

**Subject: Management**

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**Paper: 3, Strategic Management**

**Module: 15 Defensive Strategies**



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Items	Description of Module
<b>Subject Name</b>	Management
<b>Paper Name</b>	Strategic Management
<b>Module Title</b>	defensive Strategies
<b>Module Id</b>	15
<b>Pre-Requisites</b>	Basic Knowledge of Business Environment
<b>Objectives</b>	To understand the stability, defensive/ retrenchment and combination corporate level strategies.
<b>Keywords</b>	Defensive strategies, corporate level strategies.

<b>Module 15: Defensive Strategies</b>
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## 1.1 Learning Objectives

Following are the learning objectives of the lesson

1. To help students understand the difference between functional level, business level and corporate level strategies.
2. To help students understand different types of corporate level strategies.
3. To help students understand the stability, defensive/ retrenchment and combination corporate level strategies.

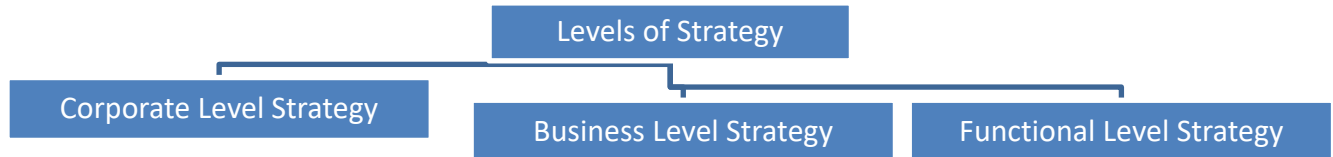
## 1.2 Introduction

As discussed throughout this subject Strategy is nothing but a companies game plan as to what it wants to and how. It is a like a proactive chess game where to plan, anticipate the moves of the competitor and the market. The main objective of the strategy and strategic management process per say is to help company satisfy customers and achieve organizational objectives.

Therefore, Strategy is a concept where the external opportunities and threats are taken advantage of while keeping in mind the constraints, resources, strengths and core competencies of the organization. It is a concept, which helps a company define its objectives and also the best way of achieving those objectives while pursuing creation of unique value for customers and other important stakeholders.

On the other hand, the term Strategic management is a term, which refers to a very systematic process of making strategy while keeping in sight the external and internal environment and also the company's vision and mission statement. It is all about honoring the company's commitment to various stakeholders. Formulation of strategy is done at three levels

1. Corporate level strategy
2. Business level strategy
3. Functional level strategy

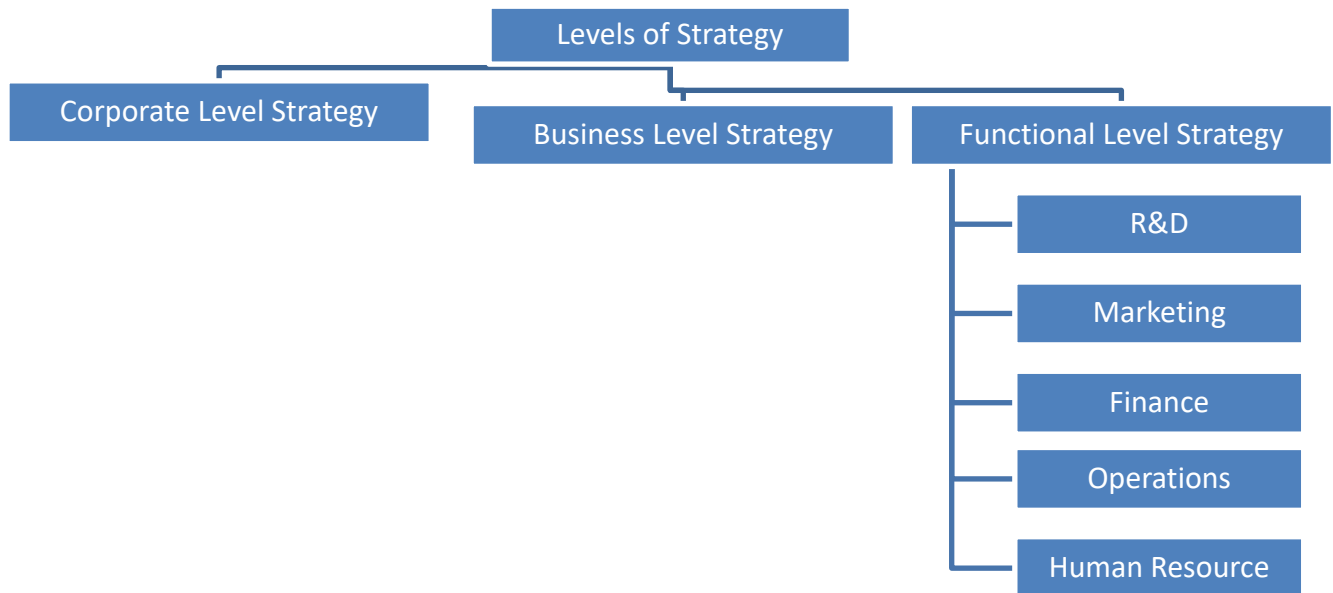


i. Corporate level strategy: this level of strategy is formulated at the top level of the organization structure i.e. the by the top level executives. This cluster of strategies is aimed at the overall development of the organization and its value. The corporate level strategies process starts with the mission and goals of the organization, leading up to working a business plan and lastly implementing different strategies in order to achieve a desired goal.

Example: Nirma deals with wide range of consumer and industrial businesses like in soaps and detergents in the consumer segment and glycerin, soda ash, pure salt etc in industrial products segment.

ii. Business Level strategy deals with translation of goals to form individual businesses.

iii. Functional Level strategy deals with specific business functions or operations like human resources, product development, customer service etc



### 1.3 Corporate Level Strategy

Corporate strategy is strategy, which refers to decisions concerning the company portfolio as a whole and deciding which units in the business need to be expanded and which units in the business need to be divested in based on the market opportunities and threat profile. The basic objective of the corporate level strategies is to achieve synergies and maximum value for the company while keeping in mind the constraints of the company. Three issues addressed in the corporate level strategies :

It helps a company decide

- where a company should compete: the question refers to a strategist working out the best market positioning in terms of the corporate which is dealing with multiple product lines. Positioning strategy is difficult to say the least when a company is dealing with one product however when a company is talking about a portfolio the answer to question where to compete becomes challenging to a new level.
- how should it compete: the question refers to a strategist deciding the basis of competition in the market that he has decide to compete in. It is important to note that these decisions are inter related and not independent decisions.

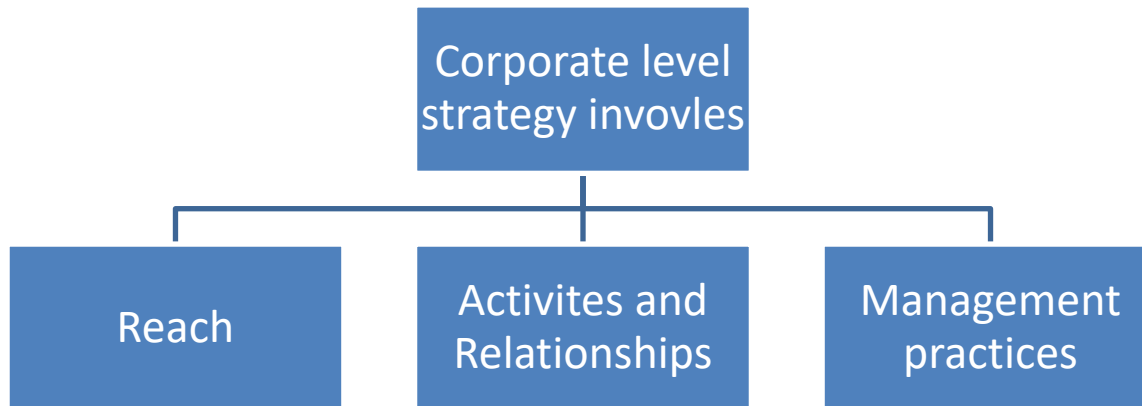
- what route would it need to take: this decision refers to a company and its executives deciding on the route to take to achieve the profitability objective i.e. cost leadership, product differentiation or focus strategies.



A company through its various strategies should maintain strategic consistency across its strategic business units and make possible cooperation amongst these units in order to not only create value for the stakeholders in these business units but also to maintain a market identity even with a diversified portfolio.

### 1.3 a Corporate level strategy involves:

- Reach- It defines company goals, types of business in which company should get involved.
- Activities and relationships- It helps in developing a relation by sharing and coordinating with the staff. It helps in investing business units in different units to harmonize different business activities.
- Management practices- Corporates decides how business units are managed by direct corporate intervention or by less government agencies.



**1.3 b Different types of corporate level strategies are:**

1. Stability Strategies:

It involves 3 strategies which are

- No change Strategies
- Pause/proceed with caution strategies
- Profit strategies

2. Expansion Strategies

It involves 5 strategies these are

- Integration
- Diversification
- Cooperation
- Internationalization

3. Defensive/ retrenchment Strategies

It involves 3 types of investments

- Turnaround

- Divestment
- Liquidation

4. Combination Strategies

It involves 3 types of strategies

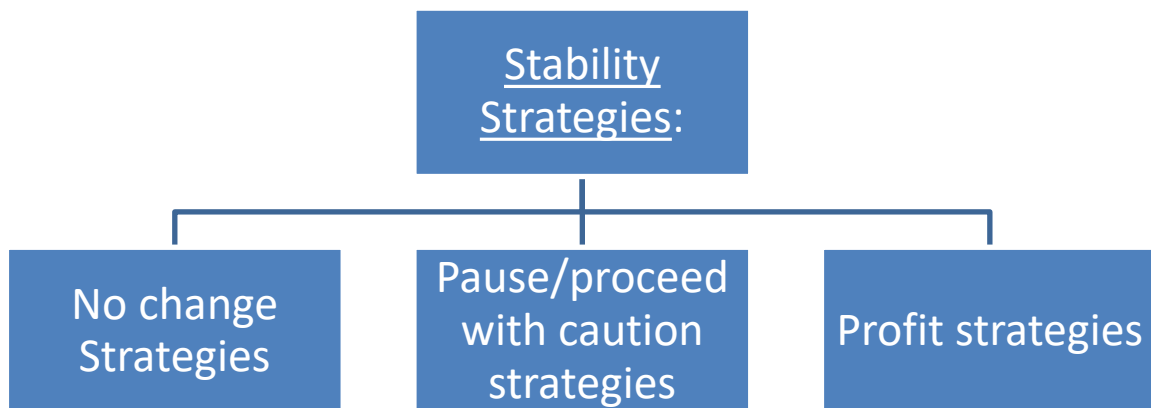
- Simultaneous
- Sequential
- Combination of both



1.4 Stability strategies



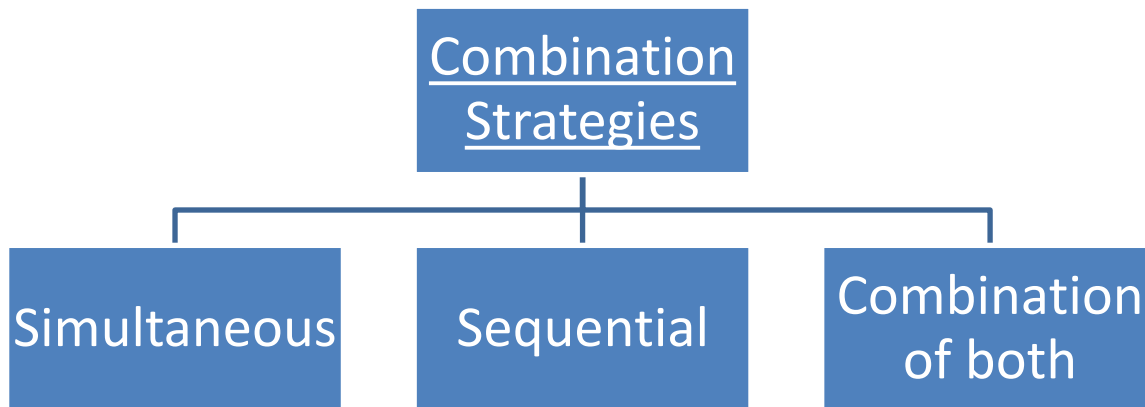
Corporate level strategies as discussed above are divided into four basic activities. Stability strategies refers to a set of strategies where a company decides to continue the current activities without any significant change in the direction. Even if the industry environment is unstable the company based on the above average rate of return could decide to continue its current strategies and not to make any changes. A company is said to be following stability strategies if it is satisfied with the market segmented targeting and with the market share it has in the industry.



### 1.5 Combination Strategy

Combination strategy means the combining of three different strategies resulting in growth, stability and defensive/ retrenchment in various forms. It is also known as mixed or hybrid strategy. A firm applying combination strategy can use this in three combinations, these are:

- Simultaneous
- Sequential
- Combination of both



### 1.5 a Reason for following

1. To improve overall performance
2. To increase competitive advantage of a business
3. When there are large number of business in the organisation, then they are needed to be reduced as some of them may not be attractive
4. Due to the impact of business cycle on various different businesses

This lesson is only about defensive or defensive/ retrenchment strategies.

### 1.6 Defensive / retrenchment Strategies.

There are two types of firms in a business or an industry. One is referred to as incumbent firms and others as new entrants. Incumbents are usually referred to as firms which are already in the business and are competing for the share of a market potential. It is the profits of these firms which motivate the new entrants to enter or not to enter a market. All these players are eyeing the same market potential. It is important to note that in short run the market potential is constant. Therefore, the only way companies can grow is by encroaching onto the share of the other competitors.

In such cases the incumbent has two options either to act as a proactive strategic company and take action to protect its market share and attract customers to its products by adopting

innovative and creative products and marketing mix. These are companies which are high risk takers and it is reflected in their strategies. They go out of their comfort zone and test with new strategies to gain market share.

However, in many cases incumbents are comfortable with the market share they have and are more than happy to stay in the comfort zone. They don't move out of the comfort zone and attack any competitor, unless their market share is threatened. It is when a company threatens their market share that these companies wake up to the demands of the market and competition. Therefore these companies adopt any one of the defensive strategies like turnaround, divestment or liquidation. The problems that they face might not manifest themselves in form of competition but might be in form of financial problems.

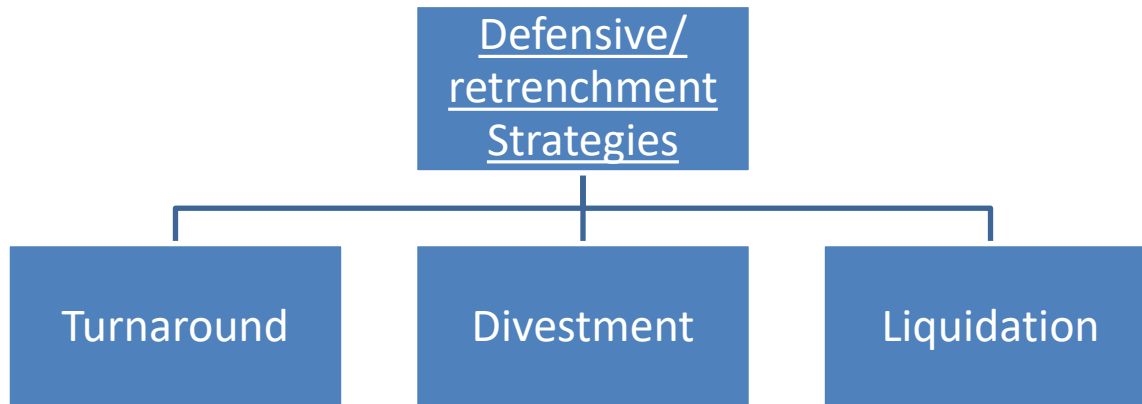
Many firms experience financial problems due to wrong decisions made by the management or the resulting market erosion which is somewhere result of companies becoming complacent in their comfort zone. These companies are not very well prepared to deal with an eventual challenger. At that time managers respond to such situation by selecting corporate level strategies in their attempt to turnaround the company by improving firm's competitive position. Defensive/ defensive/ retrenchment is considered best strategy that firms use to change the situation when their profitability is at stake. A company opts for the defensive/ retrenchment strategy when it wants to reduce the scope of its business activities. Usually companies make this decision when the company has grown at a pace faster than it could digest, the company has developed certain weaknesses and the business is not feasible or when the industry structure has undergone permanent changes and it is not feasible to stay in the business. Therefore, the defensive/ retrenchment is followed when the company just does not think staying the business is profitable enough.

As per business dictionary defensive/ retrenchment is defined as a strategy which is used by the companies and their business units to reduce the diversity in their portfolio and/ or to reduce the size of the operations of the company<sup>1</sup>. The company has to reduce the size and cost of operations because of multiple reasons like the industry has become non sustaining, increase in the competition, increase in the weaknesses in the company portfolio because of which the cost of operations has become non sustaining, the cost dynamics has changed or the consumer behavior and demand pattern has changed. Whatever be the reason the company decides to defensive/ retrenchment to free up the resources which are not adding maximum value for the stakeholder and invest them in a portfolio which will. Therefore, defensive/ retrenchment strategy basically involves taking money out of the business with the hope of being able to invest it somewhere where it will maximize stakeholders wealth.

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<sup>1</sup> <http://www.businessdictionary.com/definition/retrenchment-strategy.html>

Defensive/ retrenchment involves reducing firm's expenses which means, it can reduce the number of employees working in the company by laying them off, getting the firm out of some particular markets in order to concentrate on the firm's core competencies or by discontinuing the sales of product and services in order to make beneficial turnaround.



It is important to note that Defensive strategies are part of competitive moves of a company. Even when a company is thinking of going on offensive and acting proactively it needs to put in place the defensive strategies for its incumbent industry or market. In terms of marketing many strategies like signaling (warning competitor not to enter the market), increasing cost of entry into the industry (entry barrier), contrived deterrence barriers (sacrificing a cost of the profits to de motivate the competitor from entering into the segment or market) etc are adopted. However, in case of strategic management the scope of the defensive strategies is more diverse. Some authors refer to defensive strategies in three categories i.e. before attack, during attack and after attack. However, we talk about defensive strategies in terms of three basic strategies i.e. turnaround, divestment and liquidation strategies.

## 1.6 a Reasons for Defensive/ Retrenchment strategies

- Uncompetitive cost structure: the cost structure of the company is such that the company is unable to compete with its competitors in its present form at. In such cases companies and its managers are forced to adopt defensive/ retrenchment strategies in order to try and focus on gaining competitive cost structures.
- Inadequate returns on All of investment: primary objective of all strategies is to hit company in maximization of wealth. This really means that for the stakeholders there is an adequate rate of return on their investment. If a company is unable to get adequate rate of return its managers are forced to think of retrenching form the units which are leading to loses.
- Poor competitive position: many times companies on its managers are forced to adopt defensive/ retrenchment strategies because of their relative position in the market. The company that unable to compete in the competitive landscape given their current portfolio. Therefore companies are forced to decrease their scale of operations in order to try and gain competitive advantage and competitive position.
- Financial distress (e.g. high the need debt): sometimes companies accumulate high proportion of debt and therefore need to generate cash immediately. In such circumstances more than often companies are unable to generate more debt. Therefore one of the ways of generating cash is defensive/ retrenchment strategies.
- Market decline : companies can also adopt defensive/ retrenchment strategies to link the industry decline. When that the demand is declining one of the ways in which a company can maintain its profitability is through decreasing its operational expenditures therefore companies adopt defensive/ retrenchment strategies during the decline phase of an industry life cycle.
- Change of ownership: more than often this strategy is adopted when the companies goes through ownership change. The new philosophies of the new owner usually it is in letting go of certain parts of the organization. Therefore the defensive/ retrenchment strategies might be for you just as a part of restructuring strategy .

## REASONS FOR DEFENSIVE STRATEGIES

Uncompetitive cost structure

Inadequate returns on All of investment

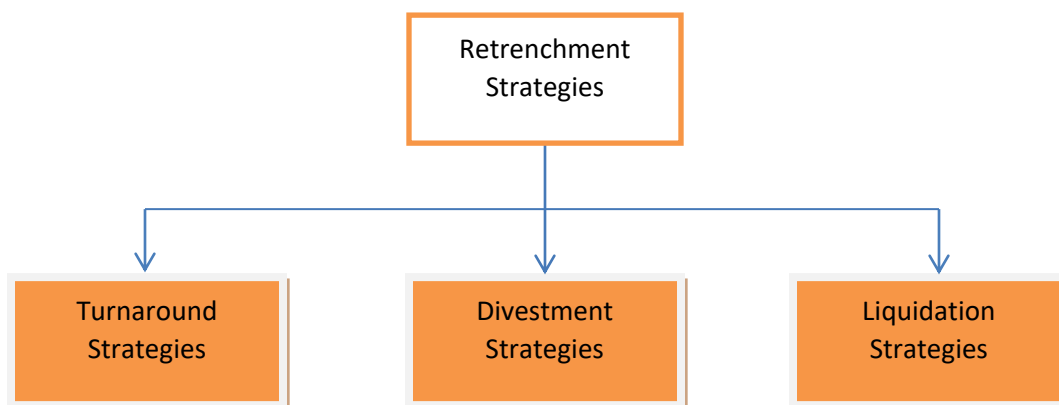
Poor competitive position

Financial distress (e.g. high the need debt)

Market decline

Change of ownership

### 1.6 b Different types of Defensive/ retrenchment Strategies of Business

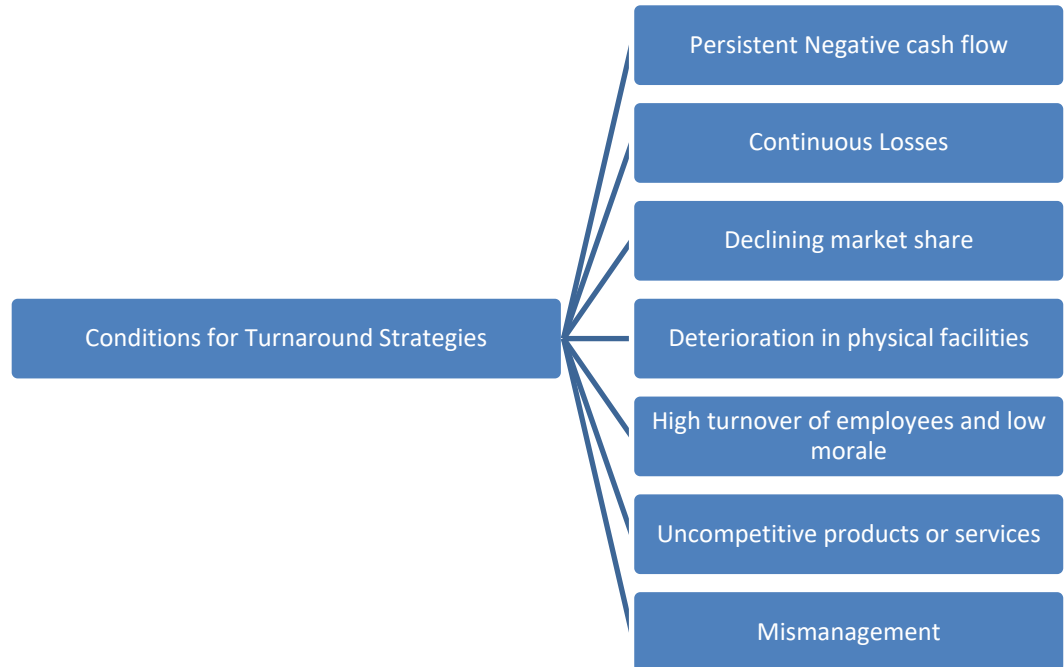


There are three different types of defensive/ retrenchment strategies i.e turnaround strategies, divestment strategies and liquidation strategies. These three strategies are adopted based on the reason for defensive/ retrenchment .

### **1.6 b i. Turnaround Strategies**

This strategy gives firm a power to back out, withdraw or even retreat from any wrong decision taken earlier in order to reverse the process of decline. Turnaround strategies derive their name from the action involved, i.e. reversing a negative trend and turning around the organization to profitability. Certain condition under which the firm consider turnaround strategies are:-

- Persistent Negative cash flow
- Continuous Losses
- Declining market share
- Deterioration in physical facilities
- High turnover of employees and low morale
- Uncompetitive products or services
- Mismanagement



- For example Voltas Ltd., The Company was incorporated on 6th September 1954 at Mumbai as a joint venture between M/s. Volkart Brothers and Tata Sons Pvt. Ltd., to take over the Engineering & Import Division of the former in India. It was one of the leading companies in India till 1994. The company saw some turbulent times from 1995-1998.<sup>2</sup> The company had suffered losses owing to some ill-timed diversifications and ill-advised investments. It was only in 2000 that a root cause analysis was done of the company. It was in 2006 that Voltas was able to turnaround by concentrating on its AC products and became the fastest growing division in the company. The base of this turnaround strategy was restructuring strategy adopted at Voltas. The restructuring strategy involved a core management team which evaluated the Voltas portfolio on parameters like growth potential, market size etc. when a business did not match these criteria's it was decided to sell that business.

Therefore, though the turnaround strategy refers to concentrating on creating a portfolio of strengths for the company yet the process might desire adoption of strategies like restructuring, joint venture, merger, spin off etc.

### 1.6 b ii. Divestment Strategies

<sup>2</sup> <http://www.marketing-trends-congress.com/archives/2011/Materiali/Paper/Brand%20Management/Datta.pdf>



Divestment is one of several strategic options for "declining" industries. In finance and economics, divestment or divestiture is the reduction of some kind of asset for financial, ethical, or political objectives or sale of an existing business by a firm. A divestment is the opposite of an investment.<sup>3</sup>These strategies are those which involve the selling of major division or a portion of business, which are not being part of cash cows. The divestment strategy is only used when the turnaround strategy has been proven to be unsuccessful. Divestment was advocated as an appropriate route in "end game" situations characterized by high volatility and uncertainty regarding future returns. Divestment has also been from a corporate portfolio perspective: a company can be regarded as a portfolio of assets, products, and activities, which should be continuously under review from both financial and strategic point of view. <sup>4</sup>

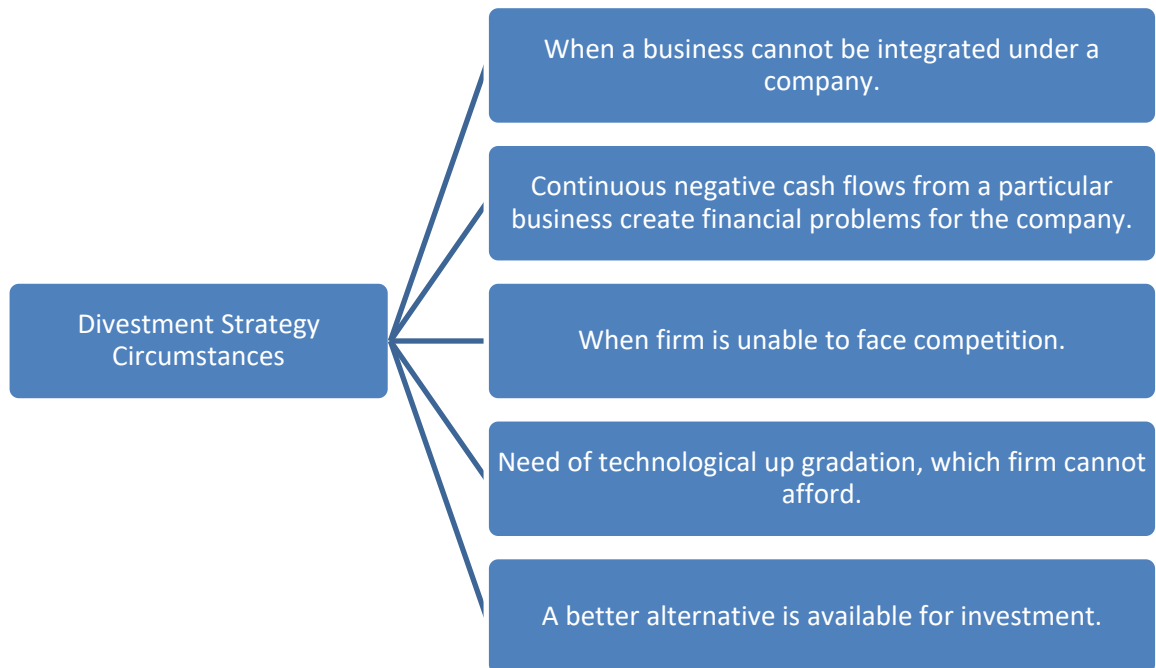
This strategy is adopted under the following condition:

- When a business cannot be integrated under a company.
- Continuous negative cash flows from a particular business create financial problems for the company.
- When firm is unable to face competition.
- Need of technological up gradation, which firm cannot afford.
- A better alternative is available for investment.

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<sup>3</sup> Business Dictionary

<sup>4</sup> Benito, G. R. (2003, September). Divestment seen through the lens of international business strategy. In *Keynote Lecture given at the International Conference on Divestment: Corporate Strategies, The Regions and Policy Responses, Lisbon*.



It is important for the company to plan the divestment in such a way that it can use the cash arising from the divestment in a effective and efficient manner. Retaining cash in the business can make the business a target for takeover. A company has following option to use the cash arising from the divestment strategy

- a company could use the cash generated for Share repurchase in the market
- the cash generated could also be used by the company for Debt restructuring
- the cash generated from the divestment could be used to Invest in another strategic business unit. The strategic business unit is chosen on basis of its performance and market forecast.
- alternatively the cash generated could also be used for Acquisition of a business unit that meets both the fit and value tests of the company.

### Spin off Divestment

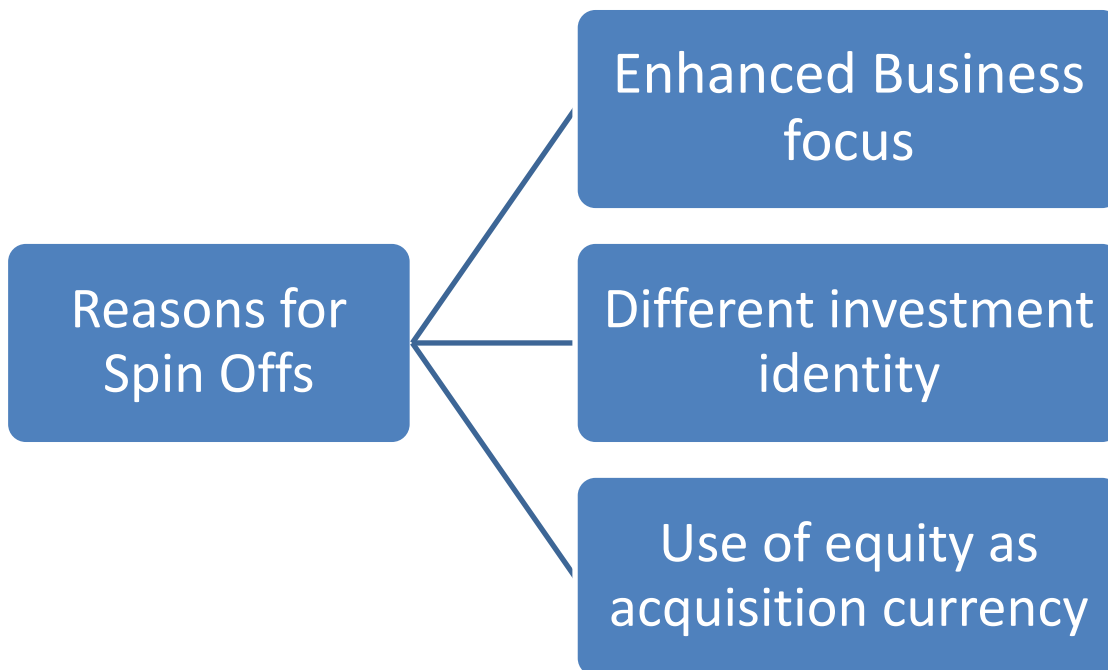
Divestment is selling of the assets by the firm, but when a firm chose to remain in the market they sell their shares and create a new entity by reducing their shares.

This strategy is known as spin off divestment. The shares of the new entity are distributed to the shareholders of the parent company on some basis.

These days spin off is becoming more popular because investors, managers feel that business will give more value if it is owned and managed separately. The process of spin off requires some factors like financial, capital markets, legal and tax which make the process little complex.

### Reasons for spin-offs

- **Enhanced Business focus**  
A spin off allows each business to focus particularly on its own strategic plans without diverting any human or financial resources from any other business.
- **Different investment identity**  
It will create different and targeted business opportunities in each business.
- **Use of equity as acquisition currency**  
A separate publically traded stock is created which will enhance the ability of spun off business to effect acquisition using this stock.



### 1.6 b . iii Liquidation Strategies

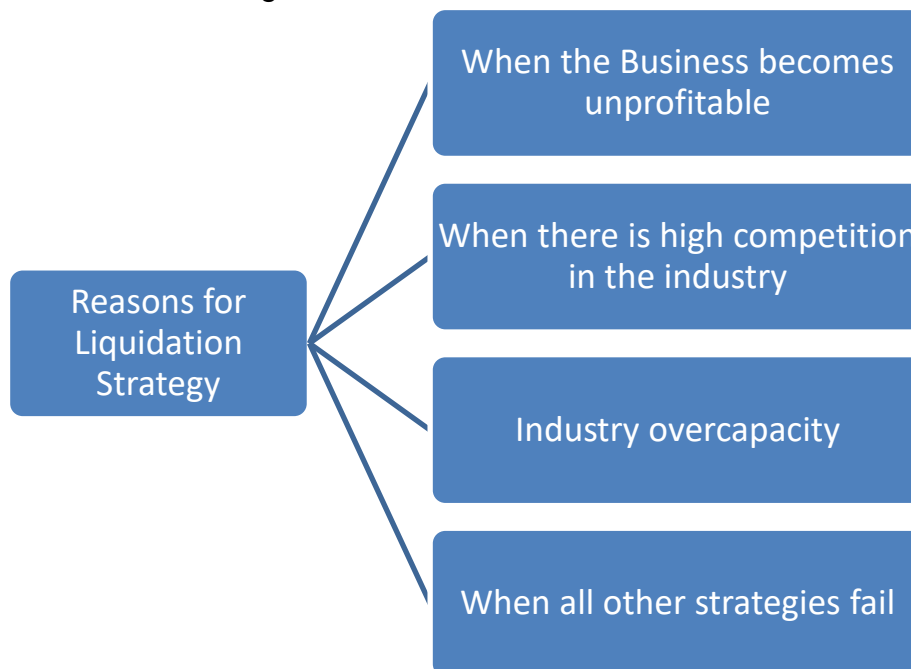
This is the final strategy under defensive/ retrenchment strategies, under this entire firm is closed down by selling all its assets. This strategy leads to loss of employment, reduction in opportunities where a firm could pursue further activities and ultimately to failure.

Liquidation strategy is only useful when “dead business is worth more than alive”. Therefore ,in simplest terms the process of winding-up of a company is completed by selling all its assets and paying all creditors in preferential orders. For this purpose, a liquidator is appointed by the court to complete the liquidation process. The duties of the liquidator are to realize the assets, discharge the liabilities and distribute the surplus, if any, to the shareholders of the company.

### Example

These are following reasons due to which company use liquidation strategies:

- When the Business becomes unprofitable
- When there is high competition in the industry
- Industry overcapacity
- When all other strategies fail



## 1.7 Summary

Strategy is a game plan to target a market, conduct operations, satisfy customers and achieve organizational objectives. It lays down organizations' desired goals, direction and destination. Strategy can never be perfect; it is flexible. There are no second best choices in strategies. Strategy is partially proactive and partially reactive. Corporate level strategy looks for the development of whole of the organization, beginning with mission, goals, to determining the business plan, resources and finally implementing different strategies in order to achieve a desired goal. Corporate level strategies are those strategies which are concerned with the strategic decision making in the company. These strategies are made by high governing bodies of the firm. The strategic decision involves financial performance, mergers and acquisition, HRM and allocation of the resources. Different types of corporate level strategies are Stability Strategies, Expansion Strategies, defensive Strategies and Combination Strategies. Stability strategies refers to a set of strategies where a company decides to continue the current activities without any significant change in the direction. Even if the industry environment is unstable the company based on the above average rate of return could decide to continue its current strategies and not to make any changes. Retrenchment Strategies: Many firms experience financial problems due to wrong decisions made by the management or the resulting market erosion. At that time managers respond to such situation by selecting corporate level strategies in their attempt to turnaround the company by improving firm's competitive position. Defensive or Retrenchment is considered best strategy that firms use to change the situation when their profitability is at stake.

