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THE OPEN UNIVERSITY OF SRI LANKA
MASTER OF BUSINESS ADMINISTRATION IN HUMAN RESOURCES MANAGEMENT PROGRAMME
FINAL EXAMINATION: 2016 Year 2 Semester I

STRATEGIC MANAGEMENT – MCP2255
Duration: Three Hours and Fifteen minutes (3 ¼ Hours)

Date: 16th July, 2016	Time: 1.30 pm – 4.45 pm

Instructions:

- **Answer Question 1 (compulsory) and any TWO (2) questions from Part B.**
- **Answers should be methodical and focused. Cite suitable Sri Lankan examples to support your answers where necessary.**

This Question Paper consists of four (4) pages and has four (4) questions.

PART A

Question One: Attempt the questions at the end of 'Altria in The U.S. Tobacco Industry'.

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.

Source -Great Speculations AUG 17, 2015-Forbes

(a) Critically Analyze the above using the tool of value chain as strategy (you need to relate the analysis regarding the case) (18 Marks)

(b) Explain the importance of Resource Based View(RBV) for Altria to make decisions in the long run. (18 Marks)

(c) As a strategic consultant explain future strategies available for Altria using Ansoff matrix. (16 Marks)

Total – 52 Marks

PART B

Question Two

(a) Organizations have to carry out environments scanning all the way through their operations since the inception of their organization. Comment. (8 Marks)

(b) Describe the external and internal factor analysis of environmental scanning with its components. (8 Marks)

(c) Explain the sources of information for environmental scanning and the systems that could be deployed by strategists in collecting necessary information in Sri Lankan context. (8 Marks)

Total-24 Marks

Question Three

"An industry has multiple segments that can be targeted by a firm. A differentiation strategy involves creating a customer perception that a product or services is superior to that of other firms, based on brand, quality, and performance, so that a premium price can be charged to customers."

(a) Critically analyse this statement. Use the model of M. E. Porter's generic strategies. (12 Marks)

(b) Critically evaluate the concept of "Stuck in the middle" of M. E. Porter's model on generic strategies with suitable examples. (12 Marks)

Total-24 Marks

Question Four

Explain **any THREE (3)** of the following related to strategic management. (each carry 8 marks)

(a) Key Successive Factors (KSF) and core competencies of an organization
(b) Strategic control and Balanced Score Card (BSC)
(c) Steps of strategy implementation and role of policies in strategy implementation
(d) BCG portfolio analysis matrix of an organization and Investment decisions of different SBUs that falls under different categories of the matrix
(e) Different situations that warrant pursuing market development and product development strategies.

Total-24 Marks