Outbound Logistics
Activities involved with collecting, storing, and physically distributing the final product to customers. Examples of these activities include finished goods warehousing, materials handling, and order processing.
Marketing and Sales
Activities completed to provide means through which customers can purchase products and to induce them to do so. To effectively market and sell products, firms develop advertising and promotional campaigns, select appropriate distribution channels, and select, develop, and support their sales force.
Service
Activities designed to enhance or maintain a product's value. Firms engage in a range of service-related activities, including installation, repair, training, and adjustment.
Each activity should be examined relative to competitors' abilities. Accordingly, firms rate each activity as superior, equivalent, or inferior.

Source: Hitt et al, 1999.

Table 9: Examining the Value-Creating Potential of Support Activities

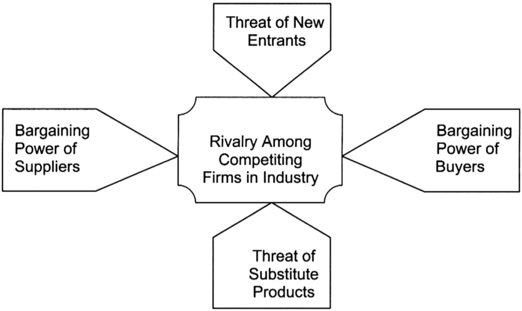
Procurement
Activities completed to purchase the inputs needed to produce a firm's products. Purchased inputs include items fully consumed during the manufacture of products (e.g., raw materials and supplies as well as fixed assets – machinery, laboratory equipment, office equipment, and buildings).
Technological Development
Activities completed to improve a firm's product and the processes used to manufacture it. Technology development takes many forms, such as process equipment, design, both basic research and product design, and servicing procedures.
Human Resource Management
Activities involved with recruiting, hiring, training, developing, and compensating all personnel.
Firm Infrastructure
Firm infrastructure includes activities such as general management, planning, finance, accounting, legal support, and governmental relations that are required to support the work of the entire value chain. Through its infrastructure, the firm strives to effectively and consistently identify external opportunities and threats, identify resources and capabilities, and support core competencies.
Each activity should be examined relative to competitors' abilities. Accordingly, firms rate each activity as superior, equivalent, or inferior.

Source: Hitt et al, 1999.

Porter's Five Forces Model of Competition

Compare to the general environment (economic, socio-cultural, global, technological, political/legal, and demographical), the industry environment has a more direct effect on strategic competitiveness and above-average returns. The intensity of industry competition and an industry's profit potential (as measured by the long-run return on invested capital) are a function of five competitive forces: the threat of new entrants, suppliers, buyers, product substitutes, and the intensity of rivalry among competitors. Figure 5 shows Michael Porter's Five Forces Model of Competition (Hitt et al, 1999).

Figure 5: Porter's Five Forces Model of Competition



Source: Hitt et al, 1999 p. 61

Developed by Michael Porter, the five forces model of competition expands the arena for competitive analysis. The five forces model recognizes that suppliers could become a firm's competitor (by integrating forward), as could buyers (by integrating backward). Additionally, firms choosing to enter a new market and those producing products that are adequate substitutes could become competitors for an existing company. The following explains the five forces in details.

Threat of New Entrants

New entrants to an industry can threaten existing competitors. New entrants bring additional production capacity. Unless product demand is increasing, additional capacity holds consumers' cost down, resulting in less sales revenue and lower returns for all firms in the industry. In the property market, overhang can result if demand is not increase as happened in the recent economic downturn. The likelihood that firms will enter an industry is a function of two factors: barriers to entry and the retaliation expected from current industry participants. Barriers to entry may consist of (1) economics of scale, (2) product differentiation, (3) capital requirements, (4) switching costs, (5) access to distribution channels, (6) cost disadvantages independent of scale, and (7) government policy.

Bargaining Power of Suppliers

Increasing prices and reducing the quality of products sold are potential means through which suppliers can exert power over firms competing within an industry. For example, suppliers of cement and other building materials can exert power on housing developers through increasing prices and reducing quality of materials. If unable to recover cost increases through its pricing structure, a firm's profitability is reduced by the supplier's actions. A supplier group is powerful when (1) it is dominated by a few large companies and is more concentrated than the industry to which it sells; (2) satisfactory substitute products are not available to industry firms; (3) industry firms are not a significant customer for the supplier group; (4) suppliers' goods are critical to buyers' market place success; (5) the effectiveness of suppliers' products has created high switching costs for industry firms; and (6) suppliers are a credible threat to integrate forward into the buyers' industry. Credibility is enhanced when suppliers have substantial resources and provide the industry's firms with a highly differentiated product.

Bargaining Power of Buyers

Customers (buyer groups) are powerful when (1) they purchase a large portion of an industry's total output; (2) the product being purchased from an industry accounts for a significant portion of the buyers' costs; (3) they could switch to another product at little, if any, cost; and (4) the industry's products are undifferentiated or standardized, and they pose a credible threat if they were to integrate backward into the sellers' industry.

Threat of Substitute Products

Substitute products are different goods or services that can perform similar or the same functions as the focal product (functional substitute). Capable of satisfying similar customer needs, but with different characteristics, substitute products place can upper limit on the prices firms can charge. In general, the threat of substitute products is strong when customers face few, if any, switching costs and when the substitute product's price is lower and/or its quality and performance capabilities are equal to or greater than the industry's products. Caravans are close but not perfect substitutes for houses. To reduce the attractiveness of substitute products, firms are challenged to differentiate their offerings along dimensions that are highly relevant to customers (example, price, product quality, service after the sale, and location). For instant, developers offered service apartments as a differentiated product to house buyers.

Intensity of Rivalry among Competitors

Competition among rivals is stimulated when one or more firms feel competitive pressure or when they identify an opportunity to improve their market position. Competition among rivals is often based on price, product innovation, and other actions to achieve product differentiation (such as extensive customer service, unique advertising campaigns, and extended product warranties). The *intensity* of competitive rivalry among firms is a function of several factors: (1) Numerous or Equally Balanced competitors; (2) Slow Industry Growth; (3) High Fixed or Storage Costs; (4) Lack of Differentiation or Low Switching Costs; (5) Capacity Augmented in Large Increments; (6) Diverse Competitors; (7) High Strategic Stakes; and (8) High Exit Barriers (Specialized Assets; Fixed cost of exit; strategic interrelationships; emotional barriers; government and social restrictions). (Hitt et al, 1999).