

CHAPTER 8

strategy formulation:
functional strategy and
Strategic Choice

STRATEGIC MANAGEMENT & BUSINESS POLICY
13TH EDITION

THOMAS L. WHEELEN J. DAVID HUNGER

8.1 Functional Strategy

Functional strategy- the approach a functional area takes to achieve corporate and business unit objectives and strategies by maximizing resource productivity

8.1 Functional Strategy

Marketing strategy deals with pricing, selling and distributing a product

8.1 Functional Strategy

Market development strategy- provides the ability to:

- Capture a larger market share
 - Market saturation
 - Market penetration
- Develop new uses and/or markets for current products

8.1 Functional Strategy

Product development strategy- provides the ability to:

- Develop new products for existing markets
- Develop new products for new markets

8.1 Functional Strategy

- Line extension- using a successful brand name to market other products
- Push strategy- promotions to gain or hold shelf space in retail outlets
- Pull strategy- advertising to “pull” products through the distribution channels

8.1 Functional Strategy

- Skim pricing- offers the opportunity to “skim the cream” from the top of the demand curve with a high price while the product is novel and competitors are few
- Penetration pricing- attempts to hasten market development and offers the pioneer the opportunity to use the experience curve to gain market share with low price and then dominate the industry

8.1 Functional Strategy

Financial Strategy- examines the financial implications of corporate and business-level strategic options and identifies the best financial course of action

Financial strategy includes the management of:

- Dividends
- Stock price
- Sales of company patents

8.1 Functional Strategy

Leveraged buyout- company is acquired in a transaction financed largely by debt usually obtained from a third party

Reverse stock split- investor's shares are split in half for the same total amount of money

8.1 Functional Strategy

Research and Development Strategy- deals with product and process innovation and improvement

- Technological leader- pioneers innovation
- Technological follower- imitates the products of competitors
- Open innovation- use of alliances and connections with corporate, government, academic labs and consumers to develop new products and processes

8.1 Functional Strategy

TABLE 8-1		Technological Leadership	Technological Followership
Research and Development Strategy and Competitive Advantage	Cost Advantage	Pioneer the lowest-cost production design. Be the first down the learning curve. Create low cost ways of performing value activities.	Lower the cost of the product or value activities by learning from the leader's experience. Avoid R & D costs through imitation.
	Differentiation	Pioneer a unique product that increases buyer value. Innovate in other activities to increase buyer value.	Adapt the product or delivery system more closely to buyer needs by learning from the leader's experience.

SOURCE: Adapted with the permission of The Free Press, A Division of Simon & Schuster Adult Publishing Group, from *COMPETITIVE ADVANTAGE. Creating and Sustaining Superior Performance* by Michael Porter. Copyright © 1985, 1988 by Michael E. Porter. All rights reserved.

8.1 Functional Strategy

Operations Strategy- determines how and where a product or service is to be manufactured, the level of vertical integration in the production process, the deployment of physical resources and relationships with suppliers

Manufacturing Types include

- Job shops
- Connected line batch flow
- Flexible manufacturing systems
- Dedicated transfer lines
- Mass production systems
- Continuous improvement
- Modular manufacturing
- Mass customization

8.1 Functional Strategy

Purchasing Strategy- deals with obtaining raw materials, parts and supplies needed to perform the operations function

Options include:

- Sole suppliers (Deming)
- Just-in-time
- Parallel sourcing

8.1 Functional Strategy

Logistics Strategy- deals with the flow of products into and out of the manufacturing process

Trends include:

- Centralization
- Outsourcing
- Internet

8.1 Functional Strategy

Human Resource Strategy

Trends include:

- Self-managed teams
- 360-degree appraisal
- Diverse workforce

Information Technology Strategy

Trends include:

- Follow the sun management
- Internet
- Extranet
- Intranet

8.2 The Sourcing Decision: Location of Functions

Outsourcing- purchasing from someone else a product or service that had been previously provided internally

- Avoid outsourcing distinctive competencies

Offshoring- the outsourcing of an activity or a function to a wholly-owned company or an independent provider in another country

8.2 The Sourcing Decision: Location of Functions

Disadvantages of outsourcing and offshoring

- Customer complaints
- Long-term contracts
- Ability to learn new skills and develop new core competencies
- Lack of cost savings
- Poor product quality
- Increased transportation costs

8.2 The Sourcing Decision: Location of Functions

Errors in Outsourcing Efforts

- Outsourcing the wrong activities
- Selecting the wrong vendor
- Poor contracts
- Personnel issues
- Lack of control
- Hidden costs
- Lack of an exit strategy

8.2 The Sourcing Decision: Location of Functions

FIGURE 8-1
Proposed
Outsourcing
Matrix

		Activity's Total Value-Added to Firm's Products and Services	
		Low	High
Activity's Potential for Competitive Advantage	High	Taper Vertical Integration: Produce Some Internally	Full Vertical Integration: Produce All Internally
	Low	Outsource Completely: Buy on Open Market	Outsource Completely: Purchase with Long-Term Contracts

SOURCE: J. D. Hunger and T. L. Wheelen, "Proposed Outsourcing Matrix." Copyright © 1996 and 2005 by Wheelen and Hunger Associates. Reprinted by permission.

8.3 Strategies to Avoid

- Follow the leader
- Hit another home run
- Arms race
- Do everything
- Losing hand

8.4 Strategic Choice: Selecting the Best Strategy

Constructing Corporate Scenarios- pro forma balance sheets and income statements that forecast the effect of each alternative strategy/its various programs will have on division and corporate return on investment

8.4 Strategic Choice: Selecting the Best Strategy

Steps include

1. Use industry scenarios to develop assumptions about the task environment
2. Develop common size financial statements for prior years
3. Construct detailed pro forma financial statements for each strategic alternative

8.4 Strategic Choice: Selecting the Best Strategy

TABLE 8-2 Scenario Box for Use in Generating Financial Pro Forma Statements

Factor	Last Year	Historical Average	Trend Analysis	Projections ¹									Comments	
				200-			200-			200-				
				O	P	ML	O	P	ML	O	P	ML		
GDP														
CPI														
Other														
Sales units														
Dollars														
COGS														
Advertising and marketing														
Interest expense														
Plant expansion														
Dividends														
Net profits														
EPS														
ROI														
ROE														
Other														

NOTE 1: O = Optimistic; P = Pessimistic; ML = Most Likely.

SOURCE: T. L. Wheelen and J. D. Hunger. Copyright © 1987, 1988, 1989, 1990, 1992, 2005, and 2009 by T. L. Wheelen. Copyright © 1993 and 2005 by Wheelen and Hunger Associates. Reprinted with permission.

8.4 Strategic Choice: Selecting the Best Strategy

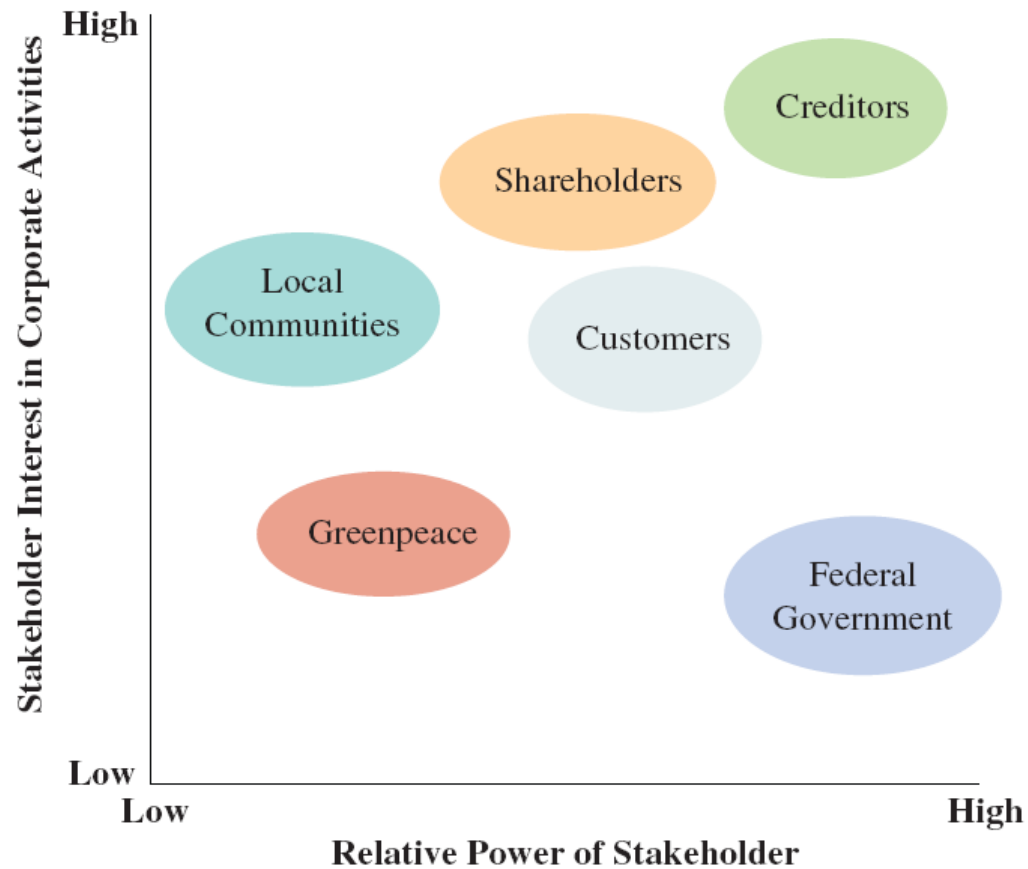
Management's Attitude Toward Risk

Risk- composed not only of the probability that the strategy will be effective but also of the amount of assets the corporation must allocate to the strategy and the length of time the assets will be unavailable for other uses

- Real options approach- a broad range of options used in environments of high uncertainty
- Net present value- calculates the value of a project by predicting its payouts, adjusting them for risk and subtracting the amount invested

8.4 Strategic Choice: Selecting the Best Strategy

FIGURE 8-2
Stakeholder
Priority Matrix



.....
SOURCE: Based on C. Anderson, "Values-Based Management," *Academy of Management Executive* (November 1997), pp. 25-46.

8.4 Strategic Choice: Selecting the Best Strategy

How to Assess the importance of stakeholder concerns

1. How will this decision affect each stakeholder?
2. How much of what stakeholders want are they likely to get under the alternative?
3. What are the stakeholders likely to do if they don't get what they want?
4. What is the probability that they will do it?

8.4 Strategic Choice: Selecting the Best Strategy

Corporate Culture Options

1. Take a chance on ignoring the culture
2. Manage around the culture and change the implementation plan
3. Try to change the culture to fit the strategy
4. Change the strategy to fit the culture

8.4 Strategic Choice: Selecting the Best Strategy

Needs and Desires of Key Managers

- Personnel characteristics and experience
- Industry and cultural backgrounds
- Tendency to maintain the status quo

8.4 Strategic Choice: Selecting the Best Strategy

Process of Strategic Choice

Strategic choice- the evaluation of alternative strategies and selection of the best alternative

- Consensus
- Devil's advocate
- Dialectical inquiry

8.4 Strategic Choice: Selecting the Best Strategy

Process of Strategic Choice

Criteria for evaluating alternatives includes:

- Mutual exclusivity
- Success
- Completeness
- Internal Consistency

8.5 Developing Policies

Effective Policies Accomplish

1. Forces trade-offs between competing resource demands
2. Tests the strategic soundness of a particular action
3. Sets clear boundaries within which employees must operate while granting them freedom to experiment within those constraints