Strategic Management – The Competitive Edge
Professor R Srinivasan
Department of Management Studies
Indian Institute of Science, Bengaluru
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BEA, Doom Loops, Corporate Strategy, Portfolio Analysis

Welcome to this session. In the last class, we were looking at breakeven analysis, the experience curve how it is useful in the manufacturing scenario just to refurbish whatever we have done this breakeven analysis can be put in terms of a few equations.

The total cost with respect to any product can be written down as fixed cost-plus variable cost multiplied by the quantity; the total revenue that you get can be written down as price for the product that you are charging, that is a company is charging multiplied by the quantity sold; at breakeven point, the total revenue should be equal to the total cost.

So, the price that is charged at breakeven point that is P multiplied by quantity of breakeven should be equal to FC plus VC variable cost multiplied by quantity of breakeven. So, this quantity of breakeven can be put down as fixed cost divided by P minus VC, where P minus VC refers to the unit contribution with respect to the product.

We also discussed about sensitivity analysis; We found that suppose we increase the variable cost, it has got marked effect on the breakeven point. The end result is it eats up the profits. Decrease in variable costs improves profitability.

Suppose you are having experience to produce same product over and over again this is, what happens in a manufacturing scenario. After several trials, the worker would have achieved a certain level of experience that is where we said suppose he is operating on the 80 percent experience curve at two units suppose, this is the cost. Suppose we increase the production by four this will be the cost. So, that is a way we looked at in experience curve.

But, the cost cannot come down to a very large extent that also we saw when we said when it goes up when on the 80 percent curve, if he goes up to 16 if he is able to produce up to 16 units, then the cost per unit will come down to 51. So, this is where experience curve is very useful in the manufacturing shop scenario.

This is also the handicap of the public sector units. Even a very good worker cannot be given exra incentives.So, these are some of the issues which public sector has to address in order to compete in this global scenario, how to overcome these disadvantages. So, the manager should be given discretionary powers to award an incentive or some other method by which this good worker is recognized in the shop floor. This is essential for the survival of the public sector, especially the manufacturing sector. So, this is what has been observed after the public sector units were opened to competition from 1984 onwards.

So, when you look at the sensitivity analysis with respect to breakeven point, fixed costs, variable costs and price. So, a decrease in fixed costs results in decrease in breakeven point. So, if you can reduce the fixed costs, then the breakeven point is likely to come down but it is difficult task; profitability at a particular volume of production improves with lower fixed costs. Companies always look at the variable cost component; suppose variable cost is reduced, it improves profitability also, this is where experience curve becomes useful. So, increase in permissible price, breakeven point comes down and vice-versa; at a particular volume of production, profitability improves; price is the most sensitive instrument followed by variable costs and fixed costs.

The points that we mentioned till now are applicable to the linear breakeven analysis; suppose, it is non-linear, it may happen sometimes. When it happens, prices may be consciously reduced to gain additional sales volume and market share or in response to competitors actions. So, this we will discuss in a few minutes with respect to the Doom loops.

So, what are the assumptions that you are making? Fixed cost is fixed for all production volumes. So, sometimes unrealistic with respect to breakeven analysis, then variable costs do not fall with increasing level of production- not true where the experience curve is very helpful.

Total costs and total revenue vary in linear relationship, may not really vary always linearly sometimes you may have nonlinear relationships also. Maximize profit before interest and tax is the desirable business objective. So, many times this is the usual objective of any business unit, what does a business unit want at least in the present-day context, if you look at it, it wants to maximize its profit.

Now, a few points before we go to dooms loop, we discussed all this with respect to this experience curve. So, if you see, this experience curve relationship is a good framework for marginal considerations for predicting industrial scenario. So, with respect to future costs, profit margins and corresponding cash flows for own and competitors operations.

Global markets, marketing efforts should be fully coordinated with manufacturing plants in lowering prices should not be with inferior quality. Suppose you say I want to lower the price and the quality also will come down then it is not a good thing to do for a company. So, you should always keep a very sensitive eye on the quality of the product.

I will give you some a very simple example. There are so many tawa which are put out by different brands of companies. Some of them are local brands some of them are well known brands. Now, the catch for the housewife as always has been the price.

So, the local brands price their product at a much lower rate saying that at this price itself, we can give you the same type of products as produced by the well-known brands or the well-known companies. Now, when the product is actually put to use, I took this example of this tawa for the simple reason, in fact, we did a very small market research on this how is a tawa which is made by local companies faring in the actual scenario?

So, when when we got the feedback from the housewives more than 75 percent of them are not satisfied; we are not happy with this local tawa, what is the reason? They were giving so many examples suppose they put the dosa on the tawa the dosa flour itself gets stuck to the tawa which does not happen with a brand like Prestige where it can be easily taken out.

So, a lot of market intelligence has to be done. A late market entrant has to operate at lower initial prices to survive.

So, do not always look at being the prime mover in the market; even if you are second mover also, the second bite of the apple is good enough that is what we say. But more and more players into the market, you may find when you are a late entrant into that market space, you may have to operate at lower initial prices to survive. When you have to operate at lower initial prices, you may find that you are not breaking even.

MSMEs under lot of stress to decrease the price of the product to move the product in the marketplace, then in the bargain getting stuck with so many problems the worst problem they face is the working capital. So, these are things which are inevitable in a competitive market.

Now with all this we look at one Doom loops. What is this doom loop? We will illustrate it in the figure very shortly. Doom loops are a self reinforcing process. It is like a whirlpool type of scenario. So, you are really going round and round but not able to come out of this -similar to what you call the Chakravyuha scenario in the Mahabharat war.

Drives an organization into cyclical situations from which an organization finds it difficult to extricate itself.

To avoid getting into a doom loop it is required to constantly upgrade the products, services and efficiency of distribution channels. So, what does it mean? It means that in order to avoid getting into this trap, you should keep on upgrading your products.

What do you mean keep on upgrading your products? That is you must and should concentrate on innovation. So, keep this innovation in an organization a continuous process, because there are so many competitors who will duplicate the product in a very short time.

So, you must constantly innovate so that competitor will find it difficult to copy the product; to get out of a doom loop refocus on small business units and a change has to be brought about in the firm's culture. What do you mean? Suppose, the company introduces a product the competitor also comes out a product.

Then the market thinks that the competitors product is better than the company's product, then the employees of the company think that they can also do better than the competitor, but for that investment is required and you are not able to invest then it will be looked down that is company will be looked down;it will be a disadvantage for the company because you are getting stuck; the morale of the employees will come down all this is presented by this figure.

This figure is also available to you in the book on strategic management, but anyhow, we will try to explain this figure - see what happens; firm cuts its price to hold onto the market share.Let us say the firm had certain percentage of the market share firm predators have come into the marketplace and they are eating into the company's market share; when they are eating into the company's market share how to keep them at bay.

So, the firm has to act. So, it takes the best method of acting. So, price is the best sensitive instrument. So, the firm tries to cut down the price in order to hold on to its market share not allow the competitor to run away. Now, what does the competitor do?

The competitor matches the company's price that is you reduced it by say X, he may reduce it by X or even X minus delta X. So, that might be lower than the company's product and yet is profitable. What does it mean- he may be operating at a higher level of experience curve than yours and in addition, he may be innovating and developing better products at a lower cost.

So, you may be paying a lot of attention to product innovation, which you as a company may not be doing now; competitor gains market share at the firm's expense. So, the market share of the company comes down- the market share of the competitor goes up;the company gets trapped in this dooms loop.

Now, in order to get out of this loop, the firm also has to innovate; if it does not innovate, then it is likely to be pushed out of the market that is also happening with respect to MSMEs. Now, in order to innovate, the company requires reinvestment. This reinvestment is possible provided the company has got good margin

MSMEs do not have great reserves. So, then even if the employees are willing to innovate, the firm is not able to give them the adequate support. Now, when you are not able to innovate in the marketplace, the employees become demoralized, because the company is not able to support this innovation drive.

Now, what happens in the ultimate analysis the quality of the product and the services become poor. So, this is what we found especially in the COVID period, where many of the MSMEs in addition to the usual problems, found that the market response to products was very poor, that is, even if you come out with a good product, the market was not responding with same trust, which it was doing earlier, that is pre COVID period.

So, in order to push the product, you had to reduce the price, reducing the price involved, so many things. So, all this contributed to a great hit that the MSMEs took in the COVID period with respect to economy. So, this is the Dooms loop. It is like a vortex where if the firm gets stuck there, it is very difficult for the firm to extricate itself from these dooms loop.

Especially after this COVID-19 you find that many people have lost their jobs, also the reasons might be manifold maybe the projects got dried up for the company.

So, the company felt that there was no way this workforce could be engaged. So, whatever might be the reason, an IT company especially, has to keep on evaluating its strategy continuously in the present-day context. So, the point that comes out is what is going to be the growth of the company- will it be stable should we go in for retrenchment of employees, all those types of issues.

This is referred as directional strategy. So, when you address these issues, you are giving a direction to the organization. Then, before company takes up serious issues of retrenchment of employees. It keeps on evaluating its options. Should they be retrenched or not retrenched?

So, in order to do that, the company starts evaluating its products or business units. So, what is the type of products or business units the company is in and how is market reacting to that, this is what is called portfolio strategy. So, when you are looking at different portfolios of the company then you have to provide a strategic direction to each of these business units.

A business unit might be having several product lines, each product line might be having different products also that is a different versions of the product. Then the third aspect of this corporate strategy refers to activity coordination and transfer of resources for achieving capabilities among product lines and business units.

This is referred to as parenting strategy. So, you have to coordinate the activities and the resource transfer across different business units. A company might be having several business units as I told you, and each business unit might be having several product lines. So, at the company level all these business units have to be provided with a parenting strategy these business units are treated like children and company as the parent so, they do this.

The main reason for doing all this is to get relative cost advantage with respect to products and product lines and also to devise a competitive strategy in the marketplace. So, as I have told you in the previous sessions, competitive strategy can come to a company basically out of the core competencies of the firm. So, from the core competencies of the firm, company has to come out with the competitive strategy.

If the competitive strategy were to sustain for a reasonably long period in the marketplace, then it becomes a distinctive competence or for the company. So, that is what we were discussing with respect to this company Gillette and its product Mach 3 I can give one or two examples from the Indian context on this the example that I have taken instead of Modi Tyres initially entered largest product segment that is truck tyres with latest technology and lower prices.

The caption that the company adopted was good value for money subsequently matched the market leaders' price and displaced him by capturing higher market shares.

The second example that I wanted to give you is that of Hero Cycles in order to get competitive advantage and also to have competitive strategy and cost advantage in the marketplace. What it did was dropped irrelevant product attributes. So, a company like Hero Cycles started subcontracting production of its parts. So, this production of its parts subcontracting and then dropping of these irrelevant product attributes has helped Hero Cycles even to this day.

So, it is one of the sought after cycles in the Indian market. Now, when we want to do a portfolio analysis what is it that we are guided by: portfolio analysis looks at corporate investments in different products or industries SBUs. when you are looking at investments in different products or industries, you have to do a fine balancing act.

This fine balancing act can be with respect to net cash flow, state of development and the risk; what do we mean by net cash flow- how much is the money that is flowing into the company maybe through sales revenues or whatever other income , then what is it that is going out and what is remaining as net.

So, this constitutes as we have discussed earlier strong point towards the health of the company, the higher the reserve of the company, the better is the health of the company. So, that is where we were discussing some of the IT companies like Infosys where its reserve position is very good.

So, it can take decisions on M & A that is mergers and acquisitions without having to source external cash flow because the reserve position is very strong. The second is the state of development with respect to an SBU a particular product might be a new product or being introduced for the first time then how do we go about balancing this?

So, when you are having a product introduction, it is always accompanied by teething problems, you have to work very hard to move this product in the BCG matrix, which we will discuss very shortly from the quadrant of question marks, to stars; when you are in the question marks, you do not know what is going to be the future of this particular product.

So, there you have to show all your capabilities to see whether these question marks can move to stars with respect to this product or the product line. Then, in the present day context what you are seeing many of the Indian firms are wary of taking risk. This attitude has to change, but now, we are seeing changes happening on this level also.

So, whatever might be some of the negative points, as an entrepreneur, the company should be willing to take risks. So, this risk-taking ability many times invariably will pay off. So, this is what has happened to many of the companies in the US also there is no reason to think why it will not happen to Indian companies. The results we are seeing of companies where they have taken risks, many of the IT companies have come out well. In order to do all these analysis of these portfolios. We make use of what is called the display matrices. We will be discussing in the coming classes.

Some five display matrices one is the BCG matrix second is the GE matrix or the McKinsey matrix, The third is the Strategic planning Institute's matrix that is the Profit Impact of Market Strategy,PIMS matrix. The fourth is the Arthur D Little companies' matrix. The fifth is the Hofer's product or the market evaluation matrix. So, we will stop here. We will continue with the BCG matrix in the next class. Thank you.