Part **Three**

Strategy Implementation

The last section of this book examines what is often called the action phase of the strategic management process: implementation of the chosen strategy. Up to this point, three phases of that process have been covered—strategy formulation, analysis of alternative strategies, and strategic choice. Although important, these phases alone cannot ensure success. To ensure success, the strategy must be translated into carefully implemented action. This means that:

1. The strategy must be translated into guidelines for the daily activities of the firm's members.
2. The strategy and the firm must become one—that is, the strategy must be reflected in the way the firm organizes its activities and in the firm's values, beliefs, and tone.
3. In implementing the strategy, the firm's managers must direct and control actions and outcomes and adjust to change.

Chapter 9 explains how organizational action is successfully initiated in four interrelated steps:

1. Creation of clear *short-term objectives* and *action plans.*
2. Development of specific *functional tactics* that create competitive advantage.
3. Empowerment of operating personnel through *policies* to guide decisions.
4. Implementation of effective *reward system.*

Short-term objectives and action plans guide implementation by converting long-term objectives into short-term actions and targets. Functional tactics translate the business strategy into activities that build advantage. Policies empower operating personnel by defining guidelines for making decisions. Reward systems encourage effective results.

Today's competitive environment often necessitates restructuring and reengineering the organization to sustain competitive advantage. Chapter 10 examines how restructuring and reengineering are pursued in three organizational elements that provide fundamental, long-term means for institutionalizing the firm's strategy:

1. The firm's *structure.*
2. The *leadership* provided by the firm's CEO and key managers.
3. The fit between the strategy and the firm's *culture.*

Since the firm's strategy is implemented in a changing environment, successful implementation requires that execution be controlled and continuously improved. The control and improvement process must include at least these dimensions:

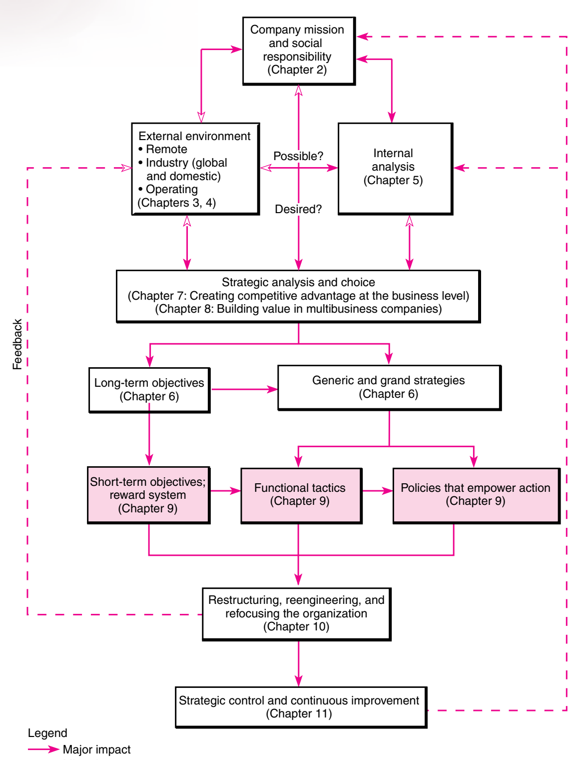
1. *Strategic controls* that "steer" execution of the strategy.
2. *Operations control systems* that monitor performance, evaluate deviations, and initiate corrective action.
3. *Continuous improvement* through total quality initiatives of a balanced scorecard perspective.

Chapter 11 examines the dimensions of the control and improvement process. It explains the essence of change as an ever-present force driving the need for strategic control. The chapter concludes with a look at the global "quality imperative," which is redefining the essence of control into the twenty-first century.

Implementation is "where the action is." It is the arena that most students enter at the start of their business careers. It is the strategic phase in which staying close to the customer, achieving competitive advantage, and pursuing excellence become realities. The chapters in this part will help you understand how this is done.

Chapter **Nine**

Implementing Strategy through Short-Term Objectives, Functional Tactics, Reward System, and Employee Empowerment



Once corporate and business strategies have been agreed upon and long-term objectives set, the strategic management process moves into a critical new phase—translating strategic thought into organizational action. In the words of two well-worn phrases, they move from "planning their work" to "working their plan" as they shift their focus from strategy formulation to strategy implementation. Managers successfully make this shift when they do four things well:

1. Identify short-term objectives.
2. Initiate specific functional tactics.
3. Communicate policies that empower people in the organization.
4. Design effective rewards.

Short-term objectives translate long-range aspirations into this year's targets for action. If well developed, these objectives provide clarity, a powerful motivator and facilitator of effective strategy implementation.

Functional tactics translate business strategy into daily activities people need to execute. Functional managers participate in the development of these tactics, and their participation, in turn, helps clarify what their units are expected to do in implementing the business's strategy.

Policies are empowerment tools that simplify decision making by empowering operating managers and their subordinates. Policies can empower the "doers" in an organization by reducing the time required to decide and act.

A powerful part of getting things done in any organization can be found in the way its reward system rewards desired action and results. Rewards that align manager and employee priorities with organizational objectives and shareholder value provide very effective direction in strategy implementation.

SHORT-TERM OBJECTIVES

Chapter 6 described business strategies, grand strategies, and long-term objectives that are critically important in crafting a successful future. To make them become a reality, however, the people in an organization that actually "do the work" of the business need guidance in exactly what needs to be done today and tomorrow to make those long-term strategies become reality. Short-term objectives help do this. They provide much more specific guidance for what is to be done, a clear delineation of impending actions needed, which helps translate vision into action.

Short-term objectives help implement strategy in at least three ways. First, short-term objectives "operationalize" long-term objectives. If we commit to a 20 percent gain in revenue over five years, what is our specific target or objective in revenue during the current year, month, or week to indicate we are making appropriate progress? Second, discussion about and agreement on short-term objectives help raise issues and potential conflicts within an organization that usually require coordination to avoid otherwise dysfunctional consequences. Exhibit 9–1 illustrates how objectives within marketing, manufacturing, and accounting units within the same firm can be very different even when created to pursue the same firm objective (e.g., increased sales, lower costs). The third way short-term objectives assist strategy implementation is to identify measurable outcomes of action plans or functional activities, which can be used to make feedback, correction, and evaluation more relevant and acceptable.

Short-term objectives are usually accompanied by action plans, which enhance these objectives in three ways. First, action plans usually identify functional tactics and activities

EXHIBIT 9–1
Potential Conflicting Objectives and Priorities

President

	Marketing	Finance and accounting	Manufacturing
Responsibilities	• Distribution channels	• Communications and data processing	• Production and supply alternatives
	• Customer service	• Carrying inventory	• Warehousing
	• Inventory obsolescence		• Transportation
Objectives	• More inventory	• Less inventory	
	• Frequent short runs		• Long production runs
	• Fast order processing	• Cheap order processing	
	• Fast delivery		• Lowest cost routing
	• Field warehousing	• Less warehousing	• Plant warehousing

that will be undertaken in the next week, month, or quarter as part of the business's effort to build competitive advantage. The important point here is *specificity*—what exactly is to be done. We will examine functional tactics in a subsequent section of this chapter. The second element of an action plan is a clear *time frame for completion*—when the effort will begin and when its results will be accomplished. A third element action plans contain is identification of *who is responsible* for each action in the plan. This accountability is very important to ensure action plans are acted upon.

Because of the particular importance of short-term objectives in strategy implementation, the next section addresses how to develop meaningful short-term objectives. Exhibit 9–2 provides a *BusinessWeek* interview with Symantec CEO John Thompson about the nature and importance of short-term objectives to Symantec's success.

Qualities of Effective Short-Term Objectives

Measurable

Short-term objectives are more consistent when they clearly state *what* is to be accomplished, *when* it will be accomplished, and *how* its accomplishment will be *measured.* Such objectives can be used to monitor both the effectiveness of each activity and the collective progress across several interrelated activities. Exhibit 9–3 illustrates several effective and ineffective short-term objectives. Measurable objectives make misunderstanding less likely among interdependent managers who must implement action plans. It is far easier to quantify the objectives of *line* units (e.g., production) than of certain *staff* areas (e.g., personnel). Difficulties in quantifying objectives often can be overcome by initially focusing on *measurable activity* and then identifying *measurable outcomes.*

Priorities

Although all annual objectives are important, some deserve priority because of a timing consideration or their particular impact on a strategy's success. If such priorities are not established, conflicting assumptions about the relative importance of annual objectives may inhibit progress toward strategic effectiveness. Facing the most rapid, dramatic decline in

Strategy in Action
Symantec CEO John Thompson

Exhibit 9–2

BusinessWeek **"You can't manage what you don't measure," says Symantec CEO John Thompson, who explains why objectives are vital in implementing strategy.**

"If you could only monitor five objectives to run/steer your business, what would they be and why?" is a question *BusinessWeek* posed Thompson, chairman and CEO of Symantec, a Cupertino (Calif)-based Internet security outfit that makes antivirus and firewall technology. In the four years since Thompson joined Symantec as top exec, revenues have more than doubled, from $632 million $1,407 billion in 2003. The company has not missed an earnings projection in the last two years.

Q: So what would be your critical objectives, and why?

A: Let's define what objectives are: They are vectors for how you are performing now, but also indicators for how you will do in the future. Here are five critical objectives I use to manage Symantec. Our most critical objectives are customer satisfaction and market share.

Customer satisfaction

We use an outside firm to poll customers on a continuous basis to determine their satisfaction with our products and services. This needs to be an anonymous relationship—a conversation between our pollster and our customers. Polling is done by product area: firewall, antivirus, services, and other product lines.

Market share

There are a couple of ways we look at this. We have our own views based on relevant markets. Then we use industry analysts such as Gartner, IDC, and Giga as benchmarks for annualized results on market share. On a quarterly basis, we look at our revenue performance and growth rates, and that of our competitors. We compare against actual realized growth rates, as compared to growth rates of relevant competitors in similar segments.

The purpose is to get trending data. That gives us a sense of market changes and market growth. We also use a blended (rating) of analyst companies in the same space. Each industry-analyst firm counts things a bit differently, based on its methodology. The numbers don't have to be spot on or Six Sigma precise.

Revenue growth

You have to consider if revenue is growing at a rate equal to or greater than the market rate. If you look at the antivirus market, for example, industry analysts projected growth in the high teens while our enterprise antivirus sector grew at a rate of 32 percent. This indicates that we are gaining market share faster than the market growth rate for the industry.

We can then assess how we had planned to grow. Did we plan to grow at 32 percent or less—or more? You have to gauge your growth relative to the market for your product or service and your own internal expectations of your performance.

Expenses

It is important to always plan for how much money will have to be spent to generate a certain level of revenue. This enables you to monitor funds flow in the company. Did I plan to spend $10 or $12, and what did I get for that expense in return? The purpose is to keep expenses in equilibrium to revenue generation.

Earnings

Two keys to watch here—operating margins and earnings per share (EPS). A business running efficiently is improving its operating margins. If you are efficient in your operating margins, this should produce a strong EPS, which is a strong objective that Wall Street looks at all the time.

Q: What problems do tracking objectives solve for a corporation? How does maintaining objectives help you manage and steer the direction of the corporation?

A: I am a little old-fashioned—I don't believe you can manage what you don't measure. The importance of objectives becomes more important as the enterprise grows in size and scale. Objectives also serve as an indication for the team about what you are paying attention

profitability of any major computer manufacturer as it confronted relentless lower pricing by Dell Computer and AST, Compaq Computer formulated a retrenchment strategy with several important annual objectives in pricing, product design, distribution, and financial condition. But its highest priority was to dramatically lower overhead and production costs so as to satisfy the difficult challenge of dramatically lowering prices while also restoring profitability.

Priorities are established in various ways. A simple *ranking* may be based on discussion and negotiation during the planning process. However, this does not necessarily communicate the real difference in the importance of objectives, so such terms as *primary, top,* and *secondary* may be used to indicate priority. Some firms assign *weights* (e.g., 0 to 100 per-

continued **Exhibit 9–2**

to. If employees know you are measuring market growth and customer satisfaction, they will pay attention to those considerations and will behave based on indicators that you, as the leader, provide to the organization. Objectives helps the team focus on what's important for an organization.

Q: To what degree is maintaining objectives also about managing expectations of different audiences: investors, Wall Street analysts, and other parties? How do you manage the expectations of these third parties and other constituent groups?

A: The one that is the most interesting group to try to manage today is the expectation that investors have in our company and its performance. Our chief financial officer and I spend a lot of time on that topic. The ones investors watch most closely are revenue growth and EPS. We set expectations realistically and deliver against those expectations consistently. These considerations are at the core of how Wall Street fundamentally values a company. You have to properly set expectations and cascade those objectives down through the organization.

I wouldn't want to say to Wall Street that we have revenue growth rate projections of 18 percent and not internalize communication of that objective to the 4,500 people that are part of the company. It would be a huge mistake if you set up different expectations for what you communicate externally and how you manage internally. You can't have a disconnect between the two.

Q: How should companies consider industry-specific objectives versus broad financial objectives: P/E ratio, etc?

A: This is an issue for all of us. I am on the board of a utility company. The company has achieved modest single-digit revenue growth. They are quite proud of that, while I would be quite concerned if that were to be the growth rate for a software firm. For example: An important consideration may be what you are spending in R&D in comparison to your peer group. Or, for a software firm, what is the license revenue mix?

I couldn't care less about the performance of Symantec relative to that of a financial-services company. But I would care about the performance of Symantec in comparison with an enterprise software company or with another securities software firm. Whatever measures you choose should give you the ability to measure your performance against like-industry companies.

Q: What do other CEOs need to keep in mind as they consider/reevaluate the use of objectives for their companies?

A: Live by the adage that you can't manage what you can't measure. The best objectives are simple to understand, simple to communicate, and relatively easy for everyone to get access to the data that represents the results. That makes your objectives an effective management tool. If you make your objectives difficult to gather, manage, or communicate, they won't be effective. Simplicity is key.

My experience has proven to me the importance of picking the few objectives that are the most critical for the running of the business. Stick with them—and communicate them to both internal and external audiences.

You don't change these objectives regardless of the whimsical views of Wall Street or the problem du jour. You have to pick the most important objectives and manage to this set standard. At the same time, you have to continually evaluate as the business changes over time to ensure that your objectives remain relevant. I would argue that all good leaders do this.

Source: "The Key to Success? Go Figure," *BusinessWeek,* July 21, 2003.

cent) to establish and communicate the relative priority of objectives. Whatever the method, recognizing priorities is an important dimension in the implementation value of short-term objectives.

Linked to Long-Term Objectives

Short-term objectives can add breadth and specificity in identifying *what* must be accomplished to achieve long-term objectives. For example, Wal-Mart's top management recently set out "to obtain 45 percent market share in five years" as a long-term objective. Achieving that objective can be greatly enhanced if a series of specific short-term objectives identify what must be accomplished each year in order to do so. If Wal-Mart's market share is

EXHIBIT 9–3
Creating Measurable Objectives

Examples of Deficient Objectives	Examples of Objectives with Measurable Criteria for Performance
To improve morale in the division (plant, department, etc.)	To reduce turnover (absenteeism, number of rejects, etc.) among sales managers by 10 percent by January 1, 2004. *Assumption:* Morale is related to measurable outcomes (i.e., high and low morale are associated with different results).
To improve support of the sales effort	To reduce the time lapse between order data and delivery by 8 percent (two days) by June 1, 2004.
	To reduce the cost of goods produced by 6 percent to support a product price decrease of 2 percent by December 1, 2004.
	To increase the rate of before- or on-schedule delivery by 5 percent by June 1, 2004.
To improve the firm's image	To conduct a public opinion poll using random samples in the five largest U.S. metropolitan markets to determine average scores on 10 dimensions of corporate responsibility by May 15, 2004. To increase our score on those dimensions by an average of 7.5 percent by May 1, 2005.

now 25 percent, then one likely annual objective might be "to have each regional office achieve a minimum 4 percent increase in market share in the next year." "Open two regional distribution centers in the Southwest in 2005" might be an annual objective that Wal-Mart's marketing and distribution managers consider essential if the firm is to achieve a 45 percent market share in five years. "Conclude arrangements for a $1 billion line of credit at 0.25 percent above prime in 2004" might be an annual objective of Wal-Mart's financial managers to support the operation of new distribution centers and the purchase of increased inventory in reaching the firm's long-term objective.

The link between short-term and long-term objectives should resemble cascades through the firm from basic long-term objectives to specific short-term objectives in key operation areas. The cascading effect has the added advantage of providing a clear reference for communication and negotiation, which may be necessary to integrate and coordinate objectives and activities at the operating level.

The qualities of good objectives discussed in Chapter 6—acceptable, flexible, suitable, motivating, understandable, and achievable—also apply to short-term objectives. They will not be discussed again here, but you should review the discussion in Chapter 6 to appreciate these qualities, common to all good objectives.

The Value-Added Benefits of Short-Term Objectives and Action Plans

One benefit of short-term objectives and action plans is that they give operating personnel a better understanding of their role in the firm's mission. "Achieve $2.5 million in 2005 sales in the Chicago territory," "Develop an OSHA-approved safety program for handling acids at all Georgia Pacific plants in 2005," and "Reduce Ryder Truck's average age of accounts receivable to 31 days by the end of 2005" are examples of how short-term objectives clarify the role of particular personnel in their firm's broader mission. Such *clarity of purpose* can be a major force in helping use a firm's "people assets" more effectively, which may add tangible value.

A second benefit of short-term objectives and action plans comes from the process of developing them. If the managers responsible for this accomplishment have participated in their development, short-term objectives and action plans provide valid bases for addressing and accommodating conflicting concerns that might interfere with strategic effectiveness (see Exhibit 9–1). Meetings to set short-term objectives and action plans become the forum for raising and resolving conflicts between strategic intentions and operating realities.

A third benefit of short-term objectives and action plans is that they provide a *basis for strategic control.* The control of strategy will be examined in detail in Chapter 11. However, it is important to recognize here that short-term objectives and action plans provide a clear, measurable basis for developing budgets, schedules, trigger points, and other mechanisms for controlling the implementation of strategy. Exhibit 9–2, Strategy in Action, describes how new Symantec CEO John Thompson used short-term objectives as a key basis for strategic control.

A fourth benefit is often a *motivational payoff.* Short-term objectives and action plans that clarify personal and group roles in a firm's strategies and are also measurable, realistic, and challenging can be powerful motivators of managerial performance—particularly when these objectives are linked to the firm's reward structure.

FUNCTIONAL TACTICS THAT IMPLEMENT BUSINESS STRATEGIES

Functional tactics are the key, routine activities that must be undertaken in each functional area—marketing, finance, production/operations, R&D, and human resource management—to provide the business's products and services. In a sense, functional tactics translate thought (grand strategy) into action designed to accomplish specific short-term objectives. Every value chain activity in a company executes functional tactics that support the business's strategy and help accomplish strategic objectives.

Exhibit 9–4 illustrates the difference between functional tactics and corporate and business strategy. It also shows that functional tactics are essential to implement business strategy. The corporate strategy defined General Cinema Corporation's general posture in the broad economy. The business strategy outlined the competitive posture of its operations in the movie theater industry. To increase the likelihood that these strategies would be successful, specific functional tactics were needed for the firm's operating components. These functional tactics clarified the business strategy, giving specific, short-term guidance to operating managers in the areas of marketing, operations, and finance.

Differences between Business Strategies and Functional Tactics

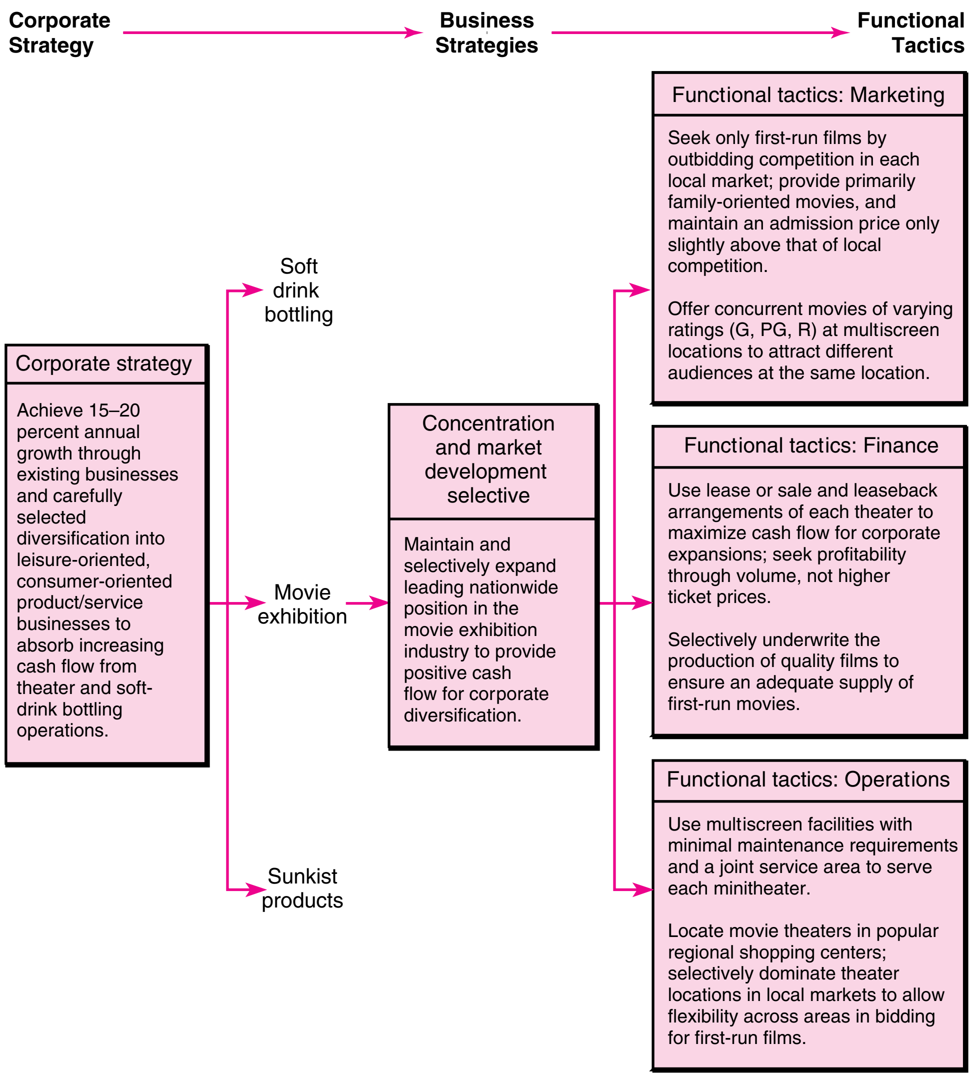
Functional tactics are different from business or corporate strategies in three fundamental ways:

1. Time horizon.
2. Specificity.
3. Participants who develop them.

Time Horizon

Functional tactics identify activities to be undertaken "now" or in the immediate future. Business strategies focus on the firm's posture three to five years out. Delta Air lines is committed to a concentration/market development business strategy that seeks competitive advantage via differentiation in its level of service and focus on the business traveler. Its pricing tactics are often to price above industry averages, but it often lowers fares on selected routes to thwart low-cost competition. Its business strategy is focused 10 years out; its pricing tactics change weekly.

EXHIBIT 9–4
Functional Tactics at General Cinema Corporation



The shorter time horizon of functional tactics is critical to the successful implementation of a business strategy for two reasons. First, it focuses the attention of functional managers on what needs to be done *now* to make the business strategy work. Second, it allows functional managers like those at Delta to adjust to changing current conditions.

Specificity

Functional tactics are more specific than business strategies. Business strategies provide general direction. Functional tactics identify the specific activities that are to be undertaken in each functional area and thus allow operating managers to work out *how* their unit is expected to pursue short-term objectives. General Cinema's business strategy gave its movie theater division broad direction on how to pursue a concentration and selective market development strategy. Two functional tactics in the marketing area gave managers specific direction on what types of movies (first-run, primarily family-oriented, G, PG, R) should be shown and what pricing strategy (competitive in the local area) should be followed.

Specificity in functional tactics contributes to successful implementation by:

- Helping ensure that functional managers know what needs to be done and can focus on accomplishing results.
- Clarifying for top management how functional managers intend to accomplish the business strategy, which increases top management's confidence in and sense of control over the business strategy.
- Facilitating coordination among operating units *within* the firm by clarifying areas of interdependence and potential conflict.

Exhibit 9–5, Strategy in Action, illustrates the nature and value of specificity in functional tactics versus business strategy in an upscale pizza restaurant chain.

Participants

Different people participate in strategy development at the functional and business levels. Business strategy is the responsibility of the general manager of a business unit. That manager typically delegates the development of functional tactics to subordinates charged with running the operating areas of the business. The manager of a business unit must establish long-term objectives and a strategy that corporate management feels contributes to corporate-level goals. Similarly, key operating managers must establish short-term objectives and operating strategies that contribute to business-level goals. Just as business strategies and objectives are approved through negotiation between corporate managers and business managers, so, too, are short-term objectives and functional tactics approved through negotiation between business managers and operating managers.

Involving operating managers in the development of functional tactics improves their understanding of what must be done to achieve long-term objectives and, thus, contributes to successful implementation. It also helps ensure that functional tactics reflect the reality of the day-to-day operating situation. And perhaps most important, it can increase the commitment of operating managers to the strategies developed.

EMPOWERING OPERATING PERSONNEL: THE ROLE OF POLICIES

Specific functional tactics provide guidance and initiate action implementing a business's strategy, but more is needed. Supervisors and personnel in the field have been charged in today's competitive environment with being responsible for customer value—for being the "front line" of the company's effort to truly meet customers' needs. Meeting customer needs, becoming obsessed with quality service, was the buzzword that started organizational revolutions in the 1980s. Efforts to do so often failed because employees that were the real contact point between the business and its customers were not *empowered* to make decisions or act to fulfill customer needs. One solution has been to empower operating personnel by pushing down decision making to their level. General Electric allows appliance repair personnel to decide about warranty credits on the spot, a decision that used to take several days and multiple organizational levels. Delta Air Lines allows customer service personnel and their supervisors wide range in resolving customer ticket pricing decisions. Federal Express couriers make decisions and handle package routing information that involves five management levels in the U.S. Postal Service.

Empowerment is being created in many ways. Training, self-managed work groups, eliminating whole levels of management in organizations, and aggressive use of automation are some of the ways and ramifications of this fundamental change in the way business organizations function. At the heart of the effort is the need to ensure that decision making

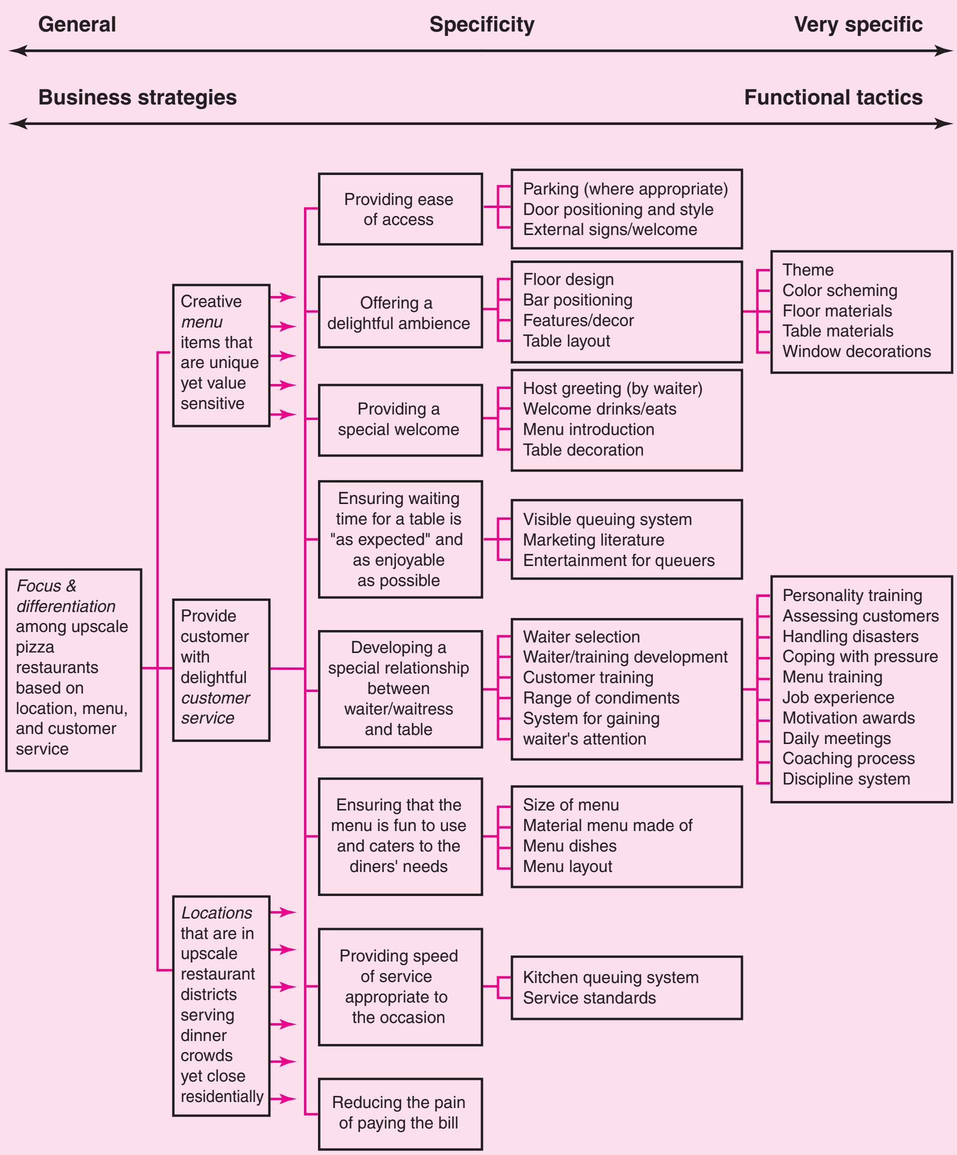
Strategy in Action

The Nature and Value of Specificity in Functional Tactics versus Business Strategy

Exhibit 9–5

BusinessWeek A restaurant business was encountering problems. Although its management had agreed unanimously that it was committed to a business strategy to differentiate itself from other competitors based on concept and customer service rather than price, it continued to encounter inconsistencies across different store locations in how well it did this. Consultants indicated that the customer experience varied greatly from store to store. The conclusion was that while the management understood the "business strategy," and the employees did too in general terms, the implementation was inadequate because of a lack of specificity in the functional tactics—what everyone should do every day in the restaurant—to make the vision a reality in terms of the customers' dining experience. The following breakdown of part of their business strategy into specific functional tactics just in the area of customer service helps illustrate the value specificity in functional tactics brings to strategy implementation.

Source: Adapted from "California Pizza Kitchen: Say Cheese!," *BusinessWeek,* July 15, 2003; and A. Campbell and K. Luchs, *Strategic Synergy* (London: Butterworth-Heineman, 1992).



is consistent with the mission, strategy, and tactics of the business while at the same time allowing considerable latitude to operating personnel. One way operating managers do this is through the use of policies.

Policies are directives designed to guide the thinking, decisions, and actions of managers and their subordinates in implementing a firm's strategy. Previously referred to as *standard operating procedures,* policies increase managerial effectiveness by standardizing many routine decisions and clarifying the discretion managers and subordinates can exercise in implementing functional tactics. Logically, policies should be derived from functional tactics (and, in some instances, from corporate or business strategies) with the key purpose of aiding strategy execution.[1] Exhibit 9–6, Strategy in Action, illustrates selected policies of several well-known firms.

Creating Policies That Empower

Policies communicate guidelines to decisions. They are designed to control decisions while defining allowable discretion within which operational personnel can execute business activities. They do this in several ways:

1. *Policies establish indirect control over independent action* by clearly stating how things are to be done *now.* By defining discretion, policies in effect control decisions yet empower employees to conduct activities without direct intervention by top management.

2. *Policies promote uniform handling of similar activities.* This facilitates the coordination of work tasks and helps reduce friction arising from favoritism, discrimination, and the disparate handling of common functions—something that often hampers operating personnel.

3. *Policies ensure quicker decisions* by standardizing answers to previously answered questions that otherwise would recur and be pushed up the management hierarchy again and again—something that required unnecessary levels of management between senior decision makers and field personnel.

4. *Policies institutionalize basic aspects of organization behavior.* This minimizes conflicting practices and establishes consistent patterns of action in attempts to make the strategy work—again, freeing operating personnel to act.

5. *Policies reduce uncertainty in repetitive and day-to-day decision making,* thereby providing a necessary foundation for coordinated, efficient efforts and freeing operating personnel to act.

6. *Policies counteract resistance to or rejection of chosen strategies by organization members.* When major strategic change is undertaken, unambiguous operating policies clarify what is expected and facilitate acceptance, particularly when operating managers participate in policy development.

[1] The term *policy* has various definitions in management literature. Some authors and practitioners equate policy with strategy. Others do this inadvertently by using *policy* as a synonym for company mission, purpose, or culture. Still other authors and practitioners differentiate policy in terms of "levels" associated respectively with purpose, mission, and strategy. "Our policy is to make a positive contribution to the communities and societies we live in" and "our policy is not to diversify out of the hamburger business" are two examples of the breadth of what some call policies. This book defines *policy* much more narrowly as specific guides to managerial action and decisions in the implementation of strategy. This definition permits a sharper distinction between the formulation and implementation of functional strategies. And, of even greater importance, it focuses the tangible value of the policy concept where it can be most useful—as a key administrative tool to enhance effective implementation and execution of strategy.

Strategy in Action

Selected Policies That Aid Strategy Implementation

Exhibit 9–6

3M Corporation has a *personnel policy,* called the *15 percent rule,* that allows virtually any employee to spend up to 15 percent of the workweek on anything that he or she wants to, as long as it's product related.

(This policy supports 3M's corporate strategy of being a highly innovative manufacturer, with each division required to have a quarter of its annual sales come from products introduced within the past five years.)

Wendy's has a *purchasing policy* that gives local store managers the authority to buy fresh meat and produce locally, rather than from regionally designated or company-owned sources.

(This policy supports Wendy's functional strategy of having fresh, unfrozen hamburgers daily.)

General Cinema has a *financial policy* that requires annual capital investment in movie theaters not to exceed annual depreciation.

(By seeing that capital investment is no greater than depreciation, this policy supports General Cinema's financial strategy of maximizing cash flow—in this case, all profit—to its growth areas. The policy also reinforces General Cinema's financial strategy of leasing as much as possible.)

IBM had a *marketing policy* of not giving free IBM personal computers (PCs) to any person or organization.

(This policy attempted to support IBM's image strategy by maintaining its image as a professional, high-value, service business as it sought to dominate the PC market.)

Crown, Cork, and Seal Company has an *R&D policy* of not investing any financial or people resources in basic research.

(This policy supports Crown, Cork, and Seal's functional strategy, which emphasizes customer services, not technical leadership.)

Bank of America has an *operating policy* that requires annual renewal of the financial statement of all personal borrowers.

(This policy supports Bank of America's financial strategy, which seeks to maintain a loan-to-loss ratio below the industry norm.)

7. *Policies offer predetermined answers to routine problems.* This greatly expedites dealing with both ordinary and extraordinary problems—with the former, by referring to these answers; with the latter, by giving operating personnel more time to cope with them.

8. *Policies afford managers a mechanism for avoiding hasty and ill-conceived decisions in changing operations.* Prevailing policy can always be used as a reason for not yielding to emotion-based, expedient, or temporarily valid arguments for altering procedures and practices.

Policies may be written and formal or unwritten and informal. Informal, unwritten policies are usually associated with a strategic need for competitive secrecy. Some policies of this kind, such as promotion from within, are widely known (or expected) by employees and implicitly sanctioned by management. Managers and employees often like the latitude granted by unwritten and informal policies. However, such policies may detract from the long-term success of a strategy. Formal, written policies have at least seven advantages:

1. They require managers to think through the policy's meaning, content, and intended use.
2. They reduce misunderstanding.
3. They make equitable and consistent treatment of problems more likely.
4. They ensure unalterable transmission of policies.
5. They communicate the authorization or sanction of policies more clearly.
6. They supply a convenient and authoritative reference.
7. They systematically enhance indirect control and organizationwide coordination of the key purposes of policies.

EXHIBIT 9–7
Make Sure Policies Aren't Used To Drive Away Customers

Every Year *Inc. Magazine* sponsors a conference for the 500 fastest growing companies in the United States to share ideas, hear speakers, and network. A recent conference included a talk by Martha Rogers, coauther of *The One to One Future.* Here is an interesting anecdote about policies she used in her talk:

"The story was about a distinguished-looking gentleman in blue jeans who walked into a bank and asked a teller to complete a transaction. The teller said she was sorry, but the person responsible was out for the day. The man would have to come back. He then asked to have his parking receipt validated. Again, she said she was sorry, but under bank policy she could not validate a parking receipt unless the customer completed a transaction. The man pressed her. She did not waver. "That's our policy," she said.

So the man completed a transaction. He withdrew all $1.5 million from his account. It turned out he was John Akers, then chairman of IBM.

The moral: Give employees information about the value of customers, not mindless policies."

The strategic significance of policies can vary. At one extreme are such policies as travel reimbursement procedures, which are really work rules and may not have an obvious link to the implementation of a strategy. Exhibit 9–7 provides an interesting example of how the link between a simple policy and strategy implementation regarding customer service can have serious negative consequences when it is neither obvious to operating personnel nor well thought out by bank managers. At the other extreme are organizationwide policies that are virtually functional strategies, such as Wendy's requirement that every location invest 1 percent of its gross revenue in local advertising.

Policies can be externally imposed or internally derived. Policies regarding equal employment practices are often developed in compliance with external (government) requirements, and policies regarding leasing or depreciation may be strongly influenced by current tax regulations.

Regardless of the origin, formality, and nature of policies, the key point to bear in mind is that they can play an important role in strategy implementation. Communicating specific policies will help overcome resistance to strategic change, empower people to act, and foster commitment to successful strategy implementation.

Policies empower people to act. Compensation, at least theoretically, rewards their action. The last decade has seen many firms realize that the link between compensation, particularly executive management compensation, and value-building strategic outcomes within their firms was uncertain. The recognition of this uncertainty has brought about increased recognition of the need to link management compensation with the successful implementation of strategies that build long-term shareholder value. The next section examines this development and major types of executive bonus compensation plans.

EXECUTIVE BONUS COMPENSATION PLANS[2]

Major Plan Types

The goal of an executive bonus compensation plan is to motivate executives to achieve maximization of shareholder wealth—the underlying goal of most firms. Since shareholders are both owners and investors of the firm, they desire a reasonable return on their investment. Because they are absentee landlords, shareholders want the decision-making logic of their firm's executives to be concurrent with their own primary motivation.

[2] We wish to thank Roy Hossler for his assistance on this section.

However, agency theory instructs us that the goal of shareholder wealth maximization is not the only goal that executives may pursue. Alternatively, executives may choose actions that increase their personal compensation, power, and control. Therefore, an executive compensation plan that contains a bonus component can be used to orient management's decision making toward the owners' goals. The success of bonus compensation as an incentive hinges on a proper match between an executive bonus plan and the firm's strategic objectives. As one author has written: "Companies can succeed by clarifying their business vision or strategy and aligning company pay programs with its strategic direction."[3]

Stock Options

A common measure of shareholder wealth creation is appreciation of company stock price. Therefore, a popular form of bonus compensation is stock options. Stock options have typically represented over 50 percent of a chief executive officer's average pay package.[4] Stock options provide the executive with the right to purchase company stock at a fixed price in the future. The precise amount of compensation is based on the difference, or "spread," between the option's initial price and its selling, or exercised, price. As a result, the executive receives a bonus only if the firm's share price appreciates. If the share price drops below the option price, the options become worthless. The largest single option sale of all time occurred on December 3, 1997. Disney Chief Executive Officer Michael D. Eisner exercised more than 7 million options on Disney stock that he had been given in 1989 as part of his bonus plan. Eisner sold his shares for more than $400 million.

Stock options were the source of extraordinary wealth creation for executives, managers, and rank-and-file employees in the technology boom of the last decade. Behind using options as compensation incentives was the notion that they were essentially free. Although they dilute shareholders' equity when they're exercised, taking the cost of stock options as an expense against earnings was not required. That, in turn, helped keep earnings higher than actual costs to the company and its shareholders. The bear market and corporate scandals of the last few years brought increased scrutiny on the use of and accounting for stock options. As of this writing there is increased pressure to begin expensing stock options to more accurately reflect company performance. The table below shows the effect expensing stocks options would have on the net earnings of the S&P 500 firms in recent years. "Stock options were a free resource, and because of that, they were used freely," said BankOne CEO James Dimon, who voluntarily began to expense stock options in 2003. "But now," he said, "when you have to expense options, you start to think" 'Is it an effective cost?' Is there a better way?" The Financial Accounting Standards Board was preparing a new ruling in 2004 that would require expensing of stock options.

A Big Hit To Earnings

If options had been expensed, earnings would have been whacked as their popularity grew

Options Expense As a Percent of Net Earnings for S&P 500 Companies

1996	1998	2000	2002
2%	5%	8%	23%

Data: The Analysis Accounting Observer R. G. Associates Inc.

[3] James E. Nelson, "Linking Compensation to Business Strategy," *The Journal of Business Strategy* 19, no. 2 (1998), pp. 25–27.
[4] Louis Lavelle, Frederick Jespersen, and Spencer Ante, "Executive Pay," *BusinessWeek,* April 21, 2003.

Microsoft shocked the business world in 2003 by announcing it would discontinue stock options, eliminating a form of pay that made thousands of Microsoft employees millionaires and helped define the culture of the tech industry. Starting in September, 2003, the company began paying its 54,000 employees with restricted stock, a move that will let employees make money even if the company's share price declines. Like options, the restricted stock will vest gradually over a five-year period and grants of restricted stock counted as expenses and charged against earnings. Said CEO Steven Ballmer, "We asked: Is there a smarter way to compensate our people, a way that would make them feel even more excited about their financial deal at Microsoft and at the same time be something that was at least as good for the shareholders as today's compensation package?" At the time of Ballmer's announcement, over 20,000 employees that had joined Microsoft in the past three years held millions of stock options that were "under water," meaning the market value of Microsoft stock was far below the stock price of their stock options.

Restricted stock has the advantage of offering employees more certainty, even if there is less potential for a big win. It also means shareholders don't have to worry about massive dilution after employees exercise big stock gains, as happened in the 1990s. Another advantage is that grants of restricted stock are much easier to value than options since restricted stock is equivalent to a stock transfer at the market price. That improves the transparency of corporate accounting.[5] At the same time, while several tech companies started downsizing their options programs in recent years, several old-line companies have been beefing their options programs up as shown in the box below.

Late to The Party
As many technology companies have downsized their options programs, old-line companies have been beefing theirs up.

	2002 Options Grant Millions	Change In Shares From 2001		2002 Options Grant Millions	Change In Shares From 2001
Lucent	14	–96%	Conoco Philips	29	+600%
Siebel Systems	6	–95	Sysco	31	+560
Aplied Materials	9	–91	Southwest Airlines	53	+435
Microsoft	41	–82	Safeco	3	+326
AOL Time Warner	115	–41	Campbell Soup	15	+301

Data: The Analyst's Accounting Observer, R.G. Associates Inc.

Research suggests that stock option plans lack the benefits of plans that include true stock ownership. Stock option plans provide unlimited upside potential for executives, but limited downside risk since executives incur only opportunity costs. Because of the tremendous advantages to the executive of stock price appreciation, there is an incentive for the executive to take undue risk. Thus, supporters of stock ownership plans argue that direct ownership instills a much stronger behavioral commitment, even when the stock price falls, since it binds

[5] Many argue that stock options are critical to start-up firms as a way to motivate and retain talented employees with the promise of getting rich should the new venture succeed. Among them appear to be FASB chairman Robert Herz, who favors sentiment to make special exceptions in the expensing of options in pre-IPO firms.

executives to their firms more than do options.[6] Additionally, "Executive stock options may be an efficient means to induce management to undertake more risky projects."[7]

Options may have been overused in the last bull market, but evidence suggests that the smart use of options and other incentive compensation does boost performance. Companies that spread ownership throughout a large portion of their workforce deliver higher returns than similar companies with more concentrated ownership. If options seemed for a time to be the route that enriched CEOs, employees, and investors alike, it still appears they will be used although with less emphasis than a mix of options, restricted stock, and cash bonuses. Whatever the exact mix, they are likely to be more closely tied to achieving specific operating goals. The next section examines restricted stock and cash bonuses in greater detail.

Restricted Stock

A restricted stock plan is designed to provide benefits of direct executive stock ownership. In a typical restricted stock plan, an executive is given a specific number of company stock shares. The executive is prohibited from selling the shares for a specified time period. Should the executive leave the firm voluntarily before the restricted period ends, the shares are forfeited. Therefore, restricted stock plans are a form of deferred compensation that promotes longer executive tenure than other types of plans.

In addition to being contingent on a vesting period, restricted stock plans may also require the achievement of predetermined performance goals. Price-vesting restricted stock plans tie vesting to the firm's stock price in comparison to an index, or to reaching a predetermined goal or annual growth rate. If the executive falls short on some of the restrictions, a certain amount of shares are forfeited. The design of these plans motivates the executive to increase shareholder wealth while promoting a long-term commitment to stay with the firm.

If the restricted stock plan lacks performance goal provisions, the executive needs only to remain employed with the firm over the vesting period to cash in on the stock. Performance provisions make sure executives are not compensated without achieving some level of shareholder wealth creation. Like stock options, restricted stock plans offer no downside risk to executives, since the shares were initially gifted to the executive. Unlike options, the stock retains value tied to its market value once ownership is fully vested. Shareholders, on the other hand, do suffer a loss in personal wealth resulting from a share price drop.

Investment bank Lehman Brothers has a restricted stock plan in place for hundreds of managing directors and senior vice presidents. The plan vests with time and does not include stock price performance provisions. It is a two-tiered plan consisting of a principal stock grant and a discounted share plan. For managing directors, the discount is 30 percent. For senior vice presidents, the discount is 25 percent. The principal stock grant is a block of shares given to the executive. The discounted share plan allows executives to purchase shares with their own money at a discount to current market prices.

Managing directors at Lehman are able to cash in on one-half the principal portion of their stock grant three years after the grant is awarded. The rest of the principal and any shares bought at a discount must vest for five years. Senior vice presidents receive the entire principal after two years and any discounted shares after five years. Provisions also exist for resignation. If managing directors leave Lehman for a competitor within three years

[6] Jeffrey Pfeffer, "Seven Practices of Successful Organizations," *California Management Review,* Winter 1998.
[7] Richard A. DeFusco, Robert R. Johnson, and Thomas S. Zorn, "The Effect of Executive Stock Option Plans on Stockholders and Bondholders," *Journal of Finance* 45, no. 2 (1990), pp. 617–35.

of the award, all stock compensation is forfeited. For senior vice presidents, the period is two years, and the penalties for jumping to a noncompetitor of Lehman's are not as severe.

Golden Handcuffs

The rationale behind plans that defer compensation forms the basis for another type of executive compensation called *golden handcuffs.* Golden handcuffs refer to either a restricted stock plan, where the stock compensation is deferred until vesting time provisions are met, or to bonus income deferred in a series of annual installments. This type of plan may also involve compensating an executive a significant amount upon retirement or at some predetermined age. In most cases, compensation is forfeited if the executive voluntarily resigns or is discharged before certain time restrictions.

Many boards consider their executives' skills and talents to be their firm's most valuable assets. These "assets" create and sustain the professional relationships that generate revenue and control expenses for the firm. Research suggests that the departure of key executives is unsettling for companies and often disrupts long-range plans when new key executives adopt a different management strategy.[8] Thus, the golden handcuffs approach to executive compensation is more congruent with long-term strategies than short-term performance plans, which offer little staying-power incentive.

Firms may turn to golden handcuffs if they believe stability of management is critical to sustain growth. Jupiter Asset Management recently tied 10 fund managers to the firm with golden handcuffs. The compensation scheme calls for a cash payment in addition to base salaries if the managers remain at the firm for five years. In the first year of the plan, the firm's pretax profits more than doubled, and their assets under management increased 85 percent. The firm's chairman has also signed a new incentive deal that will keep him at Jupiter for four years.

Deferred compensation is worrisome to some executives. In cases where the compensation is payable when the executives are retired and no longer in control, as when the firm is acquired by another firm or a new management hierarchy is installed, the golden handcuff plans are considerably less attractive to executives.

Golden handcuffs may promote risk averseness in executive decision making due to the huge downside risk borne by executives. This risk averseness could lead to mediocre performance results from executives' decisions. When executives lose deferred compensation if the firm discharges them voluntarily or involuntarily, the executive is less likely to make bold and aggressive decisions. Rather, the executive will choose safe, conservative decisions to reduce the downside risk of bold decision making.

Golden Parachutes

Golden parachutes are a form of bonus compensation that is designed to retain talented executives. A *golden parachute* is an executive perquisite that calls for a substantial cash payment if the executive quits, is fired, or simply retires. In addition, the golden parachute may also contain covenants that allow the executive to cash in on noninvested stock compensation.

The popularity of golden parachutes grew during the last decade, when abundant hostile takeovers would often oust the acquired firm's top executives. In these cases, the golden parachutes encouraged executives to take an objective look at takeover offers. The executives could decide which move was in the best interests of the shareholders, having been

[8] William E. Hall, Brian J. Lake, Charles T. Morse, and Charles T. Morse, Jr., "More Than Golden Handcuffs," *Journal of Accountancy* 184, no. 5 (1997), pp. 37–42.

personally protected in the event of a merger. The "parachute" helps soften the fall of the ousted executive. It is "golden" because the size of the cash payment often varies from several to tens of millions of dollars.

AMP Incorporated, the world's largest producer of electronic connectors, had golden parachutes for several executives. When Allied Signal proclaimed itself an unsolicited suitor for AMP, the action focused attention on the AMP parachutes for its three top executives. Robert Ripp became AMP's chief executive officer during this time. If Allied Signal ousted him, he stood to receive a cash payment of three times the amount of his salary as well as his highest annual bonus from the previous three years. His salary at the time was $600,000 and his previous year's bonus was $200,000. The cash payment to Ripp would therefore exceed $2 million. Parachutes would also open for the former chief executive officer and the former chairman who were slated to officially retire a year later. They stood to receive their parachutes if they were ousted before their respective retirement dates with each parachute valued at more than $1 million.

In addition to cash payments, these three executives' parachutes also protect existing blocks of restricted stock grants and nonvested stock options. The restricted stock grants were scheduled to become available within three years. Should the takeover come to fruition, the executives would receive the total value of the restricted stock even if it was not yet vested. The stock options would also become available immediately. Some of the restricted stock was performance restricted. Under normal conditions this stock would not be available without the firm reaching certain performance levels. However, the golden parachutes allow the executives to receive double the value of the performance-restricted stock.

Golden parachutes are designed in part to anticipate hostile takeovers like this. In AMP's case, Ripp's position is to lead the firm's board of directors in deciding if Allied Signal's offer is in the long-term interests of shareholders. Since Ripp is compensated heavily whether AMP is taken over or not, the golden parachute has helped remove the temptation that Ripp could have of not acting in the best interests of shareholders.

By design, golden parachutes benefit top executives whether or not there is evidence that value is created for shareholders. In fact, research has suggested that since high-performing firms are rarely taken over, golden parachutes often compensate top executives for abysmal performance.[9] Recent stockholder reactions to excessive executive compensation regardless of company performance are seen in Exhibit 9–8.

Cash

Executive bonus compensation plans that focus on accounting measures of performance are designed to offset the limitations of market-based measures of performance. This type of plan is most usually associated with the payment of periodic (quarterly or annual) cash bonuses. Market factors beyond the control of management, such as pending legislation, can keep a firm's share price repressed even though a top executive is exceeding the performance expectations of the board. In this situation, a highly performing executive loses bonus compensation due to the undervalued stock. However, accounting measures of performance correct for this problem by tying executive bonuses to improvements in internally measured performance.

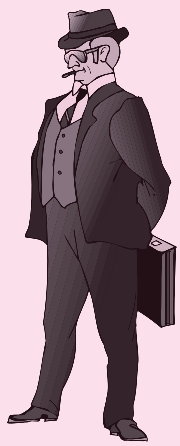
Traditional accounting measures, such as net income, earnings per share, return on equity, and return on assets, are used because they are easily understood, are familiar to senior management, and are already tracked by firm data systems.[10] Sears bases annual bonus

[9] Graef S. Crystal, *In Search of Excess* (New York: W. W. Norton & Company, 1991).

[10] Francine C. McKenzie and Matthew D. Shilling, "Avoiding Performance Measurement Traps: Ensuring Effective Incentive Design and Implementation," *Compensation and Benefits Review,* July–August 1998, pp. 57–65.

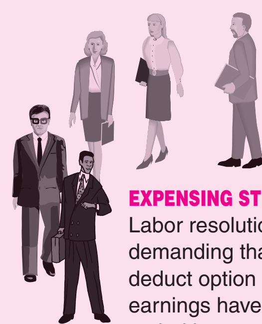
Strategy in Action
Shareholder Reaction to Executive Compensation Plans

Exhibit 9–8



FED-UP SHAREHOLDERS

Unions and public pension funds have racked up more than two dozen majority votes for shareholder resolutions opposing high executive pay



GOLDEN PARACHUTES
At Alcoa, 65% of shareholders voted for a union resolution calling for stockholder approval of lavish executive severance packages. Similar proposals won majorities at Delta and Raytheon.

CUSHY RETIREMENT DEALS
A proposal at U.S. Bancorp seeking shareholder votes on special executive pension benefits passed by 52%. Labor pulled resolutions at GE, Coke, and Exelon after they agreed to reforms.

EXPENSING STOCK OPTIONS
Labor resolutions demanding that companies deduct option costs from earnings have garnered majorities at 15 companies, including Apple and Capital One.

Source: "Executive Pay: Labor Strikes Back," *BusinessWeek,* May 26, 2003.

payments on such performance criteria, given an executive's business unit and level with the firm. The measures used by Sears include return on equity, revenue growth, net sales growth, and profit growth.

Critics argue that due to inherent flaws in accounting systems, basing compensation on these figures may not result in an accurate gauge of managerial performance. Return on equity estimates, for example, are skewed by inflation distortions and arbitrary cost allocations. Accounting measures are also subject to manipulation by firm personnel to artificially inflate key performance figures. Firm performance schemes, critics believe, need to be based on a financial measure that has a true link to shareholder value creation.[11] This issue led to the creation of the Balanced Scorecard, which emphasizes not only financial measures, but also such measures as new product development, market share, and safety as discussed in Chapters 6 and 11 of this book.

Matching Bonus Plans and Corporate Goals

Exhibit 9–9 provides a summary of the five types of executive bonus compensation plans. The figure includes a brief description, a rationale for implementation, and the identification of possible shortcomings for each of the compensation plans. Not only do compensation plans differ in the method through which compensation is rewarded to the executive, but they also provide the executive with different incentives.

[11] William Franklin, "Making the Fat Cats Earn Their Cream," *Accountancy,* July 1998, pp. 38–39.

EXHIBIT 9–9
Types of Executive Bonus Compensation

Bonus Type	Description	Rationale	Shortcomings
Stock option grants	Right to purchase stock in the future at a price set now. Compensation is determined by "spread" between option price and exercise price.	Provides incentive for executive to create wealth for shareholders as measured by increase in firm's share price.	Movement in share price does not explain all dimensions of managerial performance.
Restricted stock plan	Shares given to executive who is prohibited from selling them for a specific time period. May also include performance restrictions.	Promotes longer executive tenure than other forms of compensation.	No downside risk to executive, who always profits unlike other shareholders.
Golden handcuffs	Bonus income deferred in a series of annual installments. Deferred amounts not yet paid are forfeited with executive resignation.	Offers an incentive for executive to remain with the firm.	May promote risk-averse decision making due to downside risk borne by executive.
Golden parachute	Executives have right to collect the bonus if they lose position due to takeover, firing, retirement, or resignation.	Offers an incentive for executive to remain with the firm.	Compensation is achieved whether or not wealth is created for shareholders. Rewards either success or failure.
Cash based on internal business performance using financial measures	Bonus compensation based on accounting performance measures such as return on equity.	Offsets the limitations of focusing on market-based measures of performance.	Weak correlation between earnings measures and shareholder wealth creation. Annual earnings do not capture future impact of current decisions.

Exhibit 9–10 matches a company's strategic goal with the most likely compensation plan. On the vertical axis are common strategic goals. The horizontal axis lists the main compensation types that serve as incentives for executives to reach the firm's goals. A rationale is provided to explain the logic behind the connection between the firm's goal and the suggested method of executive compensation.

Researchers emphasize that fundamental to these relationships is the importance of incorporating the level of strategic risk of the firm into the design of the executive's compensation plan. Incorporating an appropriate level of executive risk can create a desired behavioral change commensurate with the risk level of strategies shareholders and their firms want.[12] To help motivate an executive to pursue goals of a certain risk-return level, the compensation plan can quantify that risk-return level and reward the executive accordingly.

The links we show between bonus compensation plans and strategic goals were derived from the results of prior research. The basic principle underlying Exhibit 9–10 is that different types of bonus compensation plans are intended to accomplish different purposes; one element

[12] "Executive Pay," *Business Week,* April 21, 2003.

EXHIBIT 9–10
Compensation Plan Selection Matrix

	Type of Bonus Compensation					
Strategic Goal	**Cash**	**Golden Handcuffs**	**Golden Parachutes**	**Restricted Stock Plans**	**Stock Options**	**Rationale**
Achieve corporate turnaround					X	Executive profits only if turnaround is successful in returning wealth to shareholders.
Create and support growth opportunities					X	Risk associated with growth strategies warrants the use of this high-reward incentive.
Defend against unfriendly takeover			X			Parachute helps remove temptation for executive to evaluate takeover based on personal benefits.
Evaluate suitors objectively			X			Parachute compensates executive if job is lost due to a merger favorable to the firm.
Globalize operations					X	Risk of expanding overseas requires a plan that compensates only for achieved success.
Grow share price incrementally	X					Accounting measures can identify periodic performance benchmarks.
Improve operational efficiency	X					Accounting measures represent observable and agreed-upon measures of performance.
Increase assets under management				X		Executive profits proportionally as asset growth leads to long-term growth in share price.
Reduce executive turnover		X				Handcuffs provide executive tenure incentive.
Restructure organization					X	Risk associated with major change in firm's assets warrant the use of this high-reward incentive.
Streamline operations				X		Rewards long-term focus on efficiency and cost control.

may serve to attract and retain executives, another may serve as an incentive to encourage behavior that accomplishes firm goals.[13] Although every strategy option has probably been linked to each compensation plan at some time, experience shows that there may be scenarios where a plan type best fits a strategy option. Exhibit 9–10 attempts to display the "best matches."

Once the firm has identified strategic goals that will best serve shareholders' interests, an executive bonus compensation plan can be structured in such a way as to provide the executive with an incentive to work toward achieving these goals.

Summary

The first concern in the implementation of business strategy is to translate that strategy into action throughout the organization. This chapter discussed four important tools for accomplishing this.

Short-term objectives are derived from long-term objectives, which are then translated into current actions and targets. They differ from long-term objectives in time frame, specificity, and measurement. To be effective in strategy implementation, they must be integrated and coordinated. They also must be consistent, measurable, and prioritized.

Functional tactics are derived from the business strategy. They identify the specific, immediate actions that must be taken in key functional areas to implement the business strategy.

Employee empowerment through policies provides another means for guiding behavior, decisions, and actions at the firm's operating levels in a manner consistent with its business and functional strategies. Policies empower operating personnel to make decisions and take action quickly.

Compensation rewards action and results. Once the firm has identified strategic objectives that will best serve stockholder interests, there are five bonus compensation plans that can be structured to provide the executive with an incentive to work toward achieving those goals.

Objectives, functional tactics, policies, and compensation represent only the start of the strategy implementation. The strategy must be institutionalized—it must permeate the firm. The next chapter examines this phase of strategy implementation.

Questions for Discussion

1. How does the concept "translate thought into action" bear on the relationship between business strategy and operating strategy? Between long-term and short-term objectives?
2. How do functional tactics differ from corporate and business strategies?
3. What key concerns must functional tactics address in marketing? Finance? POM? Personnel?
4. How do policies aid strategy implementation? Illustrate your answer.
5. Use Exhibits 9–9 and 9–10 to explain five executive bonus compensation plans.
6. Illustrate a policy, an objective, and a functional tactic in your personal career strategy.
7. Why are short-term objectives needed when long-term objectives are already available?

[13] James E. Nelson, "Linking Compensation to Business Strategy," *The Journal of Business Strategy* 19, no. 2 (1998), pp. 25–27.

Chapter 9 Discussion Case A

BusinessWeek

Thinking outside the Cereal Box

General Mills' Far-flung Search for Efficiency Ideas

General Mills' CEO searches for short-term objectives, functional tactics, and operating policies in unusual ways and places so he can translate a 10-year goal into tactical actions and results. Read this story about what he is doing and then see if you detect ways he is doing so!

1 As the economy has unraveled over the past three years, managers desperate to prop up profits have been beating the bushes for new ways to cut costs. Few, however, have wandered further afield in pursuit of smart ideas than General Mills (GIS), Inc. chief technical officer Randy G. Darcy. He has participated in predawn raids with a U.S. Marshals Service SWAT team, hung out with a NASCAR pit crew, and watched Air Force mechanics fix Stealth bombers. Darcy's unlikely goal: to make his operation "the best supply chain in the world."

2 It's more than just a theoretical ambition. CEO Stephen W. Sanger has given Darcy an epic challenge: cut $1 billion out of General Mills' supply chain in 10 years. By getting the company into fighting trim, Sanger hopes he'll be able to dig out from under a staggering $8.9 billion in debt from his $10.1 billion acquisition of Pillsbury from Diageo PLC in 2001. That's no small task for a company with $10.5 billion in sales that has already cut hundreds of millions of dollars over the last decade.

3 Slashing costs is just one of many challenges General Mills faces. It needs to regain market share that it ceded to archrival Kellogg Co., which became the number one U.S. cereal maker last year. And it's fighting off fierce competition from Campbell Soup Co. and ConAgra Foods Inc. in canned soups and ready-to-eat meals. Says Sanger: "We can't get by doing what we did yesterday."

4 Darcy is confident that he can save $800 million of the $1 billion target by adapting lessons in efficiency learned elsewhere. But money-saving ideas from pit crews and SWAT teams? Don't laugh: He has already made considerable progress. Darcy targets groups that routinely take performance to the extreme, studying them for efficiency secrets that might benefit General Mills—either by applying those secrets directly or by jolting employees into thinking of new ways of doing their jobs. By observing how a NASCAR pit crew was able to work with blinding speed simply through better organization, General Mills was able to cut the time it took workers to change a production line at a Lodi (Calif.) factory from one Betty Crocker product to another from 4.5 hours to just 12 minutes. And by watching the way that Stealth bomber pilots and maintenance crews cooperated, the company was able to improve its own teamwork, helping to cut cereal production costs by 25 percent at a plant in Buffalo.

5 Such gains, while impressive, may represent only a fraction of what's possible for General Mills, the maker of Cheerios cereal, Betty Crocker cake mixes, and Hamburger Helper. Anand Sharma, the CEO of TBM Consulting Group Inc. in Durham, N.C., who specializes in efficiency, says the company should be able to triple its cost-cutting goals—aiming for annual productivity improvements of 15 percent and profit gains of an additional 4 percent by aggressively applying what it learns. Moreover, experts say that seeking inspiration outside one's industry, as General Mills is doing, is the only way to leapfrog ahead of rivals. "Given how efficient many organizations have become, the next big idea won't come from internal thinking," says Ravin Jesuthasan, principal at Towers Perrin's reward and performance management consulting practice in Chicago. "It has got to come from revolutionary, outside-the-box thinking."

6 But even with all of General Mills' efforts to borrow management ideas from the unlikeliest of places, reaching the $1 billion savings goal won't be easy. Companies like General Mills, which has been cutting costs for years, may find future efficiency gains harder to come by.

7 And while Darcy believes the benefits from his excursions outside the cereal biz are real, some are impossible to measure. For example, the SWAT team's cooperative approach to nabbing fugitives inspired General Mills to replace separate performance goals for engineering, purchasing, and production with a single set of goals for all departments, eliminating the incentive for one department to cut corners at another's expense. Darcy cites a purchasing manager who met

cost-cutting goals under the old system by buying thinner cartons—even though they jammed up the production lines, raising manufacturing costs. Gross margins have improved in the four years since the new incentives were implemented—from 44 percent to 47 percent—but it's unclear how much of the improvement can be attributed to the change.

8 Finally, not all the efficiency lessons that Darcy brings back from the field can be adapted throughout General Mills. While the company was able to use the NASCAR lessons to transform the Betty Crocker plant—by replacing standard bolts with those requiring only a quarter turn and stocking toolboxes with the specific gear needed to switch product lines—efforts to duplicate much of that success elsewhere failed because many plant functions were unique.

9 Darcy isn't giving up, though. Lately, he's been working with Erik Weihenmayer, a blind mountaineer who has scaled the seven greatest summits. The goal: to understand his method for assembling expedition teams based on personality traits, instead of climbing skill, insights that Darcy says will prove critical to the success of the Pillsbury integration. "The only way to cross a glacier is on a rope to which your entire team is tied," says Weihenmayer. "You either all plunge together or succeed together." Darcy and his team are betting they won't be falling into the abyss any time soon.

Source: "Thinking Outside the Box," *BusinessWeek,* July 28, 2003.

Chapter 9 Discussion Case B

BusinessWeek

Is Kohl's Coming Unbuttoned?

Slovenly Stores and Shrewd Competition Have Hurt Sales

1 Shopping recently at a Kohl's (KSS) store in Niles, Ill., Kimberly Rellinger can't find any boys' shorts as she digs through a jumble of misplaced items. And she gives up on the shorts idea altogether when she sees the five-person checkout line. Instead, she heads to a nearby Old Navy (GPS) where she finds what she wants with no wait. "Now I will go there first," says the 36-year-old mother of two boys.

2 Plenty of Kohl's shoppers seem to be making the same call these days. On July 10, the apparel discounter reported a 2.4 percent decline in June sales at stores open at least a year. Worse, it warned that for the first time since going public in 1992, second-quarter earnings would decline. In part, the disappointing numbers reflect growing competition from department and specialty-apparel stores. But Kohl's Corp. execs may also have lost their Midas touch: Distracted by a big expansion into California, they have misjudged inventories and relaxed once-tight control of existing operations.

3 It's quite a reversal for this '90s retail star. Until recently, it seemed the Menomonee Falls (Wis,) chain could do no wrong. Kohl's has posted 35 percent compounded annual earnings growth over the past five years. It did so with the simplest of strategies: selling casual brands at low prices. By locating its stores in strip centers, Kohl's draws shoppers who find malls inconvenient. Now, having missed sales targets for 7 of the past 9 months, Kohl's heady days may be over. "It's the first crack in the growth story," says Deutsche Bank Securities Inc. analyst Bill Dreher.

4 Nonsense, says Kohl's CEO R. Lawrence Montgomery. He attributes the weak sales to a sluggish market for apparel, which affects Kohl's more than department-store rivals because clothing makes up a higher percentage of its sales. But, he admits, the competition has "narrowed a little bit."

5 Indeed, rivals ranging from JCPenney (JCP) and Sears, Roebuck to Federated Department Stores (FD) Macy's unit have borrowed from Kohl's playbook. Like Kohl's, they made their stores easier to navigate and beefed up casual brands. Most of all, they have cut prices to counter the advantage of Kohl's locations, says Marshall Cohen, chief analyst at market-research firm NPD Group Inc. As a result, Penney, Sears, and Federated all posted better sales results than Kohl's in June. "The consumer is going back to the mail because they can get a better price with a wider variety," Cohen says.

6 Department stores aren't the only ones playing better defense. Gap (GPS) Inc.'s Old Navy unit, whose shops are often based in strip centers with Kohl's, has recently shifted from trendy teenage fashion toward clothing that appeals to mothers with children, one of Kohl's targets. On the low end, Kohl's is facing more pressure from Wal-Mart (WMT) Stores Inc., which is upping the quality of its apparel and adding national brands like Levi's. "Wal-Mart is also after the same middle-level shopper," says Patrick McKeever, an analyst at Sun Trust Robinson Humphrey Capital Markets.

7 Meanwhile, Kohl's expansion into California seems to be distracting management. The chain has opened 28 stores this year in the greater Los Angeles area, where it is encountering fierce resistance from entrenched players such as Mervyn's and Macy's West. Some analysts say the challenging expansion helps explain recent stumbles at Kohl's existing stores. While the retailer has always loaded up on inventory, this year it misjudged demand and wound up having to discount heavily, which dented profits. Shoppers also complain that stores are less well-kept and check-out lines longer than they were.

8 Most troubling, perhaps, is that sales have slipped at Kohl's most mature outlets. That raises questions about the chain's growth prospects as older stores become a larger percentage of Kohl's locations. Deutsche Bank estimates that same-store sales at outlets five years old or more have declined for the past three years. In June, Kohl's worst-performing stores were in the Midwest, home to the bulk of its older shops. Montgomery blames a weak Midwest economy and lousy weather. If he's wrong, Kohl's days of rapid growth may be behind it.

Source: "Is Kohl's Coming Unbuttoned?" *BusinessWeek,* July 28, 2003.

Appendix 9

Functional Tactics

FUNCTIONAL TACTICS THAT IMPLEMENT BUSINESS STRATEGIES

Functional tactics are the key, routine activities that must be undertaken in each functional area—marketing, finance, production/operations, R&D, and human resource management—to provide the business's products and services. In a sense, functional tactics translate thought (grand strategy) into action designed to accomplish specific short-term objectives. Every value chain activity in a company executes functional tactics that support the business's strategy and help accomplish strategic objectives.

The next several sections will highlight key tactics around which managers can build competitive advantage and add value in each of the various functional areas.

FUNCTIONAL TACTICS IN PRODUCTION/OPERATIONS

Basic Issues

Production/operations management (POM) is the core function of any organization. That function converts inputs (raw materials, supplies, machines, and people) into value-enhanced output. The POM function is most easily associated with manufacturing firms, but it also applies to all other types of businesses (service and retail firms, for example). POM tactics must guide decisions regarding (1) the basic nature of the firm's POM system, seeking an optimum balance between investment input and production/operations output and (2) location, facilities design, and process planning on a short-term basis. Exhibit 9–A highlights key decision areas in which the POM tactics should provide guidance to functional personnel.

POM facility and equipment tactics involve decisions regarding plant location, size, equipment replacement, and facilities utilization that should be consistent with grand strategy and other operating strategies. In the mobile home industry, for example, the facilities and equipment tactic of Winnebago was to locate one large centralized, highly integrated production center (in Iowa) near its raw materials. On the other extreme, Fleetwood, Inc., a California-based competitor, located dispersed, decentralized production facilities near markets and emphasized maximum equipment life and less-integrated, labor-intensive production processes. Both firms are leaders in the mobile home industry, but have taken very different tactical approaches.

The interplay between computers and rapid technological advancement has made flexible manufacturing systems (FMS) a major consideration for today's POM tacticians. FMS allows managers to automatically and rapidly shift production systems to retool for different products or other steps in a manufacturing process. Changes that previously took hours or days can be done in minutes. The result is decreased labor cost, greater efficiency, and increased quality associated with computer-based precision.

Sourcing has become an increasingly important component in the POM area. Many companies now accord sourcing a separate status like any other functional area. Sourcing tactics provide guidelines about questions such as: Are the cost advantages of using only a few suppliers outweighed by the risk of overdependence? What criteria (e.g., payment requirements) should be used in selecting vendors? Which vendors can provide "just-in-time" inventory and how can the business provide it to our customers? How can operations be supported by the volume and delivery requirements of purchases?

EXHIBIT 9–A
Key Functional Tactics in POM

Functional Tactic	Typical Questions That the Functional Tactic Should Answer
Facilities and equipment	How centralized should the facilities be? (One big facility or several small facilities?)
	How integrated should the separate processes be?
	To what extent should further mechanization or automation be pursued?
	Should size and capacity be oriented toward peak or normal operating levels?
Sourcing	How many sources are needed?
	How should suppliers be selected, and how should relationships with suppliers be managed over time?
	What level of forward buying (hedging) is appropriate?
Operations planning and control	Should work be scheduled to order or to stock?
	What level of inventory is appropriate?
	How should inventory be used (FIFO/LIFO), controlled, and replenished?
	What are the key foci for control efforts (quality, labor cost, downtime, product use, other)?
	Should maintenance efforts be oriented to prevention or to breakdown?
	What emphasis should be placed on job specialization? Plant safety? The use of standards?

POM planning and control tactics involve approaches to the management of ongoing production operations and are intended to match production/operations resources with longer range, overall demand. These tactical decisions usually determine whether production/operations will be demand oriented, inventory oriented, or outsourcing oriented to seek a balance between the two extremes. Tactics in this component also address how issues like maintenance, safety, and work organization are handled. Quality control procedures are yet another focus of tactical priorities in this area.

Just-in-time (JIT) delivery, outsourcing, and statistical process control (SPC) have become prominent aspects of the way today's POM managers create tactics that build greater value and quality in their POM system. JIT delivery was initially a way to coordinate with suppliers to reduce inventory carrying costs of items needed to make products. It also became a quality control tactic because smaller inventories made quality checking easier on smaller, frequent deliveries. It has become an important aspect of supplier-customer relationships in today's best businesses.

Outsourcing, or the use of a source other than internal capacity to accomplish some task or process, has become a major operational tactic in today's downsizing-oriented firms. Outsourcing is based on the notion that strategies should be built around core competencies that add the most value in the value chain, and functions or activities that add little value or that cannot be done cost effectively should be done outside the firm—outsourced. When done well, the firm gains a supplier that provides superior quality at lower cost than it could provide itself. JIT and outsourcing have increased the strategic importance of the purchasing function. Outsourcing must include intense quality control by the buyer. ValuJet's tragic 1996 crash in the Everglades was caused by poor quality control over its outsourced maintenance providers.

The Internet and "E-commerce" have begun to revolutionize functional tactics in operations and marketing. How we sell, where we make things, how we logistically coordinate what we do, all of these basic business functions and questions have new perspectives and ways of being addressed because of the technological impact of the globally emerging ways we link together electronically, quickly, and accurately.

FUNCTIONAL TACTICS IN MARKETING

The role of the marketing function is to achieve the firm's objectives by bringing about the profitable sale of the business's products/services in target markets. Marketing tactics should guide sales and marketing managers in determining who will sell what, where, to whom, in what quantity, and how. Marketing tactics at a minimum should address four fundamental areas: products, price, place, and promotion. Exhibit 9–B highlights typical questions marketing tactics should address.

In addition to the basic issues raised in Exhibit 9–B, marketing tactics today must guide managers addressing the impact of the *communication revolution* and the *increased diversity* among market niches worldwide. The Internet and the accelerating blend of computers and telecommunications has facilitated instantaneous access to several places around the world. A producer of plastic kayaks in Easley, South Carolina, receives orders from somewhere in the world about every 30 minutes over the Internet without any traditional distribution structure or global advertising. It fills the order within five days without any transportation capability. Speed linked to the ability to communicate instantaneously is causing marketing tacticians to radically rethink what they need to do to remain competitive and maximize value.

Diversity has accelerated because of communication technology, logistical capability worldwide, and advancements in flexible manufacturing systems. The diversity that has resulted is a

EXHIBIT 9–B
Key Functional Tactics in Marketing

Functional Tactic	Typical Questions That the Functional Tactic Should Answer
Product (or service)	Which products do we emphasize? Which products/services contribute most to profitability? What product/service image do we seek to project? What consumer needs does the product/service seek to meet? What changes should be influencing our customer orientation?
Price	Are we competing primarily on price? Can we offer discounts or other pricing modifications? Are our pricing policies standard nationally, or is there regional control? What price segments are we targeting (high, medium, low, and so on)? What is the gross profit margin? Do we emphasize cost/demand or competition-oriented pricing?
Place	What level of market coverage is necessary? Are there priority geographic areas? What are the key channels of distribution? What are the channel objectives, structure, and management? Should the marketing managers change their degree of reliance on distributors, sales reps, and direct selling? What sales organization do we want? Is the sales force organized around territory, market, or product?
Promotion	What are the key promotion priorities and approaches? Which advertising/communication priorities and approaches are linked to different products, markets, and territories? Which media would be most consistent with the total marketing strategy?

virtual explosion of market niches, adaptations of products to serve hundreds of distinct and diverse customer segments that would previously have been served with more mass-market, generic products or services. Where firms used to rely on volume associated with mass markets to lower costs, they now encounter smaller niche players carving out subsegments they can serve more timely *and* more cost effectively. These new, smaller players lack the bureaucracy and committee approach that burdens the larger firms. They make decisions, outsource, incorporate product modifications, and make other agile adjustments to niche market needs before their larger competitors get through the first phase of committee-based decision making. Jack Welch, the CEO of General Electric, commented on this recently with the editors of *BusinessWeek:*

> Size is no longer the trump card it once was in today's brutally competitive world marketplace—a marketplace that is unimpressed with logos and sales numbers but demands, instead, value and performance. At GE we're trying to get that small-company soul—and small-company speed—inside our big-company body. Faster products, faster product cycles to market. Better response time. New niches, Satisfying customers, getting faster communications, moving with more agility, all these are easier when one is small. All these are essential to succeed in the diverse, fast-moving global environment.

FUNCTIONAL TACTICS IN ACCOUNTING AND FINANCE

While most functional tactics guide implementation in the immediate future, the time frame for functional tactics in the area of finance varies, because these tactics direct the use of financial resources in support of the business strategy, long-term goals, and annual objectives. Financial tactics with longer time perspectives guide financial managers in long-term capital investment, debt financing, dividend allocation, and leveraging. Financial tactics designed to manage working capital and short-term assets have a more immediate focus. Exhibit 9–C highlights some key questions that financial tactics must answer.

EXHIBIT 9–C
Key Functional Tactics in Finance and Accounting

Source: From Terence P. Pare, "A New Tool for Managing Costs," Fortune, June 14, 1993, pp. 124–129. Copyright © 1993 Time Inc. All rights reserved.

Functional Tactic	Typical Questions That the Functional Tactics Should Answer
Capital acquisition	What is an acceptable cost of capital?
	What is the desired proportion of short- and long-term debt? Preferred and common equity?
	What balance is desired between internal and external funding?
	What risk and ownership restrictions are appropriate?
	What level and forms of leasing should be used?
Capital allocation	What are the priorities for capital allocation projects?
	On what basis should the final selection of projects be made?
	What level of capital allocation can be made by operating managers without higher approval?
Dividend and working capital management	What portion of earnings should be paid out as dividends?
	How important is dividend stability?
	Are things other than cash appropriate as dividends?
	What are the cash flow requirements? The minimum and maximum cash balances?
	How liberal/conservative should the credit policies be?
	What limits, payment terms, and collection procedures are necessary?
	What payment timing and procedure should be followed?

Accounting managers have seen their need to contribute value increasingly scrutinized. Traditional expectations centered around financial accounting; reporting requirements from bank and SEC entities and tax law compliance remain areas in which actions are dictated by outside governance. Managerial accounting, where managers are responsible for keeping records of costs and the use of funds within their company, has taken on increased strategic significance in the last decade. This change has involved two tactical areas: (1) how to account for costs of creating and providing their business's products and services, and (2) valuing the business, particularly among publicly traded companies.

Managerial cost accounting has traditionally provided information for managers using cost categories like those shown on the left side below. However, value chain advocates have been increasingly successful getting managers to seek activity-based cost accounting information like that shown on the right side below. In so doing, accounting is becoming a more critical, relevant source of information that truly benefits strategic management.

Traditional Cost Accounting In a Purchasing Department		Activity-Based Cost Accounting in the Same Purchasing Department	
Wages and salaries	$350,000	Evaluate supplier capabilities	$135,750
Employee benefits	115,000	Process purchase orders	82,100
Supplies	6,500	Expedite supplier deliveries	23,500
Travel	2,400	Expedite internal processing	15,840
Depreciation	17,000	Check quality of items purchased	94,300
Other fixed charges	124,000	Check incoming deliveries against purchase orders	48,450
Miscellaneous operating expenses	25,250	Resolve problems	110,000
		Internal administration	130,210
	$640,150		$640,150

Source: Adapted from information in Terence P. Paré, "A New Tool for Managing Costs," *Fortune*, June 14, 1993, pp. 124–29. *Fortune*, © 1993, Time, Inc. All rights reserved.

FUNCTIONAL TACTICS IN RESEARCH AND DEVELOPMENT

With the increasing rate of technological change in most competitive industries, research and development (R&D) has assumed a key strategic role in many firms. In the technology-intensive computer and pharmaceutical industries, for example, firms typically spend between 4 and 6 percent of their sales dollars on R&D. In other industries, such as the hotel/motel and construction industries, R&D spending is less than 1 percent of sales. Thus, functional R&D tactics may be more critical instruments of the business strategy in some industries than in others.

Exhibit 9–D illustrates the types of questions addressed by R&D tactics. First, R&D tactics should clarify whether basic research or product development research will be emphasized. Several major oil companies now have solar energy subsidiaries in which basic research is emphasized, while the smaller oil companies emphasize product development research.

The choice of emphasis between basic research and product development also involves the time horizon for R&D efforts. Should these efforts be focused on the near term or the long term? The solar energy subsidiaries of the major oil companies have long-term per-

EXHIBIT 9–D
Key Functional Tactics in R&D

R&D Decision Area	Typical Questions That the Functional Tactics Should Answer
Basic research versus product and process development	To what extent should innovation and breakthrough research be emphasized? In relation to the emphasis on product development, refinement, and modification?
	What critical operating processes need R&D attention?
	What new projects are necessary to support growth?
Time horizon	Is the emphasis short term or long term?
	Which orientation best supports the business strategy? The marketing and production strategy?
Organizational fit	Should R&D be done in-house or contracted out?
	Should R&D be centralized or decentralized?
	What should be the relationship between the R&D units and product managers? Marketing managers? Production managers?
Basic R&D posture	Should the firm maintain an offensive posture, seeking to lead innovation in its industry?
	Should the firm adopt a defensive posture, responding to the innovations of its competitors?

spectives, while the smaller oil companies focus on creating products now in order to establish a competitive niche in the growing solar industry.

R&D tactics also involve organization of the R&D function. For example, should R&D work be conducted solely within the firm, or should portions of that work be contracted out? A closely related issue is whether R&D should be centralized or decentralized. What emphasis should be placed on process R&D versus product R&D?

Decisions on all of the above questions are influenced by the firm's R&D posture, which can be offensive or defensive, or both. If that posture is offensive, as is true for small high-technology firms, the firm will emphasize technological innovation and new product development as the basis for its future success. This orientation entails high risks (and high payoffs) and demands considerable technological skill, forecasting expertise, and the ability to quickly transform innovations into commercial products.

A defensive R&D posture emphasizes product modification and the ability to copy or acquire new technology. Converse Shoes is a good example of a firm with such an R&D posture. Faced with the massive R&D budgets of Nike and Reebok, Converse placed R&D emphasis on bolstering the product life cycle of its prime products (particularly canvas shoes).

Large companies with some degree of technological leadership often use a combination of offensive and defensive R&D strategy. GE in the electrical industry, IBM in the computer industry, and Du Pont in the chemical industry all have a defensive R&D posture for currently available products *and* an offensive R&D posture in basic, long-term research.

FUNCTIONAL TACTICS IN HUMAN RESOURCE MANAGEMENT (HRM)

The strategic importance of HRM tactics received widespread endorsement in the 1990s. HRM tactics aid long-term success in the development of managerial talent and competent employees; the creation of systems to manage compensation or regulatory concerns; and

EXHIBIT 9–E
Key Functional Tactics in HRM

Functional Tactic	Typical Questions That HRM Tactics Should Answer
Recruitment, selection, and orientation	What key human resources are needed to support the chosen strategy? How do we recruit these human resources? How sophisticated should our selection process be? How should we introduce new employees to the organization?
Career development and training	What are our future human resource needs? How can we prepare our people to meet these needs? How can we help our people develop?
Compensation	What levels of pay are appropriate for the tasks we require? How can we motivate and retain good people? How should we interpret our payment, incentive, benefit, and seniority policies?
Evaluation, discipline, and control	How often should we evaluate our people? Formally or informally? What disciplinary steps should we take to deal with poor performance or inappropriate behavior? In what ways should we "control" individual and group performance?
Labor relations and equal opportunity requirements	How can we maximize labor-management cooperation? How do our personnel practices affect women/minorities? Should we have hiring policies?

guiding the effective utilization of human resources to achieve both the firm's short-term objectives and employees' satisfaction and development. HRM tactics are helpful in the areas shown in Exhibit 9–E. The recruitment, selection, and orientation should establish the basic parameters for bringing new people into a firm and adapting them to "the way things are done" in the firm. The career development and training component should guide the action that personnel takes to meet the future human resources needs of the overall business strategy. Merrill Lynch, a major brokerage firm whose long-term corporate strategy is to become a diversified financial service institution, has moved into such areas as investment banking, consumer credit, and venture capital. In support of its long-term objectives, it has incorporated extensive early-career training and ongoing career development programs to meet its expanding need for personnel with multiple competencies. Larger organizations need HRM tactics that guide decisions regarding labor relations; EEOC requirements; and employee compensation, discipline, and control.

Current trends in HRM parallel the reorientation of managerial accounting by looking at their cost structure anew. HRM's "paradigm shift" involves looking at people expense as an investment in human capital. This involves looking at the business's value chain and the "value" of human resource components along the various links in that chain. One of the results of this shift in perspective has been the downsizing and outsourcing phenomena of the last quarter century. While this has been traumatic for millions of employees in companies worldwide, its underlying basis involves an effort to examine the use of "human capital" to create value in ways that maximize the human contribution. This scrutiny continues to challenge the HRM area to include recent major trends to outsource some or all HRM activities not regarded as part of a firm's core competence. The emerging implications for human resource management tactics may be a value-oriented perspective on the role of human resources in a business's value chain as suggested below.

Traditional HRM Ideas	Emerging HRM Ideas
Emphasis solely on physical skills	Emphasis on total contribution to the firm
Expectation of predictable, repetitious behavior	Expectation of innovative and creative behavior
Comfort with stability and conformity	Tolerance of ambiguity and change
Avoidance of responsibility and decision making	Accepting responsibility for making decisions
Training covering only specific tasks	Open-ended commitment; broad continuous development
Emphasis placed on outcomes and results	Emphasis placed on processes and means
High concern for quantity and throughput	High concern for total customer value
Concern for individual efficiency	Concern for overall effectiveness
Functional and subfunctional specialization	Cross-functional integration
Labor force seen as unnecessary expense	Labor force seen as critical investment
Workforce is management's adversary	Management and workforce are partners

Source: A. Miller, *Strategic Management*, p. 400. © 2002 by McGraw-Hill, Inc. Reproduced with the permission of The McGraw-Hill Companies.

To summarize, functional tactics reflect how each major activity of a firm contributes to the implementation of the business strategy. The specificity of functional tactics and the involvement of operating managers in their development help ensure understanding of and commitment to the chosen strategy. A related step in implementation is the development of policies that empower operating managers and their subordinates to make decisions and to act autonomously.