CHAPTER- 5: FORMULATION OF FUNCTIONAL STRATEGY

INTRODUCTION-
❖ Strategy of one functional area cannot be looked at in isolation as different functional tasks are interwoven together
❖ Effectiveness of strategic management depends how a strategy is synergised with other areas & the manner in which it is implemented
❖ Functional strategies are based on functional capabilities of an org
❖ Role/need of functional strategy
  • Making strategies formulated by top management, practically feasible at functional level
  • Facilitate flow of strategic decisions to different parts of an org
  • Act as basis for controlling activities in different functional areas of business
  • Brings harmony & coordination as these remain part of major strategies
  • Provide support to overall business strategy
  • Spell out how functional managers will work to ensure their better performance
  • Reduction in time spent by functional managers in decision-making as plans lay down clearly what is to be done & policies provide required framework
  • Similar situations occurring in different functional areas are handled in consistent manner
❖ Choice of functional strategy is affected by-
  • Relevant environmental factors
  • Strategies of org.
  • Resource allocation decisions

MARKETING STRATEGY FORMULATION-
❖ Marketing –
  ❖ Def- from business point of view, activity related to identifying customer needs & taking actions to satisfy them in return of some consideration.
  ❖ It is more important to do what is strategically right than what is immediately profitable
  ❖ Helps in moving people closer to make a decision to purchase & facilitate a sale
  ❖ Examples of marketing decisions requiring special attention-
    • Kind of distribution network to be used
    • Amount & extent of advertising
    • Be a price leader or price follower?
    • To offer complete or limited warranty?
    • To limit or enhance business share with single or few customers?
    • Basis to reward salespeople (straight salary/straight commission/combination)?
❖ Delivering Value to Customer-
  ❖ Marketing needs to work in coordination with other departments as it can’t alone produce superior value for the consumer.
  ❖ There is a challenge to get all departments to think with focus on customer
  ❖ There is a need to look beyond its own chain of activities & into the chains of its suppliers, distributors & ultimately customers to produce “value delivery network”
Connecting with consumers-
- Org must be customer centred & must win customers from competitors & keep them by delivering greater value
- since org cannot satisfy all consumers in a market, so they divide up the total market (market segmentation), choose best segments (market targeting), design strategies for serving chosen segments profitably better than competitors (market positioning)

The Marketing Process-
- Once the strategic plan has defined the org’s overall mission & objectives, marketing plays a role in carrying out these objectives
- In this process, analyse market opportunities, select target markets, develop marketing mix & manage the marketing effort
- Target customer stand at centre of the marketing process

Marketing Mix-
- Important part of overall competitive marketing strategy
- It is a blend of all the elements of marketing mix into a coordinated program to achieve the org’s marketing objectives by delivering value to customers
- Often referred to as 4Ps from marketer’s angle: product, price, place & promotion
- Often referred to as 4Cs from buyer’s angle: customer solution, customer cost, convenience & communication

Product-
- Refers to goods & services combination the org offers to target market
- Strategies are needed for managing existing products over time & adding new ones & dropping failed outs, for branding, packaging & other features
- some product may have consistent demand while others may have fleeting demand, industrial or consumer-products, essentials or luxury, durables or perishables
- can be differentiated on basis of size, shape, colour, packaging, brand-name, etc
- Often, differentiation is more psychological than physical
- Brand enables customers to identify product & org behind it, building products’ & firms’ image around it & may result in strong brand loyalty

Price-
- Amount of money customers have to pay to obtain the product
- Strategies are to be made for location of customers, price flexibility, related items within a product line & terms of sale
- Price is a composite expression of value to customer, its demand, quality, reliability, safety, competition, desired profit & so on
- Low cost org may adopt aggressive pricing strategy as they enjoy more freedom of action
- Most org have to accept market price with minor deviations & work towards cost
- Objectives to be kept in mind- making product acceptable to customers, producing reasonable margin, & achieving market that helps in developing market share
- Org may choose cost plus pricing or skimming strategy
- In skimming, prices are set very high to penetrate the market & are directed to those buyers who are relatively price insensitive but sensitive novelty of new product

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Place -
- org’s activities that make product available to target consumers
- most basic marketing decision is “choosing most appropriate marketing channel”
- take strategies for management of channels
- design applicable strategies to middlemen (such as wholesalers, retailers, etc)
- distribution policies are important determinants of functions of marketing
- sets the pattern of operation of sales force.

Promotion -
- Activities that communicate the merits of product & persuade consumers to buy it
- Strategies are needed to combine individual methods into coordinated campaign
- Strategies must be adjusted as life stage of the product changes
- It is simultaneously a communication, persuasion & conditioning process
- Individual promotional Methods-
  - Personal Selling -
    Oldest form of promotion, involving face-to-face interaction between sales force & prospective customers to provide them with high degree of personal attention. It may initially focus on developing a relationship with potential buyer, but ends up with sales-making efforts.
    Demerits- high cost as sales personnel is expensive, physical attention to only one customer at a time.
    Merits- highly effective to persuade potential customer.
  - Advertising -
    Non-personal & highly flexible method, where type of message, copy & illustration are matter of choice & creativity. Media used can be local, regional or national & includes pamphlets, brochures, newspapers, magazines, radio, television & internet. It is likely to succeed in promoting sales but its effectiveness in respect to expenses cannot be directly measured
  - Publicity -
    Non-personal form of promotion similar to advertising, where no payment is made to media. Skilfull method to promote themselves/their product without payment. It is a way to reach customers with negligible cost & can be done by press releases, press conference, reports, internet releases, etc.
  - Sales Promotion -
    Activities that are undertaken to promote business, not included under above three. These activities done periodically may help in getting larger market share. Eg includes discounts, contests, money refunds, exhibitions, fair, etc

Expanding Marketing Mix – above elements of marketing mix are not exhaustive. New Ps include -
- People -
  Human actors who play a part in delivery of the market offering, influencing buyer’s perception
- **Physical Evidence**: Envt. in which market offering is delivered & where firm & customers interact
- **Process**: Actual procedures, mechanisms & flow of activities by which product/service is delivered

❖ **Marketing Analysis**

❖ It involves complete analysis of the company’s situation by identifying SWOT
❖ It has three components: planning, implementation & control
❖ Through analysis, org feed information & other inputs to marketing management functions

❖ **Marketing Planning**

❖ Involves deciding marketing strategies which will help the org to achieve its strategic objectives
❖ Detailed plan is required for each business, product or brand
❖ Product/brand plan may contain different sections each of which is defined below.
❖ Executive summary- short summary of main goals & recommendations
❖ Current marketing situation- describes the target market & org’s position in it
❖ Threats & opportunities section- anticipated impactful important developments
❖ Objectives & Issues- set objectives & consider issues that will affect them
❖ Marketing strategy- it helps the business to achieve its marketing objectives
❖ Marketing Budget- shows projected revenues, costs & profits
❖ Controls- controls used to monitor progress & allows for corrective actions

❖ **Dealing with the marketing environment**

❖ Carefully analyse its envt. to avoid the threats & exploit opportunities
❖ Analyse forces close to the org such as ability to serve customers, channel members, suppliers, competitors & publics
❖ Analyse broader forces such as PESTLE

❖ **Marketing Strategy Techniques**

❖ **Social Marketing**
Design, implementation & control of programs seeking to increase the acceptability of a social idea, cause or practice among a target group (eg- quit smoking)

❖ **Augmented Marketing**
Additional customer service & benefits built around actual products that relate to introduction of hi-tech services, to elevate customer service (eg- movies on demand)

❖ **Direct Marketing**
Marketing through various media that interact directly with consumers, to call them for a direct response. (eg- catalogue selling, mail)

❖ **Relationship Marketing**
Process of creating, maintaining & enhancing strong relations with customers & other stakeholders, to strengthen bonds & go long way in building relationships (eg- special lounges at major airports for frequent flyers)
- **Services Marketing** - Applying concepts, tools & techniques of marketing to services, where, service is any benefit that one party offers to another which is essentially intangible & doesn’t result in banking/savings/retailing/educational/utilities.

- **Person Marketing** - Activities undertaken to create, maintain, or change attitudes or behaviour towards particular people (eg- politicians, sports star, film star do it to get votes, fans, etc.)

- **Organisation Marketing** - Activities undertaken to create, maintain or change attitudes & behaviour of targeted audience towards an org & is adopted by both profit & non-profit org.

- **Place Marketing** - Activities undertaken to create, maintain or change attitudes & behaviour towards particular places (eg- tourism marketing)

- **Enlightened Marketing** - Marketing philosophy holding that a company’s marketing should support the best long-run performance of the marketing system. Its 5 principles of marketing are: customer-oriented M, innovative M, value M, sense-of-mission M & societal M.

- **Differential Marketing** - Market-coverage strategy where firm decides to target several market segments & design separate offer for each (eg- HUL’s lux in popular & Dove in premium segment)

- **Synchro-Marketing** - strategy to find ways to alter same pattern of demand through flexible pricing, promotion, incentives, etc, when demand for product is irregular (due to season, hour basis, etc) causing idle capacity or overworked capacity, (eg-selling movie tickets at low price during weekdays to increase demand)

- **Concentrated Marketing** - Market-coverage strategy where firm goes after a large share of one/few sub market

- **Demarking** - Strategy to reduce demand temporarily/permanently with an aim to reduce/shift it & not destroy it, when there is overfull demand (eg- zoos are full during weekends)

**FINANCIAL STRATEGY FORMULATION**

- Financial strategies of an org are related to concepts considered to be central to strategy implementation.
- These are- acquire needed capital, develop budgets, usage of funds & evaluate business worth
- Eg of decisions taken under financial decisions are -
  - To raise capital with short-term or long-term debt, with preferred or common stock
  - To lease or buy fixed assets
  - To determine appropriate dividend-payout ratio
  - To extend the time of accounts receivable
  - To determine amount of cash-in-hand

- **Acquiring capital to implement strategies/sources of funds** -
  - To implement strategy successfully, often additional capital is required
  - Besides net profit, two ways to raise funds: debt & equity
  - Determine appropriate debt-equity mix

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• Raise enough debt to boost Return on Investments (ROI) by applying debt to projects earning more than the cost of debt.
• During low earning periods, too much debt endangers stockholder’s return & org’s survival
• Debt obligations must be met, regardless of circumstances.
• This doesn’t mean stock issues is always better than debts
• Stock issue can dilute ownership & control, resulting in takeovers, mergers, acquisitions, etc
• Factors for which strategy is to be made-
  • Capital structure, capital procurement, working capital borrowings, relations with lenders.
• Such strategies determine how financial resources will be made available to implementation

❖ **Projected financial statements/ budgets**-
  • It is a document that details how funds will be obtained & spent for a specified period of time
  • Allows org. to examine expected results of various actions/approaches, to forecast the impact of various implementation decisions, to compute projected financial ratios & provide valuable insights into feasibility of various strategy-implementation approaches
  • Required by almost all financial institutions for raising capital
  • Not a tool for limiting expenditure, but for planned allocation of firm’s resources based on forecasts of future
  • Types of Budgets- cash/sales/profit/expense/variable/flexible/fixed budget, etc.
  • Limitations-
    • May become so detailed that they are cumbersome & overly expensive
    • Problems can be caused by over/under-budgeting
    • May become substitutes for objectives, however, it a tool & not an end
    • Can hide efficiencies if based solely on precedent rather than periodical evaluation
    • May result in frustration, resentment, absenteeism, high turnover, but this can be overcome by making subordinates participate well in preparing budgets.

❖ **Management/usage of funds**-
  • Plans & policies relating to this deal with investment or asset-mix decisions
  • Factors/areas for which plans & policies to be made-
    • Capital investment, fixed asset acquisition, current assets, loans & advances, dividend decisions, relationship with shareholders.
  • Its importance relates to efficiency & effectiveness of resource utilization in process of strategy implementation
  • Expansion strategies typically results in increase in capital work-in-progress & current assets.
  • In absence of clear plans/policies, usage of funds will be insufficient, causing less than optimum utilization of resources
  • Important role is played by Payout policies for dividends & bonus distribution
  • Factors for which plans/policies related to management of funds are to be made-
    • Finance system, accounting, budgeting, cost control & reduction, tax planning, etc
    • Aim- conservation & optimum utilization of funds, which are central to any strategic action
  • Good management of fund creates difference between strategically successful & unsuccessful org
  • Minimisation of conflict of interest between management & shareholders is required

❖ **Evaluating the worth of a business**-
  • it is central to strategy implementation as integrative, intensive & diversification strategies are often implemented by acquiring other firms

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Method 1: On the basis of its net worth or stockholder’s equity:
- Net worth is the aggregate of common stock, additional paid-in capital & retained earnings.
- Add or subtract appropriate amount of goodwill and over/under-valued assets from net worth.

Method 2: On the basis of expected future profits:
- Based on belief that worth of business is based largely on future benefits its owner may derive through net profits.
- Conservative rule of thumb states business’s worth to be five times of firm’s current annual profit or five yr. average profit.
- Remember that firms normally suppress earnings in financial statements to reduce tax.

Method 3: Let market determine business’s worth:
- Involves three methods:
  1. First, base it on selling price of a similar or given firm, which has a problem of difficulty in locating comparable figures.
  2. Second, by method of price-earning ratio, divide market price of firm’s common stock by annual earnings per share & multiply the answer with firm’s average net income for the past five years.
  3. Third, by outstanding shares method, multiply outstanding shares by market price per share & add a premium.

PRODUCTION STRATEGY FORMULATION:
- Related to production system, operational planning & control thereof, & R&D.
- Affects the nature of product/service, the markets to be served, manner in which they are to be served; collectively influencing operations system structure & objectives used to determine the policies & plans.

Production System:
- Concerned with capacity, location, layout, product/service design, work systems, degree of automation, extent of vertical integration, etc.
- Deal with vital issues affecting the capability of org to achieve its objectives.
- Take into account production system factors as they involve long-term decisions & influence not only operational capability of org but also its ability to implement strategies & achieve objectives.

Operations Planning & Control:
- Concerned with aggregate production planning, materials supply, inventory cost & quality management, maintenance of plant & equipment, etc.
- Aim: to see the efficiency of resource utilization & manner in which day-to-day operations can be managed in light of long-term objectives.
- It is an eg of organisational activity, aimed at translating objectives into reality.
- Some org use quality as a strategic tool.

LOGISTICS STRATEGY:
- Logistics management is a process which integrates the flow of supplies into, through & out of org. to achieve a level of service which ensures that right material is available at right place, at right time, of right quality & at right cost.
- Org try to keep cost of “safe & reliable” transportation as low as possible.

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Logistical activities typically include management of inbound & outbound goods, transportation, warehousing, handling of material, order fulfilment, inventory management, supply/demand planning.

Effective logistics strategy involves raising & finding answers to following questions:
- Which sources of raw material & components are available?
- How many manufacturing locations are there?
- What products are being made at each manufacturing location?
- What modes of transportation should be used for various products?
- Should business own the transport vehicles?

Advantages - cost saving, reduced inventory, improved delivery time, customer satisfaction, competitive advantage

Supply Chain:
- Defined as the linkages between suppliers, manufacturers & customers
- Involve all activities like procurement of raw material, conversion & logistics
- Its planning & control are important concepts of its management
- It is a result of several changes in business env't. such as technological changes, reduced communication costs, increase in speed, creation of innovative products & shorter product life cycle, customers desire for customised products at lower costs.
- Improves trust & collaboration among partners, thus, improving flow & management of inventory
- It can be outsourced as well, enabling org to focus on core competencies

Supply Chain Management:
- Defined as the process of planning, implementing & controlling supply chain operations, & working closely with channel partners (suppliers, intermediaries, service providers, customers)
- Cross-functional approach to manage movement of raw material into org. & movement of finished goods out of org. to satisfy end consumer efficiently
- Encompasses all movement & storage of raw material, work-in-process inventory, & finished goods from origin point to consumption point
- It is an extension of logistics management

Logistics Management vs Supply Chain Management (SCM):
- Logistical activities typically include management of inbound & outbound goods, transportation, warehousing, handling of material, order fulfilment, inventory management, supply/demand planning
- Logistics management can be termed as one part of SCM, which is related to planning, implementation & control of movement & storage of goods & services & related information between origin point & consumption point
- SCM includes more aspects apart from logistics function.
- SCM is a tool of business transformation & involves delivering right product, at right time to the right place & at right price.
- SCM reduces cost of org & enhances customer service

Implementing SCM Systems:
- Requires change from managing individual functions to integrated activities into key supply chain processes
- Involves collaborative work between buyers & suppliers, joint product development, common systems, network of information sharing & management, shared information
- Need to share information through electronic mode & take timely decisions
- SCM systems can be implemented & successfully run by adopting following—

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Product Development -
• Customers & suppliers must work together in product development process to shorten the life cycle.
• Products are developed & launched in shorter time & help org to remain competitive

Procurement -
• Requires careful resource planning, quality issues, negotiation, order placement, inbound transportation, storage, coordination with suppliers in scheduling, & involvement of suppliers in manufacturing process

Manufacturing -
• These processes must be flexible to respond to market changes, adaptive to accommodate customization in tastes & preferences
• should be done on basis of Just-in-time
• should be modified to reduce manufacturing cycle

Physical Distribution -
• Availability of products at right place at right time is important for each participant of channel.
• SCM links marketing channel with customers

Outsourcing -
• It is not limited to material procurement, & includes outsourcing of services that traditionally have been provided within an org., so that org can focus on those activities in which it has competency

Customer Services -
• Org develop customer services through interface with org’s production & distribution operations to produce positive feelings.
• Org. work with customer to determine mutually satisfying goals & create & maintain service.

Performance Measurement -
• Supplier capabilities & customer relationships can be correlated with firm’s performance, which is measured in different parameters such as cost, quality, productivity, customer relationship, etc

Research & Development -
❖ charged with developing new products & improving old products in a way that will allow effective strategy implementation
❖ tasks performed include: transferring complex technology, adjusting processes to local raw material, adapting process to local markets, altering products to specific tastes/preferences
❖ play crucial role in strategy of product development, market penetration, concentric diversification
❖ support to R&D by management is often constrained by resource availability
❖ merits- shorten product life cycle, fuels profitability & growth
❖ org use R&D that ties external opportunities to internal strengths & is linked with objectives
❖ R&D policies enhance strategy implementation efforts to-
  • Emphasize product or process improvement
  • Be leaders or followers in R&D
  • Perform R&D within the org or contract to outside firms
  • Use university researchers or private sector researchers
❖ Effective interactions between R&D department & other functional department is crucial

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Guidelines to decide whether to outsource R&D or develop it internally:

- If rate of technical progress is slow, market growth rate is moderate, significant new entrant barriers are present, then in-house R&D is preferred (on success will result in product/process monopoly)
- If technology changes rapidly, market grows slowly, major R&D effort is risky as it may lead to development of obsolete technology or one for which there is no market
- If technology changes slowly, market grows rapidly, there is no enough time for in-house development, so outsource it exclusively or non-exclusively
- If both technology & market growth rate is fast, obtain R&D expertise through acquiring well-established firm in the industry

Approaches to R&D:

- **Approach 1** (glamourous, exciting & dangerous approach)- be the first firm to market new technological products
- **Approach 2**- be innovative imitator of successful products to minimize the risks & cost of start-up, to develop first version of new product & show that market exists. It requires excellent personnel & marketing department
- **Approach 3**- be a low-cost producer by mass-producing products similar to but less expensive than recently introduced products, because price becomes increasingly important decision as a new product is accepted by customers. It requires substantial investment in Plant & Equipment, but fewer in R&D.

**HUMAN RESOURCE STRATEGY FORMULATION**

- **Def**- linking HRM with strategic goals & objectives to improve business performance & develop organisational culture promoting innovation & flexibility
- Includes assessing staffing needs & costs for alternative strategies proposed during strategy formulation
- Includes developing a staffing plan for effectively implementing strategies
- Includes how to motivate employees & managers
- Must develop performance incentives that clearly link performance, & pay to strategies
- Yields greatest benefit when all members clearly understand how well they will benefit personally

**Responsibility of HR manager**:

- Linking of company’s objectives & personal benefits of employees
- Establishing & administering ESOPs
- Instituting an effective childcare policy
- Providing leadership to managers & employees to let them balance work & family

**HR Problems that may arise**:

- Disruption of social & political structures
- Failure to match individual’s aptitudes with implementation tasks
- Inadequate top management support for implementation activities

**Threat to many managers/employees due to strategy implementation that needs to be anticipated, considered & managed**:

- New power & status relationships
- New formal & informal groups’ values, beliefs & priorities may be largely unknown
- Resistant behaviour due to change in their roles, & power

**Methods to match managers with strategies**:

- Transferring managers
- Developing leadership workshops

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Offering career development activities & Promotions
Job enlargement & job enrichment
Managers can support strategy-implementation efforts by giving few efforts, announcing few decisions, depending heavily on informal questioning, & awarding key thrusts.
Prevent/overcome HR problems to build understanding, trust, commitment, ownership & reducing resentment by-
- Match individual aptitudes with strategy-implementation tasks
- Commitment by top-management
- Actively involving manager’s & employees in the process
Employment recruitment, selection, training, performance, appraisal, rewarding can have strong influence on employee competence by keeping below points in mind-
- Recruitment & Selection- successfully identify, attract & select competent applicants
- Training- well train employees to perform their jobs properly
- Appraisal of performance- identify performance efficiencies experienced by employees due to lack of competence & solve them by counselling, training, etc
- Compensation- offer pay & benefit packages more attractive than competitors to attract & retain most capable person

Strategy & HRM-
Select best available personnel, ensure fit between employee & job, retain/ motivate/ empower employees to perform well in direction of corporate objectives
Areas to give strategic focus to-
- Pre-selection practices (eg- HR Planning & job analysis)
- Recruitment & Selection practices including policies thereof should be formulated keeping in mind the mission & purpose of the org
- Post-selection practices (eg- training & development, performance appraisal, compensation, motivation) to maintain & improve job performance levels

Strategic role of HRM-
Providing purposeful direction-
- Must be able to lead people & org towards desired direction involving right people
- Ensure that org’s objective has been internalized by each individual working in org.
- Ensure that objective of org become objective of each person working in org
- All actions of each person must be consistent with objectives defined
Creating competitive atmosphere-
- Maintaining competitive gain is any org’s objective which can be done by cost leadership or differentiation
- Implementing these strategies carries heavy premium on having a highly committed & competent workforce
Facilitation of change-
- HR will be more concerned with substance rather than form, accomplishments rather than activities, practice rather than theory
- Will be responsible for furthering org, not just maintaining it
- Devote more time to promote changes than maintaining status quo
Diversion of workforce-
- Can be observed in terms of male & female worker, young & old worker, educated & uneducated worker, unskilled & professional worker, castes, religion, nationality etc

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Future workforce will comprise of more educated & self-conscious workers, who will ask for higher degree of participation

Money will no longer be sole motivating force for majority of workforce

Non-financial incentives will play important role in workforce motivation

Empowerment of Human resource-

- Means authorizing every member of org to take of their destiny, realizing their full potential
- Involves giving more power to those who, at present, have little control of what they do & little ability to influence the decisions being made around them

Building core competency-

- Core competence is a unique strength of org, which may not be shared by others
- Competency can be in the form of HR, marketing, technology, etc
- Business organised on core competency is likely to generate competitive advantage
- Many org’s are divesting their business which do not match their core competence
- Needs creative, courageous & dynamic leadership having faith in org’s HR.

Development of work ethics & culture

- Requires increasing emphasis on individuals, jobs have to be redesigned to provide challenge
- Flexible starting & quiting times may be necessary
- Shift focus from extrinsic to intrinsic motivation
- Create vibrant work culture to create an atmosphere of trust among people, & to encourage creative ideas among people
- Requirement is of far reaching changes with the help of technical knowledge