

Chapter 1 - Introduction to Strategic Management & Performance Evaluation.

Case Study Digest 1 – Superior Performance & Competitive Advantage

BA is the second largest airline in the Country “X”. Aviation industry in the Country “X” is growing fast. In 2011, 45 million people travelled to/ from/ or within the Country “X”. By 2020 that doubled to 100 million. This number is expected to treble to 300 million by 2030. Also, by 2025, Country “X” is expected to be the third largest air transport market in the world, behind the US and China.

Government is trying to meet the significant growth potential of aviation Industry. However, it will create challenges also for the airline industry and its industry partners.

Government also wants to ensure that broader business and policy environment should not place hurdles which inhibit growth and reduce the level of benefits that aviation can deliver to the nation. The industry, its supply chain partners, and the government and policy makers have a clear mandate to work in collaboration towards the common goal of ensuring that aviation’s economic and social benefits are fulfilled.

Despite of operating in World’s fastest growing market BA struggles for passengers. Also, BA is facing following problems:

- Aviation Turbine Fuel (ATF) prices constitute about 40% of operational costs in Country “X” and are taxed higher here than anywhere else in the World. The Central government charges 14% duty on ATF. While the state government pile on their own local tax that can go as high as 29%.
- The currency depreciation is hitting Airline harder. About 25% to 30% of their costs, excluding ATF, are dollar denominated, from aircraft lease rents, maintenance costs to ground handling and parking charges abroad etc.
- With the entry of Low Budget Carriers, full-service carrier like BA that have higher overhead costs have been forced to offer discount to passengers looking for great bargain.
- Continuous improvements in tourism infrastructure, tourism policies, human resources development, airport infrastructure density are among the areas that could further enhance Country “X”’s competitiveness. Ease of doing business over the last five years has risen.
- The intense competition among domestic airlines carriers, the need to capture a slice of the ever-expanding market and passenger price sensitivity makes the airlines difficult to raise ticket prices.

Together, these factors have now plunged Country “X”’s aviation industry to its most precarious phase in the last three years or so.

BA is facing huge competition as a “year of sharp U-turns” for “X”’s aviation industry from record profit in Financial Year 2019-20 to mega losses, resulting in direct need of recapitalisation. BA has been appealing to the government for a decade for a reduction in taxes on fuel, but all in vain. ATF is 35-40% more expensive in Country “X” than in the rest of the world, because of relatively high tax rates.

Required

ADVISE the strategy that BA should follow in order to gain superior performance and competitive advantage over its competitors.

Solution

In consideration to Michael Porter's theory about creating a superior performance and competitive advantage, a firm's overall competitive advantage derives from the difference between the value it offers to customer and its cost of creating that customer value. In order to survive and prosper in industry, firm must meet two criteria– they must supply what customers want to buy and they must survive competition.

To attain superior performance and attain competitive advantage, firm must have distinctive competencies. Distinctive competencies can take any of the following two forms:

Relative low-Cost advantage– under which customers gain when a firm's total costs undercut those of its average competitor.

An offering or differentiation advantage– If customer perceive a product or service as superior, they become more willing to pay a premium price relative to the price they will have to pay for competing offerings.

Low-Cost Advantage (Cost Leadership)

BA can enjoy relative cost advantage if its total costs are lower than those of its competitors. This relative cost advantage enables a business to do one of the following:

- Charge a lower price than its competitors for its services to gain market share and still maintain current profitability; or
- Match with the price of competing services and increase its profitability.

Cost reductions in BA can be achieved through yield management with variable pricing depending on capacity utilization with careful monitoring; application of computer and communication technology in cost effective way i.e. selling seats via the internet rather than through travel agents; trimming overhead costs by using lower cost out-of-town airports, no printed tickets, seat allocations, or free meals and drinks; efficient operations i.e. fast turnaround times for aircraft to improve utilization; and no exceptions policies to reduce the cost of handling exceptions (e.g. no flexibility for passengers who arrive late). Cost economies can also be realized from large scale operations. However, it is important to note that as soon as more firms strive to become the cost leader, rivalry become so fierce that the consequences for the profitability in the industry are disastrous.

Differentiation Advantage

It occurs when customers perceive that a business services offering is of higher quality, involves fewer risks and/or outperform services offered by competitors. In other words, customers perceive the service offered by a business to be superior. For example, differentiation may include a firm's ability to deliver services, and other factors that provide unique customer value. BA is a multinational passenger airline. It can adopt a differentiation approach by offering passengers a higher-quality experience than many of its rivals. This allows it to charge a premium for its flights compared to many other airlines.

A differentiation advantage can be achieved by offering enhanced features such as prime landing slots can be obtained at major airports around the world; using superior and advance technology; well-maintained, clean, and comfortable aircraft; training in customer care and the recruitment of high-quality

staff; providing complementary services such as in-flight entertainment, high-quality food, and drink. Customer value can also be increased by subjective features such as brand image, advertising based on quality of service provided. However, differentiator cannot ignore its cost position. If costs are too high the premium price are nullified.

On successfully differentiated its offering, management of BA may exploit the advantage in one of two ways viz., either increase price until it just offsets the cost of improvement in customer benefits, thus maintaining current market share; or price below the “full premium” level to build market share.

Alternatively, BA may focus on geographical region and short point to point flights to reduce costs. Michael Porter enlightens focus as attaining low cost or product differentiation for a particular buyer group, segment of product line, or geographic market rather than for the industry as a whole. The focuser can attain competitive advantage within a niche, because large firms are either not attracted to niche or have ignored the potential. The narrow focus in itself though is not adequate for a competitive advantage. The firms need to optimize the strategy on two variants: cost focus and differentiation focus. One risk of a ‘focus strategy’ is that broadly targeted competitors devastate the segment once it becomes economically attractive.

In addition, the currency depreciation is hitting Airlines harder and international overhead costs have risen, the BA should attempt to increase the number of internal domestic flights. Moreover, ATF cost can also be lowered by investment in fuel saving modern Airbuses, however, the reduction in operating costs may outweigh the capital equipment costs.

To gain competitive advantage BA may also assess Value Shop Model. Value Shop generates value by organizing resources (e.g. people, knowledge, and skills) and deploying them to solve specific problems, for example, delivering airline services to the passengers or delivering a solution to the business problem. Shops are organized around making executing decisions- identifying and assessing problems or opportunities, developing alternative solutions or approaches, choosing one, executing it and evaluating results.

In this way, the above discussed strategies may be more appropriate for helping BA in achieving superior performance and competitive advantage over its competitors.

Concept in Practice

Southwest Airlines (SA) targeted on a geographic region and short point-to- point flights to reduce costs. Even though it offered no-frills service (no-frills or no-frills service is one for which the non-essential features like food, entertainment, printing of boarding pass etc. have been removed to keep the price low) and was based in secondary airports, SA improved quality relative to the limited set of competing alternatives by offering direct flights rather than connecting flights requiring changing planes at large hub airports. The SA also offered better on-time performance and friendly amenities.

Case Study Digest 4 – Value Chain Analysis

Style-inn Fabric & Clothing (SFC) is manufacturer of clothing fabrics to be made up into dresses and suits. SFC established long ago back and presently enjoys the reputation as producer of quality fabric. SFC producing fabrics from high quality synthetic yarns with all standard features which other fabric manufacturer offers. Designs of fabric are old fashioned (traditional in nature) as SFC was established long ago.

Management team at SFC shown believe in integration (vertical and horizontal) and diversification (product range or market reach) as tool of risk reduction and value enhancement (profit too). SFC opts for un-organic forward integration to gain control over value chain by acquiring 'Skylark Designer Clothing' (SDC). SDC is operating in designing and weaving of fabric into fashion wears. SDC is targeting the customers who are in age group from 40 to 60 years and belongs to price sensitive income group. SFC in this way is able to reach to end consumer through retailers by manufacturing cloth themselves. Acquisition of SDC by SFC remains largely successful as result in relative high increase in sales and profits, both.

Problem Point

But the sale & profit are not growing at same old rate now, top and bottom line witness the slowdown, which may be due to exhaust of synergy benefits. Retail stores through which SFC sold its material also find it difficult to make reasonable amount of sale. SFC starts exploring new retailers. But due to presence of large number of supplier (of manufactured cloth), buying power of retailers is high; resultantly SFC has to rest at unacceptable low margins.

Down the Line

SFC is considering of acquisition of one of cloth retail chain, named 'Paridhaan' in order to deliver fabrics to the customers directly and eliminate retailers in order to boost its profit margins.

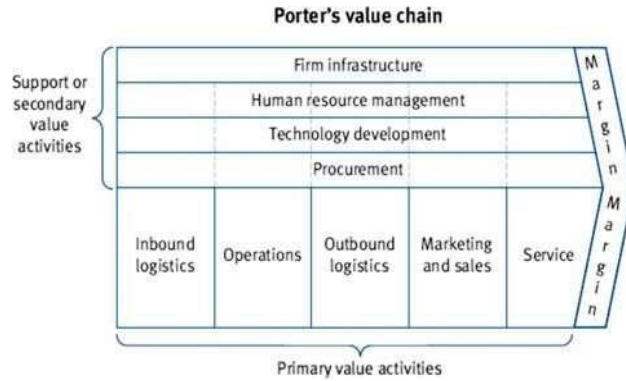
Required

- i. DRAW Value Chain and EXPLAIN briefly.
- ii. What do you mean by competitive advantage and how it can be attained? EXPLAIN.
- iii. IDENTIFY strategy SDC opted to gain competitive advantage.
- iv. DISCUSS 'value chain effect' of forward integration (acquisition of SDC) on SFCs 'competitive ability and cost competency'.
- v. EVALUATE possible acquisition of cloth retail chain 'Paridhaan' by SFC.

Solution

- (i) **Value chain** (suggested by Michael E Porter*) describe those activities of organisation, those add value to input before it become output. Value Chain can be expressed as way of assessing and explaining current competitive advantage while identifying cost drivers.

Note - Michael E Porter, in 1980 wrote a book 'Competitive Strategy; Techniques for analyzing industries and competitor' in which he explained value chain. In 1985 he along- with Miller suggested value chain as part of bigger network i.e., Value System. It split down company's activities between those which are 'primary (Those result in production of goods/rendering services)', and those which 'support (assist in such production)' these primary activities (as shown in figure) -



Concept of Value

Successful organisation able to create value for its customer (end user) either by offering differentiation (more utility through customized/unique product/services at same price) or cost competitiveness (same utility at par to competitor, but at lower price).

(ii) **Competitive Advantage** is ability to generate more economic value than competitor. There are three generic strategies, suggested by Michael E Porter (In another book which he wrote in 1985 on 'Competitive Advantage – Creating and Sustaining Super Margin') through which an organisation could achieve competitive advantage –

Scope/Scale of Strategy		Competitive Advantage can be obtained through	
		Lower Cost	Uniqueness
Competitive Scope can be	Broad Target (Industry Wide)	Overall Low Cost Leadership	Differentiation
	Narrow Target (Particular Segment)	Cost Focus	Differentiated Focus

- a) **Cost Leadership**, where there is great emphasis on keeping costs down. This opens up the profit margin by lowering costs, ideally more than any competitor can.
- b) **Differentiation**, where a better product or service is sold. This opens up the profit margin by raising selling prices.
- c) Additionally, an organisation can choose a **focus strategy**, where the organisation concentrated on a small segment of the market. Within the focus strategy, the organisation must choose whether or not to become a cost leader or a differentiator.

(iii) **Strategy at SDC**

Since SDC targeting the customers who are in age group from 40 to 60 years, and belongs to price sensitive income group, hence strategy opted to gain competitive advantage can be considered as Cost Focus.

(iv) Value Chain Effect at SFC

Acquisition of SDC by SFC can be termed as forward vertical integration. Any forward vertical integration can be justified because it ensures increase in profit, effective control over market as well on pricing and finally brand building by reaching to target group. SFC's main objective behind SDC acquisition was getting control over value chain and increase in profit. SFC has precluded the possibility of other ways of increasing fabric sales for e.g., exporting.

SFC extends the value chain. Earlier it was restricted up-till sale of fabric to garment manufacturer, but now SFC reach out to retailers to sell the in manufactured garments. Scope of value addition to end user increased but value system become more complex reason being two systems now merged into one value chain.

SDC (which is acquired by SFC) is believing in focus strategy by restricted its market to the 40-60 years aged and price sensitive income market. This may be a sensible strategy for a company engaged in designing of cloths, but surely not for a manufacturer of fabric.

Effects of forward integration on competitive ability and cost competency (Importance from cost perspective)

- a) Post integration SFC has to operate two production lines (different set of Men - Workforce, Machine and Methods - product and production layout). One being spinning the fabric and being manufacturing of cloths. Resultantly transfer pricing will be cost aspect which need to be decided.
 - b) Since the operation is sequential in nature, first weaving then stitching; hence any mismatch in capacity, lead/run time of both the production lines may result into increased cost of either warehousing or idle capacity. (may result in additional working capital required or loss of contribution)
 - c) Carrying Cost (warehousing cost) will also increase on account of manufacturing of cloth ahead of retail demand. (again, additional working capital may be required)
 - d) For SFC, it may become difficult to compete with other fabric manufacturer; because due to diversion of management focus in two production line (may lose cost competitiveness) and SFC is now directly impacted by customer/ consumer who has verity of option apart from SFC's cloths to choose between.
 - e) Since design of fabric (manufactured by SFC) are fit for traditional wear, but expertise of SDC is in fashion wear; so designer at SDC may resent the lack of freedom. (integration of objective and culture is essential to overcome)
- (v) Although, the intention is to earn more of the value in the value system, but possible acquisition of retail chain 'Paridhaan' (forward vertical integration into retail outlets) has its own pros and cons for competitive advantage.

Expected Benefits

- a) SFC will have full control over the production, pricing and marketing. So, acquisition of Paridhaan will give strength to SFC for keep relying upon differentiation strategy.

- b) Since SFC will reach to end consumer directly, hence will have access to entire customer related data. Such data can help SFC to understand customer specification and do customization in product as per requirement of specific customer group.
- c) Since post acquisition of Paridhaan, SFC will have exclusive retail chain; hence reduce the competition from other brands whose products are lying along-with SFC products at selling shelves of retails.

Anticipated Drawbacks

- a) Managing retail chain will open another area of operation for SFC (Own retail chain is capital intensive business rather labour intensive – high amount of capital will be invested in properties – even then outcome depends upon location of stores) and increase operating as well as financial risk too.
- b) Since SFC manufactures fabric, which is good for traditional clothing only, hence limited range of products may be available for sale at exclusive showroom/retails shops of SFC (through acquisition of Paridhaan); so, may not be able to attract requisite number of clients to cover the fixed cost.
- c) In order to complete product range SFC may have to complement its product with product of another manufacturers; this may be not possible in cost effective manner.

Conclusion

SFC should acquire retail chain 'Paridhaan', mainly as a response to reduce the competition from other brands whose products are lying along-with SFC products at selling shelves of retails and to reach end consumer directly to understand their needs. However, acquisition would not be so easy due to the high amount of capital investment is required. In addition, cultural changes are also essential to from overcome the traditional shell.

Overall, the benefits of acquiring retail chain do, however, need to be compared to the financial cost and other qualitative factors.

Case Study Digest 10 – Value Chain & Value Shop

Pariksha Commerce Test Ltd. (PCT) is an organization which provides service of test series of various commerce courses to facilitate students who are going to appear for such examination. PCT provides test series for 11th & 12th standard (Commerce) for CBSE as well as various other state boards; B.Com., B.B.A., M.Com., and M.B.A. of various universities; CA, CS and CMA. Company's Head Office is placed at Delhi NCR with branches and Test Series Centers (TSCs) in various cities of India. Now it is the only organization which provides test series of various courses and guidance of study and has students across India. It has also started online test series facility for students of remote locations who do not have access to travel at any of the TSC. In addition to Test Series, it provides support in preparing a reading plan, providing guidance on paper writing and counselling students, if required.

You are appointed as Cost Management Officer (CMO) of the PCT. In the Introduction Meeting, CEO, Mr. Parikshak, after brief introduction of organization addressed you, "We are rapidly growing education empire and having large student base across India. To reach here, we have faced lot of problems, but it has been overcome. I want to share few of them to make you better understand the organization. Recently, at the biggest TSC, in Delhi, printer was not working and there were almost 450-500 students

sitting and waiting for question paper. Outsourcing of print was costly and time-consuming option, so that we had mailed question paper to all of them to save time and cost. Now this approach has been applied at the most of the TSCs i.e. students come at TSC, we mail them question paper and they appear for test. It saves our printing cost. Irony is that non-maintenance of Printer can also save the cost! It may be little difficult for students to read question papers from their mobile phone or tablet, but they will be comfortable soon as “Change” is the law of life and Business too! Further to reduce advertisement cost, we have dropped the contract with Ms. Takshi Sharma, famous film star. We had contracted with her for advertisement on TV for 3 years. She was brand ambassador of ‘Pariksha’. Though we got many students due to TV advertisement, we decided to drop the contract as we have enough students and as of now, there is no competition, as such, hence no need to advertise for coming 1-2 years.

Further, we have reduced cost of question paper preparation. Up to last month we had, preciously, 57 members in question paper preparation team. They were drafting new questions for every test. Now we are having, preciously, 22 members in such team, less than half of we had. They are drafting less new questions and preparing paper with questions from past papers and other material of respective course. In our student support and student counselling team we had, preciously, 68 members, 42 for face-to-face counselling and 26 available on phone call. Now there are only 30 members, 12 for face-to-face counselling, and 18 available on phone call at our most profitable TSCs. This may require less infrastructure facility at our few TSCs which is cost beneficial for us.

Oh, I forgot to tell one of the reasons behind reducing advertisement cost is that, after analysis of financial statement, our CFO had suggested that our advertisement cost was comparatively higher than other companies working in education field as well as with our previous years.

These are the major problems we faced and changes we made during the year. Hope this set of information will be helpful to you to commence your work. Till now, we have managed cost management department very well, as you can see from the instances I narrated, however due to heavy workload and growing organization, now we are unable to handle these all alone, so we need your support in success of the organization. Thanks for listening me and you are free to ask anything, anytime. Thanks.”

After conclusion of his speech, you thanked him back and moved to your office to start work. You were thinking about strategy of paper less question paper, misuse of mobile phone or tablet during test and other matters as told to you.

In that moment, your phone had buzzed, a notification from Newsagram, an application providing news across world. Notification was about the contract between Abhyas Education Ltd., giant educationist of India and Mr. Shamkar Datta, a film star having one of the highest fans following all over India, regarding advertisement of newly introduced test series by it for commerce and science stream across India.

After proper analysis of new competitor and its products, you informed to the CEO. Discussion and various meetings had been called and after that CEO decided to do more marketing to defeat the competitor. For that the CEO approached new brand ambassador, namely Mr. Prakash Rao, more famous film star than Ms. Takshi Sharma and Mr. Shamkar Datta. This deal was little costlier, still to be in market it was required.

Now the CEO is feeling that some blunders have been made by him in handling of cost management department. Hence, he approached you to analyse various decisions made. Further, he asked you to

apply any of the value chain analysis or value shop model to deal with the situation, as he thinks both are the same.

Required

In this regard, you have been asked following questions:

- i. Whether approach of the organization to manage the cost is of the Traditional Cost Management system or the Strategic Cost Management System? EXPLAIN.
- ii. LIST out the general limitations of cost management system identified in (i) and then correlate them by identifying the problems faced by the organization.
- iii. EXPLAIN the differences and similarities of Value Chain Analysis and Value Shop Model to CEO and IDENTIFY which model can be applied in the organization.
- iv. DISCUSS importance of Strategic Cost Management.

Solution

- i. Traditional cost management system involves allocation of costs and overheads to the production and focuses largely on managing costs through cost control or cost reduction. The underlying assumption was that with reduced costs (direct) and overheads a firm could earn better profits. Strategic cost management is the application of cost management techniques to improve the strategic position of the business, reduce its costs and maintain the effective control of costs. It also involves integrating cost information with the decision-making framework to support the overall organisational strategy. It is not limited to managing costs but using cost information for management decision making. The cost management techniques should be such that they improve the strategic position of a business apart from focusing on managing costs.

In the case of PCT, approach is of managing costs by reducing number of employees, switch to paper less question paper, reduction of advertisement expenses etc. It focuses on managing costs only and not on improving strategic position of business. Hence, it can be said that the approach the organization to manage the cost is of the Traditional Cost Management System.

ii. Following are the limitations of the Traditional Cost Management System:

- The focus is on managing costs approached via responsibility centres or product cost issues. However, a broad cost reduction programme does not work effectively in today's business environment. The PCT focuses on managing costs by switching to paper less question papers, reduction of employees and reduction of advertisement cost without thinking of requirement of business environment.
- Traditional cost management system has internal focus and does not look at the external factors of competition, market growth, customer requirement etc. At the time of dropping contract, with Ms. Takshi Sharma of advertisement, was ignorance of competition. 'Enough students at the organisation' was just internal focus which led to ignorance on entry of new competitor. Additionally, other cost reduction decisions may not fulfil requirements of students.
- A broad cost reduction programme could lead to inferior quality of products & services which might drive away customers resulting in lower sales and profitability.

Due to reduction in members of paper preparation team, quality of question paper may also degrade. Further, reduction in members of student counselling team may lead to heavy workload on employees and due to that quality of service may also degrade.

- The expectations of modern customer are quite different. An excessive focus on cost reduction could impact the quality of product and services and alienate the customers.
Degraded quality of question papers and reduced student counselling team may lead to dissatisfaction in students. Further, question papers on mobile phone or tablet may be misused by students who are forced to give test. This may lead that students get higher marks in test series, however actual marks in exam may be lesser; this may lead to dissatisfaction to students' parents, ultimate customers of the organisation.
- Traditional cost accounting systems rely on accounting data which can be misleading at times. Financial statements can be a great reporting tool but might not be able to assist in strategic decision making. It does not consider dynamics of marketing and economics.
One of the reasons of reduction in advertisement cost was relying on financial statements, as suggested by CFO which might be less helpful in cost management decisions.
- There is a limited focus on review and improvisation of existing processes and activities.
Non-maintenance of printer was lack of review by the management and to overcome such problem they had mailed question paper to students, sitting at Delhi TSC, was an improvisation of activity.
- Traditional cost management is a reactive approach to cost management.
When it got the information of arrival of new competitor, it approached to Mr. Prakash Rao for advertisement, at higher cost which was reactive approach of situation.
- It has a short-term outlook e.g., saving costs on an annual basis.
At the time of dropping the advertisement contract, it thought that they did not require advertisement for 1-2 years. Approach was to save cost for short term and that approach led to higher cost by approaching new brand ambassador, Mr. Prakash Rao.

In general, PCT has been caught in the narrow-minded approach and decided for broad cost cutting. It also compromised on the fundamental business aspects like human capital development, quality, research and development (R&D), operational competitive edge, and other qualitative aspects which are of strategic nature.

(iii) Value Chain Analysis:

Value-chain analysis is a process by which a firm identifies and analyses various activities that add value to the final product. The idea is to identify those activities which do not add value to the final product/service and eliminate such non-value adding activities. The analysis of value chain helps a firm obtain cost leadership or improve product differentiation. Resources must be deployed in those activities that are capable of producing products valued by customers.

The concepts, tools and techniques of value chain analysis apply to all those organisations which produce and sell a product or provide a service.

The various activities undertaken by a firm can be broadly classified into Primary activities and Secondary activities. Primary activities are those which are directly involved in transforming of inputs

(Raw Material) into outputs (Finished Products) or in provision of service. Secondary activities (also known as support activities) support the primary activities.

Though, secondary activities are not directly involved in creation of product, it doesn't mean that they are of less importance as compared to primary activities.

Value Shop Model:

This concept aims to serve companies from service sector. In value shop principle, no value addition takes place. It only deals with the problem, figure-out the main area requires its service and finally comes with the solution. This approach is designed to solve customer problems rather than creating value by producing output from an input of raw materials. Value shops mobilizes resources (say: people, knowledge or money) to solve specific problems such as curing an illness or delivering a solution to a business problem. The 'problem' could also be how to exploit an opportunity. The shop process is iterative, involving repeatedly performing a generic set of activities until a solution is reached. The model has the same support activities as Porter's Value Chain, but the primary activities are described differently.

In the value shop they are:

- Problem finding and acquisition
- Problem solving
- Choosing among solutions
- Execution and control/evaluation

It is advisable to apply Value Shop Model in the PCT, as priority should be given to solve problems faced by the students. Satisfaction of students is only way to grow.

Case Study Digest 13 – Porter's 5 forces

Safe and Wise Advisory Limited (SWAL) is well established financial planning & risk advisory firm of the country with nation-wide presence. SWAL is engaged in selling third party products be it financial products or insurance products (life assurance only). Financial advisory business of SWAL is doing well and contributing to the half of gross revenue of group and two- third of overall group's bottom line, but insurance brokerage business is not performing as per expectation. 'Independent and impartial advice' to client is unique selling point of SWAL.

SWAL was established by Mr Kaushal Jaiswal around two decade ago (when life-assurance business goes private), at then it was one division business i.e., assurance brokerage business. Mr. Kaushal Jaiswal is dynamic leader and presently leading the company as CEO, apart from being major shareholder of the company.

SWAL is widely acknowledged in market for two distinct features, first being presence wide across the nation, in form of 'sub-agency offices' equipped with professionally trained sale staff headed by financial planner or advisor, where customer can take advise and discuss opinion prior to investing/ buying any insurance or financial product. SWAL has 'sub-agency offices' in 580 cities, towns and blocks. Locations are semi-commercial in nature but prominent. SWAL has practice to sign 30-year lease, when so ever taking and 'sub-agency office' on lease in order to reduce the lease cost and bring stability.

Secondly, SWAL sold product of all third parties, hence provide a range of products to its client to choose from. In 2010, SWAL signed a 15-year agency agreement with all 23 life insurance companies recognised then. SWAL's tagline is also depicting the same 'we are ethically committed to understand and deliver your needs'. SWAL believes in organic growth and listed on stock market 3 years back to float additional capital to fund more 'sub-agency offices'.

22 out of these 23 life assurance companies are private and registered themselves with regulatory between the year 2000-2009 for a period of 25 years. Considering the default by few insurance firms and increasing customer complaints, regulator of insurance business in country tightens the registration criteria and harden the norms.

Typically each of 'sub-agency office' comprises three regular and one contractual employee. One being financial planner/ advisor, 2 sales and relationship officer and contractual worker in role of support staff and vested with miscellaneous clerical responsibilities. The on-roll number of employees engaged in assurance brokerage business has been increased to 1,564 from 720 five year ago (up-till 3 year ago number was 845 but since expansion of 'sub-agency' office division it is around 1,500).

Market trend is changing, since the SWAL commence the business. Each of such insurance company, now has their own network of branch offices to sale their insurance product directly; that too at more prominent locations. SWAL counter this, by highlighting its 'independence and impartial advice' practice, although SWAL managed to retain the revenue at same level, but this result in low profitability of 'sub-agency office' business. Now these insurance companies are not authorising any new agent.

Being in service industry and further in order to ensure wider market reach to compensate the loss of profitability in 'sub-agency office' business, SWAL has established own 'E-platform'- 'Policy at you click' to sell the insurance product with total staff of 50 professionals, as a separate division under insurance brokerage business from 'sub-agency office' division. 'E- platform' division is prospering but 'sub-agency office' business is certainly in trouble.

Supported by revenue figures given below (in '000 Crores), analysts reach to conclusion that growth in the assurance brokerage business is slowing down both for SWAL and industry overall:

Market Size/Year	2019-20	2018-19	2017-18	2016-17	2015-16
SWAL's assurance brokerage business	326	320	312	298	280
Total market size of life assurance	2,240	2,198	2,122	2,004	1,960

Revenue earned by each division of assurance brokerage business (in term of age of the client), is shown in table below for year 2019-20:

Division/Age	20-30	30-40	40-50	50-60	60+	Total
'Sub-agency office' division	2	25	38	164	51	280
'E-platform' division	8	28	8	2	0	46
Total Business of SWAL						326

Since the profitability of 'sub-agency office' division is declining, hence the strategic review committee of board of directors are concerned about the company's declining profitability due to poor performance of 'sub-agency office' division and suggest that the 'sub-agency office' division should be sold off and that SWAL shall re-position its assurance business as an online solution.

Extract from financial statement for agency office division only (figures in '000 Crores)

Particulars/Year	2019-20	2018-19	2017-18
Revenue	280	272	250
Profit before interest and tax	18	16	31
Shareholder's' Equity	156	150	150
8% Long term debt	78	64	50
Current Liabilities	455	437	395
Current Assets	605	565	540

Applicable tax rate is 22%. The nature of cost incurred by 'sub-agency office' division is more or less balanced between the variable and fixed. Fixed costs are largely committed in nature.

But the CEO is not agreed to the suggestion made by strategic planning committee, because CEO is of belief that SWAL's USP or original business model is 'sub-agency offices' through which they ensure 'independence and impartial advice' to their clients.

In next board meeting, board is expected to pass resolution on this agenda item in order to decide either to continue or sale the 'sub-agency office' division.

Required

- ASSESS the competitive environment of life-assurance business of SWAL (including 'sub-agency office' division).
- (ii) EVALUATE the case for holding the 'sub-agency office' division, backed by financial viability among other criteria.

Solution

- Michael E Porter, in 1980 in his book "Competitive strategy: Techniques' for analysing industries and competitors" suggested five force model to assess the competitive environment of an industry. The five forces which are enumerated by this model are the bargaining power of suppliers; the bargaining power of customers (buyers); the threat of new entrants; threat of substitute products; and the level of rivalry among current competitors in the industry.



This model is also named as porter's five force analysis. Since each of these five forces affect the competitiveness of business, hence can be used to assess the potential of any organisation or entity; life-assurance business of SWAL (including 'sub-agency office' division) is not an exception to this.

The bargaining power of suppliers

Number of suppliers will decide the dominance they possess in term of bargaining power regarding the price of good and service they supply to business. In case of 'sub-agency office' division following factors will affect the suppliers' power–

Control over Value Chain – By adopting the strategy of forward integration the insurance companies them-selves getting into the direct sale through own network of branch offices in order to enhance their margin or reducing the margin earned by SWAL's 'sub-agency office' division. Since number of insurance companies are neither too less nor too much, hence bargaining power of insurance companies; in terms of percentage brokerage they offered to SWAL is moderate.

Importance of product – SWAL is also dealing in financial product's marketing and advisory, which contribute 50% of group sales and around 67% of group's profit; thus assurance business which is no doubt significant but only choice (business) available to SWAL. Hence, bargaining power of supplier is moderate.

Substitution among the brand – Life assurance product offers similar utility to client; hence easily substitutes among the brands, means if insurance company 1 charge lesser premier then insurance company 2, client will buy assurance of company 1. No doubt switching is less viable once policy subscribed. Since SWAL's 'sub-agency' division is offering the product from all 23 insurance companies, hence bargaining power of suppliers become low.

Supply of other factors – Other factor such 'sub-agency offices', which are largely on lease, has 30-year lease, this will reduce the lease cost as well as bargaining power of land-lord apart from bringing stability.

The bargaining power of customers

Whether seller is price taker or makes, this is outcome of bargaining power of customers (true sense competition). If the bargaining power is high seller will become price taker, else he is price maker. Following factors affect the bargaining power of customers of SWAL's 'sub-agency' division–

Number of buyers – In assurance industry the buyers are large (in comparison to few number of suppliers) and diversified, hence their bargaining power is low.

Standardised products – Since the life assurance is the product, which is standard from prospective of core functionality, hence buyers can easily substitute brands and can negotiate to reasonable extent.

Switching – Once policy subscribed cannot be easily switched with another, hence due to high switching cost bargaining power reduced to some extent at-least.

The threat of new entrants

Although entry of a new firm to the industry/ market depends upon the level of entry barriers, but if new entity enters into the industry; it will surely bring additional capacity which enhance the stiffness of competition; hence become a kind of threat. In case of 'sub-agency office' division, there are some major barriers to entry–

Less number of new life-assurance licenses by regulator due to tough regulations – As mentioned in the case that after considering the default by few insurance firms and increasing customer complaints, regulator of insurance business in country tighten the registration criteria and harden the norms; hence this may act as entry barrier and reduce the threat of new entrants.

Less number of new insurance agent due to no new authorisation by insurance companies – As market is revamping, the agents is becoming competitor to the insurance companies and as mentioned insurance companies stopped authorising new insurance agents, hence this will act an entry barrier for new insurance agents, which is a great positive for SWAL's 'sub-agency office' division and intact the competitive advantage.

Learning curve and economies of scale – Since all the 23 insurance companies dealing in life assurance and SWAL are 10- to 20-year-old organisations; hence learning curve and economies of scale (shared services for the 580 offices - presence in 580 cities) which they are enjoying may become entry barriers for new firm. Since new firms require huge capital to be at par to such learning curve and economies of scale.

Threat of substitution

Substitution means the product from some other industry which can render the same function which life assurance is rendering. The threat of substitute product is quiet low.

Competitive rivalry

The level of competition among the players to acquire or retain the market share directly affects the profitability in an industry. Following factor is affecting the competitive rivalry–

Number of competitors and respective market size – Since there are good number of competitors, hence competition will be intense; may cutthroat rivalry. Presently SWAL's insurance business represent 14.55% of market share (in 2019-20) in comparison to 14.29% of market share five year ago, without any major variation, hence possibility of gaining new market share is limited that too at high cost (in form of advertisement and more after sale services).

Lack of differentiation – Standardise product results in high rivalry, since the life assurance is standard product hence rivalry may be high on account of easy substitution effect among the different brands.

Slow market growth – If market is growing at high rate, rivalry may be stiffer or may be moderate; because everyone has reasonable opportunity to grow. The moment growth stagnated rivalry become stiffer because no one wish to lose market share. The industry life cycle curve is flatter here, because during last four years overall industry wide CAGR (compounded annual growth rate) of life assurance

business is 3.39%, whereas year-on-year growth from 2018-19 to 2019-20 is 1.91%. Although potential is limited, but competition is still high.

Exit barriers – If the exit cost for player to move out of industry is high, it will have to be in industry and fight for survival, which may make competition tougher. Since agency agreement and lease agreement is already signed by SWAL hence, it becomes difficult to exit from the business, hence need to participate in competition to retain the share.

(ii) Case for holding the 'sub-agency office' division

The strategic review committee suggests that the SWAL's 'sub-agency office' division should be sold off and that SWAL shall re-position its assurance business as an online solution, but the same suggestion firstly needs to be evaluated in terms of financial perspective among the other criteria.

The growth in life assurance business is stagnated and industry is in maturity stage of industry life cycle. This is evident from industry size and growth in the same. During last four years overall industry wide CAGR (compound annual growth rate) of life assurance business is 3.39%, whereas year-on-year growth from 2018-19 to 2019-20 is 1.91%. The moment growth stagnated rivalry become stiffer because no one wish to lose market share. Hence, there is intense competition in market. In cases where market witnesses intense competition, operating efficiently is essential and reduction in cost become key success factor; in order to offer competitive deals to clients and retain market share.

Hence, it becomes need of hour, that we review the operating processes followed at 'sub-agency offices' to check whether they are efficient or not, in order to ensure greater profitability rather thinking to sale off the entire 'sub-agency office' division.

Now, move to financial analysis, which suggests it is beneficial to hold back 'sub-agency' division.

Contribution to the group – Insurance business is contributing 50% of top-line of overall group revenue (and 1/3rd of bottom line), and around 86% (280/ 326) of this comes from 'sub-agency office' division and 'E-platform' division contribute only remaining 14%.

Profitability – Margins are positive. There are two major parameters to evaluate profitability further on–

- Operating profit (EBIT/ Revenue) – No doubt, operating profit shrink from 12.4% to 6.43% in three years' time frame. But as earlier quoted, margin is positive and secondly, there is sign of recovery as well. EBIT increased in absolute terms (from 16 to 18).
- Return on capital employed (ROCE) [EBIT / (Equity + Long Term Debt)] – No doubt, ROCE shrink from 15.5% to 7.69% in three years' time frame. But reduction in EBIT is not only a reason, another major reason for decline is change in capital structure. Long term debt is increased in absolute terms (from 50 to 78).

Liquidity – Current ratio (Current Assets / Current Liabilities) being reasonable measure of liquidity indicates enough liquidity in 'sub-agency office' division to meets it obligation. There is minor decline from 1.367 times to 1.33 times. Component analysis of working capital can be performed for greater insight.

Gearing (Debt / Equity) – Gearing ratio depicts the financial leverage, a measure of risk. Gearing ratio no doubt increased as result of introduction of debt, from 1/2 to 1/3, but under control.

Some other quasi-finance and significant factors relevant to the decision of sale of 'sub- agency office' division and full focus on 'E-platform' division–

Client's demography – Clients from all age groups from 20 to 60+ are clients of SWAL's assurance brokerage business. 66.56% (217/326) of revenue coming from clients with 50+ years of age, and 99% (215/217) out of them are associated through 'sub-agency offices', hence holding of 'sub-agency' division become essential. Secondly, clients from all age group may not find it convenient to shift to 'E-platform' 'Policy at you click' and their resistance may result in losing business. Thirdly, they have easily available substitute, because competitors also have branch offices which will give them same feel.

Resistance from employees – Out of 1,564 on-roll employees of assurance brokerage business, only 50 are associated in 'E-platform' division- 'Policy at you click', rest all in 'sub-agency office' division. If SWAL re-structure itself fully as online solution for life assurance then also cannot absorb all the employees, many of them need to be retrenched. Resistance will be there in both the cases because transferred employee may not have requisite skill set, result in poor quality of service and no job satisfaction to employee. Whereas in case of retrenched workers redundancy cost will become additional financial burden. This can be seen as exit barrier.

Legal aspect in term of pre-closure of lease - SWAL has practice to sign 30-year lease, when so ever taking and 'sub-agency office' on lease in order to reduce the lease cost and bring stability. It started the business 2 decades ago and expanded it 3 years ago and many of leases are active right now, in case of pre-closure, it may be possible to bear additional financial burden as per terms of lease agreement.

Loosing USP – 'Independence and impartial advice' with presence wide across the nation, in form of 'sub-agency offices' equipped with professionally trained sale staff headed by financial planner or advisor, where customer can take advise and discuss opinion prior to investing/ buying any insurance or financial product is USP for SWAL's assurance brokerage business. By disposing the 'sub-agency office' division this central idea, with which SWAL was established may be washed out.

In nutshell, the life assurance market has matured in recent years, and result in low growth potential and lower profitability but still yielding positive numbers. Hence, sale of 'sub-agency' division will adversely hit the revenue as well as profitability.