

Strategy

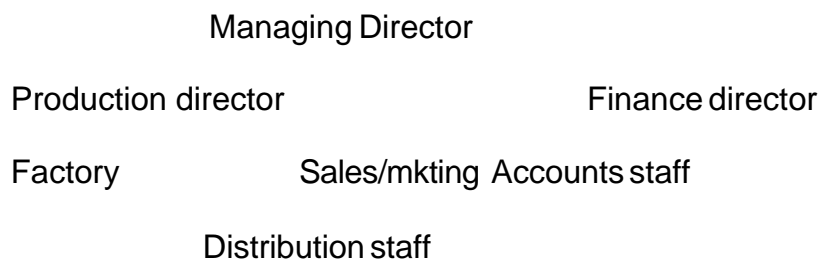
Tochnics

You have just been appointed to the post of managing and marketing director of Tochnics, which is based, along with its competitive companies in the capital city of Eternia. Your responsibility is to develop a strategy for the company over the next few years, in the face of a rapidly changing economic and competitive environment. You have to find a policy that will build competitive advantage which will make the company steadily more profitable.

Success in business is a central feature of life in Eternia; though managerial jobs are not highly paid, they provide the only access to individual advancement. Effective business managers are given honours such as the Eternian Golden Peanut which opens all doors in Eternian high society. On the other hand, unsuccessful managers are given a free transfer to helping penguins at the South Pole.

Tochnics in the first year of operation produced a single product, the radion. This, and other competitive products - which were identical in specification and price - were sold in both the department stores and electrical shops in Eternia. All companies in the market were profitable and there was limited international competition, though a wide range of advanced electronic products such as audions, telions and videons were smuggled in from the neighbouring and the slightly larger market of Hysteria, with a population of 15 million, but with a standard of living 20 per cent above that of Eternia.

Your company at the time were appointed has the following structure



The company employed around 50 staff; there were 30 in the production and distribution department, 10 in the sales and marketing department and 10 in the finance division. All staff have good qualifications and you are happy with the general attitudes within the organisation. The fixed costs of the operation are currently &5 million per annum. (The local currency was the Anda (&): 1 Anda = 100 Andinas).

The country

Eternia is a small country in the Mediterranean, with a population of 10 million. It has had a stable political system with two major parties, the Social Democrats and the Liberal Conservatives, alternately occupying office since the 1960s. The political parties had concentrated on maintaining high tariff barriers to protect local industry, and to reduce the level of imported products, while investing substantially in education to improve the skills of the workforce. Both political parties had supported local industry with soft loans, with the result that all market segments tended to be highly fragmented with a large number of companies in each sector. Recently the government has started negotiations to join the European Community, and it was likely that the country would join the Community within

the next few months.

EC membership would inevitably mean the tariff barriers against foreign firms - Sony, Akai, Phillips and others - would be removed. It is not clear initially how rapidly this will occur. Foreign competition would have a significant impact on the entire electronics sector. In neighbouring markets a range of new products had become available: the telion, audion, and videon. In these markets, these new products had substantially replaced the traditional radion with the new electronic items, so it was likely that trends in Eternia would not be significantly different. But the lower standard of living in Eternia was likely to reduce the speed at which certain products penetrated the market. These changes would create substantial opportunities as well as problems for the electronic firms currently established in Eternia. Your problem is to ensure that Tochnics is one of the successful operations, as you do not like penguins.

The government of Eternia had always rigorously enforced anti-monopoly legislation; no firm was allowed more than 20 per cent of any one market sector. With membership of the EC, this rule was likely to change. Already the government was encouraging the development of businesses that could compete effectively against other European firms. Economic growth had been fairly rapid, thanks largely to the emergent textile and tourist industries. Inflation rates had remained low and the exchange rates against the major currencies had remained stable over the last 3 years. The growth in the economy allowed the government to cut taxes, especially on consumption, so disposable incomes had grown significantly. Coupled with low levels of unemployment this meant that there was now a large level of unfulfilled consumer demand. As savings rates had traditionally remained high, it was uncertain what the exact consequences of joining the Community would be and whether inflation would rise as a result. Taxes on corporations remained high at 50 per cent, though there were signs that these would be reduced as government revenues swelled.

Family life in Eternia was important. Though the population was slowly ageing in common with other European countries, household sizes remained high, averaging 5.1, and the pattern of family development was to remain at home until the middle twenties. The Eternian consumer was fairly sophisticated largely due to foreign travel and inward tourism, which created a significant demand for high quality products.

The market

The market for radions has remained stable for a number of years with consumers buying replacement units on a fairly regular basis. The trends in the radion market are provided in Table 15A, together with a forecast for the following year provided by the government market research unit, EPIC.

Table 15A. Changes in radion market, with market size in & millions.

Year					
1	2	3	4	5*	6*
100	110	120	125	130	135

(* projected)

Because there had historically been so little price competition, price elasticity remained an unknown factor but was likely to be fairly high, with so many competitive products, and because consumer expectations had been created by the previous pricing policies in the

market (Table 15B). Price elasticities in the new product areas would however be fairly low for the first year or so, as there was a substantial amount of pent up demand. But, being unable to sell the stock that you produce will displease the Eternian Industrial Board. The Board monitors stocks closely, confiscates unsold stocks from companies that over-price, and dumps them in international markets. This drastic action has stimulated companies to plan accurately on pricing and production as some companies had moved rapidly from profit to loss caused by miscalculations on production volumes.

Table 15B. Market average price for radions in Eternia - at msp in &.

1	2	3	4	5	6*
25	26	26	27	27	28

(*projected)

For comparison, the market for electronic products in the neighbouring country of Hysteria had shown a very different developmental pattern over the last 5 years, as Table 15C demonstrates.

Table 15C. Sales of electronic products by value over previous 5 years in Hysteria converted to Eternian & (total market sales value at manufacturing selling prices).

	1	2	3	4	5
Radion	55	50	45	40	30
Audion	190	150	140	100	110
Telion	250	270	230	210	180
Videon	85	125	240	350	310

Research made available to all the electronic companies by the state research group, EPIC, showed that the margins and manufacturers' selling prices were substantially higher in these new product ranges. The average unit selling price and margin in Hysteria are in Table 15D. From this Table you are can calculate the manufacturing cost for each product. Remember that this is only a rough guide; the market in Eternia is likely to follow its own developmental path.

Table 15D. Average manufacturers selling price and margins in Eternian & converted from Hysterian?

Product	Manufacturers' selling price	Margin %
Radion	22	4
Audion	55	20
Telion	120	50
Videon	200	100

The research report indicated that the way in which the Hysterian market had developed had few similarities to many of the other European countries; and that new features and promotional expenditure were a vital factor in the success of companies selling in the telion and videon markets.

Electrical retailing had always been highly fragmented in Eternia. Land was cheap and many families had set up shops in the 1950s. The Eternian retailer believed in providing a high level of service, which was guaranteed by a government training scheme which required each employee to pass stringent retailing diplomas. The retailers stocked all the products available in the market, to provide customers with the best possible service.

Physical distribution was no problem as all the electrical retailing outlets were established in the main towns of Plumbing, Heating, Cooking, Lighting and Showering, all of which were close to the centres of production.

Resources

Tochnics has a representative share of the audion market, with each audion produced selling at a margin of 25 per cent, or &7 per unit. On a turnover of 1 million units, the company would have the cost structure in Table 15E.

Table 15E Tochnics - company cost structure (&)

Revenue

Sales	27,000,000
Cost of sales	20,000,000
Net income	7,000,000
Fixed costs	5,000,000
Profit	2,000,000
Tax	1,000,000
Net revenue	1,000,000

The success of policies over the past 10 years had enabled the company to build up a reserve of &5 million. This cash reserve was currently held by the Eternian Reserve Bank, and yielded 3 per cent interest per year. The government maintained a close watch over all manufacturing companies; all money had to be banked in the ERB, with individuals and corporations holding equity stakes in the manufacturing sector via the Eternian Investment Bond. Individual companies could raise additional finance by approaching the ERB, which would then grant the loan on certain conditions.

Much of the remaining profits had been allocated, by the previous director, to sophisticated manufacturing equipment. This system was so flexible that it could produce a wide range of alternative electronic products, with each unit of radion production equivalent to one audion, telion or videon. The manufacturing system would handle up to 1.5 million units of production; additional manufacturing plants would need a capital investment of around &30 million.

Costs of options

There are a variety of ways in which the resources that you have at your disposal can be spent.

1. Product withdrawal. You estimate that there would be costs incurred in withdrawing from any particular market, if the sales of any one particular item falls below 100,000 units. This would depend on the exact ruling of the Eternian Industrial Board, but was likely to be in the region of &500,000.

2. Cost reduction. Money spent on sourcing new materials and improvements in the training of staff would have a significant effect on the reduction of cost, and therefore on margins. Your production director has estimated that each &200,000 spent in this way would improve margins by 5 per cent. The cost saving would only apply to one particular product type; should you decide to change the product range these savings are not transferable. You are also aware that research suggests that as you produce more of one product, costs are likely to fall as the labour force learns to make the product more effectively, but you do not know what effect this might have on prices.

3. Promotion. You are aware that increased promotional expenditure would substantially

increase the overall market size for the company products, and more importantly, its market share. There are three options open: to concentrate on sales promotion, media promotion or a combination of both. Experience from other markets suggest that Tochnics could gain an additional 10 per cent market share through each &2 million expenditure on sales promotion, though this would depend on limited activity by the competition. Such an investment would have an immediate effect on sales, but would - in common with the expenditure on cost reduction - only have an effect on one particular product range. Sales promotion would not have any long term effects, acting only in one particular market sector for one particular year.

Media promotional expenditure would have an effect across the entire product of the company. Research in Hysteria suggested that an expenditure of around &1.5 million could increase sales by around 12 per cent, but this growth in sales would not occur immediately; there would be a significant lag factor while the advertising took effect. However, media promotion would be cumulative in building up the company's position in the market place.

4. Product quality. The improvement in product quality would enable Tochnics to either increase market share, or profitability, or both. A &100,000 investment in research and development would significantly improve product quality. This would strengthen the company's market position - if the competition did not upgrade their product as well. Exactly what this achieve would become clearer as the market research revealed product and pricing positions. Additional investment would enable the company to further improve their position. This expenditure would again only be relevant to one particular product. The investment in product improvement also required time to take effect. It was anticipated that investment in product improvement would take one period or year before it came into effect. This would mean that an investment in year 1 would only effect the sales of the product in year 2.

5. Product development. Tochnics could also invest in product development in the potentially new markets of the audion, telion, and videon markets. The move into each of these markets would have different potential costs and speed of achievement (how quickly the company could get the product into the market). Details are in Table 15F. For example, a decision in period 1 to develop audions would enable them to be introduced in period 2; a decision to introduce telions and audions taken in period 1 would lead to manufacture in period 3. The government research group, EPIC will provide analyses of market sizes of each of these product groups on a period by period basis; it is likely that - with the decline in import tariffs - these markets will initially be dominated by foreign brands, but these will remain much more expensive throughout the foreseeable future.

Table 15F. Costs and potential time scale of new product development by sector.

Sector	Costs	Time scale (period/year)
Audion	&300,000	1
Telion	&800,000	2
Videon	&1,500,000	2

Your task

You have the responsibility for the development of Tochnics over the next few years. This will require you to set goals and take decisions on action. Remember that you compete with other companies: and what the other companies do will change the market. Each period you will receive a report on the outcome of your decisions and a brief economic, political and social report from EPIC with a rough market forecast for the next year.

All plans have to be presented to the Eternian Industrial Board. Should they fail to be presented on time, the board will order the company to continue an identical policy to that of the preceding year. The format of the plan is given below. To it you should attach a statement of what you are trying to achieve in the particular market conditions that you face and how this relates to the long term objectives that you have set for the company. In addition you should include estimates of what you think each market sector will contain for the following period.

Action

You need to produce a plan for the company which includes sales volumes, your pricing decisions, the costs of production, your investment policy and the likely effect that you think that this will have on your cash flow. To help you with this calculation a framework is provided to help you think through the various problems.

- * How are you going to build competitive advantage?
- * What are the market sectors going to do?
- * What are your competitors likely to do?
- * Should you be cautious or adventurous?