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THE OPEN UNIVERSITY OF SRI LANKA
BACHELOR OF MANAGEMENT STUDIES (HONOURS) DEGREE PROGRAMME
LEVEL 6
FINAL EXAMINATION: 2020 January
STRATEGIC MANAGEMENT – MSU6501/MCU4201

Duration: Three Hours and Fifteen Minutes. (3 Hrs. and 15 mts.)

Date: 4th January 2020	Time: 1.30 pm – 4.45 pm

This Question Paper consists of five (5) questions and has five (5) pages.

Instructions:

- Answer **Question 1 and any three (3)** from the others. Maximum marks 100.
- Answers should be methodical and focused to the question.
- Cite suitable illustrations and Sri Lankan examples where possible.
- Illegible handwriting may cost marks.

Question 1.

Read the following article on the application of Michael Porter's 5 forces model and attempt the questions given at the end.

Altria In The U.S. Tobacco Industry -- A Porter's Five Forces Analysis

The U.S. tobacco industry is rather interesting. At a time when the industry on the whole is grappling with declining volumes, two big tobacco players, Reynolds (No.2) and Lorillard (No.3) have joined forces to increase the level of consolidation in the industry, which could significantly alter the competitive landscape going forward. In this article, we use Porter's model of industry rivalry to assess the U.S. tobacco industry on the basis of the threat of potential new entrants, the bargaining power of suppliers, the bargaining power of buyers, and the threat of substitutes. We use this analysis to assess prospects for the leader, Altria, in this industry.

— Threat of New Entrants: The threat of new entrants is an important factor for judging the level of competition in an industry, since a proliferation of new entrants could result in share losses for incumbent firms. In this case, pricing power could be severely hampered as firms may have to slash prices in order to maintain their market shares.

Now, do we foresee any new players in the U.S. tobacco industry in the short to medium run? Probably not. Although barriers to entry in the tobacco industry are low, in the sense that it is easy for smaller players to enter the market, it may not be very viable for them to compete against conglomerates such as Altria at a national level. This is because these companies enjoy economies of scale in manufacturing, packaging, branding, distribution, and marketing, the costs associated with which, could be extremely high for a smaller company to undertake. Furthermore, a ban on tobacco advertisements could make it difficult for smaller names to drive brand recognition among the masses, making it hard for them to broaden their customer base. Having said this however, Altria could face stiff competition in the future from other big tobacco names that have established themselves in markets outside of the U.S. For one, with the Reynolds-Lorillard merger, the industry will see the British tobacco company, Imperial, competing at the No.3 spot with some of its own brands, and some divested brands from Reynolds. In this case, Altria continues to face a threat from new entrants, who have already built the necessary capital needed to compete at a national level from operations in other markets.

— Bargaining Power of Suppliers: Supplier bargaining power is an important parameter to assess competition since it could translate into higher costs for tobacco producers to reduce overall industry profitability. The degree of supplier bargaining power depends on factors such as the number of suppliers in the market, the value of the firm demanding the product to the supplier, the scarcity of the resource, and the substitutability of the resource.

Companies such as Altria rely on farmers for tobacco supply. Since the 1930s, the U.S. government regulated the tobacco market under a quota system, where a farmer could grow only a fixed amount of the crop. This restriction in supply, along with government initiatives such as the provision of low interest loans, guaranteed minimum price and grower cooperatives (bought unsold tobacco), and made the crop a rather profitable one for farmers to grow. However, in 2004, this system ended with the introduction of a $9.6 billion buyout program, which paid farmers a fixed sum annually to help them transition to free markets. This, coupled with dwindling tobacco volumes, have led to plummeting profits, against which, farmers have lost their bargaining power. The loss in the degree of bargaining power for suppliers in the U.S. is evident from the statement below made by Marvin Eaton, a farmer who currently supplies tobacco to Altria and Reynolds — *"The companies, they're in control, and if they don't want Marvin Eaton raising tobacco and I can't make a living on what they say they're going to pay me for, then I, Marvin Eaton needs to get him something else he enjoys doing."*

— Bargaining Power of Buyers: In some cases, powerful buyers could exert a downward pressure on prices to reduce industry profitability. Bargaining power here depends on factors such as the number of buyers in the market, availability of substitutes, and the number of firms producing the product.

In the tobacco industry, at large, bargaining power of buyers may be lower. Part of this is solely based on the addictive nature of the product involved. In general, tobacco companies tend to have a greater command on pricing since there will always be a proportion of the population that will buy cigarettes irrespective of its price. Furthermore, cigarette demand in general is price inelastic, i.e. demand is less responsive to changes in price. Now, with the Reynolds-Lorillard merger, and further consolidation in the industry, buyers could lose out further on bargaining power since they would have fewer substitutes to turn to in the situation that any one firm resorts to price hikes.

— Threat of Substitutes: A substitute product can be anything that is produced in a different industry but manages to meet the same needs. In the case of tobacco, this would entail over-the-counter products such as nicotine patches, gum, nasal sprays, lozenges, and other products. With growing awareness about the ill-effects of smoking and regulatory crackdown on the industry making the product expensive, many Americans have been opting for tobacco substitutes. Furthermore, there are hardly any costs associated with switching to an alternate in this case. For instance, if a smoker smoking a pack of cigarettes costing $5.50 chooses to quit, he can save up to $1,980 in a year. Even the cost of nicotine replacements is far lower than that of cigarettes, in that the smoker could save anything between $11-$47 a week depending on his choice of therapy. (See: Choice of Over-the-Counter Nicotine Replacement Therapy – Factsheet) Such savings could be a huge incentive for smokers to kick the habit going forward. However, new on the block are e-cigarettes, which have been seeing unprecedented growth over the past few years. Big tobacco companies such as Altria have been capitalizing on the opportunity in this realm, which could go on to benefit them. However, while e-cigarettes could be an effective tool for "damage control," it is highly unlikely that they will actually go on to offset the losses coming in from a declining market.

— Competitive Rivalry: The U.S. tobacco industry was already highly consolidated and this level of consolidation is expected to further intensify this year on, with the Reynolds-Lorillard merger. The post-merger Reynolds is expected to have a stronger presence with 34% of the market, as opposed to 28%, to form a stronger competitive force against Altria. Apart from this, the entity is expected to have a clear win in the Menthol market, with America's top brand, Newport (37% market share), in its portfolio. Clearly, these two powerhouses joining forces is bound to bring in synergies in production, distribution, and promotions. In order to compete effectively, Altria may have to incur costs going forward to drive its brand presence among the masses. This is particularly true for Menthol, where Altria's Marlboro Menthol could lose share to the likes of Newport and Camel, which have, in general, been seeing rising shares and could only benefit further from the merger.

In conclusion, while Altria could have little to worry about when it comes to factors such as new players entering the market, they could be threatened as an increasing number of smokers opt for substitutes in an attempt to quit smoking. This development, along with an intensifying competitive landscape, could threaten prospects for the company. However, further consolidation in the industry could bring with it certain advantages, particularly in the form of higher pricing power, which could ensure steady profits for Altria going forward.

(Forbes, Aug 17, 2015)

Questions.

a) Explain why strategists use Michael Porter's 5 forces model. Describe the level of success of the above description as per your view. (14 marks)

b) Describe the forces and their respective competitiveness if Altria wishes to invest further and expand the business. (12 marks)

c) Identify threats and opportunities for Altria from the above facts given. (14 marks)

d) Express your opinion on what the management of Altria should do? Give justifications. (12 marks)

Question 2.

a) 'An organization without a clear mission leads to directionless people associated with it.' Comment on this statement explaining salient features of a good mission statement of an organization and advantages of having a mission statement. (6 marks)

b) Explain the key features of objectives. (5 marks)

c) How does short term and long-term objectives help to achieve expected outcomes of a strategic plan? Explain. (5 marks)

Question 3.

a) Describe 'Core competencies' of an organization. Explain how the management of an organization can identify and maintain core competencies. (6 marks)

b) Describe the competitive advantage of an organization. (5 marks)

c) Explain what a learning organization is and how a learning organization can improve the core competencies and competitive advantage of an organization. (5 marks)

Question 4.

'Strategy implementation requires different type of skills than what is required for strategy formulation.'

a) Express your opinion on the above statement elaborating on the activities involved in 'strategy formulation' and 'strategy implementation'. (8 marks)

b) Explain how the top management of an organization ensure the effectiveness and efficiency of strategy implementation process. Your answer should describe the information required for the said task and activities involved in strategic control. (8 marks)

Question 5.

Explain **any FOUR (4)** of the following in the context of strategic management.

a) The need for SWOT and TOWS for strategists

b) International market entry concerns compared to doing business locally

c) Generic and differentiation strategies available to a strategist

d) First Mover and Late Mover strategies

e) Corporate Social Responsibilities and its benefits to an organization

(4 marks each x 4 = 16)